

The Inflation Update: June 2004
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Most people would call this morning's CPI report "soft." The high headline inflation reading of 3.9% (at an annual rate) is easily explained by the burst in energy prices (+36.5% a.r.). Removing energy alone knocks the one-month inflation reading down to 1.9% (a.r.). In fact, core measures designed to give a better picture of the long-term trend showed a decline from previous months. The traditional CPI excluding food and energy rose only 1.2% (a.r.) while the median CPI computed by the Federal Reserve Bank of Cleveland was up 2.2% (a.r.).

Even taking this one month dip into account, inflation is substantially higher than it was at the end of last year. The six month average of the CPI excluding food and energy is now 2.6% (a.r.), up from 1.0% (a.r.) over the second half of 2003. And the median CPI has now risen from 2.3% (a.r.) to 2.8% (a.r.) over the same period. Regardless of how you look at it, we are back to where we were in late 2002.

The detail of the report provides evidence that inflation is stabilizing. Core good prices (commodities excluding food and energy commodities) were unchanged for the month, and are up 0.9% (a.r.) for the year. Core services (services excluding energy services) rose a modest 2.1% (a.r.) in June, and are up 3.2% (a.r.) for the year. Looking deeper still, we see that owner equivalent rent rose 2.2% (a.r.) for the month, and is up 2.8% (a.r.) over the past six months. Together all of this confirms my conclusion of last month – the inflation trend is in the range of 2½%.

What does all of this mean for monetary policy? This is the final CPI reading before the August 10 FOMC meeting. Committee members may see the weakness in the inflation data as a vindication of their view that the inflation burst earlier this year was an anomaly. Combined with recently disappointing reports on real growth, the result could be an even more measured pace.

Monetary policy is always a difficult balancing act. This is especially true when policymakers take on the burden of stabilizing the real economy as well as inflation. The decision by the FOMC to focus so much attention on real stability has put them into a dangerous position. Recent public statements suggest that Committee members believe much of the recent inflation burst has been a result of "technical factors" that reversed the inflation declines of the fall. But that reasoning suggests there was never a risk of deflation in the first place. (Something I believed then, and continue to believe now.) So which was it? Was there never a deflation problem, or has inflation gone up? Aren't interest rates too low in either case?

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

Previous	All Items CPI	CPI ex Food & Energy	Median CPI
1 Month	3.9	1.2	2.2
3 Months	4.8	2.3	3.0
6 Months	4.9	2.6	2.8
12 Months	3.3	1.9	2.5
12 Months ended June 2003	2.1	1.5	2.2

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

[The Inflation Update: June 2004](#)

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

Detail for Computation of the Median CPI

June 2004

Component	Annualized 1- month % change	Relative Importance	Cumulative Relative Importance
Car and truck rental	-19.94	0.10	0.10
Used cars and trucks	-10.39	1.98	2.08
Fresh fruits and vegetables	-10.17	0.95	3.03
Lodging away from home	-9.93	3.06	6.09
Processed fruits and vegetables	-6.04	0.26	6.35
Personal care products	-6.04	0.61	6.96
Miscellaneous personal goods	-5.33	0.19	7.15
Jewelry and watches	-4.43	0.28	7.43
Other food at home	-1.44	1.78	9.21
Communication	-1.37	3.02	12.23
Nonalcoholic beverages and beverage materials	0.00	0.90	13.13
Footwear	0.00	0.77	13.90
Motor vehicle fees	0.00	0.50	14.40
Public transportation	0.00	1.04	15.44
Household furnishings and operations	0.96	4.43	19.87
Tenants' and household insurance	1.04	0.39	20.26
Medical care commodities	1.35	1.51	21.76
Cereals and bakery products	1.76	1.20	22.96
Personal care services	1.85	0.65	23.61
Food away from home	1.95	6.15	29.76
Women's and girls' apparel	2.13	1.70	31.46
Owners' equivalent rent of primary residence	2.16	23.42	54.88
New vehicles	2.65	4.77	59.65
Rent of primary residence	2.89	6.17	65.82
Men's and boys' apparel	3.09	1.01	66.83
Infants' and toddlers' apparel	3.11	0.19	67.02
Miscellaneous personal services	3.33	1.46	68.48
Meats, poultry, fish, and eggs	3.35	2.33	70.81
Recreation	3.37	5.84	76.65
Motor vehicle parts and equipment	3.39	0.36	77.01
Alcoholic beverages	4.47	1.01	78.02
Medical care services	4.60	4.65	82.67
Motor vehicle maintenance and repair	5.56	1.35	84.01
Water and sewer and trash collection services	6.00	0.93	84.94
Education	6.05	2.90	87.85
Tobacco and smoking products	6.52	0.80	88.65
Motor vehicle insurance	6.53	2.47	91.12
Dairy and related products	21.84	0.91	92.04
Gas (piped) and electricity	29.07	3.67	95.71
Motor fuel	43.11	4.04	99.75
Fuel oil and other fuels	46.48	0.25	100.00