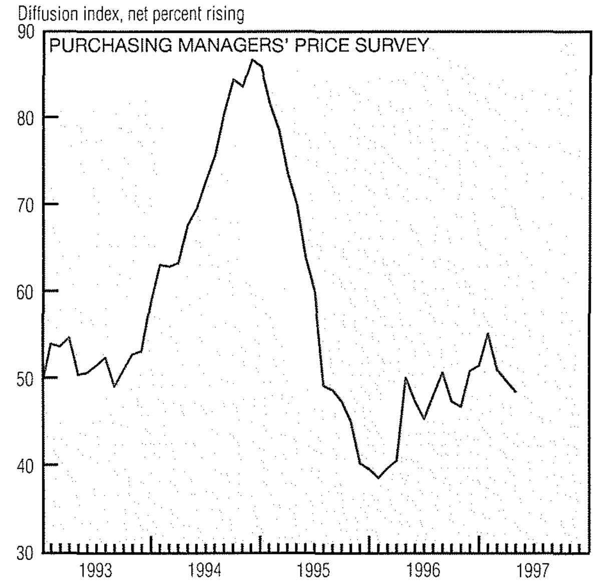
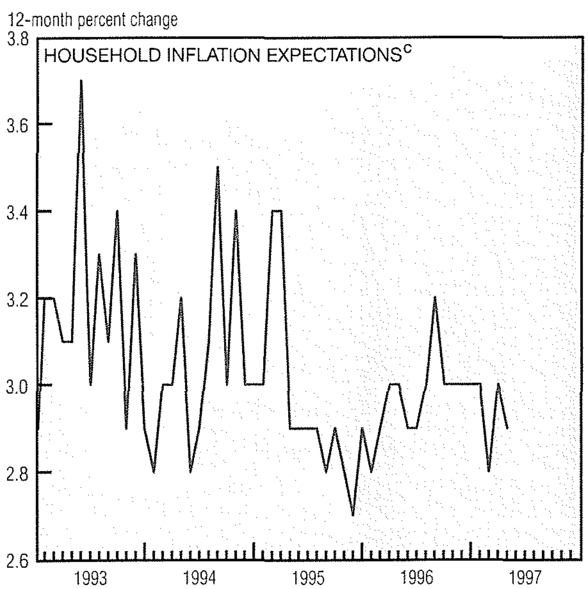
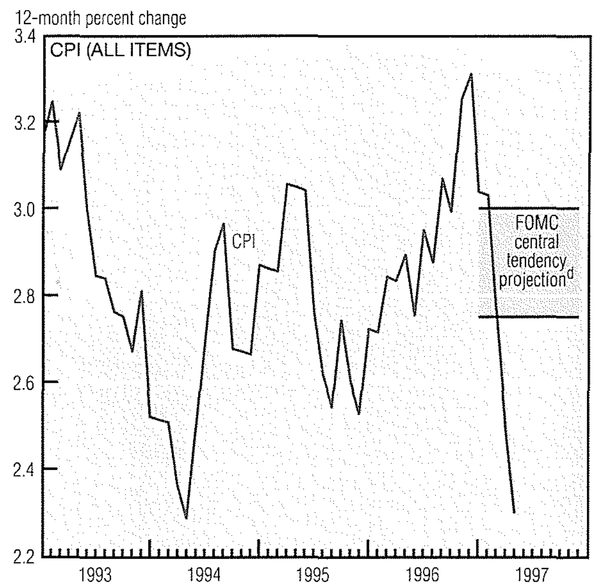
Inflation and Prices

May Price Statistics

	Annualized percent change, last: 1 mo.	5 mo.	12 mo.	5 yr.	1996 avg.
Consumer Prices					
All items	0.8	1.4	2.3	2.7	3.3
Less food and energy	2.1	2.6	2.5	2.9	2.6
Median[a]	3.1	3.0	2.7	2.9	2.7
Producer Prices					
Finished goods	−3.6	−3.9	0.3	1.3	2.9
Less food and energy	−3.3	−0.5	0.1	1.1	0.6
Commodity futures prices[b]	32.5	8.0	−2.9	3.8	−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. Median expected 12-month change in consumer prices as measured by the University of Michigan's Survey of Consumers.
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; the Federal Reserve Bank of Cleveland; the University of Michigan; and the Commodity Research Bureau.

May marked the third consecutive month that the Consumer Price Index (CPI) rose at an annual rate of just 0.8%, bringing the year-to-date average increase to 1.4%. Over the first five months of the year, the CPI is tracking almost 2 percentage points below its 1996 average. However, other measures of retail price movements have been substantially higher. The CPI less food and energy goods is up 2.6% for the year, and the median CPI has increased 3.0%—approximately the same rates as last year.

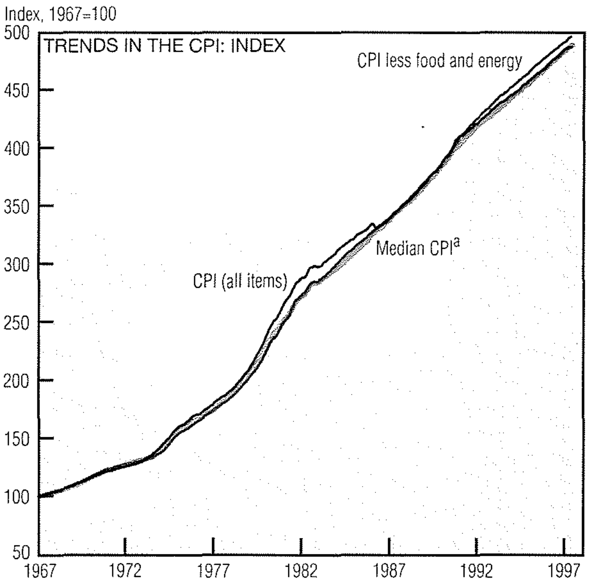
Price behavior at the wholesale level has been even more subdued than the CPI. The Producer Price Index (PPI) declined at a 3.9% annual rate during the first five months of 1997, following a 2.9% increase in 1996. Even excluding food and energy goods, wholesale prices are down 0.5% since last December.

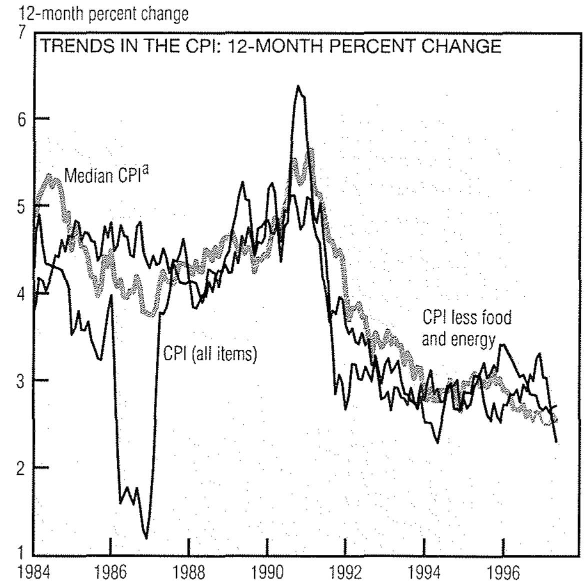
Survey data show the same basic patterns. The University of Michigan's survey of households indicates that consumers expect retail prices to jump about 3% over the next 12 months, roughly the same increase they were projecting at this time last year and not much different from the current trend in the "core" retail price measures. What's more, households see inflation holding steady at this rate over the next five to 10 years.

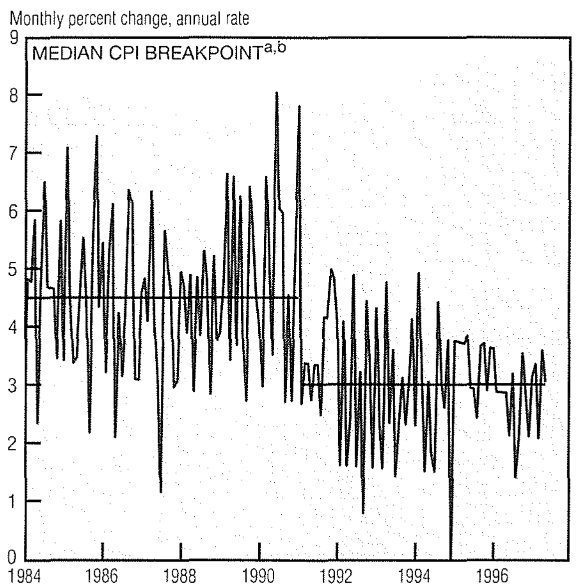
On the other hand, reports from purchasing managers continue to reveal little upward pressure on industrial prices. The National Association of Purchasing Management's price index has been hovering around the 50 mark for most of the past year,

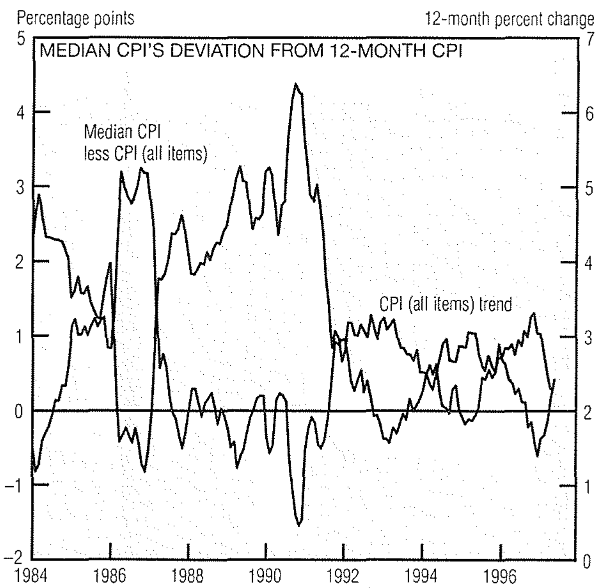
(continued on next page)

Inflation and Prices (cont.)









a. Calculated by the Federal Reserve Bank of Cleveland.
b. Horizontal lines represent trends.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and the Federal Reserve Bank of Cleveland.

indicating that roughly the same percentage of buyers are reporting higher prices as lower ones.

This year's CPI performance has come as a bit of a surprise to inflation forecasters, including the Federal Reserve. The recent 12-month trend increase in the index, at only 2.3%, is almost ½ percentage point below the bottom end of the 1997 range projected by the Federal Open Market Committee (FOMC) in February. A key question facing the FOMC is whether this year's unexpectedly low CPI increase is the beginning of a new, lower inflation trend, or merely a transitory dip in the data that will ultimately turn upward again.

This is exactly the question that the "core" inflation statistics are designed to address. For example, the median CPI is constructed to follow the same trend as the CPI over long periods, although at any particular moment it should reveal a more accurate—and more stable—reading of the inflation trend.

Consider the most recent 12-month period. The rise in the median CPI since last year has exceeded the downward-moving CPI by 0.4 percentage point. In fact, the median measure appears to have been following a nearly steady 3% growth trend since early 1991. In light of this divergence—and considering that over long horizons these two indexes tend to follow the same path—is it more likely that the CPI will accelerate or that the median CPI will fall? Historical experience favors the former. In 1987, 1992, 1994, and 1996—four recent episodes when the CPI fell relative to the median CPI—the CPI tended to accelerate over the subsequent 12-month period.