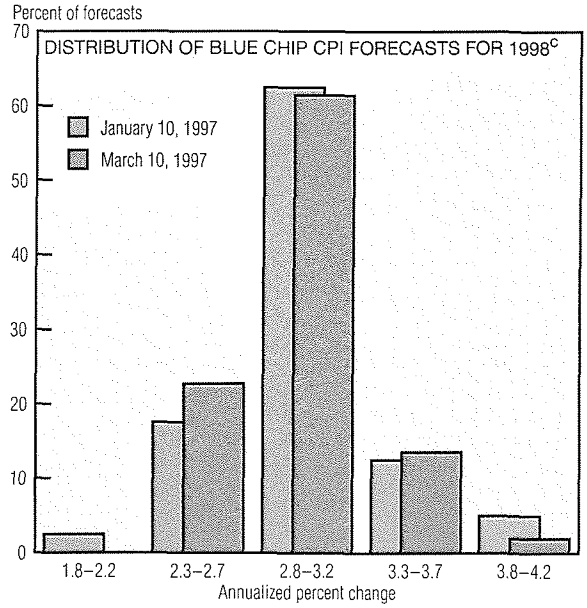
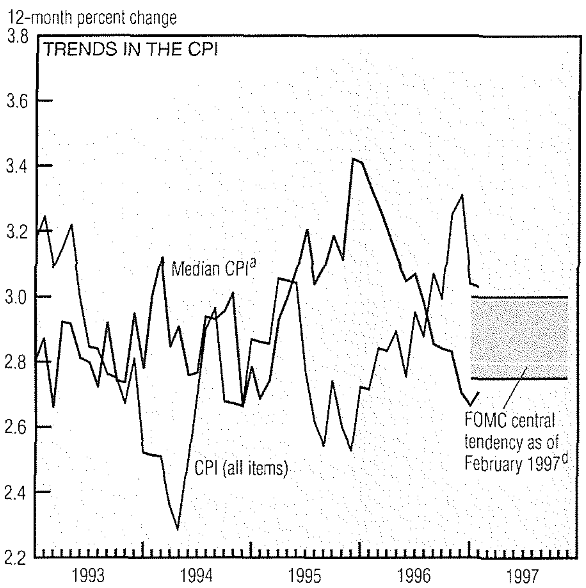
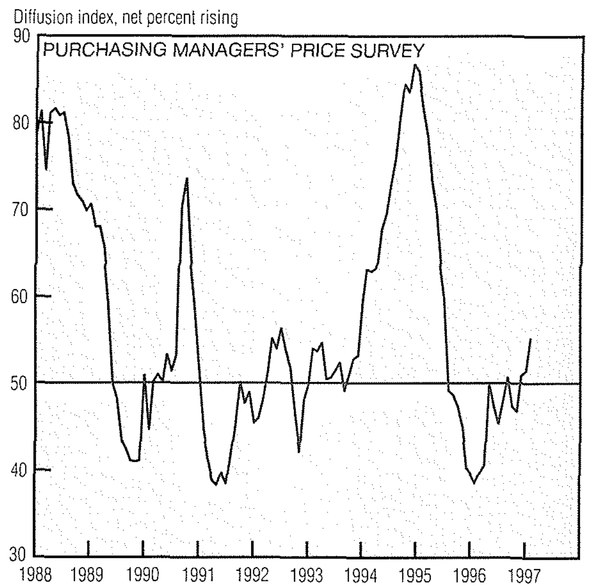
Inflation and Prices

February Price Statistics

	Annualized percent change, last: 1 mo.	6 mo.	5 yr.	Year avg.: 1995	1996
Consumer Prices					
All items	3.1	3.1	2.9	2.5	3.3
Less food and energy	2.9	2.5	2.9	3.0	2.6
Median[a]	3.4	2.8	2.9	3.4	2.7
Producer Prices					
Finished goods	−4.4	1.4	1.6	2.2	2.9
Less food and energy	−1.7	0.0	1.3	2.6	0.6
Commodity futures prices[b]	−8.8	−6.7	2.6	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; Board of Governors of the Federal Reserve System; the Federal Reserve Bank of Cleveland; the Commodity Research Bureau; National Association of Purchasing Management; and *Blue Chip Economic Indicators*, January 10 and March 10, 1997.

On March 25, the Federal Open Market Committee (FOMC) took a small and perhaps cautious step toward monetary restraint by raising the federal funds target by ¼ percentage point, its first overt policy action since January 1996. In a press release, the Committee described the rate hike as a prudent step aimed at prolonging the business expansion by maintaining the existing low inflation rate through the end of this year and next.

At the moment, the inflation indicators are showing no clear sign of moving away from the 3% trend they have followed over the course of the current expansion. In February, the Consumer Price Index (CPI) rose at a 3.1% annual rate, just a shade above its average since 1991 (2.9%). The median CPI, which measures underlying inflation, advanced at a 3.4% pace, but was still not far from its five-year trend.

The consensus among economists, however, is that it can take two years or more for inflation to respond to a monetary policy action, and that this lag forces policymakers to be forward-looking in their fight to keep prices stable. Indeed, the commentary accompanying the rate hike suggests that the FOMC's move was intended to head off a growing *potential* for higher inflation, rather than to stem an immediate uptick in the price data.

The FOMC's central tendency projection shows CPI growth holding at just under 3% this year—a

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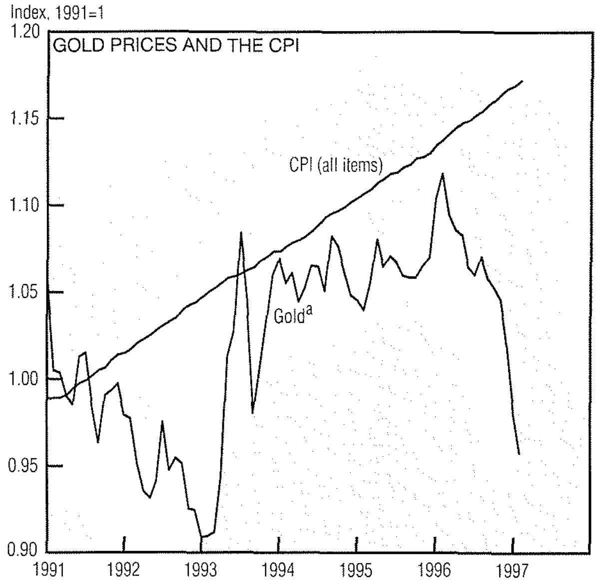
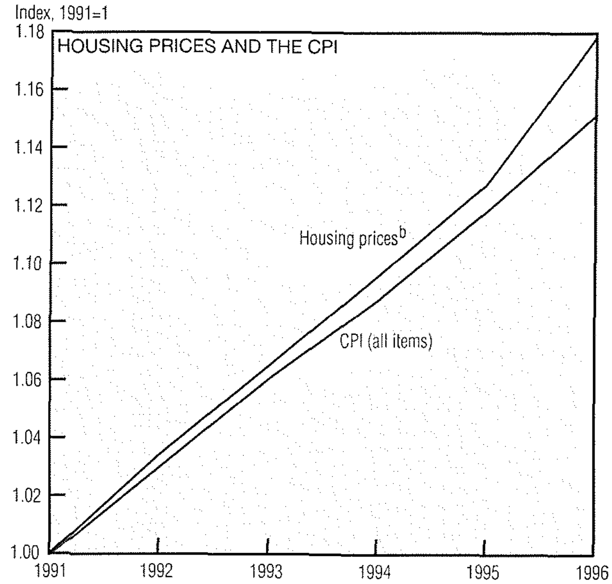
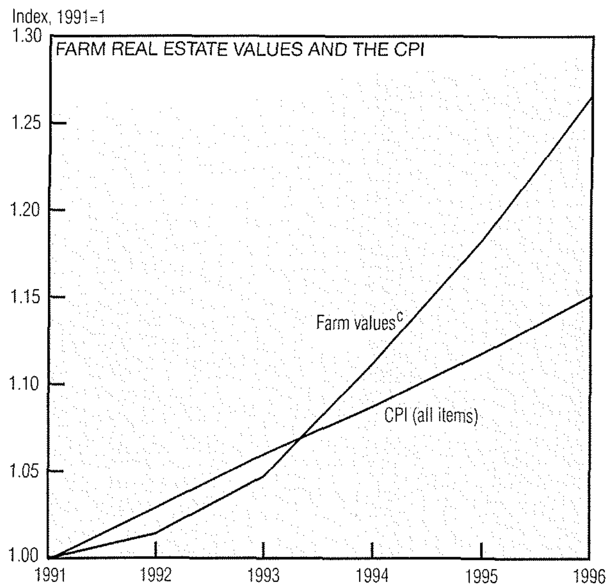
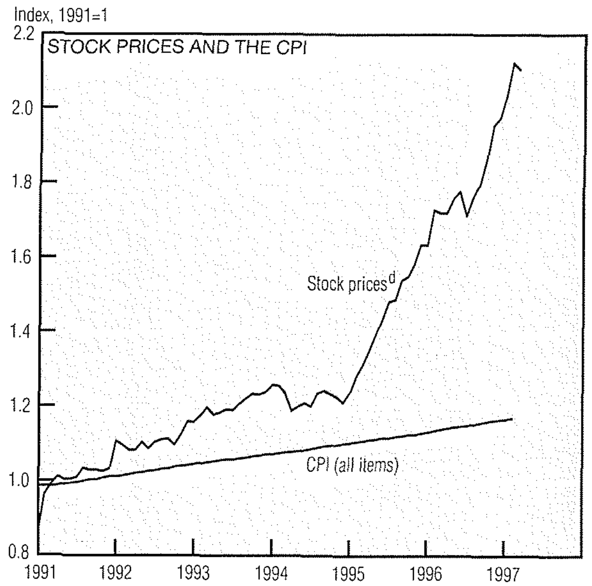
Inflation and Prices (cont.)









a. Handy and Harman base price, New York.
b. Median sales price, existing single-family homes.
c. Nominal value of land and buildings, per acre.
d. Standard & Poor's stock price index, composite.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Agriculture, Economic Research Service, Natural Resources and Environment Division; National Association of Realtors; Standard & Poor's Corporation; and *Metals Week*, various issues.

few tenths of a percentage point below last year's rise. The latest Blue Chip survey of economists predicts the inflation trend will remain steady at around 3% in 1998 as well.

The leading indicators of inflation continue to be inconclusive and extremely mixed. Survey data from purchasing managers indicate that the net downward pressure on costs may have dissipated, but as of yet, there has been no significant acceleration in industrial prices.

Economists often cite the price movements of "inflation-hedged" assets as evidence of a growing inflationary psychology among investors. But of these, there appears to be an indicator for every conceivable point of view. Gold prices, a highly touted inflation predictor, have fallen in real terms since 1991, and sharply so since early last year. By contrast, median home sale prices have climbed at approximately the same rate as the CPI since 1993, and the price of farm land has risen twice as fast. But perhaps the most troubling indicator of potential inflation has been the dramatic rise in equity prices. Although higher equity values (or any asset price rise, for that matter) may reflect "real" developments like greater economic potential, some part of this increase may be associated with investor anticipation of higher *nominal* earnings due to future inflation.