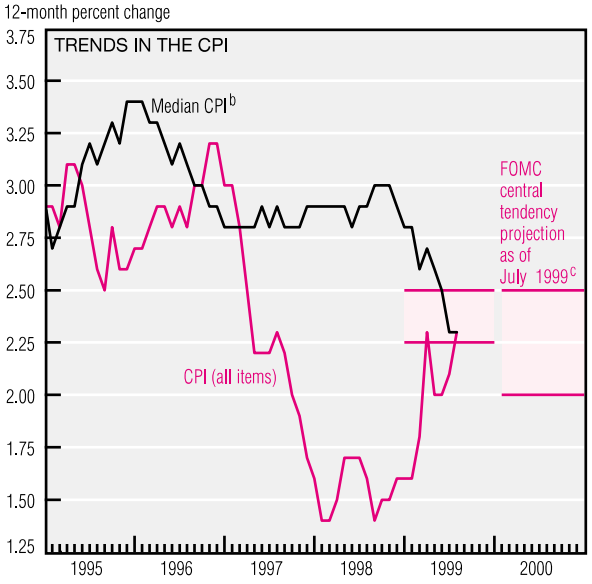
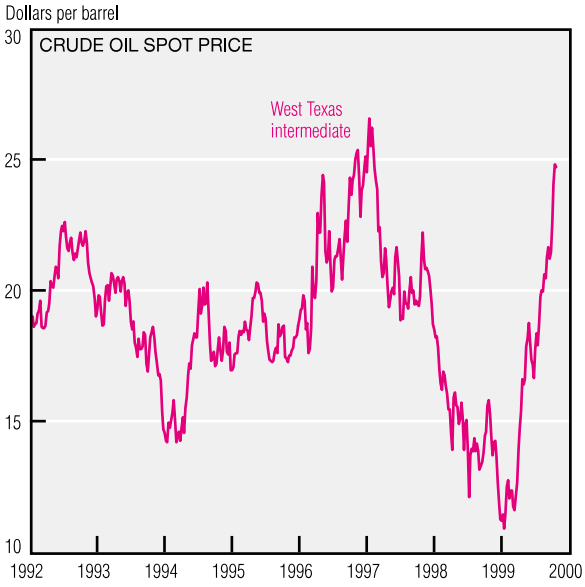
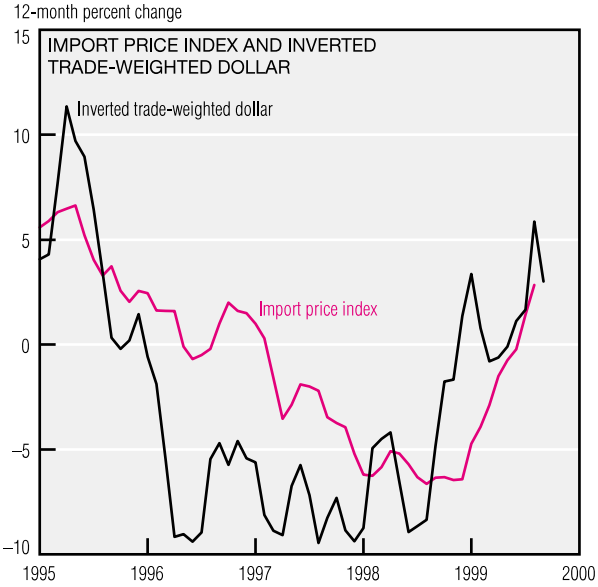
Inflation and Prices

August Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	1998 avg.
Consumer prices					
All items	3.7	2.4	2.3	2.3	1.6
Less food and energy	1.4	1.4	1.9	2.4	2.5
Median[b]	2.5	1.7	2.3	2.9	2.9
Producer prices					
Finished goods	6.5	2.7	2.3	1.1	–0.1
Less food and energy	–0.8	–1.1	1.3	1.1	2.5







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.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; International Monetary Fund, *International Financial Statistics;* Organisation for Economic Co-operation and Development, *World Economic Outlook*; Standard & Poor's Corporation; and *Blue Chip Economic Indicators,* September 1999.

Retail prices continued to rise rapidly in August, as shown by a 3.7% (annualized) increase in the Consumer Price Index (CPI). Persistent upward pressure on energy prices contributed greatly to the increase. For the year to date, crude oil prices have climbed about $13 per barrel (nearly 115%) and are nearing the levels of early 1997.

The CPI minus food and energy posted a modest increase of 1.4% in August, equal to its average over the past three months. However, another measure of core inflation, the median CPI, rose 2.5% during the month. This suggests that retail price inflation actually lies somewhere between the CPI and the CPI excluding food and energy.

Over the past 12 months, the CPI and the median CPI showed the same increase (2.3%), the first time this has happened in roughly 2½ years. The narrowed gap between these two inflation statistics has resulted partly from a rising CPI trend during 1999, but also from a falling median CPI trend (on the order of half a percentage point). The latter change, however, may be mostly an artifact of methodological adjustments to the CPI.

Another cause of the recent acceleration in retail prices is the dollar's declining value in foreign-exchange markets. Inverting the trade-weighted dollar value of foreign currencies shows how, as the dollar falls, the dollar prices of foreign goods to U.S. consumers might be expected to rise. Import prices, which are believed to have had a strong downward influence on the measurement of U.S. retail prices in 1997 and 1998, have contributed to the rise in aggregate prices this year.

While the CPI is the most popular retail price index, an alternative

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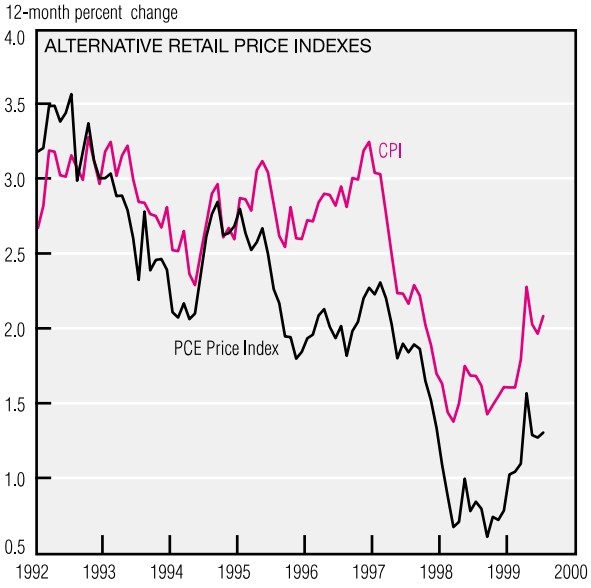
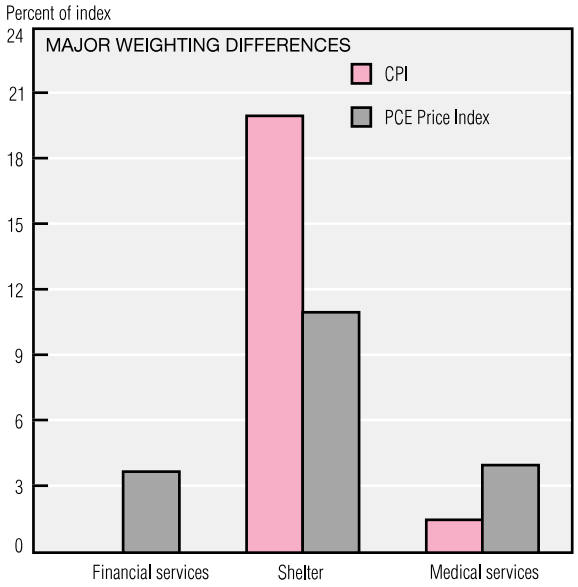
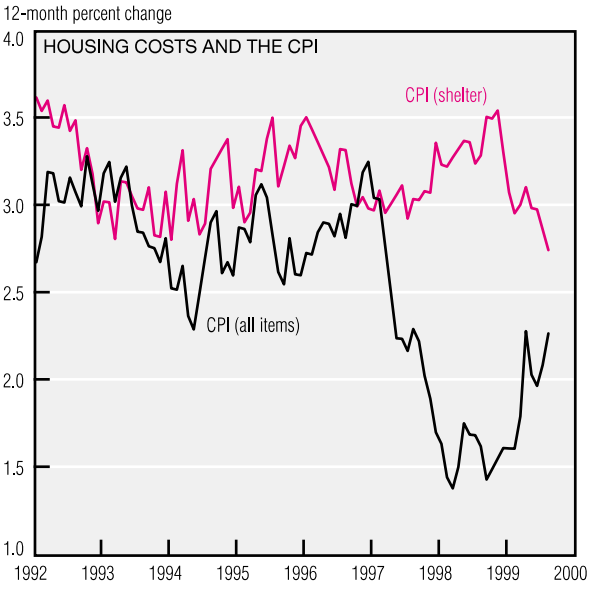
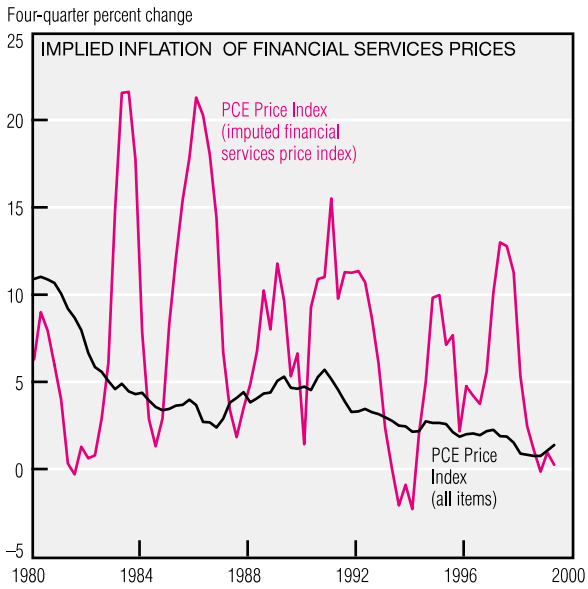
Inflation and Prices (cont.)









SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; and Todd E. Clark, "A Comparison of the CPI and the PCE Price Index," Federal Reserve Bank of Kansas City, *Economic Review,* third quarter 1999.

statistic is the Personal Consumption Expenditures Chain Price Index (PCEPI). While the PCEPI has also trended upward this year (presumably for the same reasons as the CPI), it has risen from a much lower level. Indeed, it has shown smaller rates of increase than the CPI over much of the past four years.

There are many reasons why these two price measures do not always agree. First, they differ in the scope of coverage. The CPI measures only out-of-pocket costs paid by urban consumers, while the PCEPI includes expenditures made on behalf of households by employers, government agencies, and nonprofit organizations. The two measures also use different surveys of consumer spending to gauge the importance of various items in the consumer market basket. As a result, the two indexes weight many components differently, and some of these differences are substantial. For example, the CPI gives greater importance to shelter costs, while the PCEPI places more emphasis on medical services. Shelter costs have tended to rise more rapidly than prices of other goods and services over the past few years, and this, among other things, has helped push the CPI above the PCEPI.

One major drawback of the PCEPI, however, as argued in a recent Federal Reserve Bank of Kansas City research paper, is its way of computing nonmarket prices (which are outside the scope of the CPI). For example, the PCEPI tries to include the value of unpriced financial services afforded to many account holders. Because the value is difficult to compute, it raises questions as to the accuracy of these imputed price movements. The Bureau of Economic Analysis, which produces the PCEPI, is expected to introduce a new method for computing this item with its upcoming revision to the National Income and Product Accounts, scheduled for the end of October.