

The Inflation Update: February 2004
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This morning's Consumer Price Index numbers are certainly grist for the inflation hawks' mill. The all-items CPI is up 3.3% for the month (at an annual rate), far above its 12-month average of 1.7%. Core measures fared little better, with the CPI excluding food and energy up 2.5% (a.r.) and the Median CPI computed by the Federal Reserve Bank of Cleveland rising 2.9% (a.r.). The 12-month readings are a bit more soothing. The headline CPI is up 1.7% since February 2003, while the conventional core CPI rose 1.2%. The Median CPI increased by 2% for the same period.

While the numbers seem to validate the view that things are generally under control, there are signs pointing to problems in the very near future. Specifically, the index of core goods prices (commodities excluding food and energy commodities) rose for the first time since the summer of 2002, and the increase was a whopping 2.6% (a.r.). In fact, core goods prices rose by a full percentage point more than core service prices did. The last time that happened was in March 1999. It will take a few months like this one before we can conclude that goods price inflation is really back; but if it is, that will be a big change.

Even though recent service price inflation looks subdued, there may be some problems brewing as well. Owner equivalent rent, by far the most important single component in the CPI, rose 2.7% (a.r.) for the month, well above its 12-month average of 1.9%. After falling steadily for 2 years, it appears that OER may be on the way back up. (While OER was not the median good this month, it is surely responsible for the fact that the Median CPI rose by as much as it did.)

In the grander scheme of things, one month's inflation data doesn't mean all that much. That is almost surely going to be the reaction of the FOMC. The Committee's statement following yesterday's meeting continues to point to labor market slack as the defining factor in determining the path of future policy. In the meantime, a small up-tick in inflation is unlikely to cause much concern. This is especially true in light of statements suggesting that comfort with long-term inflation over 2%.

But one has to wonder whether current conditions really justify a federal funds rate of 1%. This is at least 3 full percentage points below the long-run equilibrium level. Shouldn't the rate be closer to 3%? Wouldn't that be expansionary enough?

[A note for the die-hard inflation statisticians in the crowd, I will note that the 16% trimmed mean pretty much exploded this month, rising 3.5% (a.r.) from January to February. That's more than double its 12-month average of 1.7%. My various research papers on limited-influence estimates of trend inflation conclude that this is the preferred measure. If those analyses are right, watch out!]

**Consumer Price Inflation, Various Measures
(Through February 2004, all data s.a. at an annual rate)**

Previous	All Items CPI	CPI ex Food & Energy	Median CPI
1 Month	3.3	2.5	2.9
3 Months	3.7	1.7	2.1
6 Months	2.0	1.2	2.1
12 Months	1.7	1.2	2.0
12 Months ended February 2003	3.0	1.8	2.7

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

[The Inflation Update: February 2004](#)

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

Detail for Computation of the Median CPI
February 2004

Component	Annualized 1- month % change	Relative Importance	Cumulative Relative Importance
Lodging away from home	-17.2	3.0	3.0
Jewelry and watches	-14.7	0.3	3.3
Miscellaneous personal goods	-9.0	0.2	3.5
Meats, poultry, fish, and eggs	-7.7	2.4	5.8
Women's and girls' apparel	-2.1	1.7	7.5
Dairy and related products	-2.1	0.9	8.4
Motor vehicle maintenance and repair	-1.2	1.4	9.7
Tobacco and smoking products	-1.0	0.8	10.5
Cereals and bakery products	-0.6	1.2	11.7
Public transportation	-0.6	1.1	12.8
Motor vehicle parts and equipment	0.0	0.4	13.2
Communication	0.0	3.1	16.3
Nonalcoholic beverages and beverage materials	0.9	0.9	17.2
Motor vehicle fees	0.9	0.5	17.7
Used cars and trucks	1.9	2.0	19.7
Tenants' and household insurance	2.1	0.4	20.1
Motor vehicle insurance	2.3	2.5	22.6
Owners' equivalent rent of primary residence	2.7	23.5	46.1
Household furnishings and operations	2.9	4.5	50.6
Rent of primary residence	2.9	6.2	56.8
Infants' and toddlers' apparel	3.1	0.2	57.0
Men's and boys' apparel	3.1	1.0	58.1
Footwear	3.1	0.8	58.8
Processed fruits and vegetables	3.2	0.3	59.1
Alcoholic beverages	3.2	1.0	60.1
Miscellaneous personal services	3.4	1.5	61.6
Recreation	3.4	5.9	67.5
Personal care services	3.8	0.7	68.1
Food away from home	4.0	6.2	74.3
Medical care commodities	4.6	1.5	75.8
New vehicles	5.4	4.8	80.7
Personal care products	5.6	0.6	81.3
Education	6.2	2.9	84.2
Medical care services	8.8	4.6	88.8
Other food at home	10.0	1.8	90.6
Gas (piped) and electricity	11.1	3.7	94.3
Fuel oil and other fuels	13.1	0.2	94.5
Water and sewer and trash collection services	13.7	0.9	95.4
Fresh fruits and vegetables	14.4	1.0	96.4
Car and truck rental	26.9	0.1	96.5
Motor fuel	35.2	3.5	100.0