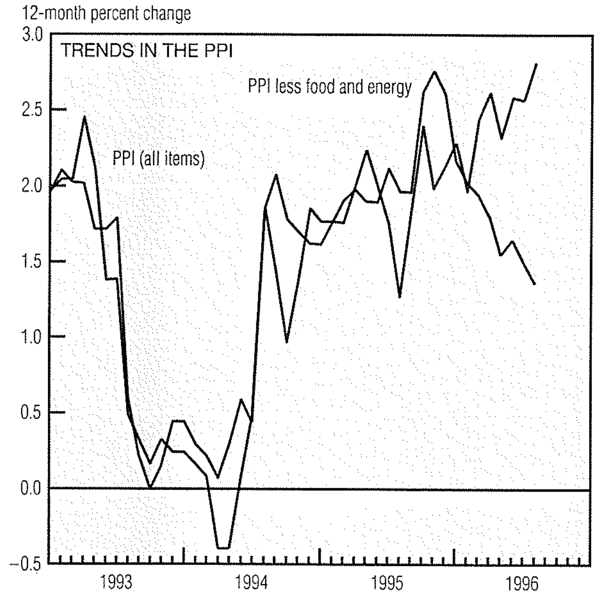
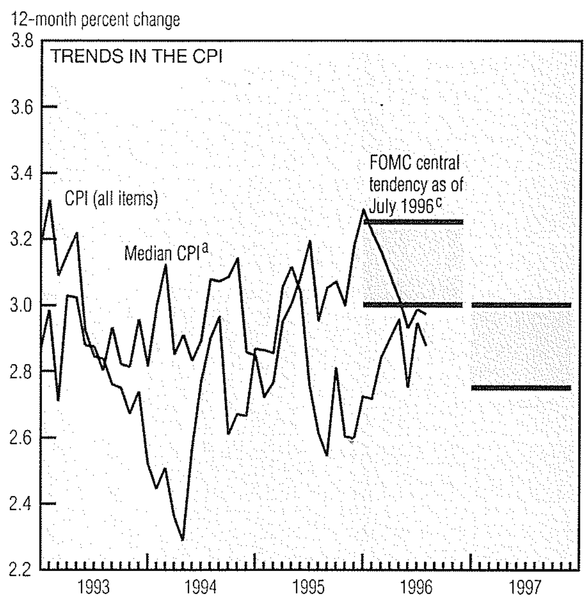
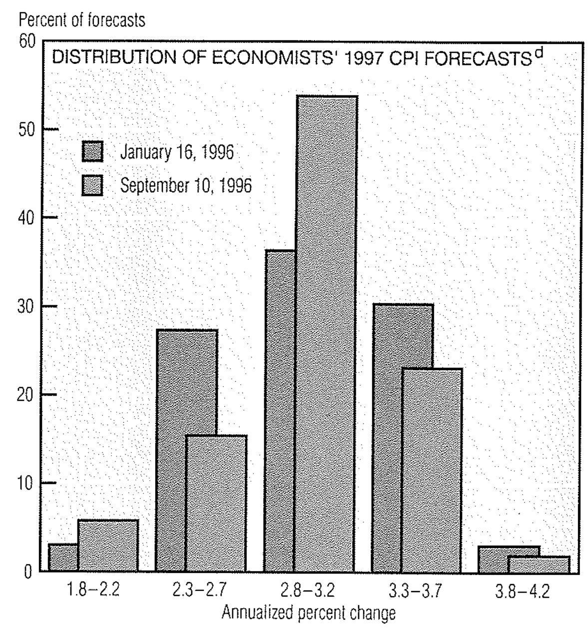
Inflation and Prices

August Price Statistics	Annualized percent change, last: 1 mo.	8 mo.	12 mo.	5 yr.	1995 avg.
Consumer Prices					
All items	1.5	3.2	2.9	2.9	2.6
Less food and energy	0.7	2.7	2.6	3.0	3.0
Median[a]	1.5	2.9	3.0	3.1	3.2
Producer Prices					
Finished goods	4.0	2.2	2.8	1.6	2.1
Less food and energy	−0.8	0.5	1.4	1.6	2.6
Commodity futures					
prices[b]	12.3	2.4	5.2	3.4	5.4







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. 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.
d. Consensus forecast of the Blue Chip panel of economists.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; the Commodity Research Bureau; and *Blue Chip Economic Indicators*, January 16 and September 10, 1996.

After accelerating during the first five months of the year, the inflation indicators slowed substantially through August. Inflation for the year to date is comparable to its 1995 pace—3% or so.

The most notable deceleration has occurred at the wholesale level. While the Producer Price Index (PPI) has risen at an annualized 2.2% rate since December (an increase similar to last year's and about half a percentage point higher than its five-year trend), virtually all of the upward pressure has come from food and energy items. Excluding these two volatile components, the PPI's increase was about two percentage points below last year's rate.

Price increases at the retail level continue to outpace cost pressures from producers. The Consumer Price Index (CPI) has climbed one percentage point faster than the PPI to date in 1996. Since last December, the core retail price indexes—the median CPI and the CPI less food and energy—have outpaced the core PPI by more than two percentage points.

Overall, the recent slowing in the inflation indicators has helped calm analysts' fears that, after holding around the 3% level since 1991, inflation had ratcheted up. In fact, the CPI is actually tracking at, or slightly below, the lower end of the Federal Open Market Committee's midyear projection. According to that projection, the CPI should remain at, or

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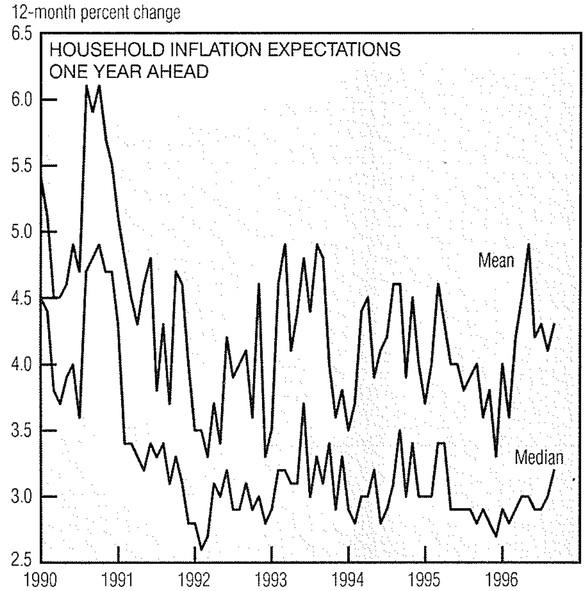
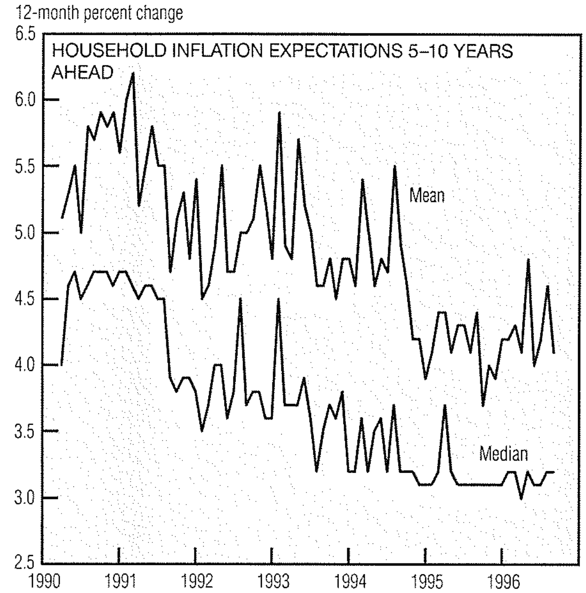
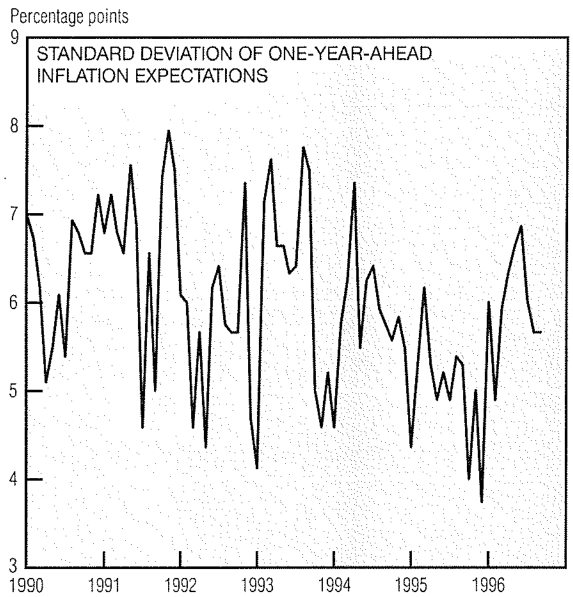
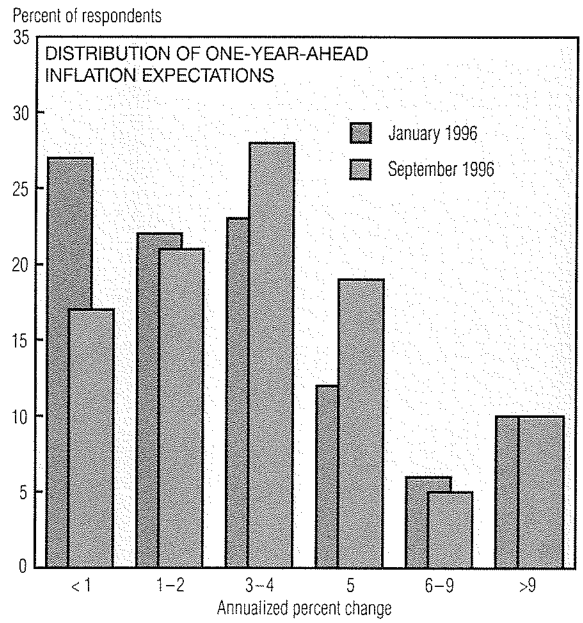
Inflation and Prices (cont.)









SOURCE: University of Michigan, Survey of Consumers.

slightly below, 3% in 1997. September's Blue Chip survey of economists also suggests that next year's CPI inflation will hold around 3% on average. Moreover, the proportion of economists who anticipate a significant increase in inflation (about 25%) is only marginally greater than the share expecting a significant slowdown (about 21%).

Tracking inflation expectations is important for several reasons. Many believe that monetary policy affects most prices only after a long and variable lag, implying that policymakers need to consider future—not current—inflation when deliberating about potential policy actions. Further, Federal Reserve Chairman Greenspan has defined "price stability" as an environment where inflation does not enter into the decisions of households and firms.

In addition to economists' forecasts, inflation expectations can be gauged from household surveys. One of these, the University of Michigan's Survey of Consumers, has shown an upward trend in the average inflation expected by households over the next 12 months as well as five to 10 years into the future. That view seems to reflect growing uncertainty over the future trend in prices (as evidenced by an upturn in the standard deviation of year-ahead inflation expectations). The breakdown of households' inflation expectations also reveals considerable dissipation of the optimism expressed earlier this year. In January, about 50% of all households expected that inflation would be 2% or less over the next 12-month period. By September, fewer than 40% held that view.