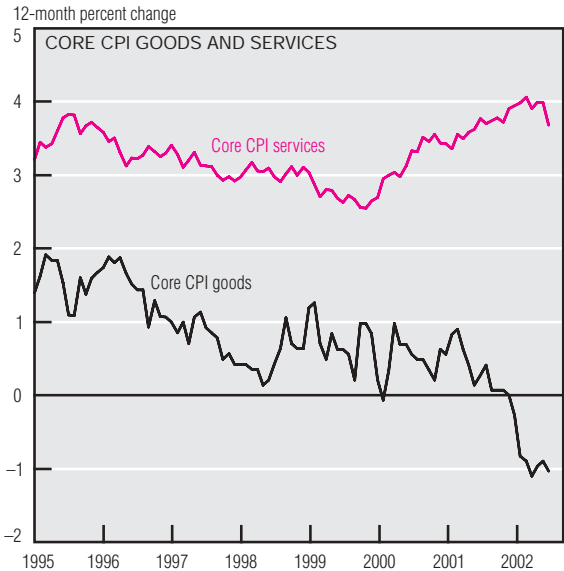
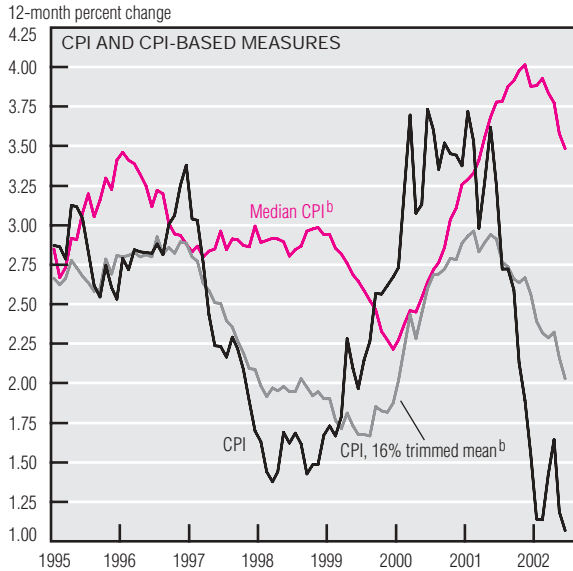
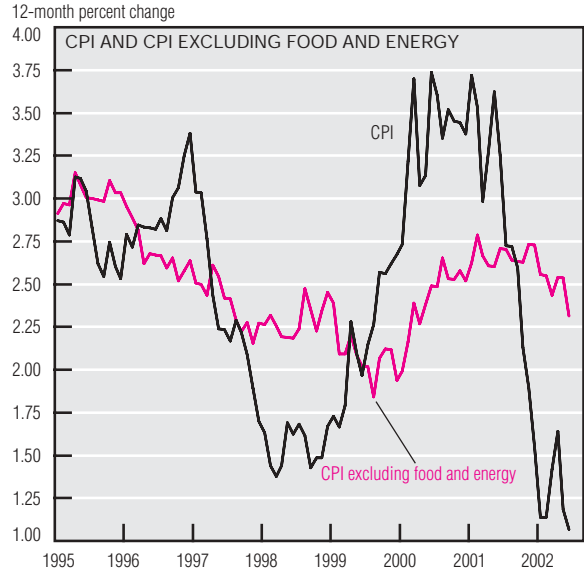


Inflation and Prices

	Percent change, last:				
	1 mo. ^a	3 mo. ^a	12 mo.	5 yr. ^a	2001 avg.
Consumer prices					
All items	1.3	2.5	1.1	2.3	1.5
Less food and energy	0.6	1.9	2.3	2.3	2.7
Median ^b	3.1	2.9	3.5	3.1	3.9
Producer prices					
Finished goods	1.7	-2.0	-2.0	1.1	-1.7
Less food and energy	2.4	1.1	0.3	1.1	0.9



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) rose 0.1% in June (1.3% annualized rate) after remaining unchanged in May. According to the Labor Department, a sharp increase in the prices of tobacco and smoking products was offset by declining recreation and communications products prices and disinflation in the indexes for shelter and medical care. The CPI's food and energy indexes registered no change in June; excluding these items, the CPI increased 0.1% (0.6% annualized rate) for the month and 2.3% over the past 12 months.

The all-items CPI rose only 1.1% over the same period, its smallest year-over-year percent change since October 1964.

Trimmed-mean measures of the CPI—which eliminate the smallest and largest price changes—also are showing smaller year-over-year rates of change. During 2002, for instance, the median CPI's 12-month rate of increase has slowed nearly half a percentage point, from 3.9% in December 2001 to 3.5% in June 2002. Likewise, the 12-month rate of increase in the 16% trimmed-mean

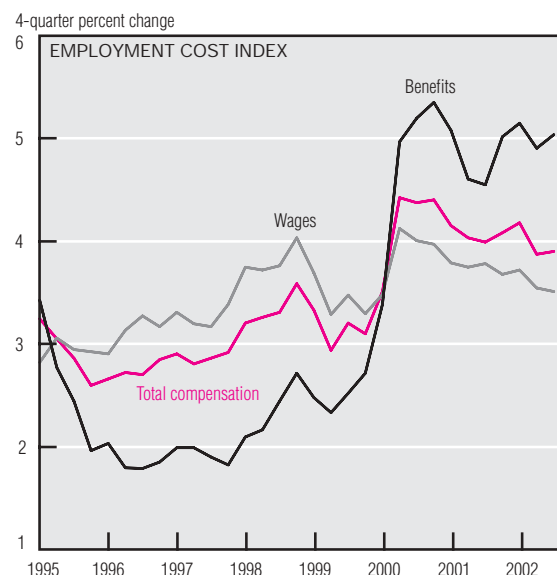
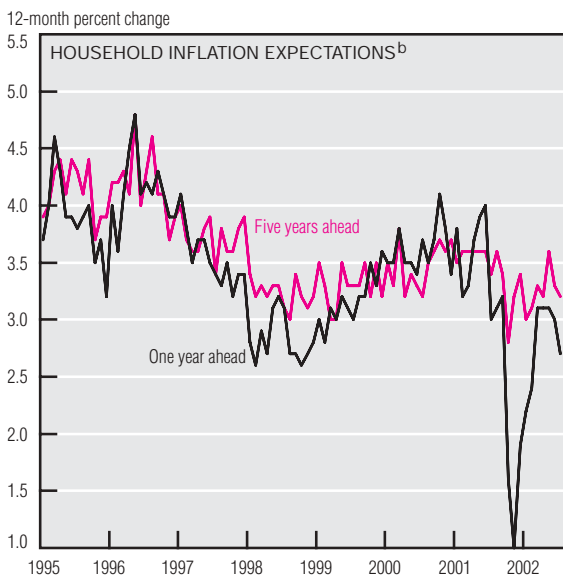
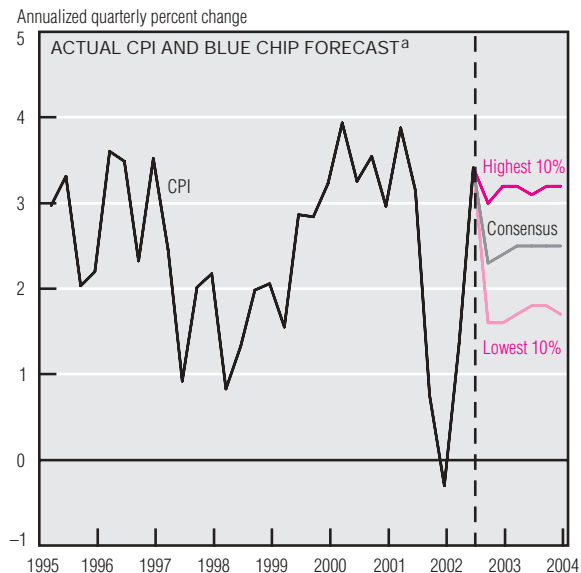
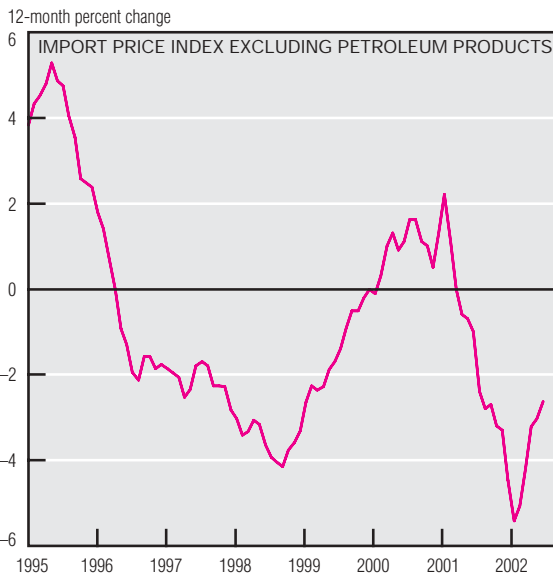
CPI has slowed just over half a percentage point, from 2.6% in December 2001 to 2.0% in June 2002.

The downward pressure on these measures is clearly coming from goods prices. However, the rate of increase in core CPI services prices has begun to trend downward, reversing its course of the past several years. Professional medical care services and rent of primary residence are two of the components responsible for the recent declines.

Despite the recent reversal in core CPI services prices, the gap between

(continued on next page)

Inflation and Prices (cont.)



a. Blue Chip panel of economists.

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

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; University of Michigan; and *Blue Chip Economic Indicators*, July 10, 2002.

the CPI's goods and services prices has widened since 2000. The reason for this divergence may be that, in general, goods are tradable and services are not. Over the last several years, prices for nonpetroleum products from foreign producers have, on average, been falling, and this is likely reflected in downward pressure on goods prices in the CPI.

The inflation outlook appears hopeful at present. The consensus inflation expectation among economists for the next year and a half

is around 2½%. Even the most pessimistic economists surveyed expect inflation to be only slightly above 3% during this period. Households are similarly sanguine about the inflation outlook: Both long- and short-term inflation expectations have fallen in recent months, and they continue to be historically low.

Economists believe there is a link between inflation expectations and wages—namely, that if workers believe inflation is about to increase, they will demand higher wages to preserve their present buying power.

The fact that wage rates (as well as total compensation), as measured by the Employment Cost Index (ECI), have moderated may be another indication of households' improving inflation outlook. Many economists also believe that because employment costs represent a significant share of firms' total costs, declining wage growth puts less pressure on output prices, and hence future inflation. In either case, the ECI's decline since the spring of 2000 may bode well for future inflation.