The 1989 rise in prices: largest increase in 8 years

Energy prices accelerated in the first half, driving the CPI higher by 4.6 percent and the PPI, by 4.8 percent

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Increases in the Consumer Price Index for All Urban Consumers and the Producer Price Index for Finished Goods were marginally larger in 1989 than in 1988, reflecting an acceleration of energy prices. The sharp advances in energy and food prices that occurred during the first 5 months of the year, however, were not sustained during the remaining months of 1989. Nevertheless, the 1989 advances in the CPI and PPI were the largest annual changes since 1981.

Consumer prices

For the 12-month period ended December 1989, the CPI rose 4.6 percent. This compares with increases of 4.4 percent in both 1987 and 1988 and was the largest annual change since an 8.9-percent rise in 1981. While advances in the food, shelter, and energy components were each larger than in 1988, the slight acceleration in the CPI was principally because of the sharp increases in petroleum-based energy items during the first half of 1989. Food prices rose notably more in the first half, registering their largest increase since 1980. The index for all items except food, shelter, and energy—up 4.1 percent in 1989—rose less than in 1988, as prices of other commodities registered their smallest increase in 3 years. In particular, apparel prices increased only 0.7 percent in 1989, after rising 4.8 percent in 1988. Prices for other services moved up about the same as in 1988. An 8.4-percent increase in medical care services accounted for about one-third of the rise. The rates for these groups during the past 10 years are shown in table 1.

Food. Food prices at the retail level rose 5.6 percent in 1989, the largest increase since a 10.2-percent jump in 1980. Grocery store food prices advanced 6.2 percent, following a 5.6-percent rise in 1988. The acceleration in this index was primarily a result of larger increases in the prices of meats, eggs, and dairy products.

The CPI for meats, poultry, fish, and eggs increased 6.6 percent in 1989, after a 5.3-percent rise in 1988. The index for beef and veal was up 6.5 percent in 1989, and the index for pork climbed 6.9 percent. During 1988, prices for beef and veal rose 5.6 percent, while those for pork declined 3.1 percent. The index for poultry was virtually unchanged in 1989—up 0.6 percent—after spurting 17.9 percent during 1988. The index for fish and seafood increased 3.0 percent in 1989, moderately less than in the previous year. Prices for eggs continued to surge, up 35.4 percent, following a 16.5-percent jump in 1988. The higher egg prices were in

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Table 1. **Percentage changes for major catagories of the Consumer Price Index and the Producer Price Index, 1980-89**

Index	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Consumer Price Index										
All items	12.5	8.4	3.8	3.8	3.9	3.8	1.1	4.4	4.4	4.6
Energy	18.0	11.9	1.3	-.5	.2	1.8	-19.7	8.2	.5	5.1
Energy commodities	19.2	10.6	-5.0	-3.2	-1.8	3.4	-30.5	7.8	-2.3	7.9
Energy services	15.9	14.7	14.1	4.1	3.5	-.6	-3.3	.2	3.2	2.8
All items less energy	11.7	8.5	4.2	4.5	4.4	4.0	3.8	4.1	4.7	4.6
Food	10.2	4.3	3.1	2.7	3.8	2.6	3.8	3.5	5.2	5.6
All items less food, and energy	12.2	9.5	4.5	4.8	4.7	4.3	3.8	4.2	4.7	4.4
Shelter	15.0	9.9	2.4	4.7	5.2	6.0	4.6	4.8	4.5	4.9
All items less food, shelter and energy	9.8	9.4	6.1	5.0	4.3	3.7	3.3	3.8	4.7	4.1
Other commodities	9.5	8.0	5.5	5.0	3.1	2.2	1.4	3.5	4.0	2.7
Other services	10.6	11.1	7.3	4.9	6.0	5.4	5.6	4.3	5.6	5.5
Producer Price Index										
Finished goods	11.8	7.1	3.6	.6	1.7	1.8	-2.3	2.2	4.0	4.8
Finished consumer foods	7.5	1.5	2.0	2.3	3.5	.6	2.8	-.2	5.7	5.0
Finished energy goods	27.9	14.1	-.1	-9.2	-4.2	-.2	-38.1	11.2	-3.6	9.6
Finished goods less foods and energy	10.8	7.7	4.9	1.9	2.0	2.7	2.7	2.1	4.3	4.2
Intermediate materials supplies and components	12.7	6.0	.2	1.8	1.4	-.3	-4.4	5.4	5.6	2.4
Intermediate foods and energy	16.0	-12.9	-.1	9.3	-5.4	-4.2	-.5	5.5	10.8	0
Intermediate energy goods	25.4	11.1	-.7	-5.5	-.1	-.8	-29.0	9.0	-4.4	11.8
Intermediate goods less foods and energy	10.0	6.5	.6	2.9	2.1	-.1	.1	5.2	7.2	.9
Crude materials for further processing	12.8	-3.8	.4	4.7	-1.6	-5.6	-8.9	8.9	3.1	6.9
Foodstuffs and feedstuffs	8.6	-14.0	1.5	7.9	-1.2	-6.4	-1.5	1.8	14.2	2.6
Crude energy materials	27.0	22.7	2.6	-4.7	-1.2	-4.9	-27.6	10.7	-9.5	17.9
Crude nonfood materials less energy	7.5	-11.4	-7.6	15.5	-3.4	-4.3	1.8	22.6	7.5	-3.8

NOTE: Data are calculated on a December-to-December basis.

response to increased consumer demand at the same time supplies were limited because of a decline in the number of laying hens.

The index for cereals and bakery products increased 7.5 percent in 1989, down slightly from the 8.4-percent rise in 1988. Lingering effects from the drought conditions during the summer of 1988 led to decreased milk production. This resulted in a jump of 10.3 percent in the index for dairy products, the sharpest rise since 1979.

The index for fruits and vegetables rose 4.4 percent in 1989, compared with increases of 6.2 percent in 1988 and 12.8 percent in 1987. However, the trend in prices for fresh fruits and fresh vegetables was different. Prices for fresh fruits increased 8.1 percent in 1989, considerably less than the 13.4-percent rise in 1988. Declines in prices for apples and oranges were more than offset by increases in prices for bananas and, especially, other fruits (grapes, peaches, plums, cherries, and berries). Prices for fresh vegetables rose 2.6 percent in 1989, reversing a 5.1-percent decline in 1988. Higher prices for potatoes, tomatoes, and other vegetables were partially offset as lettuce prices plummeted 22.1 percent from the levels of 1988, when prices rose because of adverse weather and insect damage. The index for processed fruits and vegetables was up 2.5 percent in 1989, following a double-digit increase in 1988.

The other two components of the food and beverages index—restaurant meals and alcoholic beverages—rose 4.6 and 4.8 percent.

Housing. The housing index rose 3.9 percent in 1989, about the same increase as in 1988. Higher costs for shelter and fuels and other utilities were offset by a smaller rise in costs for household furnishings and operation.

The CPI for shelter rose 4.9 percent in 1989, following a 4.5-percent increase in 1988. Owners' equivalent rent, which makes up more than two-thirds of the weight of the shelter index, rose 5.1 percent in 1989, up slightly from the 1988 increase of 4.8 percent. Residential rent increased 4.2 percent in 1989, after a 3.6-percent rise in 1988. "Other renters' costs" also accelerated, rising 5.5 percent in 1989, after a 4.8-percent increase the previous year. The 1989 rise reflected larger increases in both lodging while at school and other lodging away from home. Household maintenance and repair costs increased 3.2 percent in 1989.

The cost of fuel and other utilities increased 3.2 percent in 1989, following a 2.9-percent rise in 1988. The 1989 increase was primarily the result of a 19.5-percent jump in fuel oil prices. During the first quarter, fuel oil prices soared at a seasonally adjusted annual rate of 46.6 percent, reflecting sharply higher prices for crude oil.

During the fourth quarter, prices for fuel oil shot up at a 35.0-percent seasonally adjusted annual rate as a result of the record cold temperatures in the eastern half of the country at a time when inventories of fuel oil were inordinately low. However, charges for electricity—up 2.8 percent—rose at the same rate as in 1988, and charges for piped gas—up 2.7 percent—rose slightly less than the year before. The index for other utilities and public services increased 2.2 percent in 1989, after rising 3.8 percent in 1988. The primary reason was the decline in charges for telephone services in 1989—down 0.3 per-

cent. Charges for cable television increased 3.8 percent in 1989, after registering a double-digit rise the previous year. Charges for the remaining components of other utilities and public services—water and sewerage maintenance, up 6.6 percent, and refuse collection, up 9.7 percent—both climbed more than in 1988.

Prices for household furnishings and operation increased only 1.0 percent in 1989, compared with 3.1 percent in 1988. A decline of 0.4 percent in the index for housefurnishings was more than offset by increases of 5.6 percent and 1.5 percent in the indexes for housekeeping supplies and housekeeping services.

Apparel and upkeep. The index for apparel and upkeep rose 0.9 percent in 1989. This compares with increases of 4.7 percent in 1988 and 4.8 percent in 1987. The introduction of higher-priced apparel in both the spring and fall of 1989 was quickly followed by widespread clothing sales and promotions. For the 12 months ended in December, prices for men's and boys' clothing rose 1.3 percent, while the prices for both women's and girls' apparel and infants and toddlers' clothing fell 0.1 and 1.7 percent. Prices for footwear moved up 1.8 percent, after rising 5.9 percent in 1988. The index for apparel services rose 3.6 percent in 1989, after advancing 4.4 percent in 1988, reflecting smaller increases in charges for laundry and drycleaning services.

Transportation. Transportation costs rose 4.0 percent in 1989, following a 3.0-percent increase in 1988. The acceleration was largely a result of the turnaround in gasoline prices, which rose 6.5 percent after falling 1.8 percent.

Motor fuel prices (gasoline and diesel) continued their volatile pattern of the last few years. The 6.8-percent rise in 1989 compares with a drop of 2.1 percent in 1988, an increase of 18.7 percent in 1987, and a decline of 30.7 percent in 1986.

For the 3-month period March through May, gasoline prices shot up at a seasonally adjusted annual rate of 18.1 percent primarily because of a massive oil spill in Alaska's Prince William Sound. The incident led to a temporary disruption in the supply of refined oil products, resulting in near-panic pricing.

New car prices advanced 2.3 percent in 1989, after rising 2.1 percent the year before. For the third consecutive year, new car sales were sluggish, and manufacturers offered price or financing incentives to reduce substantial inventories. Prices for used cars fell 0.4 percent in 1989, following a 3.4-percent rise in 1988.

Among other automotive expenses, finance charges and insurance costs rose 4.3 and 5.9 percent. Both indexes increased more than 8 percent in 1988. The 5.7-percent increase in the index for automobile fees was slightly more than in 1988. Costs for automobile maintenance and repair increased 2.2 percent in 1989, about the same as during each of the previous 2 years. The index for other private transportation commodities increased 2.0 percent in 1989, following a 2.9-percent rise in 1988. In particular, prices for tires, motor oil, coolant, and other products registered small declines in 1989, while those for automobile parts and equipment rose 2.2 percent.

The index for public transportation rose 4.1 percent in 1989, after moving up 3.6 percent in 1988 and 1.8 percent in 1987. Higher airline fares in 1989 more than offset declines in the indexes for other intercity and intracity public transportation.

Medical care. Medical care costs, which increased 6.9 percent in 1988, rose 8.5 percent in 1989, the largest advance since an 11.0-percent rise in 1982. The acceleration in medical costs reflects higher charges for both commodities and services. Among commodities—up 8.2 percent in 1989 after a 6.9-percent rise in 1988—the index for prescription drugs rose 9.5 percent while the index for over-the-counter drugs and medical supplies increased 5.8 percent.

Charges for medical care services jumped 8.6 percent in 1989, after rising 6.9 percent in 1988. The index for hospital and related services (hospital rooms, other inpatient services, and outpatient services) rose 11.3 percent. The index for professional medical services increased 6.5 percent in 1989, slightly less than in 1988. During the 1980's, the cost of medical care climbed 118.7 percent, at an annual rate of 8.1 percent.

Retail food prices continued to rise significantly.

Entertainment. Entertainment prices increased 5.1 percent in 1989, following a 4.6-percent rise in 1988. The index for entertainment services advanced 6.8 percent in 1989. Admission fees for movies, theaters, sporting events, and other forms of entertainment climbed 9.5 percent on average—the largest increase for this component since pricing began in 1978. Admission fees for participant sports rose 7.7 percent in 1989, while fees

for club memberships increased 4.0 percent. The index for entertainment commodities increased 3.5 percent in 1989, compared with 4.4 percent in 1988. The moderation was primarily the result of a smaller rise in prices for sporting goods and equipment—up 2.1 percent in 1989, after rising 4.4 percent in 1988. The index for toys, hobbies, and other entertainment also rose less in 1989 than in 1988. Prices for reading materials rose 4.7 percent in 1989, slightly more than in 1988.

Other goods and services. The index for other goods and services, up 8.2 percent in 1989, continued to register larger-than-average increases. The 1989 increase followed a 0.7-percent advance in 1988 and was the largest increase since a 12.1-percent jump in 1982. The escalation in this index was principally because of sharply higher prices for tobacco and smoking products—up 14.7 percent in 1989, after a 9.4-percent rise in 1988. Higher State-imposed excise taxes as well as a sharp rise in wholesale prices for tobacco were passed on to consumers by retailers during the year. In the decade ended December 1989, prices of tobacco and smoking products spurted 152 percent, nearly a 10-percent annual rate.

Also adding to the upward pressure on prices for other goods and services was a 7.2-percent increase in the index for personal and educational expenses. Prices for both school books and supplies—up 7.8 percent—and personal and educational services—up 7.2 percent—rose more rapidly than in 1988. College tuition rose 8.1 percent in 1989 and climbed 149 percent during the decade. Helping to moderate the upward trend in the index for other goods and services was the index for personal care, which rose 3.8 percent in 1989, compared with 5.1 percent in 1988.

Producer prices

Prices received by domestic producers of finished goods rose 4.8 percent in 1989, the fastest pace since 1981's climb of 7.1 percent. The acceleration from the 4.0-percent advance registered in 1988 stemmed from an upturn in the index for finished energy goods, which surged 9.6 percent in 1989, after falling 3.6 percent a year earlier. Consumer food prices at the producer level increased 5 percent versus 5.7 percent in 1988.

The index for finished goods other than foods and energy, often considered a good measure of the so-called "underlying rate of inflation," moved up 4.2 percent, about as much as the year before. Of the three major categories within this grouping, capital equipment and consumer durables both rose about 3.5 percent each year, while consumer nondurables other than foods and energy moved up about 5.5 percent in both 1989 and 1988.

As was the case at the finished goods level, indexes at earlier stages of processing saw a decided resurgence in energy price indexes. Prices for both intermediate and crude energy goods rose at double-digit rates, after falling in 1988. The slowdown in food-related indexes was much more pronounced at the intermediate and the crude levels than at the finished, as the impact of the severe drought of 1988 waned. The intermediate foods and feeds index showed no change in 1989, following a 10.8-percent rise a year earlier, while the increase in the index for crude foodstuffs and feedstuffs decelerated from 14.2 percent in 1988 to 2.6 percent a year later, similar to the 1987 rise.

The most notable discrepancy in behavior between the finished goods stage and the other stages was to be found outside the often-volatile food and energy sectors. While prices for such items at the finshed level rose almost equally in 1988 and 1989, the index for such items at the intermediate level slowed dramatically, from 7.2 percent to 0.9 percent. By the same token, the index for crude nonfood materials other than energy (often referred to as the index for basic industrial materials) shifted from a 7.5-percent advance in 1988 to a 3.8-percent decline. Increases in productive capacity, as well as a more sluggish economy, contributed to the reversal.

The fact that a slowdown or reversal in prices for many kinds of manufacturing materials was not reflected in a price deceleration at the finished goods level mirrored an earlier acceleration in prices of materials that failed to result in a proportionate rise for finished goods. Part of the explanation for this development is that the pass-through of price increases of materials at successive stages of processing may have been more muted in recent years in some industries than might have been expected on the basis of previous experience. The strategies of domestic producers of some finished goods may have grown closer to the volatility-dampening pattern often observed for supermarkets that absorb, rather than pass through, food cost runups and then recover any losses by holding retail prices level when those food costs retreat. The rapid rise in manufacturing

productivity in the 1980's, impelled in large part by the need to cut costs to remain competitive with a surge in imports, would have facilitated a volatility-dampening strategy, rather than the more traditional pass-through strategy.

Another part of the explanation focuses on the normal lags and dampened effects in material cost pass-throughs to the finished goods level. The fact that the index for finished goods except foods and energy slowed from a seasonally adjusted annual increase of 5.3 percent in the first half of 1989 to a 3.3-percent rate in the second half might indicate that the slowdown or reversal in material cost increases was in fact being reflected at the finished goods level. In addition, price movements are usually dampened across successive stages of processing because costs for labor, capital, and other factors of production are less volatile than material price movements and account for a larger share of total costs at more advanced stages of processing. In any event, the continued growth in labor costs in most industries served to offset the effect of lower costs for many manufacturing materials in 1989.

Energy goods

The upturns in energy prices noted at each of the three stages of processing occurred chiefly in the first half of 1989. The crude energy index, for example, soared at a 35.4-percent rate from December 1988 to June 1989, but slowed to a rate of just 2.6 percent in the second half, resulting in a 17.9-percent advance for the year as a whole. Increases were registered for all three major categories within this grouping—crude oil, natural gas, and coal.

By June, crude petroleum prices were nearly one-third higher than their December levels. Greater restraints on oil production imposed by OPEC (Organization of Petroleum Exporting Countries) in late 1988 boosted world prices early in the year. The decline in U.S. oil production, and the consequent increase in crude imports, has made domestic petroleum prices even more sensitive to world supplies.

In June, OPEC set a new agreement which allowed for a higher production level. The additional supply eased crude oil price increases during the latter half of the year. Yearend crude petroleum prices were 35 percent higher than their December 1988 levels.

The index for natural gas rose 3.5 percent in 1989, after inching up 0.4 percent in the previous year. Increases were noted mostly in the beginning of the year, following in part the pattern of crude oil prices. Coal prices advanced 2.4 percent for the year, the increases occurring chiefly around midyear when a labor dispute reduced output. However, the strike's effect on prices was muted because of adequate inventories held by electric utilities and by coal companies; in addition, production levels rebounded by the end of the year. Increased export demand from Europe helped to bolster prices.

The intermediate energy goods index rose 11.8 percent in 1989. Prices increased by about 30 percent over the year for liquefied petroleum gas, diesel fuel, jet fuels, and residual fuel. Electric power climbed 5 percent, following a marginal rise in 1988.

The index for finished energy goods jumped at a 33.6-percent annual rate during the first half, but then fell at a 10.2-percent rate in the latter half of the year. Prices for refined petroleum products rose markedly in the spring, prompted by a rise in crude petroleum costs. There was a temporary jump in prices in response to concerns about the Alaskan oil spill in March, but that event had only a short-lived effect. Although gasoline prices fell markedly during the latter half of the year, December price levels were nonetheless 9.2 percent above their year-ago levels.

Home heating oil prices advanced by a third in 1989. Prices were pushed up by increases for crude petroleum in the spring and rose even more rapidly towards the end of the year as a frigid spell boosted demand at a time of already-low inventories.

Prices of finished energy goods turned sharply higher.

Foods and related products

At the farm level, the Producer Price Index for crude foodstuffs and feedstuffs moved up 2.6 percent in 1989. This followed a 14.2-percent advance in 1988, when the 2-year drought culminated in a sharp reduction in agricultural harvests. The grains index fell 7.3 percent in 1989, after skyrocketing almost 40 percent a year earlier. Prices for corn and oats turned down substantially, and wheat and barley prices rose far less than in the previous year, as more favorable growing weather increased supplies well beyond the drought-suppressed levels of a year earlier.

Among oilseeds, prices for soybeans fell almost 25 percent from December 1988 to December 1989, reflecting ample post-drought supplies; prices might have fallen

even lower except for smaller-than-expected harvests from other producing countries, such as Brazil. After surging about 63 percent higher in 1988, prices for live chickens turned down 20 percent, reflecting increased broiler production.

However, prices for hogs and live turkeys turned up after falling a year earlier, and prices rose more rapidly than a year earlier for fluid milk, cattle, and raw cane sugar. Although hog production increased slightly in 1989 and prices generally fell during the second quarter, hog prices soared from September to December to end the year about 15 percent above December 1988 levels; the upturn was attributable to decreased fourth-quarter production coupled with strong domestic and export demand for pork. Vigorous consumer demand and aggressive promotion of new turkey products led to higher turkey prices. Price increases for milk accelerated to 19.2 percent in 1989, with most of the advance recorded in the second half; static production at the farm level was insufficient to cope with good demand from manufacturers of dairy products. Cattle prices moved up 7.8 percent in response to lower commercial beef production. Supplies of raw cane sugar were tight in world markets. Pecan prices jumped 70 percent, because of shortened product supplies.

Prescription drug prices followed a pattern of large increases.

At the intermediate stage of processing, prices for foods and feeds were unchanged in 1989 after advancing almost 11 percent in 1988. Prices turned down after rising a year earlier for crude vegetable oils and prepared animal feeds, price increases slowed for flour and confectionery materials, and prices for refined sugar rose about 7 percent for the second consecutive year.

Prices for prepared animal feeds moved down 8.7 percent, as supplies of coarse grain inputs were about 50 percent above year-earlier levels. Lower prices for soybeans and other legume ingredients caused prices for crude vegetable oils to fall 10 percent. Corn sweetener prices rose over the year in response to short supplies of corn syrup. Higher costs for raw sugar were passed on by refiners.

The index for finished consumer foods rose 5.0 percent, slightly less than in 1988. Prices turned down after rising a year earlier for fresh and dried vegetables, processed chickens, fish, roasted coffee, and shortening and cooking oils. Prices for fresh fruits fell much more than in 1988. In contrast, egg prices rose more than 40 percent for the second consecutive year. Price increases accelerated sharply for pork, processed turkeys, and dairy products, and milled rice prices turned up after falling a year earlier. Prices also rose, but less than in 1988, for bakery products, pasta, beef and veal, processed fruits and vegetables, and confectionery end products.

The index for fresh and dried vegetables moved down in 1989, reflecting good harvests compared with 1988. However, both white and sweet potato prices advanced, chiefly because of heavy export demand. Tomato prices also increased, despite a bumper California crop, because of heavy demand from processors. Processed-chicken prices declined in response to higher production levels. The decline in the fish index was led by salmon prices. Roasted coffee prices decreased 3.5 percent, as supplies of coffee beans were plentiful in the wake of the expiration of the agreement among coffee-exporting nations. Lower soybean costs led to a modest decline in the index for shortening and cooking oils. Although the index for citrus fruits rose because of short supplies as a result of freeze damage in Florida in February, other fruits decreased in price. Apple prices were lower because of the adverse effect of the ALAR insecticide controversy and abundant supplies from a bumper crop, while decreased demand for wine grapes helped to hold grape prices down. Demand for crushing grapes soured because of high inventories of wine from the large 1988 crush.

Tight supplies as a result of reduced laying flocks led to a 40.9-percent rise in egg prices in 1989, almost as large as the 42.1-percent surge of a year earlier. After virtually no change a year earlier, pork prices rose 19.4 percent in 1989, reflecting strong domestic and export demand, coupled with decreased yearend marketings. Increased demand for turkey and new turkey products helped to raise the index for processed turkeys 7.6 percent. The index for dairy products climbed 14.3 percent, far more than 1988's rise of 4.4 percent. Dairy markets tightened because of strong cheese sales, an increase in nonfat dry milk exports, and static milk production. However, increased production of low-fat liquid milk and nonfat dry milk led to larger supplies of butter and consequently an 8-percent drop in butter prices.

Prices for breakfast cereals rose considerably in 1989 as strong demand, particularly for nutritious cereal products, led manufacturers to alter existing product lines or, more commonly,

to introduce new products in the marketplace. The increase of 5.4 percent for bakery products was broad-based. Beef and veal rose 5.9 percent, as total commercial beef production fell about 2 percent over the year.

Nondurables except foods and energy

Although intermediate material cost pressures abated in 1989, this was not reflected by and large in the prices of finished nondurable goods. Consumer demand for nondurables continued a sluggish growth pattern through most of the year; however, a generally high rate of capacity utilization facilitated price increases by some manufacturers.

The Producer Price Index for consumer nondurable goods except foods and energy advanced 5.3 percent from December 1988 to December 1989, nearly as much as the year before. Most products in this category registered increases of about the same magnitude as the year before, with a few notable exceptions. However, the index for nondurable manufacturing materials turned down 0.8 percent in 1989, after surging 11.4 percent in 1988. A further paradox was the sharp upturn in several crude nondurable materials following declines in 1988, the opposite trend of the nondurable goods category at the intermediate level.

While prices for crude petroleum rebounded in 1989 after dropping the year before, the reverse was true of two intermediate products closely related to petroleum developments: Industrial chemical prices turned down 2.1 percent after advancing 16.3 percent in 1988, and plastic resins and materials fell 12.4 percent following double-digit jumps in the two preceding years. New plant startups resulted in a 4-percent expansion in aggregate capacity for the domestic chemical industry during 1989, and weakening demand from housing, automotive, and other markets created an oversupply. Prices for ethylene, propylene, and toluene (all key petrochemical feedstocks) fell nearly 30 percent over the year, while other chemicals showed mixed movements. Among plastic resins, polyethylene resin prices fell, because of ample inventories and lower feedstock costs. Poly-propylene prices dropped in the wake of the cancellation of large orders from China, coupled with increased foreign competition.

Led by sharp advances for polyester and rayon fibers, synthetic fiber prices advanced 7.0 percent, about the same as the year before. The closure of a rayon-producing plant in Virginia for environmental reasons resulted in tight supplies. Raw cotton prices surged 15.7 percent for the year, after an 8.7-percent decline in the previous year. Whereas 1988 had been marked by slow domestic demand for cotton goods coupled with a glut on the world market, demand improved during 1989 at the same time that supplies tightened overseas, because of such factors as the political upheaval in China. Thus, American exports of cotton in late 1989 were two-thirds above year-earlier levels, and prices firmed. Prices for processed yarns, gray fabrics, and finished fabrics all continued to climb slowly but steadily. The textile mill capacity utilization rate remained around 90 percent for most of 1989; the rate for nondurable manufacturing industries in general was around 86 percent.

No outstanding trends were evident among apparel prices, as small increases predominated. Apparel imports from East Asian and Caribbean Basin nations continued to increase during 1989, providing competition that made it difficult for domestic producers to raise their prices. Men's and boys' apparel prices rose 3.4 percent, about the same as in each of the two years before. Knit underwear and hosiery prices were nearly flat, thus moderating the effect of increases in the 4- to 6-percent range for a few other items. Women's apparel prices only moved up 1.0 percent over the year in spite of a stronger market, compared with 1988, when prices rose 3.2 percent.

Signs of a slowdown in the paper industry finally appeared in 1989, as the rate of capacity utilization retreated somewhat from the 95-percent level of the year before. Paper prices edged up 0.2 percent, following an 11.5-percent jump in the previous 12-month period. Newsprint and form bond paper actually fell between 4 percent and 9 percent, partly because of increased capacity, while prices for some kinds of paper used for packaging continued to rise substantially. A decline in paper usage was attributed to reduced advertising lineage in publications and higher postage rates, which discouraged direct mail advertising. Woodpulp and paperboard price increases slowed to 9.7 percent and 2.3 percent, after two consecutive years of much sharper advances. Woodpulp prices were bolstered by continued good export demand. In spite of continued woodpulp price hikes, prices for wastepaper once again slumped in 1989. Legislation mandating recycling efforts in several States caused a glut of wastepaper, and paper manufacturers were

Crude foodstuff prices eased in the wake of a 2-year drought.

unwilling or unable to substitute the additional recycled material for virgin pulp.

Circulation rates for publications reflected the abating of paper price hikes. Newspaper prices moved up 2.0 percent over the year, after a 6.7-percent rise in 1988, while periodical price increases slowed to 5.2 percent, from 8.0 percent in the prior year. However, prices for sanitary papers and health products surged 12.7 percent, reflecting successful efforts to restore profit margins following sharp cost hikes for pulp in recent years.

Although over-the-counter medications rose somewhat less than in 1988, prices for prescription pharmaceuticals advanced 9.6 percent, continuing their persistent sharp climb of the past decade. In no year since 1979 have prices for this group risen less than 8 percent, a record that is highly unusual in the PPI. The pharmaceutical industry cites high costs for research, development, and marketing of new drugs. Tobacco product prices advanced 13.3 percent, the third consecutive year of double-digit increases. As in the drug industry, marketing costs play a greater role than do material costs; leaf tobacco prices actually edged down following moderate increases in the last 2 years.

Price increases of cars and trucks were smaller than in 1988.

Fertilizer material prices turned lower following 2 years of large increases; nitrogenates fell nearly 20 percent, and phosphates declined about 8 percent. Fertilizer use in 1989 was down, partly because planted acreage did not rise as much as expected after the 1988 drought. The 12.2-percent decrease in the inedible fats and oils index more than offset the upward movement of the previous year; lower fish and marine oil prices, reflecting a surge of imports of Menhaden fish oil from Japan late in the year, were largely responsible. Prices for soaps and synthetic detergents (partly derived from tallow and other fats) moved down 3.0 percent, the only decline among consumer nondurables other than food and energy. Although cattle hide prices climbed 26.7 percent after moving down 11 percent in 1988, this upturn had relatively little impact on leather or footwear prices, both of which continued to advance about as much as in the previous year.

Durable goods

The Producer Price Index for consumer durable goods moved up 3.2 percent from December 1988 to December 1989. This followed a 3.5-percent advance in 1988, and a 0.6-percent increase in 1987. The capital equipment index followed a similar course, accelerating from 1.3 percent in 1987 to 3.6 percent a year later and then leveling at 3.7 percent in 1989.

At the intermediate stage of processing, the index for durable manufacturing materials, which had jumped 11.6 percent in 1987 and 10.1 percent in 1988, slumped 3.4 percent in 1989, declining in 8 out of the last 9 months of the year. Similarly, at the crude stage of processing, price indexes for scrap metals and nonferrous metal ores turned down sharply after double-digit surges in both 1987 and 1988.

Durable manufacturing materials. Abrupt changes in direction for prices of nonferrous metals accounted for both the runup in the durable manufacturing materials index during 1987-88 and the subsequent downturn in 1989. Primary copper prices were especially volatile throughout the 3-year period, nearly doubling in 1987 and soaring 28.5 percent a year later, before plummeting 27.1 percent in 1989. Indexes for copper and brass mill shapes and for copper base scrap echoed this pattern, although their annual price changes were not as large as those for primary copper.

Primary aluminum prices also contributed heavily to the movements in the durable manufacturing materials index, climbing nearly a third in 1987 and about 20 percent in 1988 and then decreasing 21.5 percent in 1989. This pattern was reflected in movements for aluminum mill shapes and aluminum base scrap, except that more often than not the annual price changes for these items were even larger than those for primary aluminum. The downturn in aluminum prices came despite increased input costs for energy and alumina and despite stronger demand from beverage can manufacturers.

Price movements for primary zinc, lead, gold, and silver followed, very roughly, the pattern set by copper and aluminum prices during the 1987-89 period, although the timing of price downturns was different in each instance. Lower production levels in the automotive and appliance industries, as well as falling prices for aluminum, helped to force down zinc prices, while poor sales of storage batteries depressed lead prices; storage batteries used in automobiles account for about 80 percent of lead consumption in this country.

The Producer Price Index for steel mill products rose about 6 percent in 1987 and again in 1988 before easing to a 1.1-percent rise in 1989. Demonstrating the turnaround in

the steel market more starkly, the index for ferrous scrap jumped 42.7 and 13.5 percent in 1987 and 1988 and then fell 16.1 percent in 1989.

The widespread downturn in metal prices during 1989 largely reflected weaker demand from many of the principal metal-consuming industries, such as motor vehicles, construction, and appliances. The slump in new car sales and the resulting unplanned bulge in dealer inventories, for example, led to substantial auto production cutbacks in the final quarter and hence a sharp drop in purchases of steel, copper, and aluminum by domestic car manufacturers. Similarly, demand for metals used in residential, commercial, and other nonresidential construction was restrained by weakness in those sectors. Heavy sustained demand from military and commercial aircraft manufacturers, however, led to sharply higher prices for titanium sponge and titanium mill shapes. Demand from Japan and other East Asian nations also remained vigorous for many kinds of nonferrous scrap metal, cushioning the price drop for those items somewhat.

At the same time that demand growth was tapering off, expanded metal-producing capacity was being introduced in this country and elsewhere, much of it inspired by the substantial price increases recorded in 1987-88. In addition, some of the problems that had restricted the production or availability of metals from other nations in recent years (for example, labor unrest in South American copper mines) eased in the latter part of 1989. The result of rising capacity and falling demand was a considerable drop in capacity utilization rates in much of the metal-producing sector. The rate for the steel industry, for example, peaked at nearly 94 percent in March but fell to about 75 percent by yearend; accordingly, the steel price index climbed rapidly during the first quarter, but then eased down for most of the rest of the year.

Components for manufacturing. The manufacturing components index moved up 2.9 percent from December 1988 to December 1989, after accelerating from a 1.9-percent rise in 1987 to a 3.9-percent advance a year later. Most of the categories within this index followed a roughly parallel course during the 1987-89 period, responding to metal price movements and shifts in general industrial demand. One of the exceptionally volatile series was the index for ball and roller bearings, which rose 0.9 percent in 1987 but surged 10.9 percent in 1988 before slowing to a 4.6-percent increase in 1989.

Durable finished goods. Although prices for most kinds of consumer durables and capital equipment rose about as much in 1989 as in 1988, there were also a few notable exceptions. Prices increased more than a year earlier for aircraft, ships, transformers and power regulators, construction machinery, and metal forming machine tools, all within the capital equipment grouping, as well as for household glassware, flatware, and appliances within consumer durables. But even among these items, only flatware, glassware, and transformers rose more than 6 percent from December 1988 to December 1989. Price advances slowed in 1989 for motor vehicles, mining machinery, printing trades machinery, commercial furniture, and mobile homes, while prices of floor coverings edged down.

The extreme volatility in price movements for durable manufacturing materials during the 1987-89 period was reflected in a much more muted fashion in the behavior of the indexes for motor vehicles. The passenger car index followed a 3.5-percent decrease in 1987 with a 3.8-percent climb a year later and then decelerated to a 2.1-percent rise in 1989. Indexes for both light and heavy trucks followed the same pattern.

The price slowdown in 1989 also reflected the relatively sluggish state of consumer demand for new motor vehicles during much of the year. By midyear, domestic auto manufacturers were faced with an unusually high level of unsold inventories held by their dealers. Producers then changed their timing strategies by introducing price incentives during the summer that were tantamount to liquidation allowances, in order to clear out excess inventories from dealer lots; in previous years, such allowances were not common until the fall, immediately before new model-year cars were ready for sale. The discounts effectively brought inventory levels to normal for a while but apparently at the expense of the new-year models. Poor demand at the end of the year led to another buildup in dealer inventories, widespread production cutbacks at auto factories, and another round of price rebates to spur consumer interest.

Construction materials

The Producer Price Index for intermediate materials and components for construction moved up 2.4 percent from December 1988 to December 1989, after rising 5.6 percent in 1988 and 4.2 percent in the year before that. The 1989 deceleration was largely due to

slower increases or downturns for construction materials manufactured from metals. However, prices strengthened for wood-derived construction materials.

The level of construction expenditures changed only sluggishly in 1989, partly because several years of strong building activity had reduced the pressure of pent-up demand. Residential construction spending was hindered in some areas by problems associated with the savings and loan industry. The persistence of high mortgage interest rates also dampened the residential construction market.

Prices for nonferrous wire and cable, which had soared 23.9 and 18.3 percent in 1987 and 1988, fell 4.0 percent in 1989. Prices for fabricated structural metal products rose 3.2 percent in 1989, after an 8.1-percent climb the year before. Increases in indexes for other metal-intensive construction materials, such as plumbing fixtures and brass fittings, metal valves, and heating equipment, also slowed.

Other types of construction materials whose prices were weak in 1989 included plastic construction products, which dropped 4.7 percent after substantial advances in both 1987 and 1988, and most kinds of nonmetallic mineral products. The index for gypsum products, for example, decreased 4.3 percent, the fourth consecutive annual decline, partly reflecting the drop in single-family housing starts. Among crude materials for construction, the index for construction sand, gravel, and crushed stone nudged forward about 2 percent, just as in 1988.

In contrast to most kinds of construction materials, the plywood index advanced 10.3 percent, after inching up 0.5 percent a year earlier. Similarly, indexes for softwood lumber and for building paper and board, both of which had declined marginally in 1988, turned up in 1989, and millwork price increases accelerated. At the crude stage of processing, the index for logs and timber, which had slowed from a surge of nearly 25 percent in 1987 to a far more modest rise of 2.7 percent a year later, recorded an 18.2-percent jump in 1989, partly because of increased exports to Canada and Japan.

Most of the relative price strength for wood-derived products in 1989 was due to a variety of supply disruptions and other unusual factors. Lumbering in the Pacific Northwest, for example, was impeded for much of the year by court-ordered restrictions in conjunction with an environmental lawsuit. Demand and prices for plywood soared in the aftermath of Hurricane Hugo and the California earthquake; however, plywood prices receded considerably by year end. □