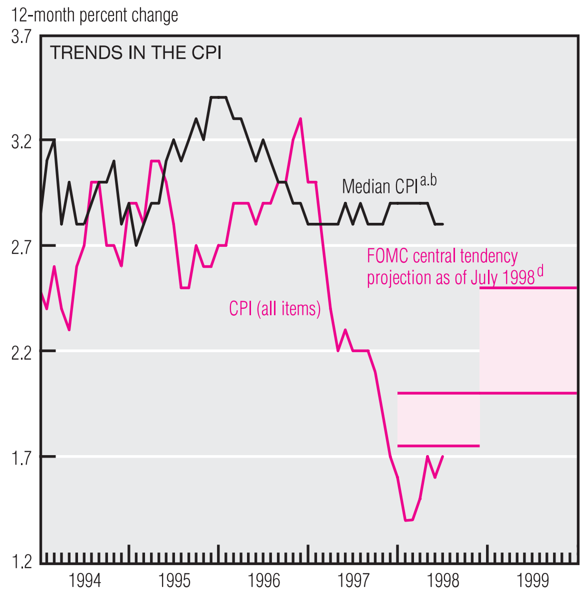
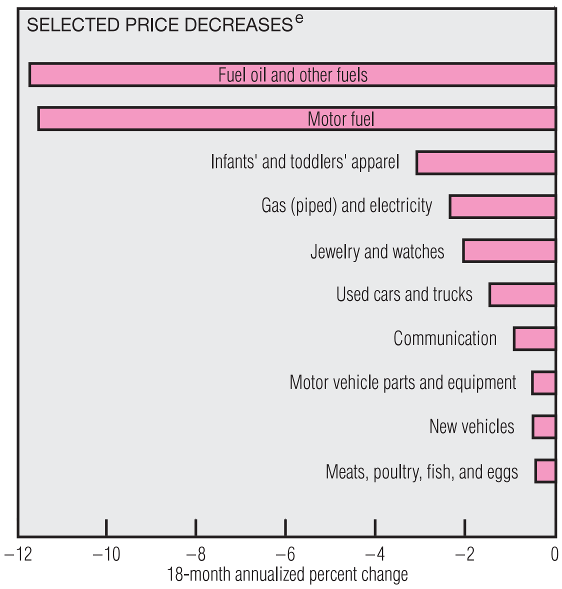
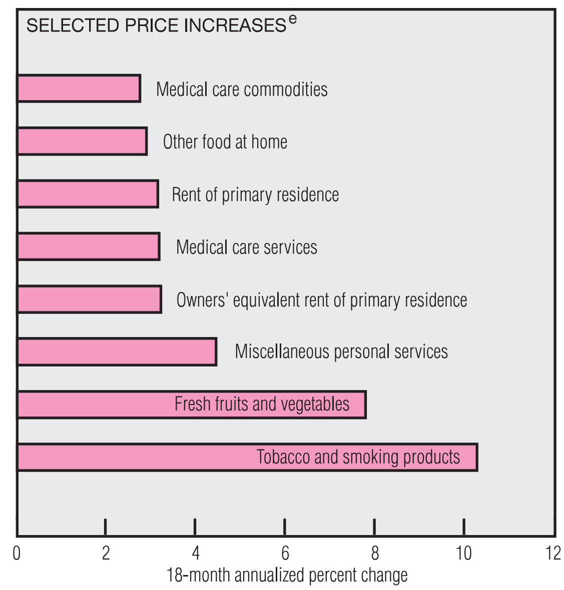
Inflation and Prices, 1998 and 1923

July Price Statistics

	Annualized percent change, last: 1 mo.	3 mo.	12 mo.	5 yr.	1997 avg.
Consumer Prices					
All items	2.2	2.2	1.7	2.5	1.7
Less food and energy	2.1	2.1	2.2	2.6	2.2
Median[a,b]	3.0	2.8	2.8	3.0	2.9
Producer Prices					
Finished goods	2.8	1.2	−0.3	0.9	−1.2
Less food and energy	1.7	2.3	1.1	1.0	0.0
Commodity futures prices[c]	−36.5	−30.4	−16.2	−1.4	−3.5







a. Calculated by the Federal Reserve Bank of Cleveland.
b. The median CPI component structure and market basket were updated in May 1998, and the weighting scheme was revised.
c. 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.
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.
e. January 1997–July 1998.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; and the Commodity Research Bureau.

Consumer prices continue to hover just under the lower bound of the FOMC central tendency established in July 1998, with the Consumer Price Index (CPI) rising an annualized 2.2% in July. The median CPI, an alternative measure of core inflation, continues to hold around the 2.8% (annualized) mark. Shifting focus to wholesale prices, recent Producer Price Index (PPI) data show some upward pressure, rising at a 2.8% annualized rate in July.

Several components used to calculate the CPI have shown relatively large price movements over the last 18 months. By and large, these have offset one another, although the extreme price declines have generally represented a greater share of the market basket than have the extreme increases. In the first category, the energy components have plummeted more than 11% (annual rate). In the second, prices for many foods, such as fresh fruits and vegetables, have moved sharply higher over the last 18 months.

Before the Federal Reserve was established in 1913, and certainly before it achieved any well-orchestrated management of credit markets (which occurred about 10 years later), "monetary policy" was based on the establishment of a single price-level objective—the price of gold. Money stocks were adjusted to keep the price of gold at a nearly constant $20.64 per ounce. Indeed, students of money and banking are often surprised by the stability in gold prices over the period economists call "the gold standard," until they understand that gold "defined"

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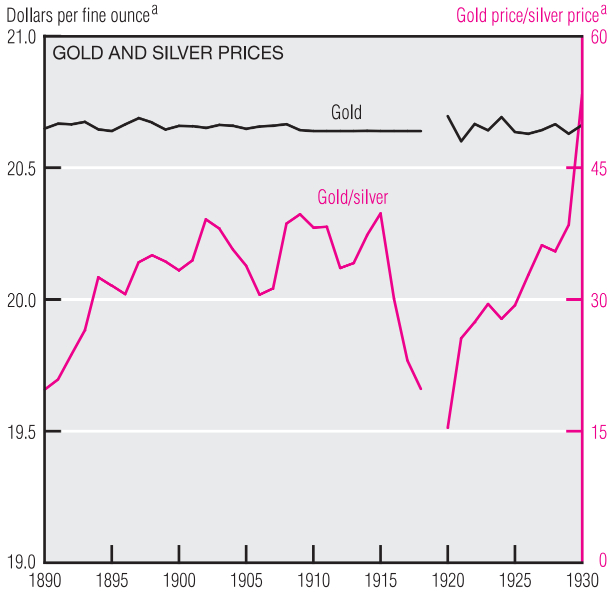
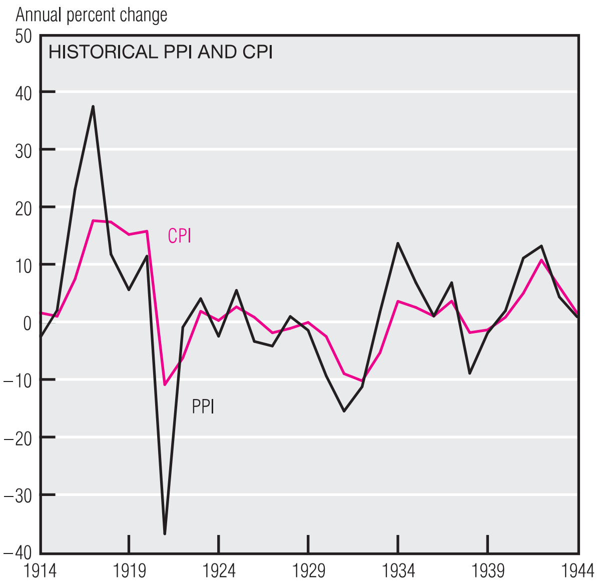
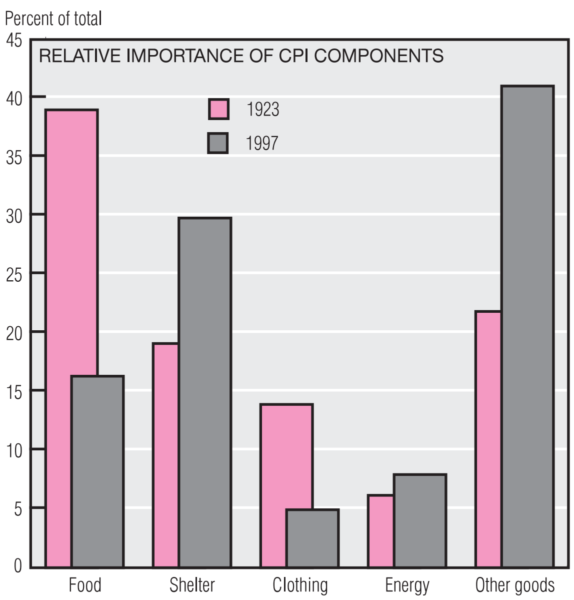
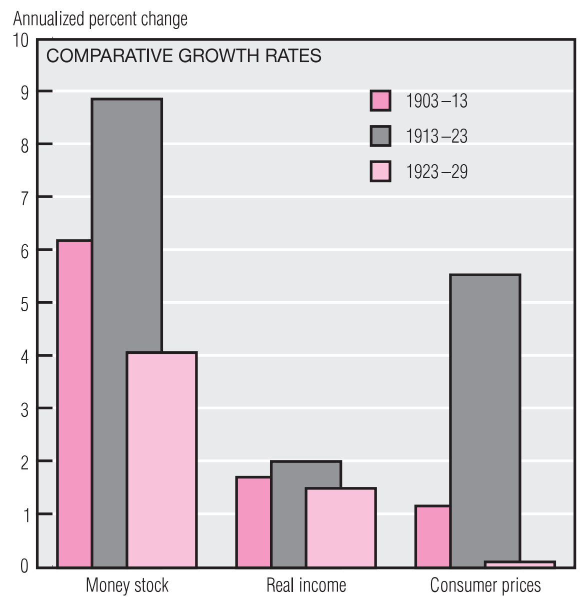
Inflation and Prices, 1998 and 1923 (cont.)









a. The lines break in 1919 due to a change in the definition of the gold series.

SOURCES: Office of the Director of the Mint, Annual Report, 1944; U.S. Department of Labor, Bureau of Labor Statistics; National Industrial Conference Board, Inc., *The Cost of Living in the United States, 1914–26*. New York: National Industrial Conference Board, Inc., 1927, pp. 158–59; U.S. Department of Commerce, Bureau of the Census, *Historical Statistics of the United States: Colonial Times to 1970*, part 2. Washington, D.C.: 1975, p.164; and Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867–1960*. Princeton, N.J.: Princeton University Press, 1963, pp. 704–22.

a dollar. But it was only the price of gold that was stabilized, as is suggested by wide swings in the price of gold relative to the price of another precious metal, silver.

But stabilizing the stock of money relative to gold does not necessarily stabilize money's power to purchase other goods and services, particularly over short time horizons. Of course, during the early years of the Federal Reserve System, the market basket purchased by most households was more limited than it is today. In 1923, food accounted for roughly 40% of the CPI market basket, compared with only about 15% today. Still, the dollar cost of a representative market basket fluctuated widely during those years. Some analysts, like the noted economist Irving Fisher, urged the Fed to stabilize an index for the price of a broadly defined basket of goods and services.

It was also around this time that the Federal Reserve System began to fully appreciate the impact it could have on national credit markets—and, presumably, on industry and trade—through open market operations. Between 1913 and 1923, the System allowed the growth rate of the money stock to rise at twice the pace of the previous 10-year period, and this expansion appears to have been accompanied by a stronger pace of real income growth. But the period also saw a sharp rise in prices (which averaged about a 5½% annual rate during the first 10 years of the Federal Reserve System, compared with only about a 1% pace during the previous 10-year period). Cutting back on the expansion of money in the 1923–29 period, the System witnessed a falloff in the growth of business activity, along with a flattening of prices.