

The Inflation Update: October 2004
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It's not as bad as it seems. Yes, inflation rose last month. But this time around, the numbers are misleadingly high. The 7.9% (annual rate) increase in the all items CPI for October is clearly transitory. Just removing the 8.5% monthly increase in energy price knocks this down to 3.1% (a.r.). Taking out food to get to the conventional measure of core inflation brings it down to 2.5% (a.r.). And the Median CPI computed by the Federal Reserve Bank of Cleveland shows an equally moderate increase, up 2.2% for the month. While inflation is clearly over 2 percent, it is not above 2.5.

The detail of the report confirms this estimate of the inflation trend. Owner equivalent rent rose 2.2% (a.r.) in October, and is up 2.3% for the past 12 months. Increases in prices of food away from home are stable as well, up 3.3% over the past year. Even medical care prices seems on a stable path, albeit one rising at between 4 and 5 percent per year.

The most important thing to note in numbers released this morning is the upward trend in goods price inflation. Core goods (commodities excluding food and energy commodities) rose 4.4% (a.r.) for the month, and are up 1.7% (a.r.) in the past 3 months. We are starting to see the consequences of dollar depreciation and energy price increases passed through into commodities. Fortunately, though, as goods price inflation has risen, service price inflation has moderated. Core services (services excluding energy services) rose a very modest 2.1% (a.r.) last month. I repeat: inflation is between 2 and 2.5%.

As the election fades from memory, winners and loser alike can take comfort in the fact that monetary policy has been removed from the political arena. The arguments over a tradeoff between low inflation and high growth are fortunately a thing of the past. Today, everyone agrees that central bankers only have the luxury of worry about growth once they have managed to keep inflation low. And there is little reason for anxiety that policymakers want inflation to rise above its current levels. I suspect that the FOMC now sees the warning signs, and will continue to raise interest rates, ensuring that they get back to a neutral level by late next year. Unless the numbers get worse than they are now, we can expect 25 basis points per meeting for the next year, which will bring the federal funds rate to 4% in late 2005.

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

| Previous | All Items CPI | CPI ex Food & Energy | Median CPI |
|---------------------------------|---------------|-------------------------|------------|
| 1 Month | 7.9 | 2.5 | 2.2 |
| 3 Months | 3.4 | 2.3 | 2.2 |
| 6 Months | 3.5 | 1.9 | 2.2 |
| 12 Months | 3.2 | 2.2 | 2.4 |
| 12 Months ended October 2003 | 2.0 | 1.3 | 2.0 |

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(Note: If you have trouble viewing the tables, you may prefer looking at them in html at
[The Inflation Update: October 2004](#)
or you can download the pdf file
[The Inflation Update: October 2004 PDF Format](#)
These also include the table used to construct the Median CPI.)

| Detail for Computation of the Median CPI | | | |
|---|------------------------------------|------------------------|--------------------------------------|
| <i>October 2004</i> | | | |
| Component | Annualized 1- month % change | Relative Importance | Cumulative Relative Importance |
| Motor fuel | 168.4 | 3.9 | 3.9 |
| Fuel oil and other fuels | 154.4 | 0.3 | 4.2 |
| Fresh fruits and vegetables | 139.4 | 0.9 | 5.1 |
| Women's and girls' apparel | 23.7 | 1.7 | 6.8 |
| Miscellaneous personal goods | 19.6 | 0.2 | 7.0 |
| Public transportation | 17.7 | 1.0 | 8.0 |
| Household furnishings and operations | 13.2 | 4.4 | 12.4 |
| Motor vehicle fees | 6.6 | 0.5 | 12.9 |
| Processed fruits and vegetables | 6.4 | 0.3 | 13.2 |
| Medical care services | 5.3 | 4.7 | 17.8 |
| Education | 5.1 | 3.0 | 20.8 |
| Motor vehicle maintenance and repair | 4.9 | 1.4 | 22.1 |
| Cereals and bakery products | 4.7 | 1.2 | 23.3 |
| Medical care commodities | 4.5 | 1.5 | 24.8 |
| New vehicles | 4.5 | 4.7 | 29.5 |
| Personal care products | 4.0 | 0.6 | 30.1 |
| Water and sewer and trash collection services | 3.9 | 0.9 | 31.1 |
| Other food at home | 3.7 | 1.8 | 32.9 |
| Food away from home | 3.2 | 6.2 | 39.0 |
| Used cars and trucks | 2.7 | 2.0 | 41.1 |
| Rent of primary residence | 2.3 | 6.2 | 47.3 |
| Motor vehicle insurance | 2.2 | 2.5 | 49.8 |
| Motor vehicle parts and equipment | 2.2 | 0.4 | 50.1 |
| Owners' equivalent rent of primary residence | 2.1 | 23.5 | 73.6 |
| Lodging away from home | 1.9 | 3.1 | 76.7 |
| Personal care services | 1.8 | 0.7 | 77.3 |
| Alcoholic beverages | 1.2 | 1.0 | 78.4 |
| Miscellaneous personal services | 1.2 | 1.5 | 79.8 |
| Recreation | 1.1 | 5.8 | 85.6 |
| Tobacco and smoking products | -1.5 | 0.8 | 86.5 |
| Dairy and related products | -2.6 | 0.9 | 87.3 |
| Tenants' and household insurance | -3.0 | 0.4 | 87.7 |
| Meats, poultry, fish, and eggs | -3.2 | 2.3 | 90.1 |
| Nonalcoholic beverages and beverage materials | -3.4 | 0.9 | 91.0 |
| Communication | -9.3 | 3.0 | 93.9 |
| Infants' and toddlers' apparel | -9.6 | 0.2 | 94.1 |
| Gas (piped) and electricity | -9.8 | 3.7 | 97.9 |
| Jewelry and watches | -11.5 | 0.3 | 98.1 |
| Footwear | -12.1 | 0.8 | 98.9 |
| Men's and boys' apparel | -12.6 | 1.0 | 99.9 |
| Car and truck rental | -13.0 | 0.1 | 100.0 |

