

**The Inflation Update: October 2003**  
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My impression is that the deflation hysteria has now subsided. News reports about the impending economic death spiral are thankfully fewer and farther between. This morning's consumer price index release comes as added balm for those fretting about deflation. For the rest of us who have worried off and on about *inflation*, the new numbers are cause for some concern.

This morning the Bureau of Labor Statistics announced that the all-items CPI was unchanged from September to October. But a sharp decline in energy prices – gasoline dropped 6.8 percent for the month – means that core measures showed substantial increases. The conventional core, the CPI excluding food and energy, rose 2.5 percent at an annual rate (a.r.), while the median CPI calculated by the Federal Reserve Bank of Cleveland increased a somewhat more dramatic 3.3 percent. Over the last 12 months, the headline CPI is now up 2 percent. The two core measures showed increases of 1.3 percent for the CPI ex. food and energy, and 2.0 percent for the Median CPI.

Looking just under the surface, we can see the continued divergence of core goods from core service prices. Commodities excluding food and energy commodities (core goods) fell 3.4 percent (a.r.) for the month, substantially more than the -2.7 percent average over the last year. The decline in goods prices was centered on auto, where new and used car prices were down 8 percent at an annual rate. This surely can't continue. Looking deeper, we can see that clothing prices have now been rising for much of the year. With women's apparel leading the way, clothing prices are up 3.4 percent (a.r.) since July. Maybe dollar depreciation is finally starting to affect the price of the things we import. It is worth noting that computer prices rose at 15.7 percent (a.r.) for the month (it's lumped into communication in the table below) – suggesting that people are finally starting to order the things again.

Meanwhile, services excluding energy services (core services) rose 4.9 percent (a.r.). That's far above the 2.9 percent average rise since October 2002. Regular readers of this update will not be surprised to learn that the story here is owner equivalent rent. OER is up a healthy 3.9 percent (a.r.) for the month, way above it's 12-month average of 2.1 percent. The acceleration in OER alone added about one-half of one percentage point to the increase in the conventional core measure.

Where does all of this leave Chairman Greenspan and the FOMC? What does it mean for their belief “that policy accommodation can be maintained for a considerable period”? My expectation is that the FOMC will continue to sit on their hands for some time to come. That is, I believe the “considerable period” will extend well into 2004, and possibly beyond. Committee members are very unlikely to be swayed by the firming in the prices that has been revealed in this morning's report. Instead, they are going to continue to focus on the labor market and the job gap. Their reasoning will be that a large job gap will hold wages down. With low wage growth, price inflation is not a threat. That's what their forecasting models are going to tell them, and I expect them to believe it. The risk is that these models will turn out to be flawed, and that inflation will start to rise. We can only hope that the process stops before inflation goes beyond 3 percent. In the meantime, all we can do is try to enjoy the low-interest-rate ride.

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

Previous	All Items CPI	CPI ex Food & Energy	Median CPI
1 Month	0.0	2.5	3.3
3 Months	2.4	1.5	2.6
6 Months	1.9	1.7	2.3
12 Months	2.1	1.3	2.0
12 Months ended October 2002	2.0	2.2	3.1

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

[The Inflation Update: October 2003](#)

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

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

Component	Annualized 1- month % change	Relative Importance	Cumulative Relative Importance
Motor fuel	-57.0	3.5	3.5
Used cars and trucks	-30.3	1.9	5.4
Miscellaneous personal goods	-15.8	0.2	5.6
Fuel oil and other fuels	-14.1	0.2	5.8
Jewelry and watches	-13.8	0.4	6.2
Gas (piped) and electricity	-12.3	3.7	9.8
Infants' and toddlers' apparel	-10.1	0.2	10.0
New vehicles	-3.4	4.8	14.8
Communication	-2.7	2.8	17.6
Cereals and bakery products	-2.3	1.3	18.9
Footwear	-1.0	0.8	19.8
Recreation	0.0	6.0	25.7
Rent of primary residence	0.6	6.6	32.3
Alcoholic beverages	0.6	1.0	33.4
Tenants' and household insurance	1.0	0.4	33.7
Personal care services	1.2	0.9	34.7
Miscellaneous personal services	1.3	1.6	36.3
Medical care commodities	1.4	1.4	37.7
Other food at home	1.5	1.8	39.5
Personal care products	1.6	0.7	40.1
Motor vehicle maintenance and repair	1.9	1.4	41.6
Tobacco and smoking products	2.1	0.9	42.5
Processed fruits and vegetables	2.1	0.3	42.8
Motor vehicle parts and equipment	2.3	0.4	43.2
Household furnishings and operations	2.9	4.5	47.8
<b>Food away from home</b>	<b>3.3</b>	<b>6.3</b>	<b>54.0</b>
Owners' equivalent rent of primary residence	3.9	22.5	76.5
Men's and boys' apparel	4.1	1.0	77.5
Education	4.5	3.0	80.5
Medical care services	4.8	4.7	85.2
Nonalcoholic beverages and beverage materials	6.2	0.9	86.1
Water and sewer and trash collection services	6.3	0.9	87.0
Motor vehicle insurance	7.0	2.6	89.6
Dairy and related products	11.1	0.9	90.5
Women's and girls' apparel	12.3	1.7	92.2
Public transportation	13.9	1.2	93.4
Fresh fruits and vegetables	14.4	1.0	94.3
Meats, poultry, fish, and eggs	23.3	2.3	96.6
Car and truck rental	31.8	0.1	96.8
Lodging away from home	32.1	2.7	99.4
Motor vehicle fees	43.9	0.6	100.0