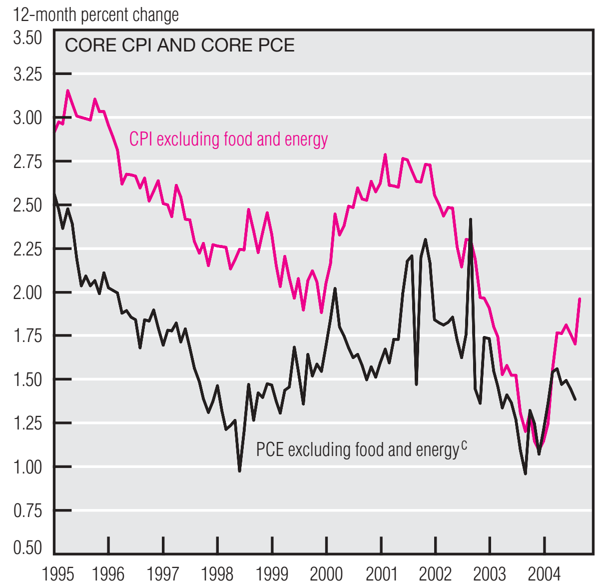
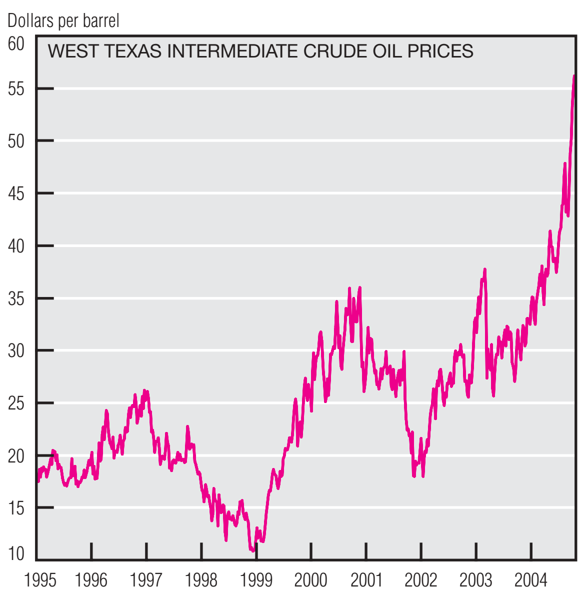
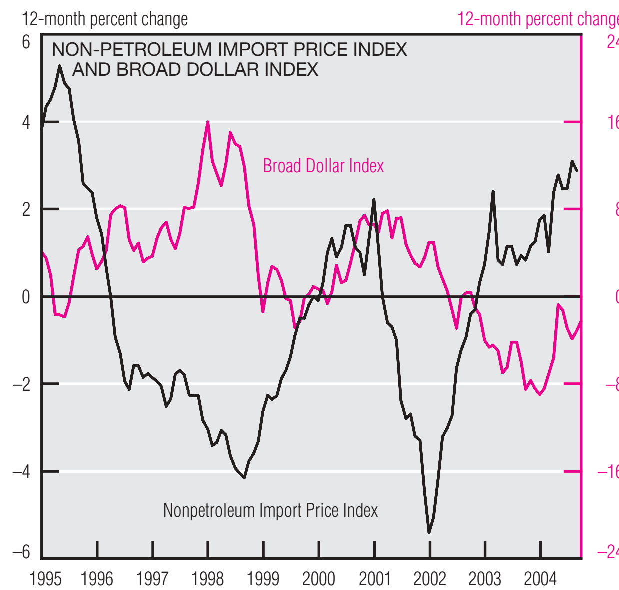
Inflation and Prices

September Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	2003 avg.
Consumer prices					
All items	1.9	0.6	2.5	2.5	1.9
Less food and energy	3.7	1.8	2.0	2.1	1.1
Median[b]	1.4	2.0	2.4	2.9	2.1
Producer prices					
Finished goods	0.8	0.3	3.3	2.0	4.4
Less food and energy	4.0	1.1	1.9	1.0	1.1







a. Annualized.
b. Calculated by the Federal Reserve Bank of Cleveland.
c. Personal Consumption Expenditures Price Index.
SOURCES: Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Foreign Exchange Rates," H.10, *Federal Reserve Statistical Releases*; Federal Reserve Bank of Cleveland; and *Wall Street Journal*.

The September inflation statistics showed neither a continuation of the disinflation seen for much of the summer nor the significant reacceleration of inflation that seemed to be occurring last spring.

The Consumer Price Index (CPI) rose 1.9% during the month, a slower pace than its sharp rise of 4.8% in the second quarter but faster than its slight 0.6% uptick in the third. Surging costs of petroleum and other imports have made it difficult to identify a distinct inflation trend. The cost of crude oil has continued to rise at an alarming pace, recently breaking $55 a barrel for West Texas intermediate crude—an increase of 80% since the beginning of the year. Meanwhile, the dollar devaluation that began in late 2002 has been putting upward pressure on nonpetroleum import prices, which, at around 3%, show the highest growth rate in almost a decade.

The rising cost of oil and other imports can have a major impact on households' cost of living. They can also cause a temporary fluctuation in the price indexes that otherwise would help us gauge inflation, making it difficult to know whether the change is part of a generalized rise in the overall price level. Unfortunately, the core inflation measures, which help us see through the price data's monthly volatility to gauge its underlying trend, showed mixed behavior in September. The growth rate for CPI excluding food and energy jumped to 3.7%—its largest increase since last March—while the median CPI showed an increase of only 1.4%—its smallest rise since June 2003.

Economists often use statistical "filters," which smooth the data to reveal their trend and cycle components. Applying one popular filter to

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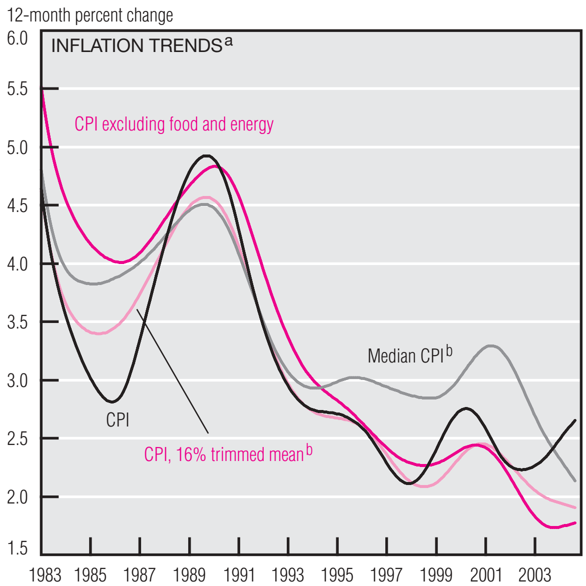
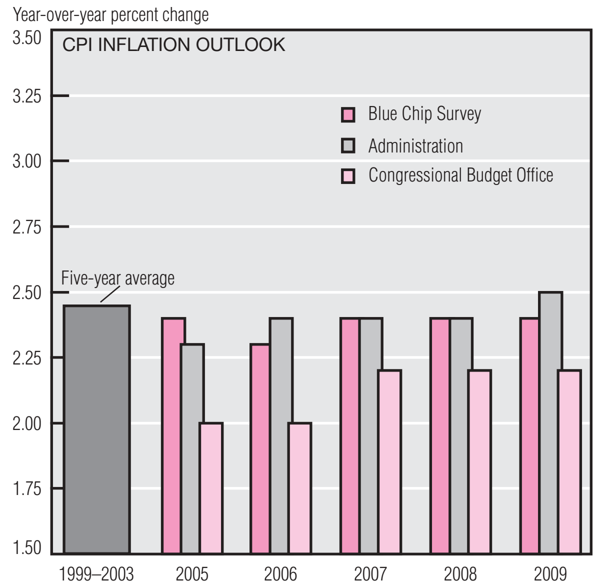
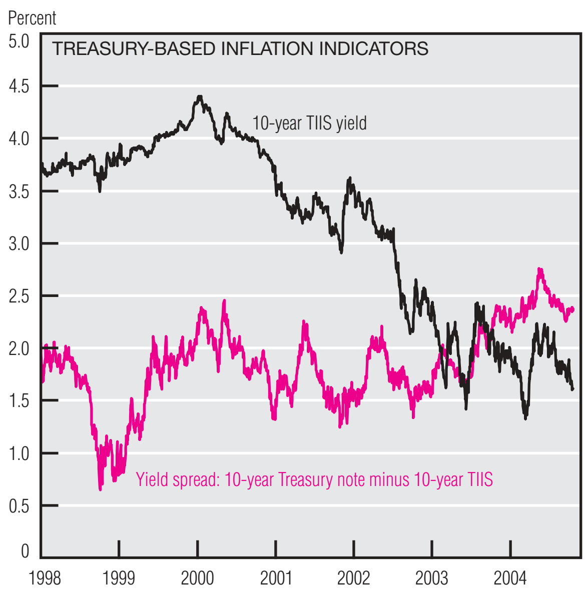
Inflation and Prices *(cont.)*







Selected Leading Inflation Indicators

	Percent change last: 12 mo.	Percent change last: 3 mo.[c]
Gold prices	8.5	26.7
Commodity Futures Price Index	14.5	8.7
Commodity Price Index	13.6	1.6
Institute for Supply Management's Manufacturing Price Index	35.7	–22.5
Nonpetroleum Import Price Index	2.9	1.6
Domestic nonfinancial business debt[d]	2.1	1.4

a. Inflation trends in the price measures determined using the Hodrick–Prescott filter.
b. Calculated by the Federal Reserve Bank of Cleveland.
c. Annualized.
d. Quarterly data.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Office of Management and Budget, *Mid-Session Review, Budget of the United States Government*, *Fiscal Year 2005*, July 2004; Congressional Budget Office, *The Budget and Economic Outlook: An Update*, September 2004; Federal Reserve Bank of Cleveland; *Blue Chip Economic Indicators*, October 10, 2004; Commodity Research Bureau; Institute of Supply Management; and Bloomberg Financial Information Services.

the alternative CPI measures indicates the inflation trend is somewhere between 1.75% and 2.50%. This resembles the CPI growth rate for the past five years and is in the range of long-term forecasts. For example, the consensus view of economists provided by the Blue Chip survey predicts an average rise of 2.4% in the CPI over the next five years. This estimate is about the same as the Administ ration's forecast and only slightly higher than that of the Congressional Budget Office.

Similarly, only a few indicators that economists use to spot changes in the inflation trend have shown signs that it is changing. In financial markets, the yield spread between ordinary 10-year Treasury securities and TIIS (Treasury inflation-indexed securities) is 2.4%, which is near its level for the past year and consistent with the various economic projections. The constellation of leading inflation indicators, which economists have touted from time to time, has failed to reveal any clear change in the inflation trend. On the one hand, gold prices are up 8.5% in a year and almost 27% (annualized) in the past three months.

Commodity futudres prices likewise have been rising at an above-average rate. However, commodity spot price increases have been subdued over the past three months, and purchasing managers' price reports have been falling. Another closely watched barometer of future inflation—growth in domestic nonfinancial business debt—continues to rise only modestly.