

**The Inflation Update: December 2003**  
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Prices remain stable. This morning the Bureau of Labor Statistics announced that the all items Consumer Price index rose 2.6% at an annual rate (a.r.) for the month of December. That increase exactly matches the decrease in November, so the index is now at the same level as was reported for September and October. Overall, this comprehensive inflation index is up 1.9% for the last 12 months.

As usual, core inflation measures show much less volatility than the headline index. The traditional CPI excluding food and energy rose a modest 1.2% (a.r.) in December – very nearly the same as its 12-month increase of 1.1%. Meanwhile, the Median CPI computed by the Federal Reserve Bank of Cleveland rose 1.6% (a.r.) for the second consecutive month and is up 1.9% for the year. Importantly, increases in the core measures were one-percentage point lower in 2003 than they were in 2002. The conclusion is that the inflation trend has fallen, and is now in the range between 1 and 1½%, very close to most estimates of the upward bias in these measures. To many, we have arrived at price stability.

The detail in this morning's report confirms that the view that inflation is not an immediate problem. Owner equivalent rent (OER) – the perennial median component – rose 1.6% (a.r.) for the second straight month, and is up 2.0% for the past 12 months. This is the lowest level since the BLS began constructing the data in 1983. While there is still chatter about housing price bubbles, the data suggest that these problems remain local. In line with the OER number is the 2.7% (a.r.) increase in core services for the December. Prices of services excluding energy services are now on a very stable trajectory, showing very few signs of acceleration or deceleration.

If there is a cloud in the sky this morning, it is small. Core goods (commodities excluding food and energy commodities) fell by *only* 0.9% (a.r.). This has been falling almost steadily since April 2001, and is down 2.5% for the year. If core goods prices were to stop falling and remain stable, while core services prices continue to rise at 2.5%, it would imply an increase in trend inflation to around 1¾% (core services are 70% of the ex. food and energy CPI and  $0.7 \times 2.5 = 1.75$ ).

As for monetary policy, this morning's report changes nothing. As FOMC members have said repeatedly over the past few months, inflation is now at the low end of the acceptable range. Even with the 12 to 18 month lag with which policy changes influence inflation, this means that they are likely to wait to actually see an uptick before they start to tighten policy. There is no sign of this yet, and most of the forecasts are for continued moderation, this suggests that the funds rate is unlikely to rise at all this year.

**Consumer Price Inflation, Various Measures  
(Through December 2003, all data s.a. at an annual rate)**

Previous	All Items CPI	CPI ex Food & Energy	Median CPI
1 Month	2.6	1.2	1.6
3 Months	0.0	1.0	2.2
6 Months	1.5	1.2	2.3
12 Months	1.9	1.1	1.9
12 Months ended December 2002	2.4	2.0	3.0

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(Note: If you have trouble viewing the tables, you may prefer looking at them in html at

[The Inflation Update: December 2003](#)

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These also include the table used to construct the Median CPI.)

**Detail for Computation of the Median CPI**  
*December 2003*

Component	Annualized 1- month % change	Relative Importance	Cumulative Relative Importance
Car and truck rental	-36.2	0.1	0.1
Infants' and toddlers' apparel	-17.3	0.2	0.3
Public transportation	-12.3	1.2	1.5
Miscellaneous personal goods	-9.0	0.2	1.7
Jewelry and watches	-8.1	0.4	2.1
Used cars and trucks	-7.9	1.8	3.9
Processed fruits and vegetables	-6.2	0.3	4.1
Fuel oil and other fuels	-5.2	0.2	4.3
Women's and girls' apparel	-4.2	1.7	6.0
Footwear	-3.9	0.8	6.9
Motor vehicle parts and equipment	-2.2	0.4	7.3
Men's and boys' apparel	-2.0	1.0	8.3
Motor fuel	-1.8	3.1	11.5
Tenants' and household insurance	0.0	0.4	11.8
New vehicles	0.0	4.8	16.6
Motor vehicle fees	0.0	0.6	17.2
Recreation	0.0	6.0	23.2
Communication	0.0	2.8	26.0
Motor vehicle insurance	0.4	2.5	28.6
Personal care services	0.6	0.9	29.5
Personal care products	1.6	0.7	30.1
<b>Owners' equivalent rent of primary residence</b>	<b>1.6</b>	<b>22.6</b>	<b>52.8</b>
Miscellaneous personal services	1.7	1.6	54.4
Household furnishings and operations	1.9	4.6	59.0
Rent of primary residence	2.3	6.6	65.6
Cereals and bakery products	2.4	1.3	66.9
Alcoholic beverages	3.2	1.0	67.9
Food away from home	3.3	6.3	74.3
Tobacco and smoking products	3.4	0.9	75.2
Water and sewer and trash collection services	4.1	0.9	76.1
Medical care commodities	4.6	1.4	77.5
Fresh fruits and vegetables	7.3	1.0	78.5
Motor vehicle maintenance and repair	7.6	1.4	79.9
Gas (piped) and electricity	7.8	3.6	83.5
Medical care services	8.0	4.7	88.2
Education	8.1	3.0	91.3
Other food at home	8.4	1.8	93.0
Dairy and related products	13.4	0.9	93.9
Meats, poultry, fish, and eggs	14.3	2.4	96.4
Nonalcoholic beverages and beverage materials	21.9	0.9	97.3
Lodging away from home	23.0	2.7	100.0