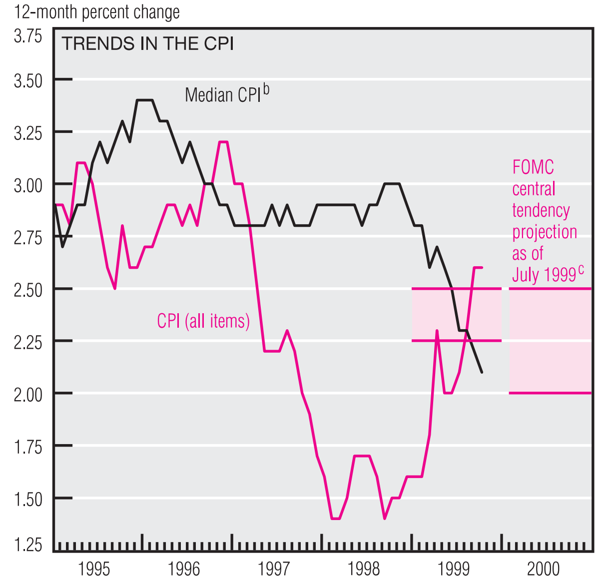
Inflation and Prices

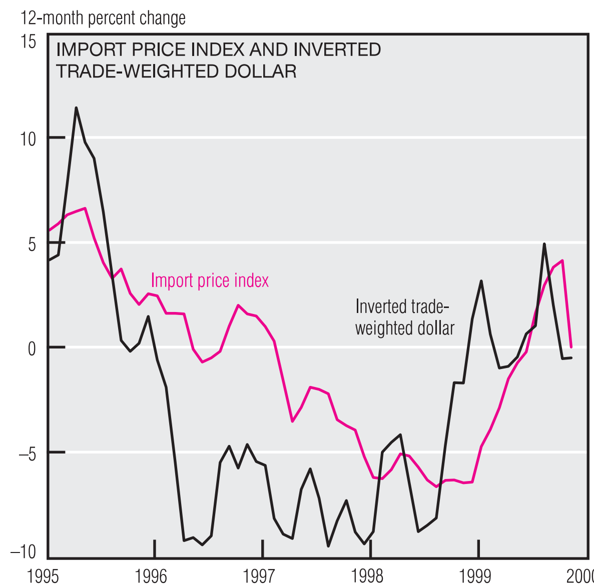
October Price Statistics

	Percent change, last: 1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	1998 avg.
Consumer prices					
All items	2.2	3.5	2.6	2.4	1.6
Less food and energy	2.0	2.5	2.1	2.5	2.5
Median[b]	1.9	2.1	2.1	2.8	2.9
Producer prices					
Finished goods	–1.8	5.9	2.7	1.4	–0.1
Less food and energy	3.3	3.9	1.9	1.4	2.5



Shifts in CPI Components

Component	Relative importance[d]	Percent change in price 1998	1999[e]
Processed fruits and vegetables	0.33	2.00	3.41
Alcoholic beverages	0.97	1.82	2.72
Tenants' and household insurance	0.37	–0.10	3.22
Fuel oil and other fuels	0.23	–11.65	18.46
Gas (piped) and electricity	3.57	–3.64	2.25
Car and truck rental	0.14	1.50	2.77
Motor fuel	2.49	–16.52	36.65
Public transportation	1.35	1.40	4.48
Personal care products	0.74	2.34	3.87



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. Percent of CPI (all items) as of December 1998.
e. Year to date.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Federal Reserve Bank of Cleveland; International Monetary Fund, *International Financial Statistics;* and Organisation for Economic Co-operation and Development, *World Economic Outlook.*

After accelerating sharply over the summer, consumer price increases moderated to a 2.2% annualized pace in October—under their 12-month trend (2.6%). Two measures of so-called core inflation, the CPI excluding food and energy and the median CPI, both rose about 2% (annualized) during the month, also slightly under their recent trends. Still, on average, the rise in consumer prices this year has topped its 1998 pace by about a percentage point, heightening worries about a long-anticipated inflationary upturn. The 12-month trend in the CPI growth rate is now slightly above the upper end of the range projected for 1999 and 2000 by the Federal Open Market Committee.

While the sharpness of this year's jump in retail prices came as something of a surprise, a turnaround in the inflation trend has been widely anticipated. This expectation probably arises partly from the belief that the observed inflation numbers were artificially low—temporarily restrained by short-lived events. Indeed, the same nine components that cumulatively reduced the CPI by about ½ percentage point in 1998 have combined to help push the index upward by slightly more than a percentage point this year. Topping the list of items contributing to this year's swing in retail inflation numbers are energy goods like home heating oil and gasoline. Other contributors to faster CPI growth this year are fruits and vegetables, alcoholic beverages, and home insurance.

Imported goods are notably absent from this year's turnaround in retail prices. In fact, many items thought to consist largely of imports,

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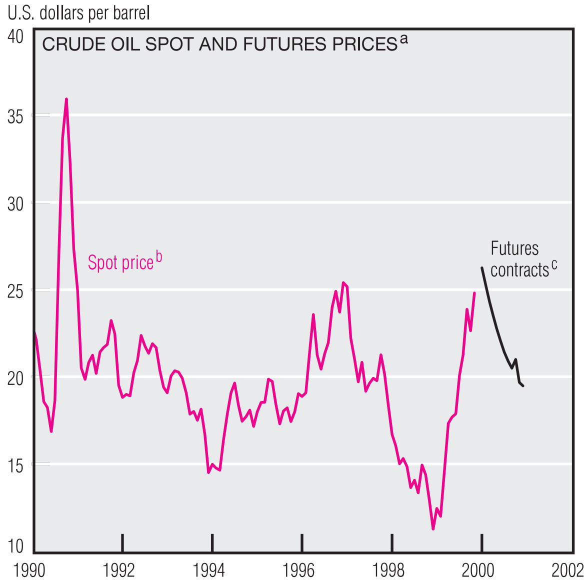
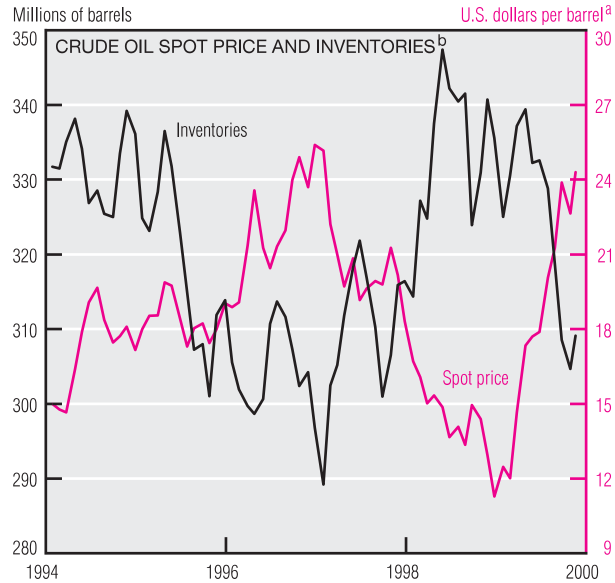
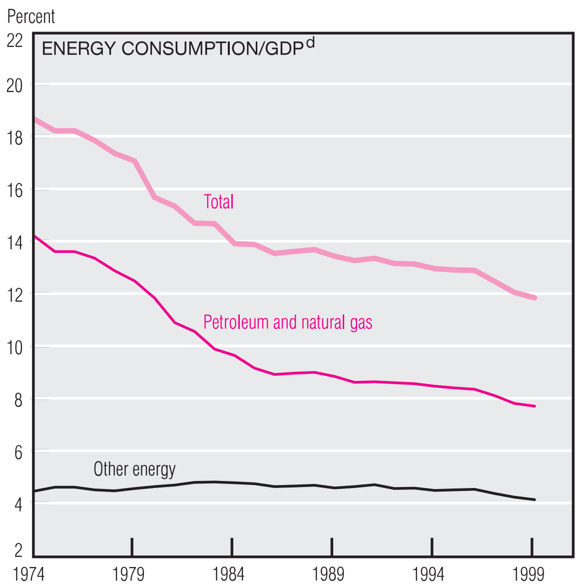
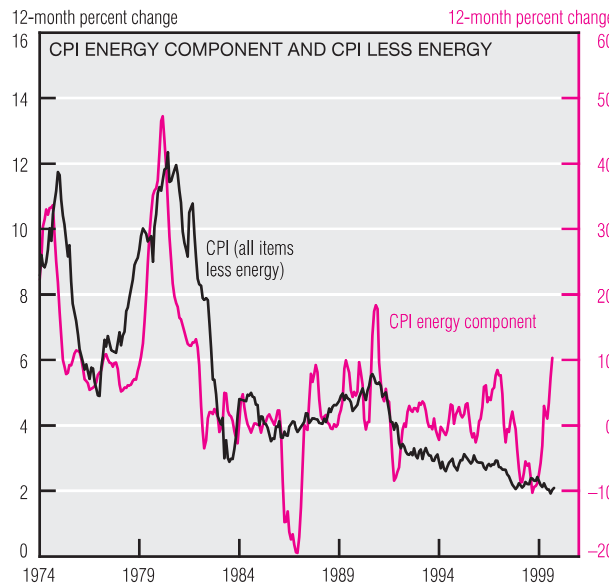
Inflation and Prices (cont.)









a. West Texas intermediate crude oil.
b. Data for November 1999 are estimated.
c. Closing price on November 29, 1999.
d. Observations for 1999 are based on two quarters of data.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Energy, *Monthly Energy Review,* October 1999; American Petroleum Institute; Bloomberg Financial Information Services; and Dow Jones Energy Service.

such as apparel, new vehicles, and electronic equipment, are still exerting downward pressure on the CPI. It may very well be that the dollar's fall during the second half of 1999 is not yet reflected by the index.

The most dramatic price development this year has been the sharp rise in oil prices. Since January, the spot price of crude oil has more than doubled (from about $12 per barrel to $25), pushing the nominal price of oil close to its nine-year high. Industry analysts have attributed the recent ascent in oil prices partly to sharply reduced stockpiles worldwide, reportedly caused by stricter adherence to OPEC production quotas. For example, U.S. oil inventories, which reached almost 350 million barrels two years ago, have since fallen by about 11%. But investors seem unconvinced that these developments will continue to exert upward pressure on oil prices; a reading of recent futures prices shows that oil prices are expected to fall back below $20 per barrel by the middle of next year.

The impact of higher oil prices on the overall CPI is unclear, especially relative to historical experience. Energy use accounts for a substantially smaller share of national output today than at any time in the recent past. Furthermore, monetary policy may not accommodate current and future oil price hikes as readily as in the past. During the 1970s, surging oil prices were accompanied by price hikes for a broad range of nonenergy goods. These increases may have resulted from an expansionary monetary policy that allowed oil price increases to spark a generalized inflation. Energy price fluctuations in the 1980s and 1990s (albeit of smaller magnitude), have not been accompanied by widespread inflationary movements.