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February 1996
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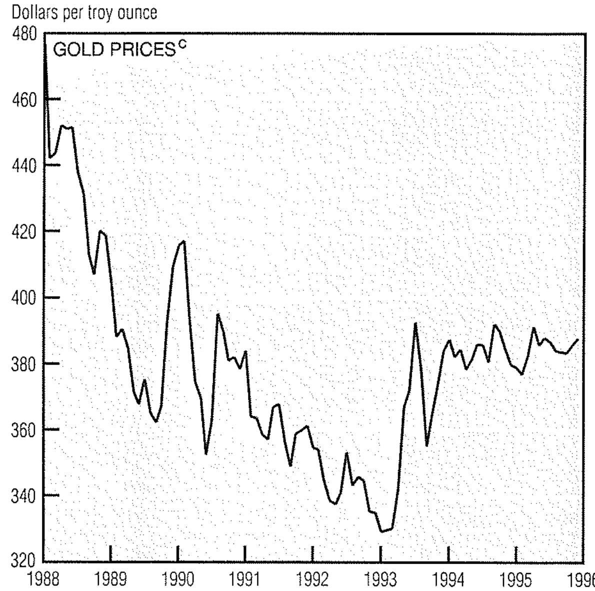
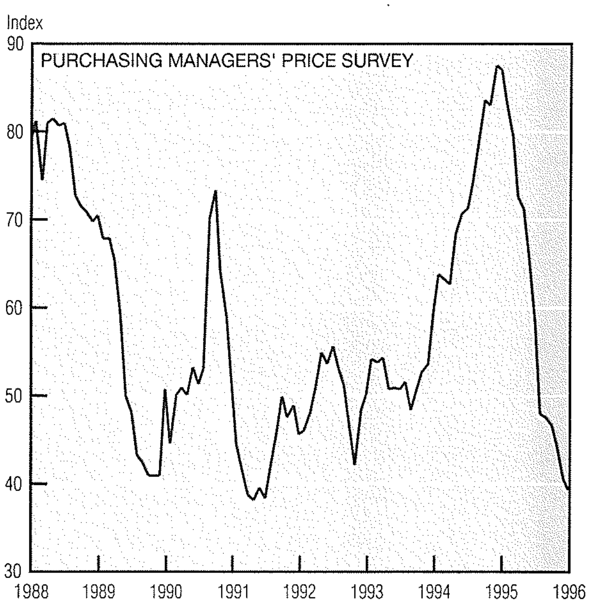
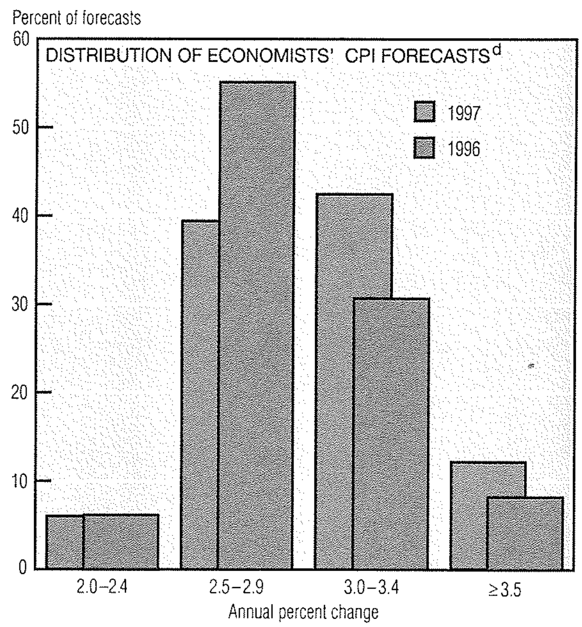
Inflation and Prices

December Price Statistics

	Annualized percent change, last: 1 mo.	12 mo.	5 yr.	1994 average
Consumer Prices				
All items	2.4	2.6	2.8	2.6
Less food and energy	1.5	3.0	3.3	2.7
Median[a]	2.9	3.4	3.2	2.8
Producer Prices				
Finished goods	6.3	2.2	1.2	1.8
Less food and energy	2.2	2.6	1.9	1.6
Commodity futures prices[b]	2.6	4.9	1.9	3.5







a. Calculated by the Federal Reserve Bank of Cleveland.
b. As measured by the KR–CRB composite futures index, all commodities. Data reprinted with permission of the Commodity Research Bureau, a Knight-Ridder Business Information Service.
c. Handy and Harman base price, New York.
d. Consensus forecast of the Blue Chip panel of economists, January 16, 1996.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; the Commodity Research Bureau; the National Association of Purchasing Management; *Metals Week;* and *Blue Chip Economic Indicators,* January 16, 1996.

Retail prices increased at an annualized rate of 2.4% in December, just a shade under their average increase for the whole of 1995. However, inflation signals from the core measures were mixed. The CPI less food and energy moderated to a 1.5% annualized rate for the month, while the median CPI continued to show price pressure of around 3%. Still, for the year overall, both core inflation measures stood at about 3%, a small rise from 1993 and 1994 levels.

Two presumed leading indicators of inflation have shown generally contradictory patterns in recent months. After inching down in the first three quarters of 1995, gold prices began to rise by year's end and, in January, topped the $400 per ounce threshold for the first time in over five years. However, purchasing managers are increasingly reporting more moderate price increases. In December, about 10% noted that prices were moving higher, the lowest proportion since mid-1991.

According to the Blue Chip panel of economists, the U.S. is likely to see slightly higher inflation this year and next. Most of the panel believes that inflation will fall into the 2½% to 3% range this year, with a substantial minority (30%) anticipating a 3% to 3½% rate. For 1997, the proportion pegging inflation at or above 3% is somewhat larger than the share expecting a milder rise (54% and 46%, respectively).

From the perspective of monetary policymakers, the CPI's 1995 performance came as somewhat of a surprise. At 2.6%, last year's rise was ½ percentage point below the lower

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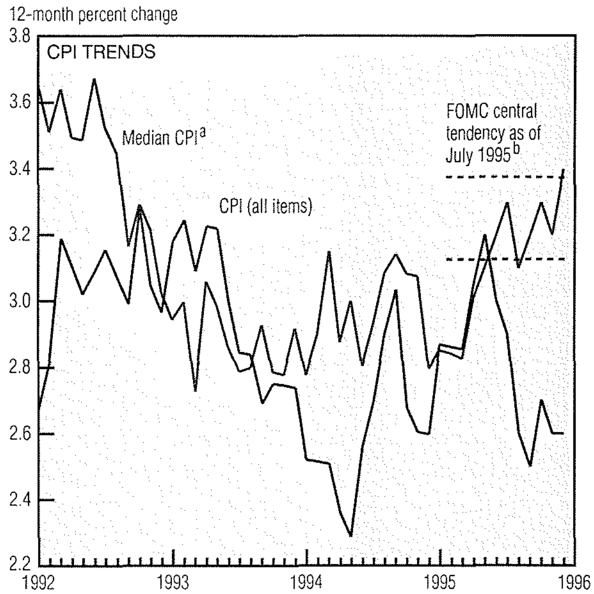
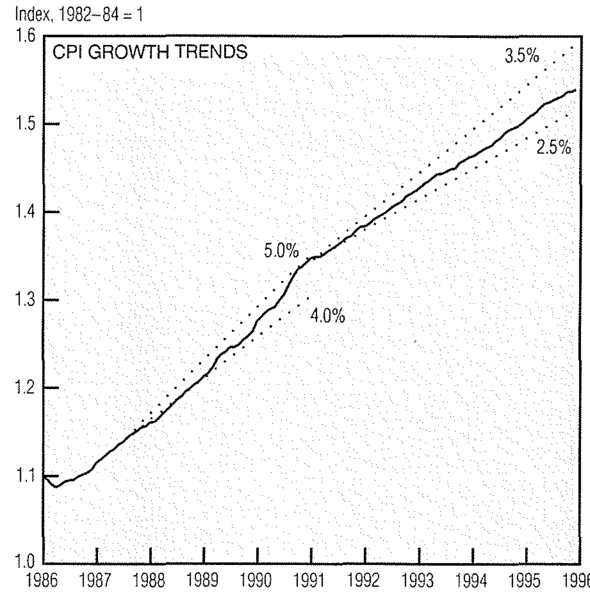
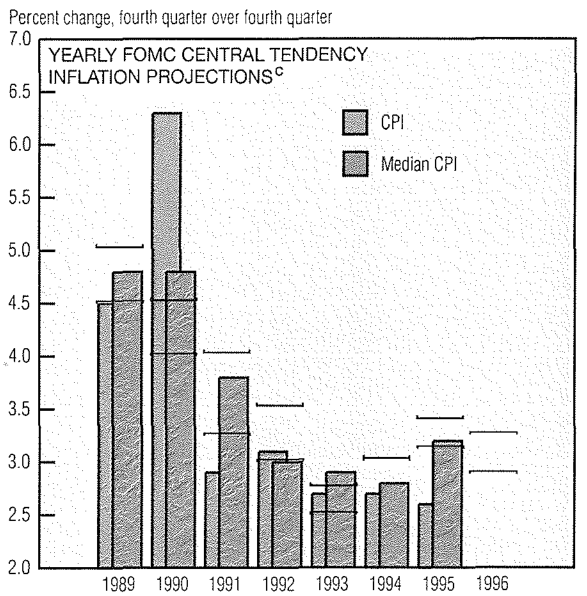
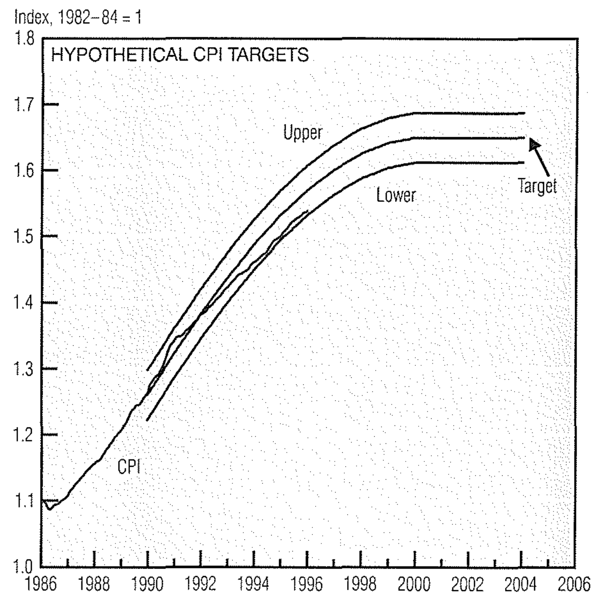
Inflation and Prices (cont.)









a. Calculated by the Federal Reserve Bank of Cleveland.
b. Upper and lower bounds for CPI inflation path as implied by the central tendency growth ranges issued by the FOMC and nonvoting Reserve Bank presidents. As of July, the stated range (fourth-quarter to fourth-quarter percent change) is 3.125 to 3.375 for 1995 and 2.875 to 3.25 for 1996.
c. Brackets represent upper and lower bounds of the central tendency growth ranges issued each February. Bars represent actual inflation.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; and Board of Governors of the Federal Reserve System.

end of the Federal Open Market Committee's central tendency projection issued at midyear (3.1%), but nearly on target for the core inflation measures. In fact, the economy appears to have been on a 3% inflation trend over much of the past five years, well below the 5% average growth rate posted during the 1986–90 period.

There seems to be little consensus among economists that the CPI is following a path that will lead to successively lower inflation. However, legislation pending in Congress would make price stability the primary long-term goal of the Federal Reserve. Presumably, such a legal mandate would include a timetable for achieving that objective.

To some, such a proposal would bind policymakers such that they would not have sufficient liberty to respond to financial or other economic calamities should they arise. In 1990, the Cleveland Federal Reserve Bank proposed a program for achieving price stability that would have gradually reduced inflation (at that time around 5%) by ½ percentage point per year until a stable price environment was reached in the year 2000. That inflation target included a relatively wide 3-percentage-point band on both sides of the target price level to ensure that policy would not be inhibited from responding to near-term problems. Indeed, had such a policy been adopted, the monetary authorities might have found themselves with a considerable margin to work with today: The downshift in the inflation trend over the past five years has put the price level at the very bottom of the target ranges that the proposed policy envisioned.