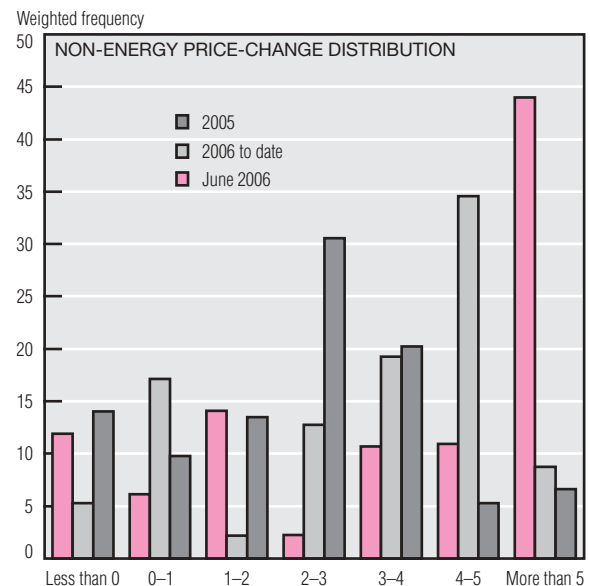
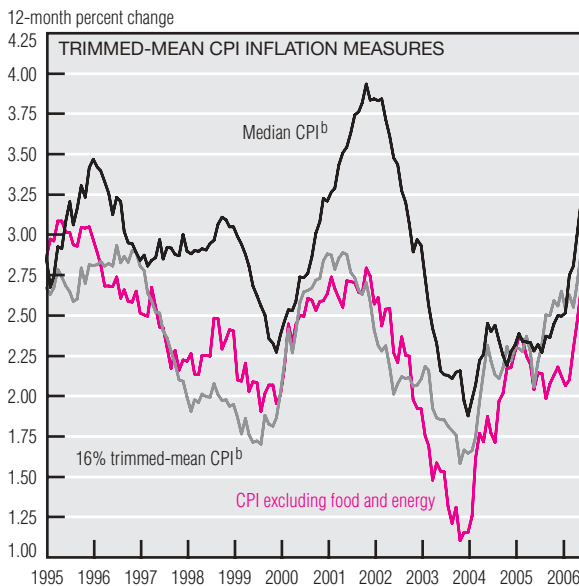
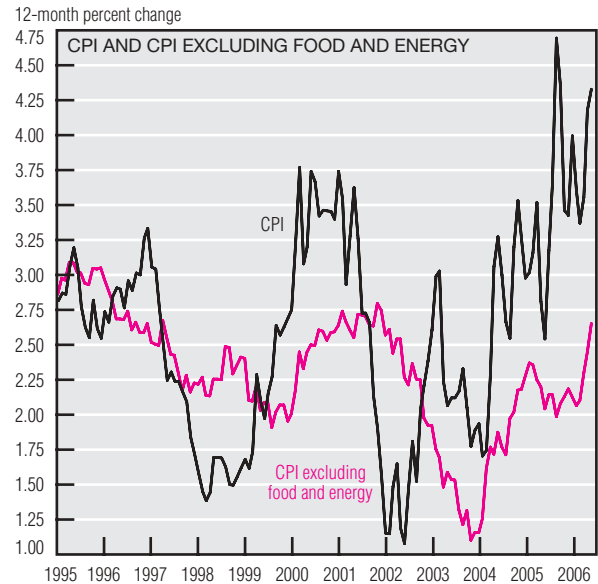


# Inflation and Prices

	Percent change, last:				2005 avg.
	1 mo. <sup>a</sup>	3 mo. <sup>a</sup>	12 mo.	5 yr. <sup>a</sup>	
<b>June Price Statistics</b>					
<b>Consumer prices</b>					
All items	2.4	5.1	4.3	2.6	3.6
Less food and energy	3.6	3.6	2.6	2.1	2.2
Median <sup>b</sup>	4.6	4.1	3.2	2.7	2.5
<b>Personal consumption Expenditure Price Index</b>					
All items	2.1	4.1	3.5	2.3	3.0
Less food and energy	2.9	2.8	2.4	1.9	2.1



a. Annualized.

b. Calculated by the Federal Reserve Bank of Cleveland.

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

Inflation remained elevated in June. The Consumer Price Index (CPI) rose 2.4% (annualized rate) during the month, following a 5.5% (annualized rate) advance in May. Nevertheless, monthly growth in the “core” retail price measures continued to exceed longer-term trends: The CPI excluding food and energy jumped 3.6% (annualized rate) for the second consecutive month, while the median CPI surged at a 4.6% annualized rate.

Longer-term growth trends in retail price measures were still accelerating

in June, reaching levels unseen since late 2002 at least. The 12-month growth rate in the CPI excluding food and energy inched up to 2.6%, while the 12-month growth rate in the 16% trimmed-mean CPI ticked up to 2.9% and the median CPI rose to 3.2%.

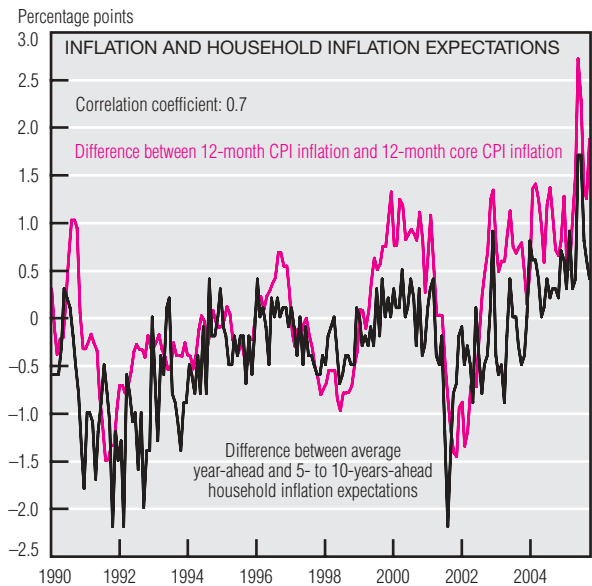
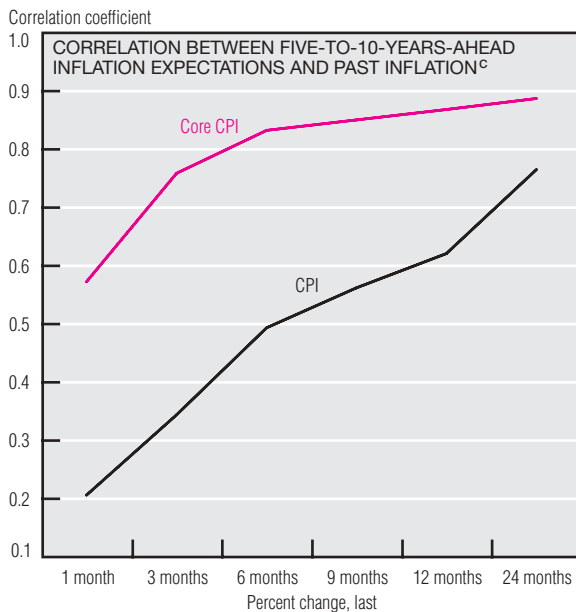
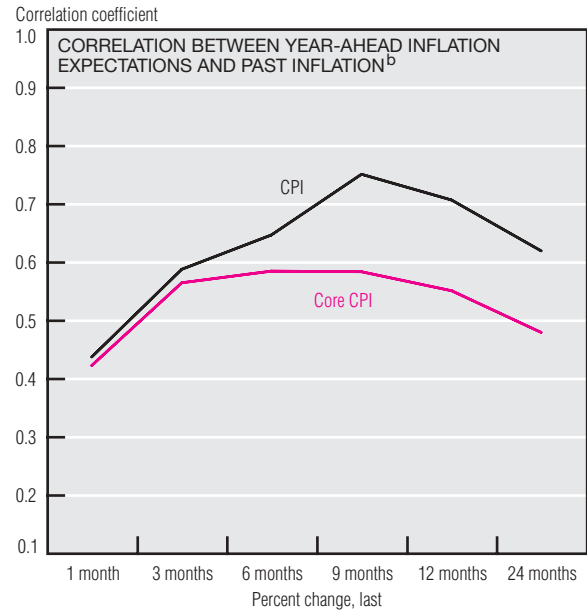
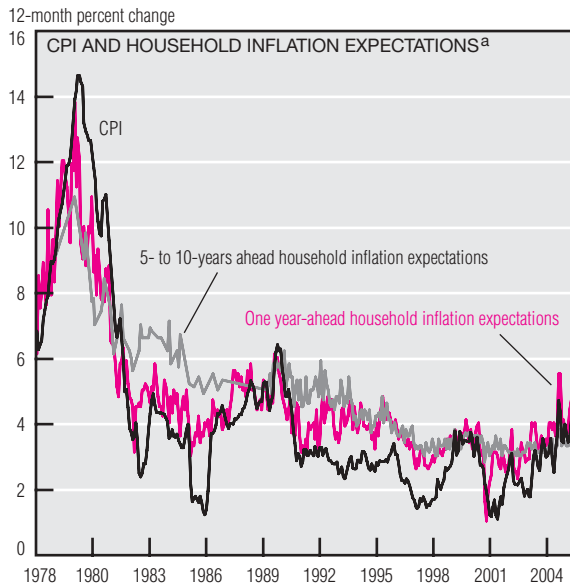
The intensity of retail price increases continues to be rather persistent and broad-based. In 2005, about one-third of non-energy CPI components posted average monthly increases of 2% to 3%, while prices of only one-third of these components

rose over 3%. Since the beginning of this year, a majority of the non-energy components has risen at average monthly rates exceeding 3%, while nearly 70% rose 3% or more in June. Indeed, nearly 45% of non-energy CPI components rose 5% or more in June for the second consecutive month.

Short-term household inflation expectations have also been elevated in the last few months, perhaps in response to upward retail price pressure. July survey data from U.S.

(continued on next page)

## Inflation and Prices (cont.)



a. Mean expected change as measured by the University of Michigan's *Survey of Consumers*.

b. Correlations between the year-ahead household inflation expectations and 1-, 3-, 6-, 9-, 12-, and 24-month percent changes in the CPI and core CPI (lagged by one month), April 1990 to June 2006.

c. Correlations between the 5- to 10-years-ahead household inflation expectations and 1-, 3-, 6-, 9-, 12-, and 24-month percent change in the CPI and core CPI (lagged by one month), April 1990 to June 2006.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; University of Michigan; and Federal Reserve Bank of Cleveland.

households show they expect retail prices in the next 12 months to rise 3.8%—down a bit from recent levels, but still on the high end of the rather narrow range in which they have fluctuated over much of the past decade. Meanwhile, longer-term inflation expectations are holding steady, with households anticipating a 3.2% rise in retail prices over the next five to 10 years.

What information households base their inflation expectations on is the

topic of frequent academic debate. Rather crude correlations, which examine the relationship between realized inflation rates and households' expectations, indicate that their year-ahead expectations are most closely correlated with the headline CPI inflation rate, and are especially sensitive to this measure over longer time horizons. Interestingly, expectations for the inflation rate over the next five to 10 years are more closely correlated with the core CPI inflation

rate than with headline CPI. The correlation also grows stronger as the underlying core CPI inflation trend becomes more persistent. Indeed, the divergence between short- and long-term inflation expectations is correlated to the divergence between headline and core CPI inflation rates; this may indicate that households see through the same transitory fluctuations in prices that the core inflation measure is designed to isolate.