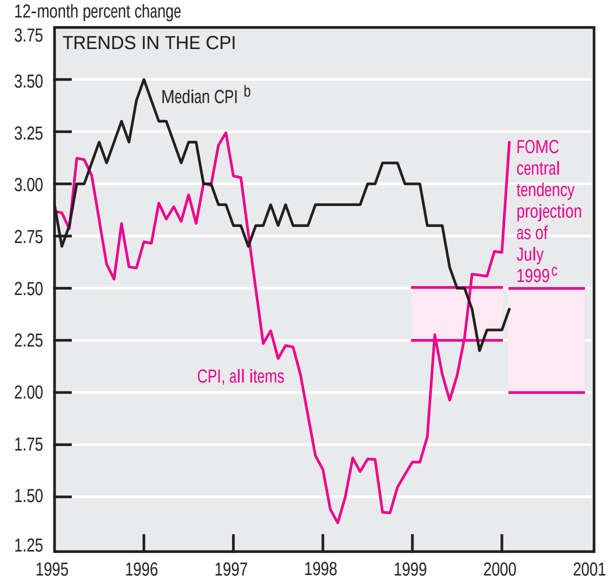
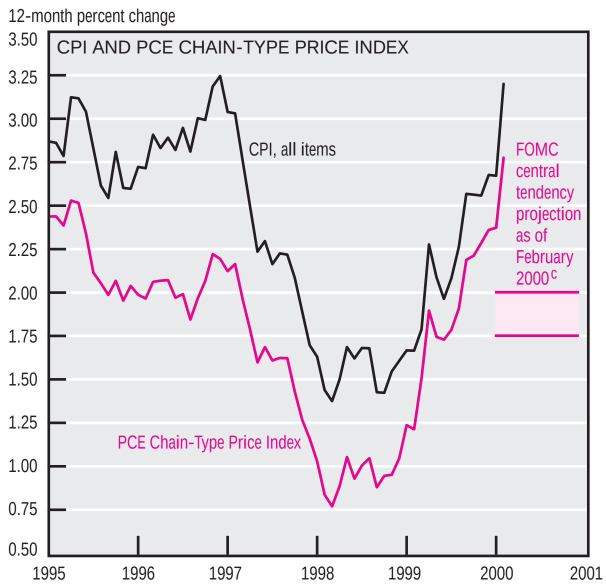
Inflation and Prices

February Price Statistics					
	Percent change, last:				1999
	1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	avg.
Consumer prices					
All items	6.6	3.9	3.2	2.4	2.7
Less food and energy	2.0	1.8	2.1	2.4	1.9
Median[b]	3.7	3.1	2.4	2.9	2.3
Producer prices					
Finished goods	13.2	4.5	4.0	1.4	3.0
Less food and energy	4.2	0.8	1.0	1.2	0.8





Tails of the CPI Distribution	Relative importance[d]	Percent change[e]
Bottom 5		
Communication	0.3	–2.3
Miscellaneous personal goods	0.2	–2.2
Footwear	0.8	–2.1
Jewelry and watches	0.4	–1.6
Dairy and related products	1.1	–0.9
CPI excluding food and energy		2.1
Median CPI		2.4
CPI		3.2
Top 5		
Infants' and toddlers' apparel	0.3	5.3
Public transportation	1.4	5.7
Tobacco and smoking products	1.3	9.8
Motor fuel	3.2	41.3
Fuel oil and other fuels	0.3	70.7

a. Annualized.
b. Calculated by the Federal Reserve Bank of Cleveland.
c. Upper and lower bounds for 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 1999.
e. Over the last 12 months.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of Economic Analysis; and Federal Reserve Bank of Cleveland.

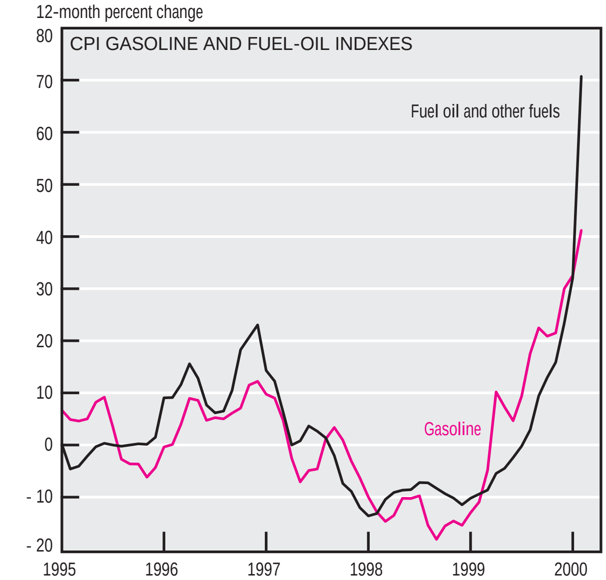
The Consumer Price Index rose 0.5% in February (6.6% at an annualized rate), its largest monthly increase since April 1999. Rising energy costs were largely responsible; the CPI's energy index rose 4.6% in February alone. Within the energy category, petroleum-based fuels registered an 8.0% price increase. The transportation index also reflected rising energy costs, increasing 1.3% in the month.

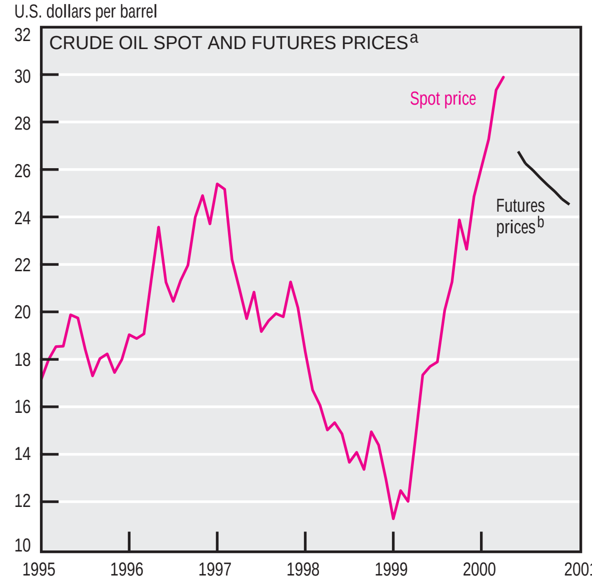
Energy prices began their ascent at the beginning of 1999, when Asian economies began to recover, swelling world oil demand. At about the same time, the Organization of Petroleum Exporting Countries (OPEC) agreed to limit oil production, pushing prices up still further. Indeed, crude oil prices have risen more than 100% over the past year; in March 2000, they were as high as they have been since the Gulf War in 1990.

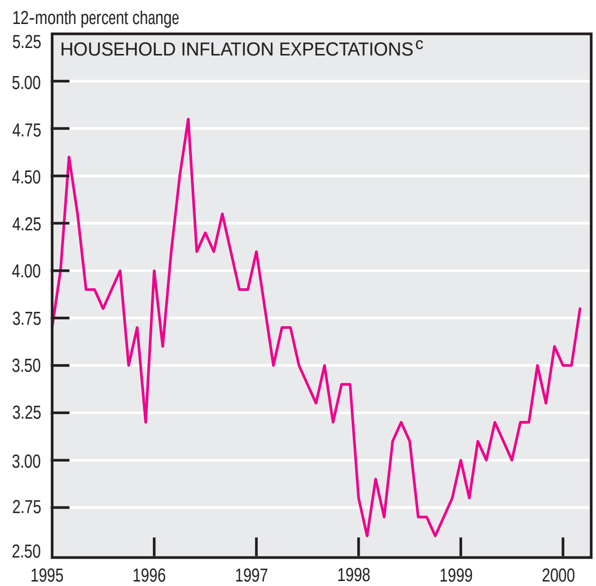
Are higher oil prices "inflationary"? They certainly can push up retail prices temporarily, as witnessed by patterns in the Consumer Price Index and the Personal Consumption Expenditure (PCE) Chain-Type Price Index during the last year or so. It is often said that because energy is an input in the production of virtually all goods and services, an increase in its price can have a widespread, persistent influence on the overall price level. But despite its presumed importance in production, we should not attribute too much influence to oil as a determinant of the inflation trend. If monetary policy does not accommodate energy-related price increases, consumers who expend larger shares of their limited resources on energy-intensive commodities will necessarily spend less on other goods and

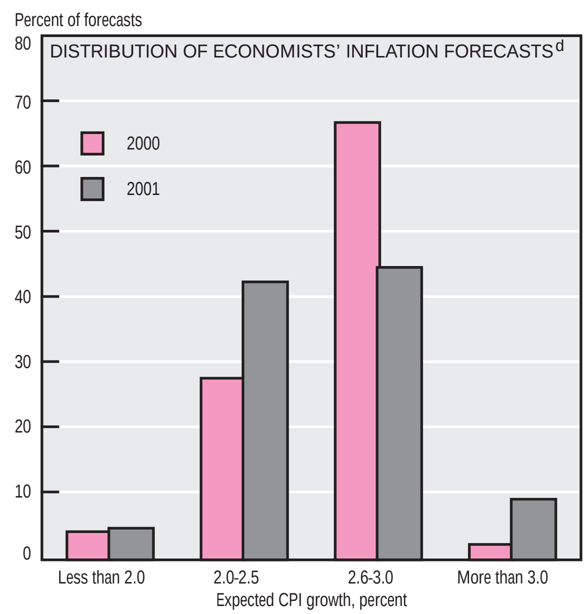
(continued on next page)

Inflation and Prices (cont.)









a. West Texas intermediate crude oil.
b. As of April 3, 2000.
c. Mean expected change in consumer prices as measured by the University of Michigan's Survey of Consumers.
d. Blue Chip panel of economists.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Organisation for Economic Co-operation and Development, International Energy Agency, *Monthly Oil Market Report,* March 2000; University of Michigan; Bloomberg Financial Information Services; Dow Jones Energy Service; and *Blue Chip Economic Indicators,* March 10, 2000.

services, putting downward pressure on those prices as a result.

This unconventional view seems to be borne out by the behavior of the median CPI. While energy prices have passed through several periods of inflation and deflation since the Gulf War, the median CPI has seemingly been immune to these shifts. While some items, like energy, have pushed retail prices higher, others, like communications equipment, footwear, jewelry and watches, and some food products, have had the opposite effect.

How much and how long oil prices will produce gyrations in the retail price numbers is hard to tell. OPEC officials have said they intend to keep prices between $22 and $28 a barrel. And at a meeting in late March, they announced plans to begin increasing production by nearly 1.5 million barrels a day—a 2% increase. These reports are in line with the oil-price patterns expected by traders in energy futures markets: a rather modest downward movement throughout 2000, with prices falling to slightly more than $24 a barrel by the end of the year.

Households and professional economists, however, seem unconvinced that much in the way of offsetting downward price pressures—whether from energy or from a noninflationary monetary policy—will occur anytime soon. Households' expectations of inflation one year hence (as measured by the University of Michigan) have been rising since early 1999 and have continued their ascent into 2000. Economists expect inflation in 2001 to be very much the same as in 2000. Though the distribution of forecasts differs for each year, the consensus expectations are identical at 2.6%.