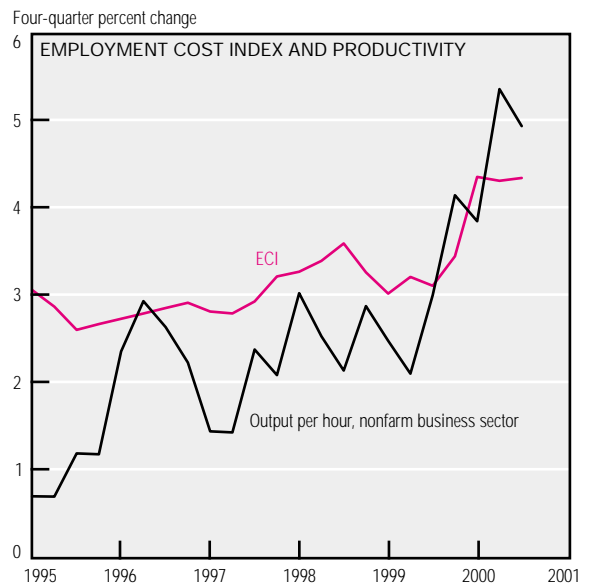
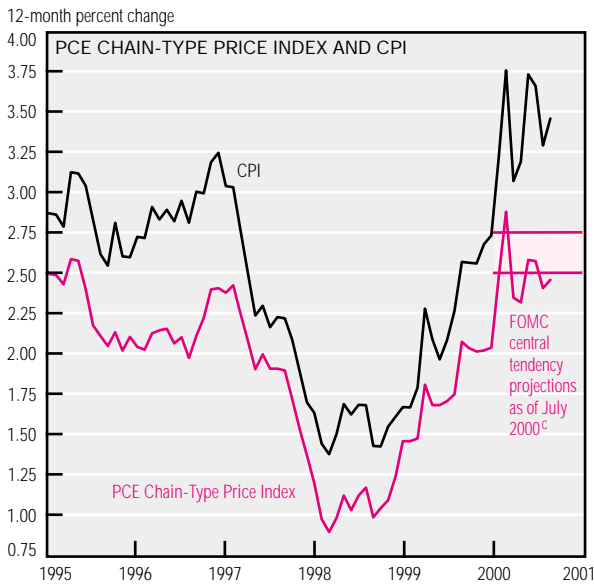
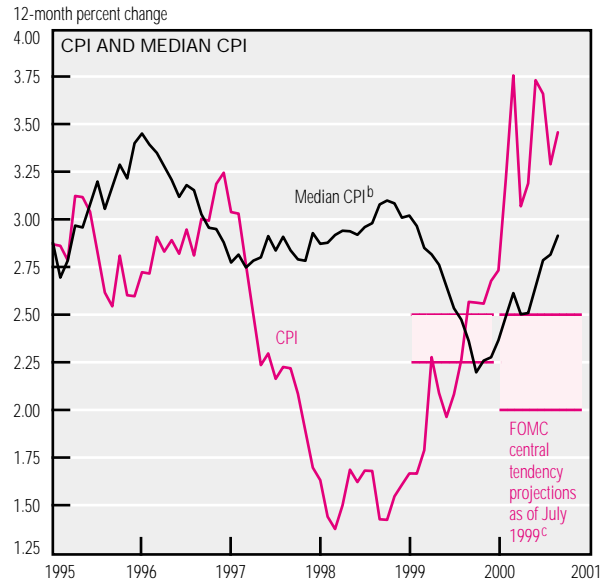


# Inflation and Prices

	Percent change, last:				1999 avg.
	1 mo. <sup>a</sup>	3 mo. <sup>a</sup>	12 mo.	5 yr. <sup>a</sup>	
<b>Consumer prices</b>					
All items	6.4	2.8	3.5	2.5	2.7
Less food and energy	3.3	2.7	2.5	2.4	1.9
Median <sup>b</sup>	3.1	3.2	2.9	2.8	2.3
<b>Producer prices</b>					
Finished goods	11.0	2.6	3.3	1.6	2.9
Less food and energy	4.1	2.2	1.2	1.2	0.8



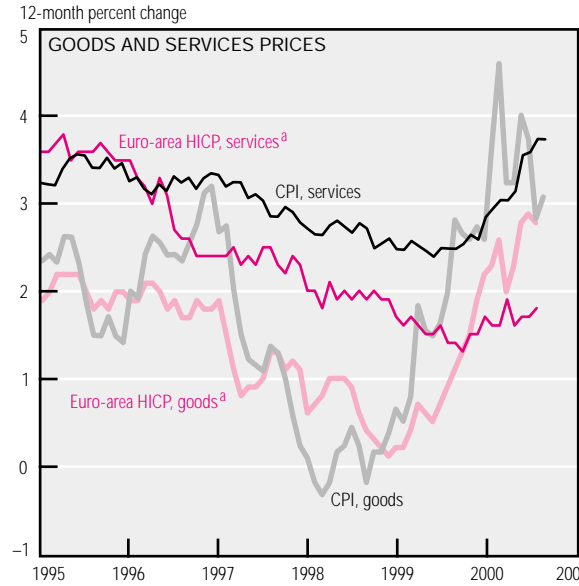
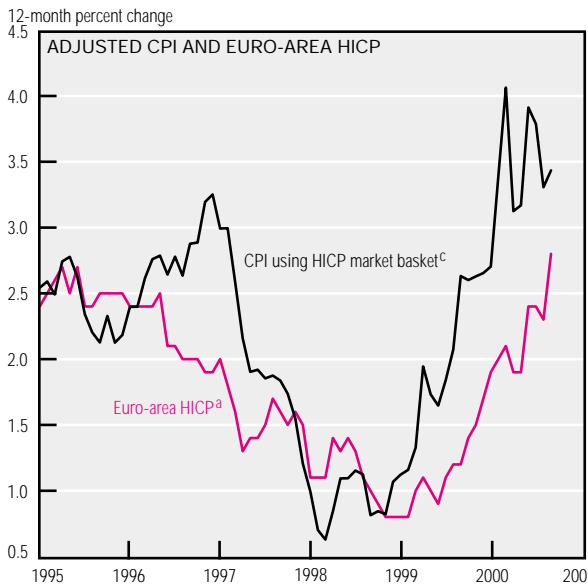
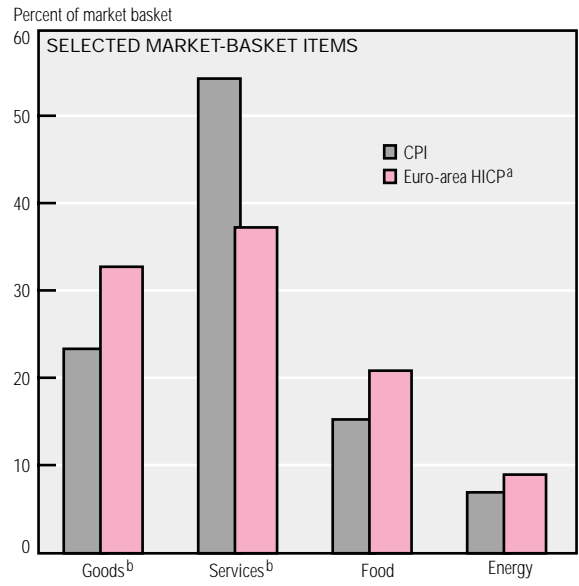
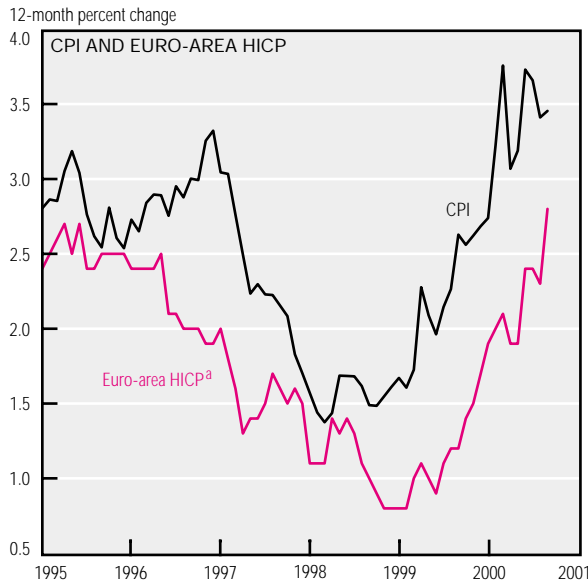
a. Annualized.  
 b. Calculated by the Federal Reserve Bank of Cleveland.  
 c. Upper and lower bounds for inflation path as implied by the central tendency growth ranges issued by the FOMC and nonvoting Reserve Bank presidents.  
 SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; and Federal Reserve Bank of Cleveland.

The CPI rose 0.5% (6.4% annual rate) during September, after falling for the first time in more than 14 years the month before. September's retail price numbers were driven principally by the CPI's energy component, which rose by a substantial amount in September (56.8% annual rate) after falling in August. In fact, the correlation between monthly percent changes in the CPI's energy component and the CPI has been nearly 97% in 2000, suggesting how strongly energy price movements have affected the overall CPI.

Accordingly, it might be instructive to consider the CPI without energy prices to see whether other goods prices show a similar pattern. If they do, we might suppose that broader price pressures are at work in the economy. But in September, the CPI excluding energy rose at an annual rate of 2.7%, almost exactly the same as in August. Moreover, while energy prices have been very volatile throughout 2000, the CPI excluding energy has been quite stable, posting quarterly increases at annual rates of 2.4%, 2.7%, and 2.7% to date this year.

One closely watched indicator of future price increases at the retail level is the quarterly Employment Cost Index (ECI). Part of its popularity results from two theories that emphasize the importance of labor market dynamics in determining the inflation rate. According to one of these views, if firms are forced to pay workers more for the same output, the cost increase will ultimately be passed on to consumers in the form of higher goods prices. The other view holds that causation runs in the opposite direction: The expectation  
*(continued on next page)*

# Inflation and Prices (cont.)



a. Harmonized Index of Consumer Prices.  
 b. Excludes food and energy items.  
 c. This adjustment applies the euro area's HICP market-basket shares for 2000 to the entire time series of CPI data. The limited extent of the CPI's disaggregation makes this adjustment only an approximation.  
 NOTE: Price data are not seasonally adjusted.  
 SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and Eurostat.

of higher goods prices in the future induces workers to seek greater compensation gains. In either case, third-quarter ECI data give little cause for concern. Year-over-year ECI increases were larger in 2000 than in the recent past. But unlike those earlier increases, they have not exceeded productivity growth.

European countries seeking entrance to the continent's Economic and Monetary Union must demonstrate (among other things) a measure of price stability. The Harmonized Index of Consumer Prices (HICP) provides a consistent

basis for comparing inflation performance across nations. It also permits evaluation of inflation in the entire 11-nation euro area, whose monetary policy is controlled by the European Central Bank.

A look at the two prominent retail price measures for the euro area and the U.S. suggests that Europe's inflation performance is superior. However, this sort of comparison may be misleading because the two areas' market baskets differ so significantly, most noticeably in the very different proportions of goods and services in each index. A more valid comparison involves applying the market basket

of the euro area's HICP to price data from the CPI.

The result suggests that the two regions' inflation performances are more similar than the unadjusted indexes show, but inflation in Europe since 1998 is still shown to be lower than in the U.S. Disaggregating each retail price measure into price indexes for goods and services reveals the reason: Although the inflation rate for goods has recently been somewhat lower in Europe than in the U.S., Europe's inflation rate for services has been well below that of the U.S. since 1996.