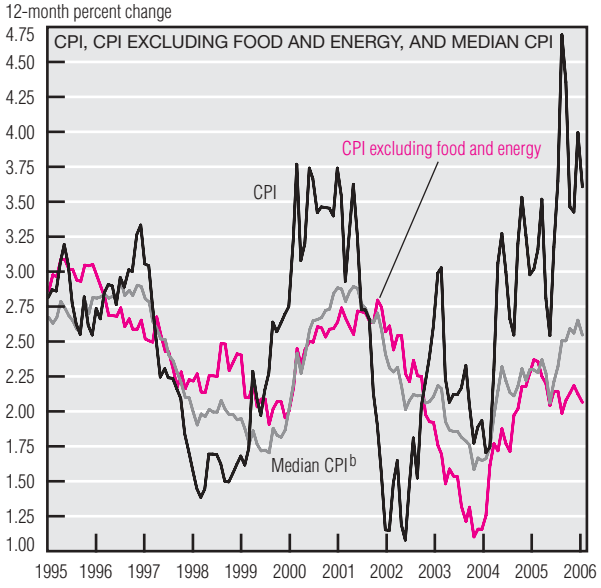
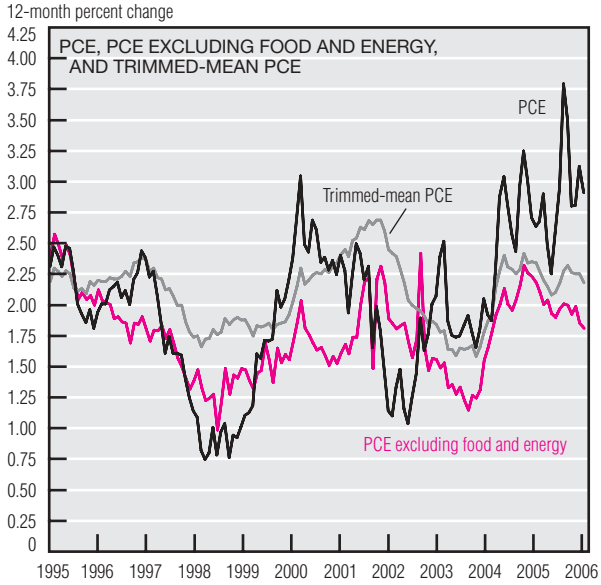
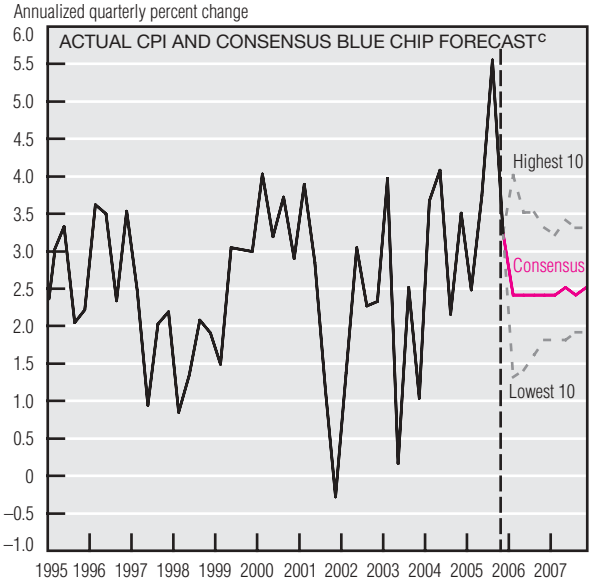
Inflation and Prices

February Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	2005 avg.
Consumer prices					
All items	0.6	2.7	3.6	2.5	3.6
Less food and energy	1.8	2.0	2.1	2.0	2.2
Median[b]	3.5	2.9	2.5	2.7	2.5
Producer prices					
Finished goods	–15.3	–2.0	3.7	2.2	5.8
Less food and energy	3.1	3.1	1.7	1.2	1.7







a. Annualized.
b. Calculated by the Federal Reserve Bank of Cleveland.
c. Blue Chip panel of economists.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; Federal Reserve Bank of Dallas; Federal Reserve Bank of Cleveland; and *Blue Chip Economic Indicators*, March 10, 2006.

The Consumer Price Index (CPI) rose a mere 0.6% (annualized rate) in February, after rising at a brisk annualized rate of 8.2% in January. Monthly growth in the core retail price measures was mixed: The CPI excluding food and energy rose 1.8% (annualized rate), whereas the median CPI was up a rather high 3.5% (annualized rate) during the month, exceeding its 12-month growth rate.

Longer-term trends in the core inflation measures are hovering at levels that some consider the high end of the range associated with price stability. The 12-month growth rates were 2.1% for the core CPI and 2.5% for the median CPI; the core PCE and the trimmed-mean PCE were 1.8% and 2.2%, respectively. The consensus estimate from the Blue Chip panel of forecasters indicates that overall CPI growth over the next two years will be stable at 2.4%.

In recent months, questions about whether the economy has, or soon will, reach its potential seem to have become more urgent as policymakers and others decide whether the Federal Reserve's cumulative policy actions have sufficed to keep the economy from pushing beyond a sustainable level and, presumably, fueling higher inflation.

Unfortunately, monitoring the data for signs of rising inflation is not easy. Price data fluctuate widely and obscure the underlying, more stable, inflation trend. Furthermore, monetary policy actions are usually assumed to influence underlying inflation with a substantial lag. This means that at any point, a policymaker's ability to

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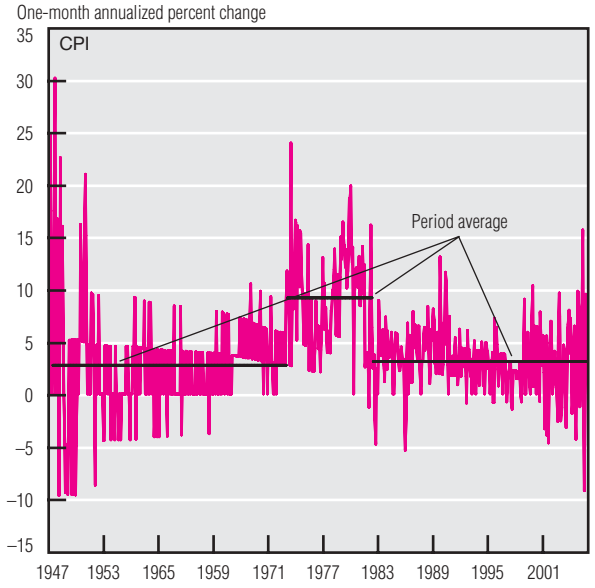
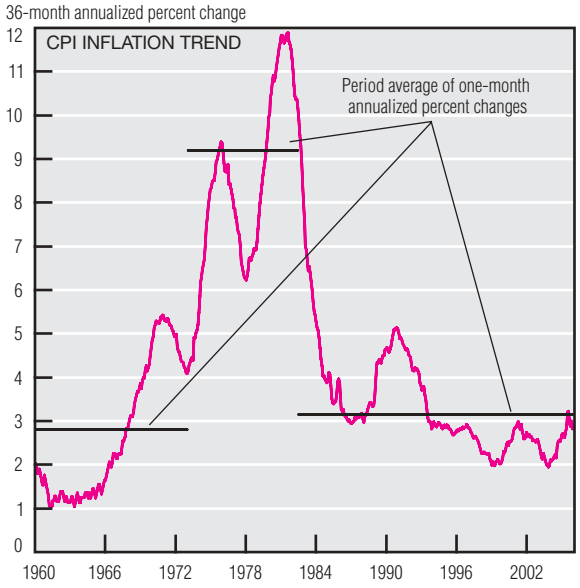
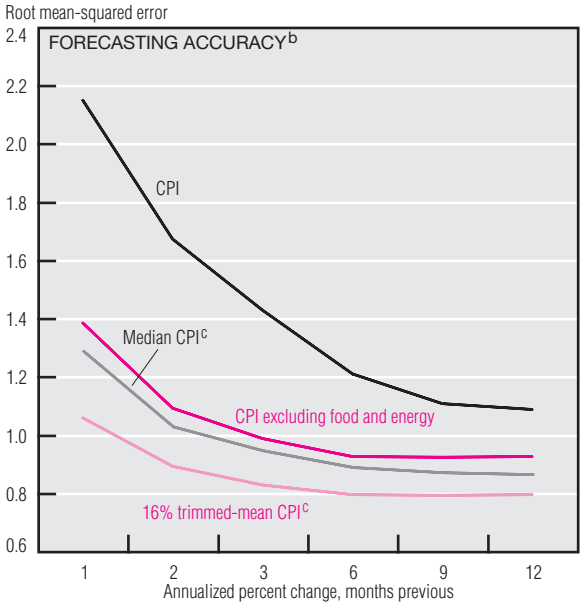
Inflation and Prices (cont.)





Time-series Variance of Alternative Inflation Measures, January 1990–February 2006

	Annualized percent change, last				
	One month	Three months	Six months	Nine months	12 months
CPI	7.0	2.8	1.5	1.2	1.1
Core CPI	2.0	1.2	1.0	1.0	1.0
Median CPI	1.3	0.6	0.5	0.5	0.5
16% trimmed-mean CPI	1.2	0.8	0.7	0.7	0.7
PCE	4.5	1.9	1.1	0.9	0.8
Core PCE	2.6[a]	1.1	0.9	0.8	0.8
Trimmed-mean PCE	0.6	0.4	0.3	0.3	0.3



a. The time-series variance is 2.3 after adjusting for insurance considerations arising from September 11.
b. Calculated using the root mean-squared error between the annualized one-, two-, three-, six-, nine-, and 12-month percent changes and the annualized percent change in the CPI over the next 36 months (January 1990–February 2003).
c. Calculated by the Federal Reserve Bank of Cleveland.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and Federal Reserve Bank of Cleveland.

discern the inflation trend and anticipate its movement is imperfect at best.

Note the CPI's highly erratic monthly behavior from three distinct inflation trends over the past 60 years. Identifying changes in the inflation trend is generally only possible after long periods of time have passed. Moreover, methods to measure the underlying inflation pattern in the data, such as long-run averages, can reveal a shift in the inflation trend only well after that change has occurred.

To improve the inflation signal in the price data, economists have often appealed to so-called core inflation measures, like the CPI excluding food and energy items—goods notorious for causing transitory fluctuations in the aggregate price data. A more recent approach is the use of trimmed-mean estimates that systematically strip out the more extreme—and presumably most transitory—price changes. These measures have been shown to substantially reduce short-run variation in the inflation estimates and, hopefully, give policymakers a quicker read on shifts in the inflation trend. Indeed, these estimates have predicted the long-term growth rate of the CPI better than either the CPI or the more traditional CPI excluding food and energy. For example, since 1990, monthly changes in the median CPI and the 16% trimmed-mean CPI have been about twice as effective as changes in the overall CPI for predicting the longer-term CPI inflation trend (that is, the 36-month annualized percent change).