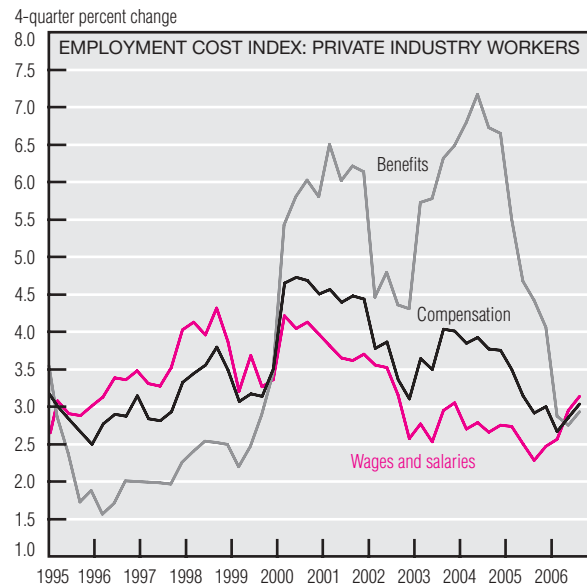
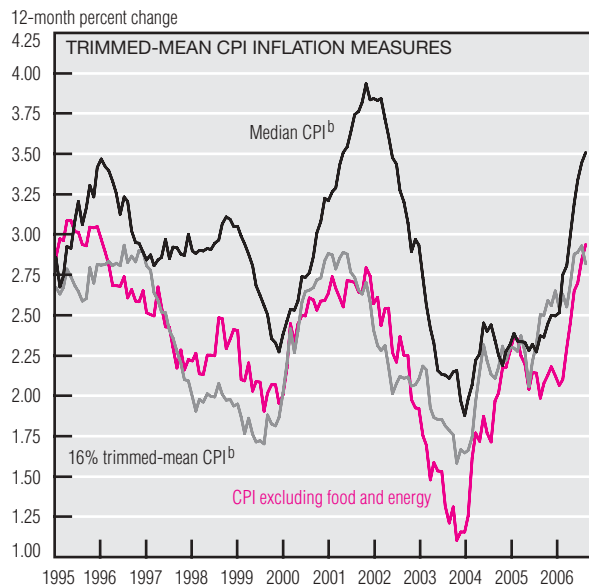
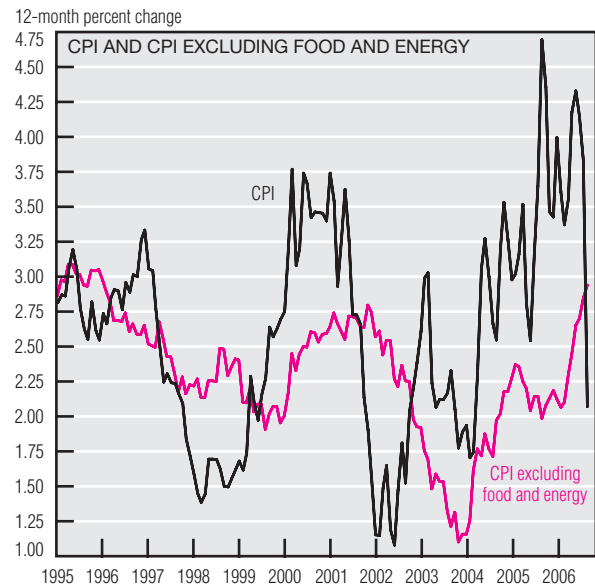


Inflation and Prices

	Percent change, last:					2005 avg.
	1 mo. ^a	3 mo. ^a	6 mo. ^a	12 mo.	5 yr. ^a	
Consumer Price Index						
All items	-5.7	0.8	2.9	2.1	2.6	3.6
Less food and energy	2.9	2.7	3.2	2.9	2.1	2.2
Median ^b	3.6	3.8	3.9	3.5	2.7	2.5
16% trimmed mean	2.4	2.9	3.0	2.8	2.3	2.6
Producer Price Index						
All items	-14.5	-4.4	0.9	0.9	2.5	5.7
Less food and energy	7.0	-0.3	1.0	1.2	1.1	1.5



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and Federal Reserve Bank of Cleveland.

The Consumer Price Index (CPI) fell at a 5.7% annualized rate during September, its sharpest one-month decline this year and a dramatic reversal of the 3% rise the index posted the previous month. Not surprisingly, the core inflation measures showed considerably more steadiness in September and suggest that the underlying inflation trend may be stabilizing. The CPI excluding food and energy rose 2.9% for the second straight month, and the median CPI rose

3.6%. The 16% trimmed-mean CPI, which attempts to isolate an inflation trend by eliminating the highest and the lowest 8% of the monthly price changes, rose 2.4%. All of these inflation measures were about the same or down slightly from their trends over the past six and 12 months.

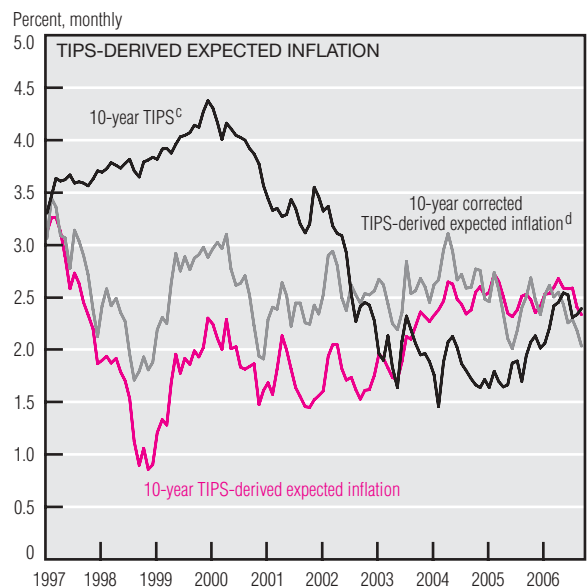
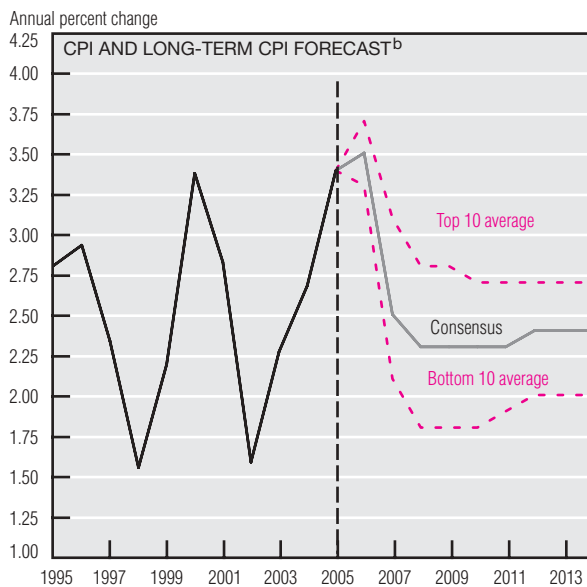
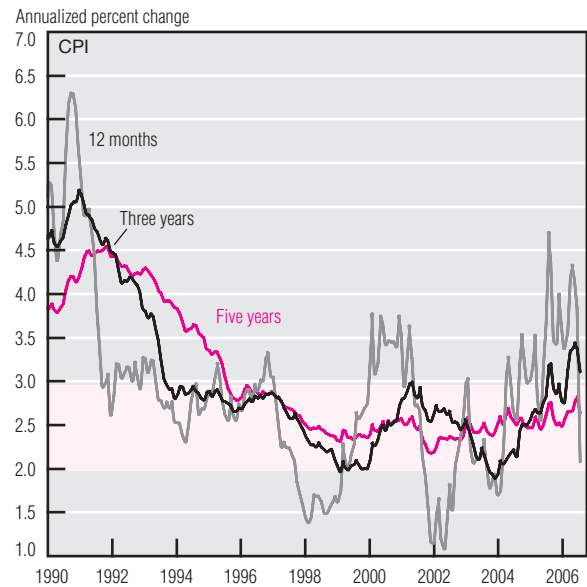
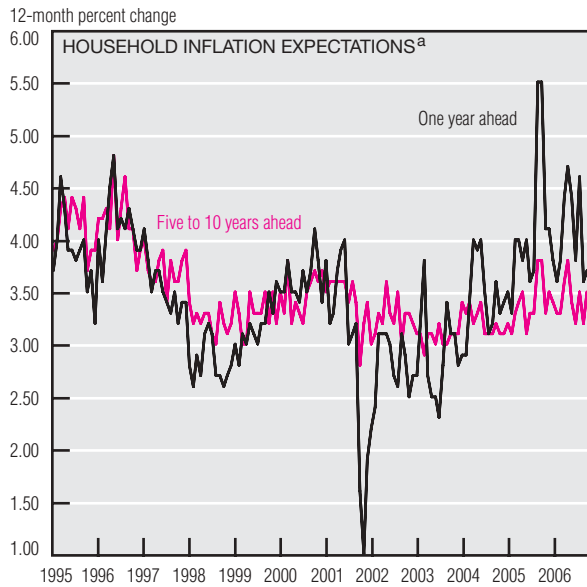
Nevertheless, longer-term growth trends in the “core” retail price measures continue to be elevated: The 12-month growth rates of the CPI excluding food and energy and the

16% trimmed-mean CPI were between 2³/₄% and 3% in September. The 12-month growth rate in the median CPI reached 3¹/₂% during the month, its highest rate in more than four years.

Among the factors that analysts are watching closely to gauge shifts in the inflation trend is the growth in labor costs—which have been inching a bit higher in recent quarters. In 2006:IIIQ, employment costs’ four-quarter growth rate ticked up

(continued on next page)

Inflation and Prices (cont.)



a. Mean expected change as measured by the University of Michigan's *Survey of Consumers*.

b. Blue Chip panel of economists.

c. Treasury inflation-protected securities.

d. Ten-year TIPS-derived expected inflation, adjusted for the liquidity premium on the market for the 10-year Treasury note.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; *Blue Chip Economic Indicators*, October 10, 2006; University of Michigan; and Bloomberg Financial Information Services.

to 3% amid a modest rise in benefit costs. Wage and salary growth has shown steadier acceleration and, at 3.1% over the four quarters ended in 2006:IIIQ, is the strongest wage and salary gain in four years.

Where is the long-run inflation trend headed? According to the University of Michigan's October survey, households anticipate that prices will rise 3.7% over the next year and average only a slightly more moderate

3½% over the next five to 10 years. This is a bit higher than the long-run inflation predictions that households made between 2001 and 2005.

Indeed, although the CPI's five-year growth trend has been maintained within the range between 2% and 3% for more than a decade, it has recently drifted to the upper end of that range. Economists and others generally expect that the long-run CPI trend will eventually begin to drift lower, but the consensus

prediction from the Blue Chip panel of economists calls for the CPI to stay between 2¼% and 2½% through the forecast horizon ending in 2013. This is similar to the long-run inflation prediction implied in the bond market. The spread between the 10-year Treasury bond and Treasury inflation-protected securities (TIPS) indicates that market participants expect CPI inflation to average between 2% and 2½% over the next 10 years.