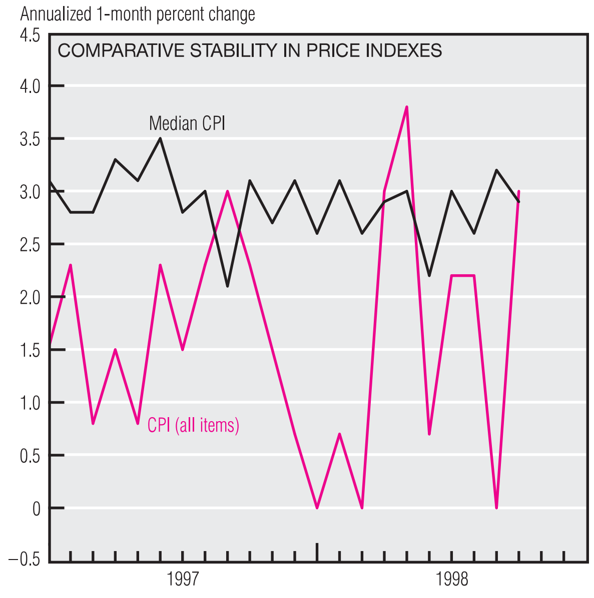
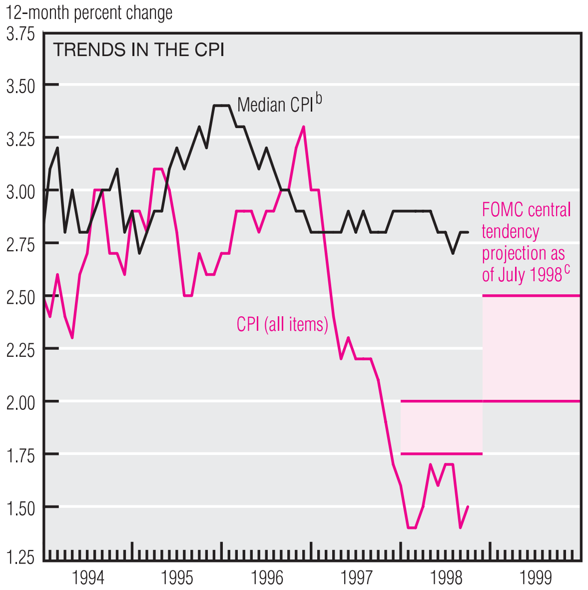
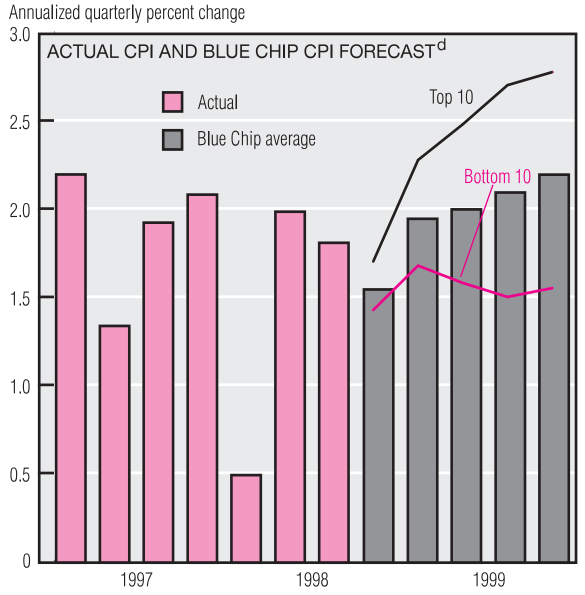
Inflation and Prices

October Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	1997 avg.
Consumer prices					
All items	3.0	1.7	1.5	2.4	1.7
Less food and energy	2.1	2.3	2.3	2.6	2.2
Median[b]	2.9	2.9	2.8	3.0	2.9
Producer prices					
Finished goods	2.8	0.6	–0.7	1.1	–1.2
Less food and energy	0.8	1.7	1.1	1.3	0







a. Annualized.
b. Calculated by the Federal Reserve Bank of Cleveland.
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. Blue Chip panel of economists.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; and *Blue Chip Economic Indicators*, November 10, 1998.

The Consumer Price Index (CPI) increased at an annualized 3% rate in October, twice its average pace for the past year. However, there was no change in September, and the CPI has risen at an annualized pace of only 1.7% over the last three months.

The recent wide swings in inflation as reported by the CPI are typical of this relatively volatile index, which has fluctuated between 0% and 3¾% over the past year. While much of this volatility has resulted from wide variations in the price of petroleum products, several other items have also shown large price swings. The median CPI, however, which filters out such extreme price readings, has followed a steadier path, varying within a range of 2¼% to 3¼% during the same period.

Besides being less volatile, the median CPI has been tracking at a much higher level than the overall CPI; indeed, it has been more than one percentage point higher for the past 12 months. Which of these two trends more accurately represents the economy's inflation path is still unknown. The CPI is currently running well below the Federal Open Market Committee's 1998 and 1999 projections for the index, and the median CPI is considerably above that range.

According to many economists, the inflation trend as measured by the CPI is headed higher; not surprisingly, however, there is a wide range of opinion on its trajectory.
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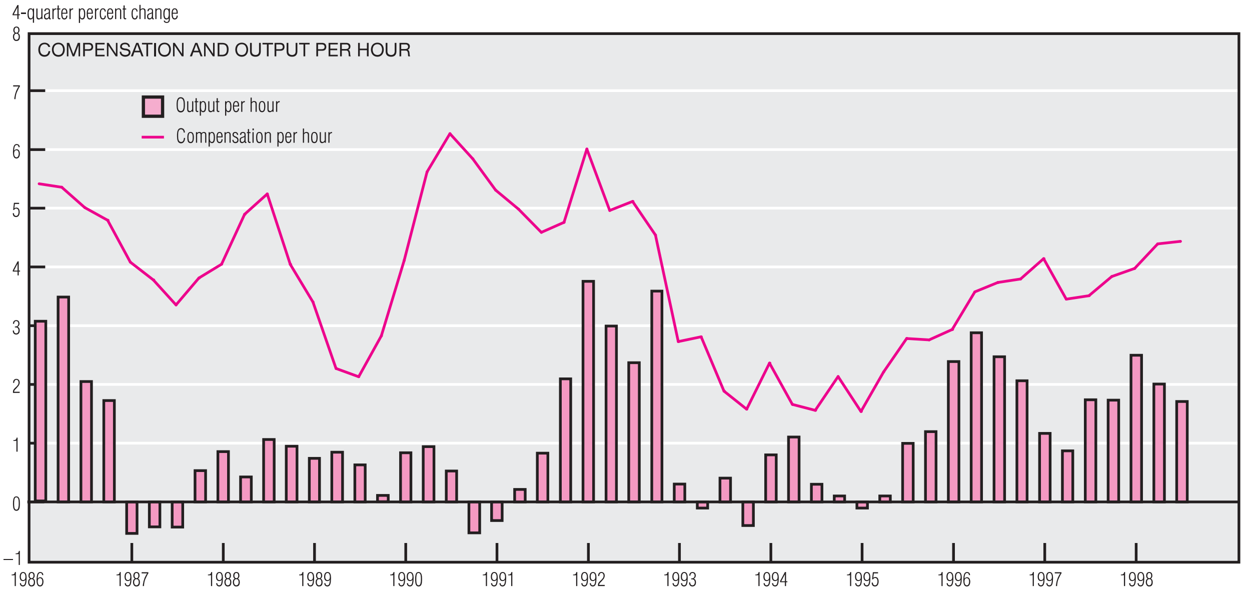
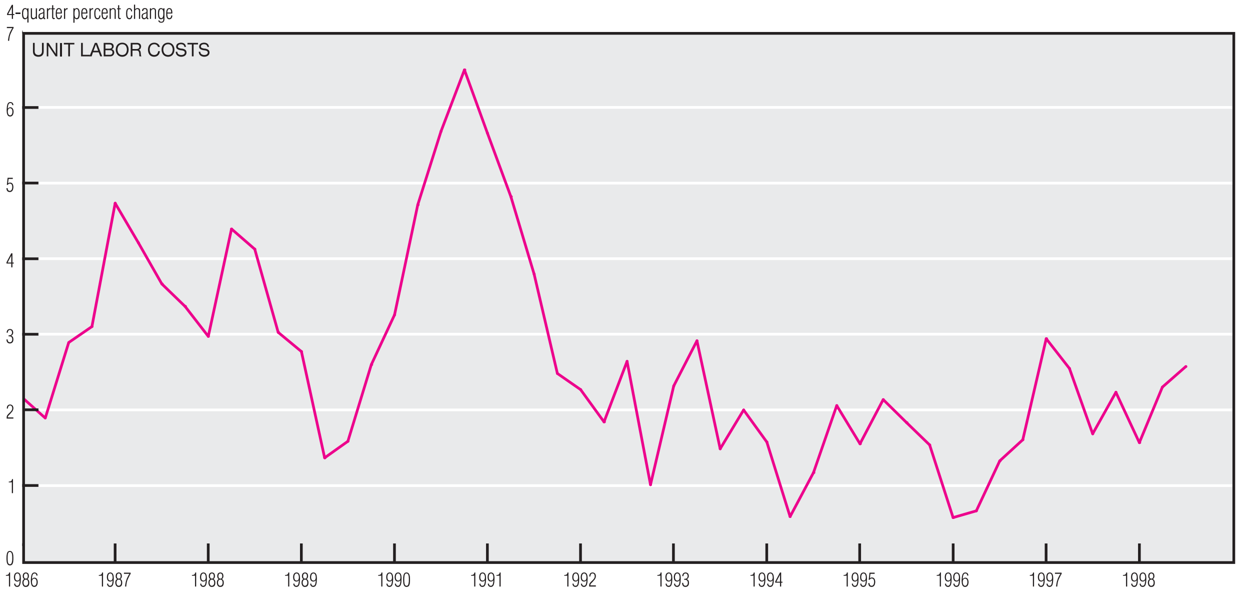
Inflation and Prices (cont.)





SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.

Inflation optimists do not expect the CPI trend to stray far from its recent 1½% level, while inflation pessimists expect it to move sharply higher, reaching 2¾% by the end of next year.

Inflation pessimists have been especially attentive to the gradual but persistent rise in the rate of labor compensation. Indeed, the growth rate of compensation per hour, which held steady at around 2% over the three-year period ending in 1995, began picking up in 1996 and has continued to climb since then. Over the past four quarters, the growth rate of hourly compensation in the nonfinancial business sector reached about 4½%, a level not seen since 1992.

Higher labor compensation does not necessarily imply a potential for more inflation, as long as it is accompanied by higher worker productivity. In 1992, for example, the growth rate of output per hour averaged about 3% per year, a relatively high level. In 1995, when compensation began to move higher, it too was accompanied by increased worker productivity. But in recent quarters, the gap in the trend rates of compensation growth and output-per-hour growth have been widening.

By subtracting the growth rate of productivity from that of labor compensation, economists get *unit labor costs*, an alternative measure of inflationary pressure. Unit labor costs have been relatively subdued over the current economic expansion, hovering mostly in the range of 1% to 2%. Since 1997, though, unit-labor-cost increases have been in the 2% to 3% range, lending support to the inflation pessimists' position.