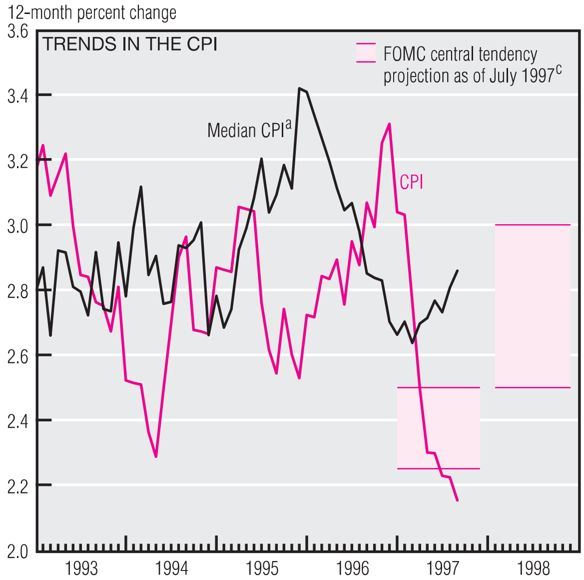
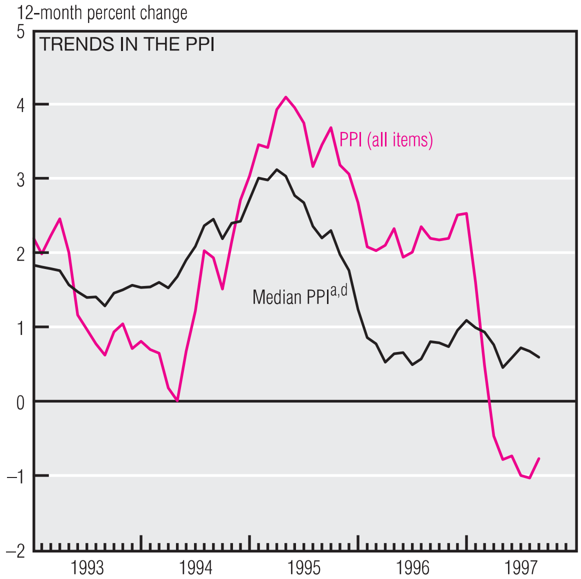
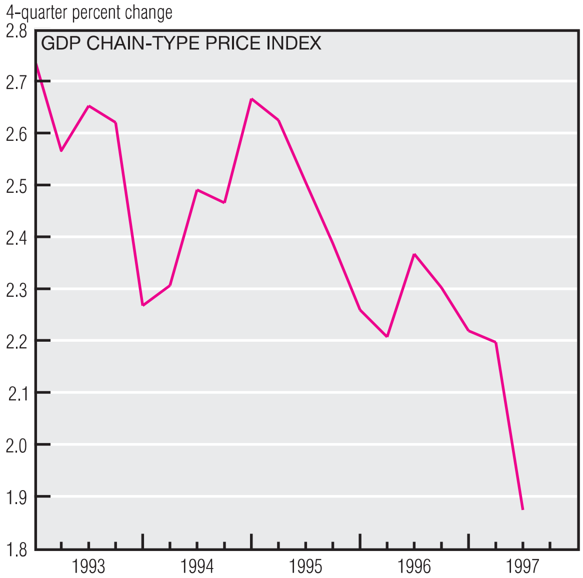
Inflation and Prices

September Price Statistics

	Annualized percent change, last: 1 mo.	3 mo.	9 mo.	5 yr.	1996 avg.
Consumer Prices					
All items	3.0	2.5	1.8	2.7	3.3
Less food and energy	2.1	1.7	2.2	2.8	2.6
Median[a]	2.7	2.6	2.9	2.9	2.7
Producer Prices					
Finished goods	5.6	2.8	–1.0	1.3	2.9
Less food and energy	5.2	0.3	0.3	1.2	0.7
Commodity futures prices[b]	6.5	13.3	–0.2	3.7	–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. 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. Based on the PPI for all items.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; and the Commodity Research Bureau.

The inflation indicators have accelerated a bit recently, although the year-to-date estimates are still quite low by historical standards. In the past three months, the Consumer Price Index (CPI) has increased at a 2.5% annual rate, an uptick from its nine-month average of 1.8% but a shade under its five-year pace of 2.7%. The median CPI, an alternative measure of the retail price trend, has moved up 2.6% over the past three months, also slightly under its five-year trend (2.9%). Similar patterns at the wholesale level are apparent in the Producer Price Index (PPI).

The recent acceleration in the price indexes does not necessarily augur a renewal of inflation. Rather, it may simply reflect the easing of transitory factors, particularly the drop in energy costs, which had a strong moderating influence earlier in the year. In fact, by some measures, the moderate behavior of prices continued into the third quarter. The GDP chain-type price index, which puts only a small weight on energy costs, rose at an extremely modest pace (less than a 1.9%) over the four quarters ended in 1997:IIIQ.

This year's moderate rate of price increase has been accompanied by speculation about the prospect of a deflationary period, which would not be unprecedented in the U.S. Prolonged periods of price decline were relatively common in the second half of the nineteenth century. Moreover, deflation occurred more often than inflation during most of

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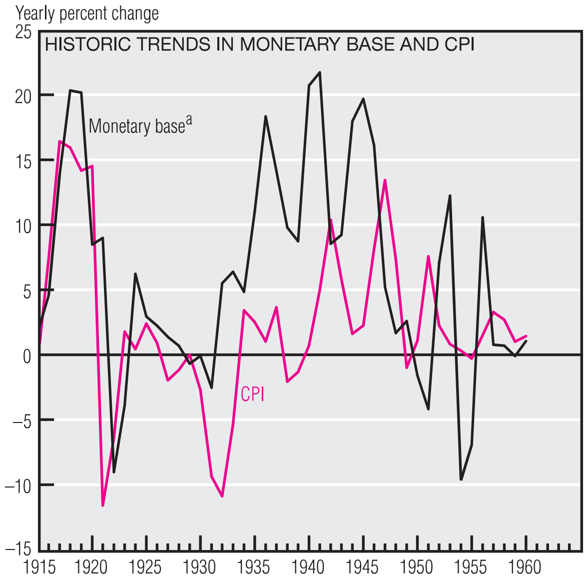
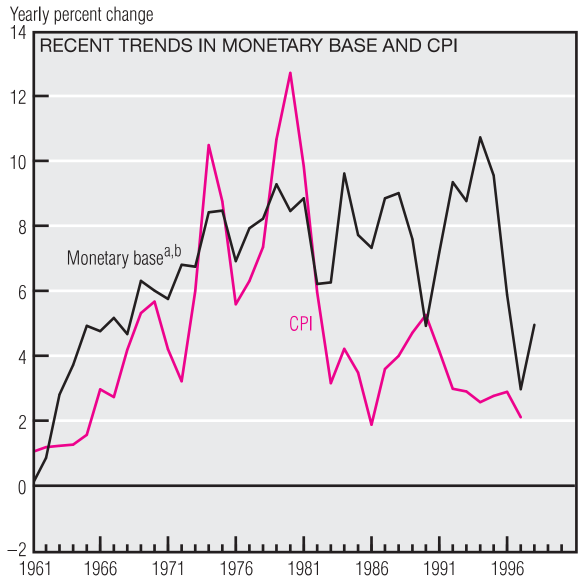
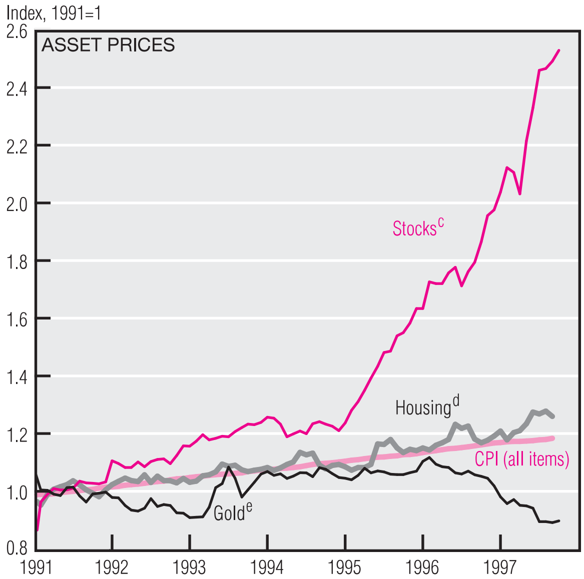
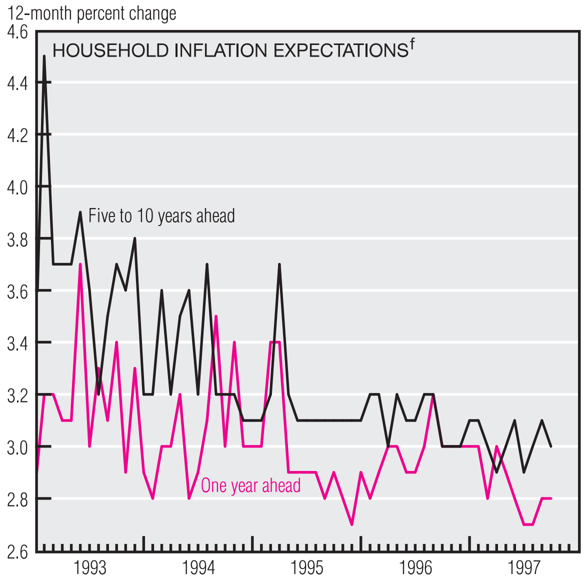
Inflation and Prices (cont.)









a. Yearly average, one year earlier.
b. Year to date.
c. S&P stock price index, composite (common stocks).
d. Median sales price, existing single-family homes, not seasonally adjusted.
e. Handy and Harman base price, New York.
f. Median expected change in consumer prices as measured by the University of Michigan's Survey of Consumers.
SOURCES: Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States, 1867–1960*, Princeton, N.J.: Princeton University Press, 1963; Board of Governors of the Federal Reserve System; National Association of Realtors; Standard & Poor's Corporation; *Metals Week,* various issues; and the University of Michigan.

the 1920s and 1930s, in contrast to the almost constant inflation of the postwar period.

Could another deflationary episode occur in this country? A number of business analysts have cautioned that the current economic environment shares many characteristics with the early 1920s, including rapid technology change, high business profitability, and wildly surging equity values. Still, the two periods differ in many important ways. For example, in the earlier one, domestic income taxes were on the rise, world trade was becoming increasingly protectionist, and monetary policy was considerably more restrictive. Between 1920 and 1930, the narrow money stock shrank, a condition that, given the period's economic expansion, put downward pressure on aggregate prices. Although growth in the monetary base has moderated over the past two years, it is still increasing at roughly a 5% annual pace.

It is difficult to cite compelling evidence that markets anticipate a period of deflation. Among a broad set of U.S. assets, only gold prices are falling relative to trend inflation, and household survey data suggest a continued expectation that prices will rise about 3% annually for the next five to 10 years.