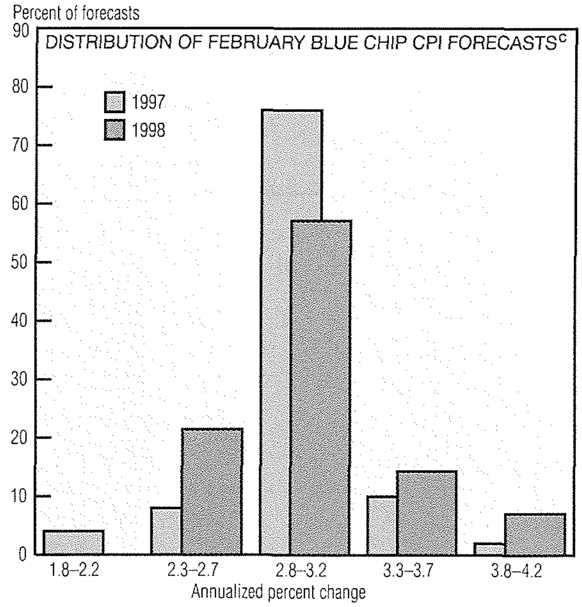
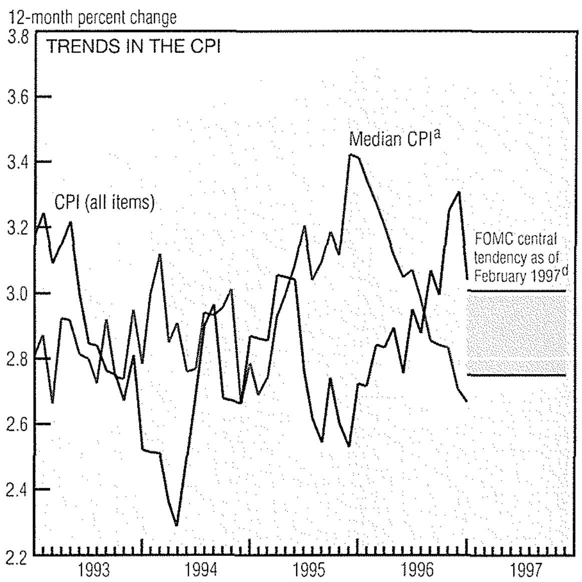
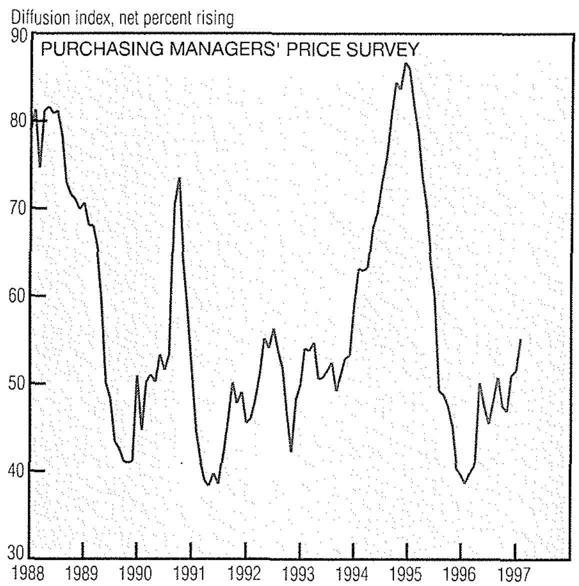
Inflation and Prices

January Price Statistics

	Annualized percent change, last: 1 mo.	6 mo.	5 yr.	Year avg. 1995	1996
Consumer Prices					
All items	1.5	2.9	2.9	2.5	3.3
Less food and energy	1.4	2.3	2.9	3.0	2.5
Median[a]	3.1	2.5	2.9	3.4	2.7
Producer Prices					
Finished goods	−3.5	2.8	1.7	2.2	2.9
Less food and energy	0.0	0.4	1.4	2.6	0.6
Commodity futures prices[b]	−4.6	−3.5	2.8	5.4	−0.7







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. Forecast of the Blue Chip panel of economists.
d. 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.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; the Commodity Research Bureau; National Association of Purchasing Management; and *Blue Chip Economic Indicators*, February 10, 1997.

Substantial declines in a handful of categories contributed to mild increases in the major price indexes in January. Falling food prices and airline fares, along with slower energy price gains, helped hold the Consumer Price Index (CPI) to a seasonally adjusted annual rate of 1.5%. Sharp declines in food prices also helped push the Producer Price Index (PPI) down.

The PPI for finished goods posted its first downtick since October 1994, falling 3.5% for the month. Excluding the volatile food and energy components, however, the PPI was unchanged and the CPI rose a mere 1.4%, with both indexes following a moderating trend for more than a year. Nonetheless, the median CPI's increase of 3.1% suggests that, at least at the retail level, underlying price pressures have remained stable.

Reports from purchasing managers hint that the downturn in producer prices has also run its course. In January, the National Association of Purchasing Management's index rose to its highest level since July 1995. Still, more than 80% of those surveyed reported no change or a decrease in supplier prices.

More than 75% of the economists participating in the latest Blue Chip survey see CPI-measured inflation rising in the 2.8% to 3.2% range in 1997. For 1998, the distribution changes only slightly, with nearly 60% of the respondents predicting that the index will remain within a few tenths of a percentage point of its five-year average (2.9%).

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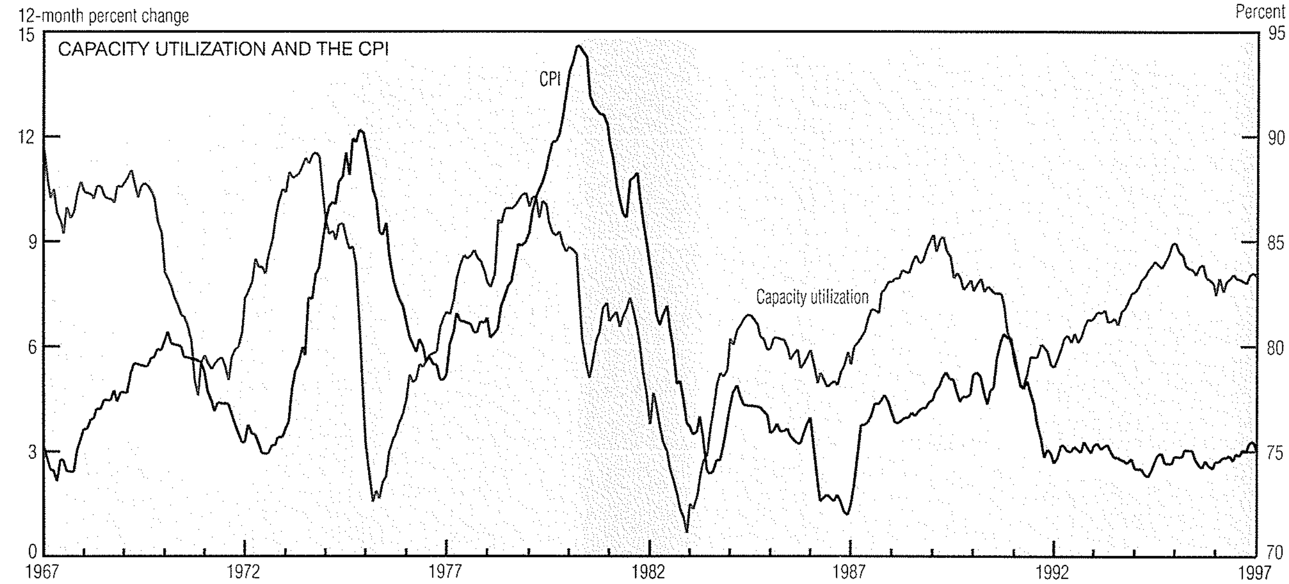
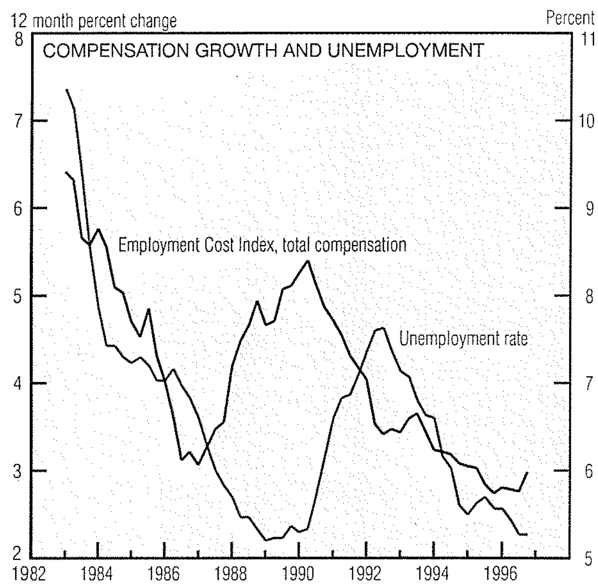
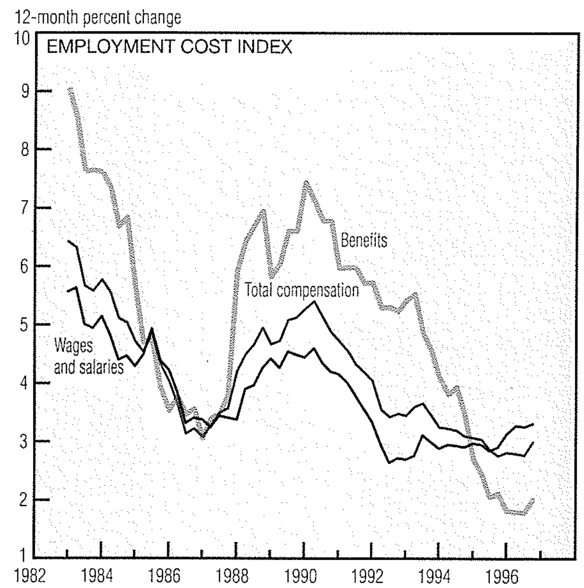
Inflation and Prices (cont.)







SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and Board of Governors of the Federal Reserve System.

The Blue Chip consensus forecast varies little from that of the Federal Open Market Committee (FOMC). In his semiannual report to Congress in February, Federal Reserve Chairman Alan Greenspan noted that the central tendency of policymakers' 1997 inflation projections is 2.75% to 3.0%. The Chairman suggested that the unusually good inflation outcome in 1996 and the expectation of continued restraint in 1997 "...owe in large part to some temporary factors, of uncertain longevity." Specifically, he noted that worker compensation costs have been held down by savings on employee benefits resulting from considerable, but perhaps temporary, reductions in health care prices. Over the last two years, the Employment Cost Index (ECI) for benefits has been tracking one full percentage point below the ECI for wages and salaries, after trending substantially above the rate of wage growth for nearly eight years.

More important, the Chairman addressed the apparent breakdown of the link between inflation and resource utilization—particularly the use of labor. During the 1960s and 1970s, capacity utilization rates of more than 80% typically corresponded to an acceleration in the CPI. Similarly, when the unemployment rate fell below about 6%, wage and price growth tended to pick up.

In light of this historical relationship, our current subdued inflation in the face of high capacity utilization and low unemployment may seem surprising. Greenspan suggests that the "... atypical restraint on compensation increases...appears to be mainly the consequence of greater worker insecurity." But he warns that this is a "...temporary rather than a lasting phenomenon, because there is a limit to the value of additional job security people are willing to exchange for lesser increases in living standards."