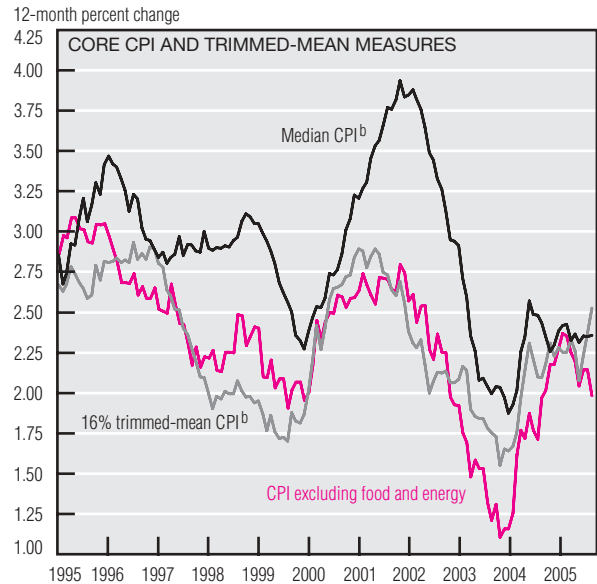
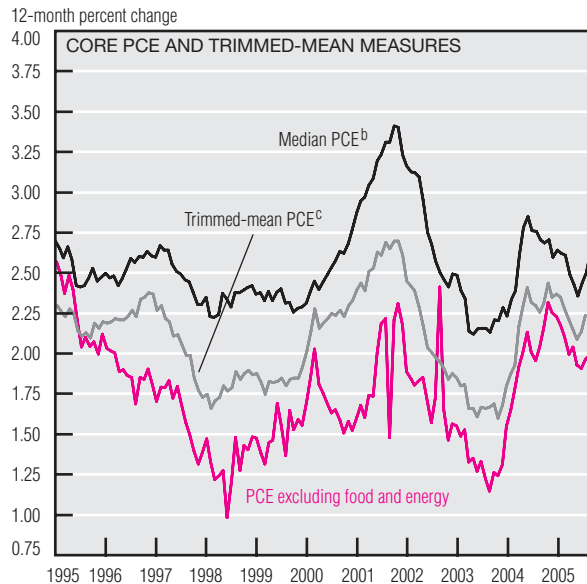
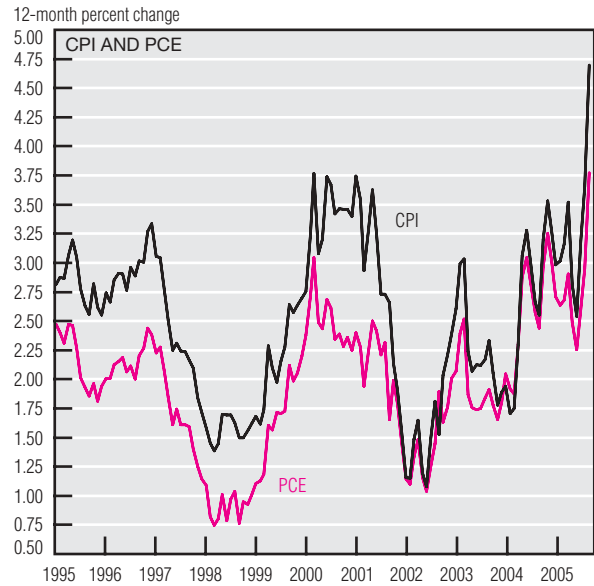


Inflation and Prices

| | Percent change, last: | | | | 2004 avg. |
|-------------------------|-----------------------|--------------------|--------|--------------------|--------------|
| | 1 mo. ^a | 3 mo. ^a | 12 mo. | 5 yr. ^a | |
| Consumer prices | | | | | |
| All items | 15.7 | 9.4 | 4.7 | 2.7 | 3.4 |
| Less food and energy | 1.2 | 1.4 | 2.0 | 2.0 | 2.2 |
| Median ^b | 1.7 | 2.1 | 2.3 | 2.8 | 2.3 |
| Producer prices | | | | | |
| Finished goods | 24.7 | 14.8 | 6.9 | 2.7 | 4.4 |
| Less food and energy | 3.1 | 2.6 | 2.6 | 1.1 | 2.2 |



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

c. Calculated by the Federal Reserve Bank of Dallas.

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

The Consumer Price Index surged up 15.7% (annualized rate) in September, the largest monthly rise in overall retail prices in more than 25 years. Energy costs, which accounted for over 90% of the CPI's September rise, soared 289.1% (annualized rate), the highest monthly price increase since the series began in 1957. Meanwhile, growth was considerably more subdued in the core and median CPI, rising 1.2% and 1.7%, respectively.

Longer-term trends in CPI- and PCE-measured inflation were similar:

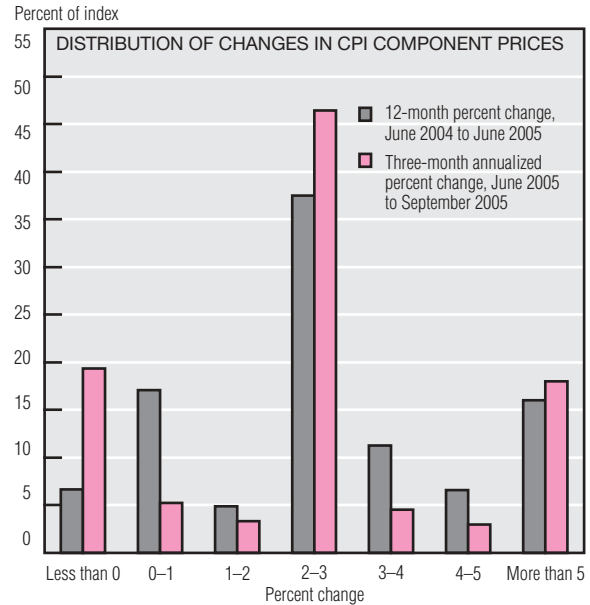
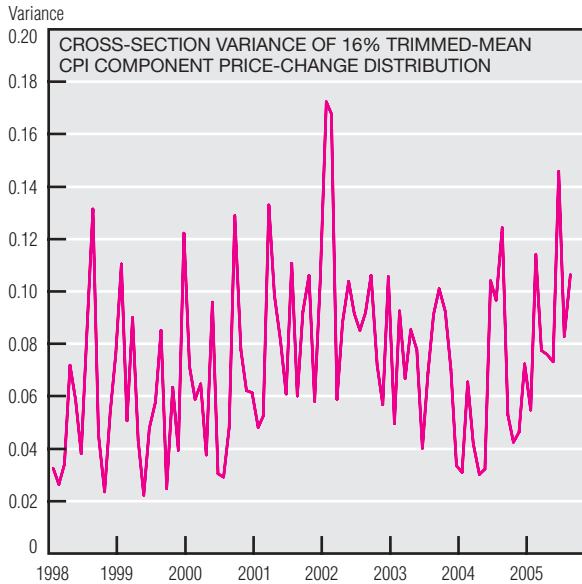
Their 12-month growth rates continued to accelerate. However, longer-term inflation trends among the core retail price measures were relatively stable, despite the recent dramatic increases in energy costs; most measures showed a 2.0% to 2.5% rise since September 2004. Growth in the core, median, and trimmed-mean PCE retail price measures, which consider an alternative basket of consumer goods and services, has remained subdued over the past year, generally fluctuating between 2.0% and 2.75%.

After trending upward throughout 2004, growth in various CPI retail price measures has also remained modest for the past year or so, generally fluctuating between 2.0% and 2.5%.

Interestingly, the variance of the 16% trimmed-mean CPI components' price-change distribution, while volatile, has generally trended upward since early 2004. The greater variance of price changes among components suggests marked differences in the monthly inflation rate of

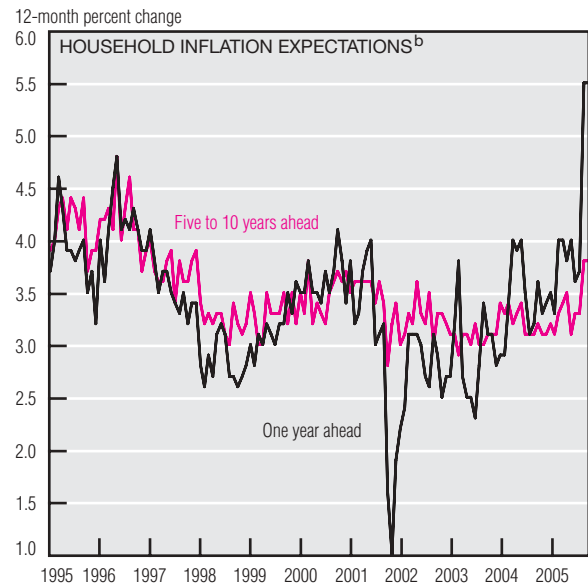
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Inflation and Prices (cont.)



Price Changes for Highest and Lowest 10% of CPI Components^a

| | Relative importance, Sept. 2005 | Three-month annualized percent change, June 2005–Sept. 2005 | 12-month percent change, June 2004–June 2005 |
|----------------------------------|---------------------------------|---|--|
| Miscellaneous personal goods | 0.2 | -13.1 | -0.6 |
| Infants' and toddlers' apparel | 0.2 | -12.5 | 0.2 |
| Lodging away from home | 3.0 | -11.2 | 2.9 |
| Men's and boys' apparel | 1.0 | -4.7 | -2.0 |
| Tenants' and household insurance | 0.4 | -4.7 | 1.5 |
| New vehicles | 4.6 | -4.3 | 0.7 |
| Women's and girls' apparel | 1.6 | -3.2 | -2.7 |
| Tobacco and smoking products | 0.8 | 10.3 | 4.6 |
| Jewelry and watches | 0.3 | 20.2 | -4.4 |
| Car and truck rental | 0.1 | 21.8 | 1.2 |
| Gas (piped) and electricity | 3.9 | 31.2 | 6.3 |
| Fuel oil and other fuels | 0.3 | 123.0 | 29.4 |
| Motor fuel | 4.8 | 234.7 | 7.1 |



a. Based on the three-month annualized price-change distribution.

b. Mean expected change 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 Federal Reserve Bank of Cleveland.

the core components, and makes it harder to determine a longer-term trend in overall retail prices.

Although the CPI rose dramatically in September, largely because of surging energy prices, more than 45% of the index's components still showed modest price inflation since June (2.0%–3.0% annualized), before the monthly energy shocks began. However, the distribution of changes in CPI component prices over the past three months differs dramatically

from the distribution of inflation rates in the 12 months previous to that, before the energy price shocks. Indeed, nearly four times as many index components registered price deflation over the past three months as over the previous 12. Most of the price deflation over this period was in the index's new-vehicle and lodging-away-from-home components, perhaps reflecting runaway energy prices. Deflation also occurred in apparel prices. The jump in the CPI since June resulted primarily

from price increases among the top 17% of the components in the price-change distribution, of which more than half were energy components with dramatic price increases.

Households seem especially concerned that high energy prices will persist; as a result, inflation expectations remained high though stable in October. Households expect that prices will rise 5.5% over the next year and 3.8% over the next five to 10 years.