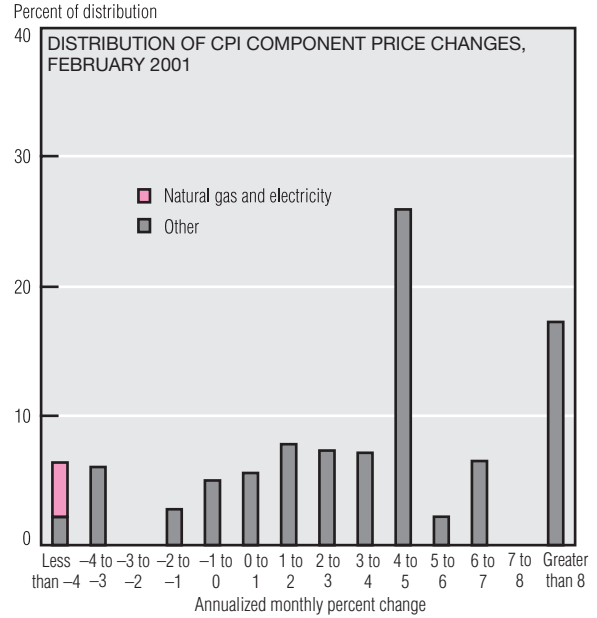
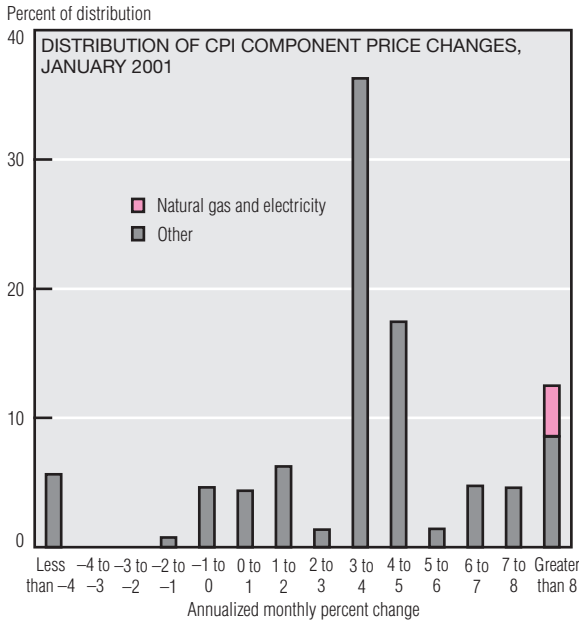
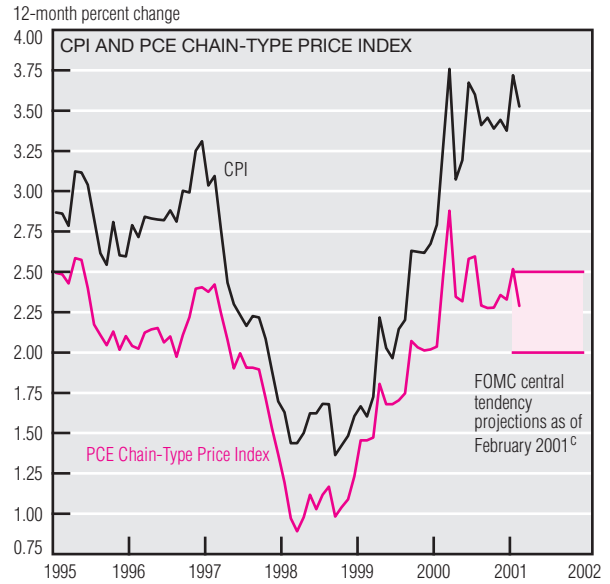


# Inflation and Prices

	Annualized percent change, last:				
	1 mo. <sup>a</sup>	3 mo. <sup>a</sup>	12 mo.	5 yr. <sup>a</sup>	2000 avg.
<b>February Price Statistics</b>					
<b>Consumer prices</b>					
All items	3.5	4.4	3.5	2.6	3.4
Less food and energy	4.0	3.1	2.8	2.4	2.5
Median <sup>b</sup>	4.2	3.8	3.3	2.9	3.2
<b>Producer prices</b>					
Finished goods	1.7	6.1	4.0	1.8	3.6
Less food and energy	-3.9	1.9	1.3	1.1	1.2



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; and Federal Reserve Bank of Cleveland.

The recent acceleration in energy price increases reversed course in February, after a January in which the Consumer Price Index (CPI) posted its largest monthly increase in more than a decade. The sharp January rise was largely the result of an outsized increase in the CPI's energy subindex; according to the Labor Department, this measure rose an annualized 57.6%, accounting for over half of the overall increase in the CPI. The energy subindex itself was propelled by a record increase in the

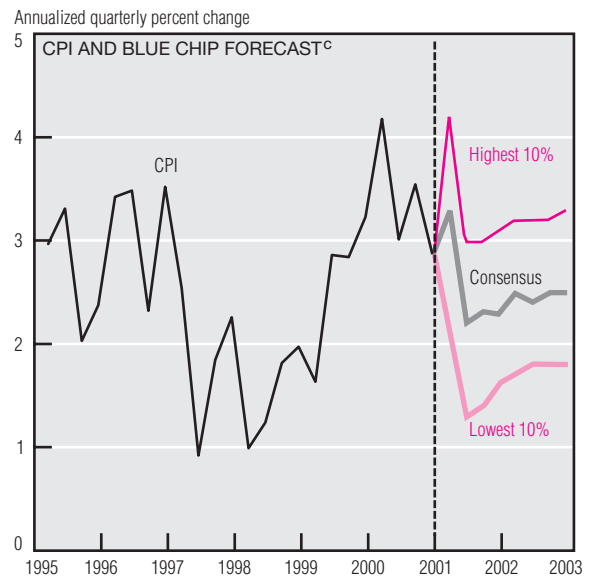
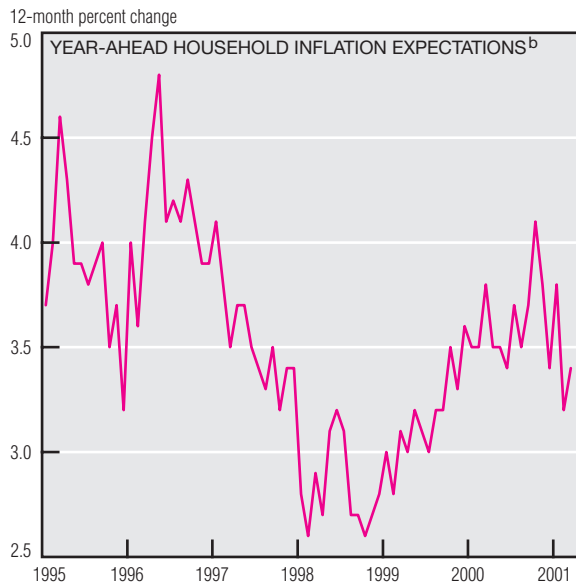
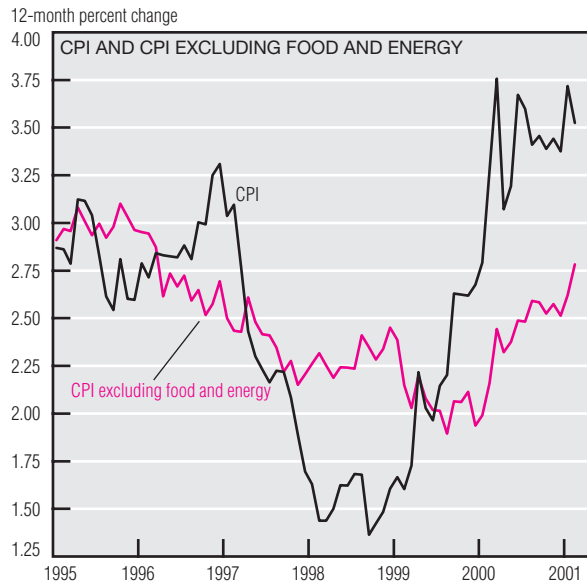
index for utility natural gas, which rose 17.4% in the month.

In February, by contrast, retail price increases settled down to a more familiar pace. After an annualized increase of 7.8% in January, the CPI rose an annualized 3.5% in February. Not surprisingly, this more moderate increase was also the result, in large measure, of the CPI's energy components. In particular, natural gas prices rose a much more modest 2.4% in February, while the energy subindex as a whole fell an annualized 2.7%.

These marked fluctuations in the prices of energy goods and services—and their impact on the unadjusted measures of inflation—are almost certainly distorting our sense of inflation's current state. A look at the so-called core measures of inflation may, therefore, be more instructive. Both the CPI excluding food and energy and the median CPI have shown similar rates of change thus far in 2001. The CPI excluding food and energy rose an annualized 4.0% in February, just as it did in January, while the median CPI rose an annualized 4.2% in

(continued on next page)

## Inflation and Prices (cont.)



a. Calculated by the Federal Reserve Bank of Cleveland.

b. Mean expected change in consumer prices as measured by the University of Michigan's *Survey of Consumers*.

c. Blue Chip panel of economists.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; University of Michigan; and *Blue Chip Economic Indicators*, March 10, 2001.

February after rising an annualized 3.6% in January. Taken together, these measures suggest that the underlying inflation rate is currently about 4%.

Despite the decidedly upward trend in both core and non-core measures of inflation over the last several quarters, households' expectations of future inflation have actually fallen in recent months. After peaking at just above 4% in late 2000, expectations fell to 3.2% in February. For March, they rebounded somewhat to just below 3.5%. This recent

decline is important, because achieving price stability is less a matter of limiting actual inflation than of keeping inflationary expectations in check. This is because inflation's corrosive influence on the economy results from inefficient reallocation of the nation's resources as businesses and households attempt to protect themselves from an unknown future price level. In other words, economic prosperity is jeopardized by the anticipation of rising prices, not by realized price increases, so the observed decline in the public's

expectation of inflation may be more significant than the recent upturn in retail prices.

Like households, professional forecasters also see inflation falling in the near future. After a slight increase in early 2001, the consensus forecast has the CPI settling at about 2.5% by late 2001 and staying there through 2002. Even the most pessimistic forecasters do not anticipate that inflation by year's end will be much above current levels; their expectation for the CPI in late 2001 and through 2002 is about 3%.