Consumer prices in the 1980's: the cooling of inflation

The deceleration in prices can be traced to the easing of monetary policy in late 1982; however, prices over the decade remained historically high

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Reducing inflation was the major economic problem facing U.S. policymakers at the start of the 1980's. With consumer prices at the highest peacetime rate on record—up 13.3 percent in 1979—the focus of economic policymakers was on "reducing inflation, while achieving satisfactory growth in employment, output and productivity."[1] Three years later, the rate of inflation had slowed considerably, with the Consumer Price Index for Urban Consumers (CPI-U) advancing only 3.8 percent during the year.

The success in reducing inflation was largely attributable to monetary policy resulting from actions of the Federal Reserve Board. In October 1979, the Federal Reserve modified its monetary policy by giving greater emphasis to holding the growth of the monetary stock within target ranges and allowing interest rates to vary widely. In essence, the Federal Reserve began to target the quantity of money rather than its price. With the supply of money curtailed, interest rates rose sharply.

The reduction in the rate of inflation from 1979 through 1983 was not costless. Two recessions (January 1980–July 1980 and July 1981–November 1982), the second a particularly severe one, resulte in double-digit unemployment rates, reduced incomes, and a decline in output. The loss of revenue resulted in a sharp increase in the Federal deficit before economic recovery began at the end of 1982.

The deceleration in consumer prices early in the decade was substantial and was largely sustained throughout the 1980's. However, when the decade is viewed in total, the 5.1-percent average annual rate of increase is second in magnitude only to the 7.4-percent rate in the 1970's, after excluding those decades encompassing World Wars I and II. In fact, the 3.7-percent average annual increase during the last 8 years of the decade, after the inflationary spiral had been broken, was substantially larger than the annual rates in the 1950's and 1960's, when the CPI rose 2.2 and 2.5 percent.

The movement in prices during the decade was neither uniform over time—it ranged from a 12.5-percent increase in 1980 to a 1.1-percent rise in 1986—nor uniform among items. Table 1 shows that, among the seven major CPI expenditure groups, medical care costs rose the most rapidly. The prices of other goods and services also advanced at a substantial rate due to increases in prices of tobacco products and tuition. Table 2 decomposes the CPI by systematically removing the volatile energy, food, and shelter components in order to identify the "underlying rate of inflation." Viewed in this way, inflation declined gradually through 1986 and edged up a notch in the last 3 years. Table 3 gives the total percent change over the decade for all the series of individual CPI components that are continuous through the decade. The

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changes range from a 161.9-percent increase (10.1-percent annual rate) in charges for hospital rooms to a decline of 27.0 percent (–3.1-percent annual rate) in television prices.

Historical setting

The early 1960's were characterized by rapid economic expansion, with prices increasing at an annual rate of only 1.3 percent for the 5-year period which ended in December 1965. Price pressures developed in the late 1960's, however, as expenditures for the Vietnam war stimulated an economy already at nearly full employment. The annual rate of inflation in consumer prices rose to more than 6 percent in 1969.

A recession which began late in 1969 and lasted until November 1970 caused the rate of price increase to subside only partially, and much of that reduction was due to the impact of declining mortgage interest rates. In reaction to the failure of inflation to fully abate, a Presidential wage and price freeze was announced on August 15, 1971. The price freeze and subsequent economic controls were accompanied by a lower rate of inflation during the final months of 1971 and throughout 1972. However, prices started on an upward spiral in late 1973, coincident with the relaxation of price controls in August and an oil embargo in October. Inflation rose to double-digit rates during 1974 and registered what was then the largest annual change in the 77-year history of the CPI, except for the inflationary periods directly associated with the two World Wars. During the recovery from the steep recession of 1973–75, inflation moderated substantially so that, by the end of 1976, consumer prices were rising at an annual rate of less than 5 percent. With the economic expansion in 1977, prices accelerated moderately. Sharp increases in energy, food, and shelter costs followed, pushing consumer prices up 13.3 percent in 1979, an unprecedented peacetime rate.

1980

The 12.5-percent increase in prices in 1980 was, like that in 1979, due primarily to increases in the food, shelter, and energy components, which accounted for more than two-thirds of the 1980 rise in the overall CPI. In 1979, these three groups, whose combined relative importance as of December 1979 was just under 60 percent, had accounted for more than 75 percent of the CPI advance. Despite the similarity in the annual increases in 1979 and 1980, there were some notable differences in the price movements during the years. The monthly increases in the CPI–U in 1979 showed little variance, ranging between 0.9 and 1.2 percent. In 1980, the largest monthly advance was 1.4 percent; the July rise of 0.1 percent followed nine consecutive monthly increases of 1.0 percent or more, and was the smallest since price controls were in effect in the early 1970's. This plunge in the monthly inflation rate was largely the result of a 5.4-percent drop in mortgage interest rates. The decline was brought about by the Federal Reserve Board's decision in the spring to ease the restrictive monetary policy it had instituted in October. The move was made to combat the recession that had begun in January 1980. While this easing of monetary policy was a temporary respite in the struggle against inflation, it brought an end to the recession in July. It would not be until the fourth quarter of 1981 that a sustained drop in the rate of inflation would be experienced.

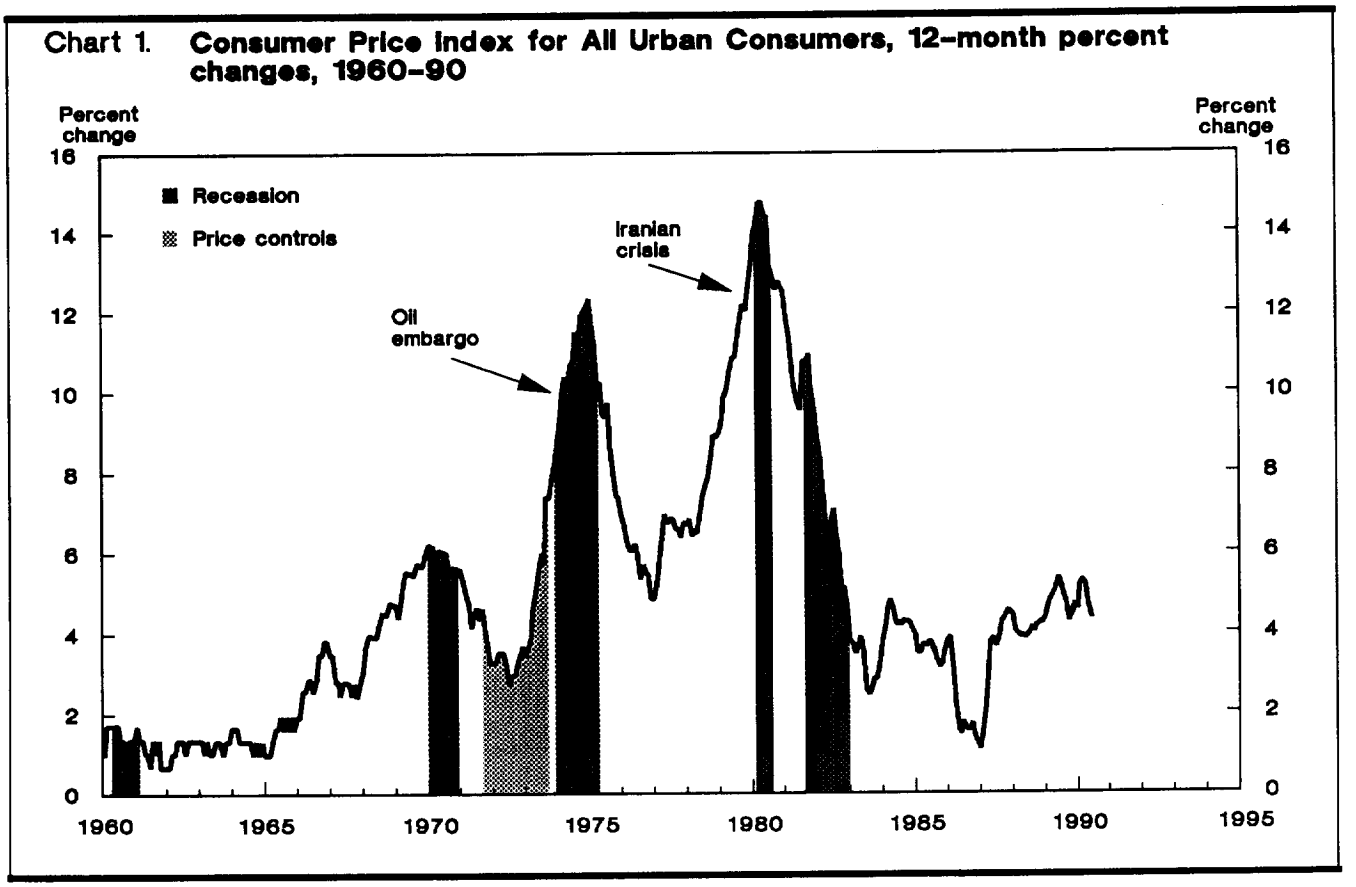
1981

The reinstitution of a tighter monetary policy by the Federal Reserve in the fall of 1980 had a dual effect on inflation. Indirectly, over time it would slow the recent economic expansion such that by July 1981 the economy would be in another recession. Directly and with little lag,

Table 1. **Percent change in Consumer Price Index for All Urban Consumers, by major group, 1979–89**

[12 months ended December]

Category	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Average annual change
All items	12.5	8.9	3.8	3.8	3.9	3.8	1.1	4.4	4.4	4.6	5.1
Food and beverages	10.1	4.3	3.2	2.7	3.8	2.8	3.7	3.5	5.1	5.5	4.4
Housing	13.7	10.2	3.6	3.5	4.3	4.3	1.7	3.7	4.0	3.9	5.2
Apparel and upkeep	6.8	3.5	1.6	2.9	2.0	2.8	.9	4.8	4.7	1.0	3.1
Transportation	14.6	10.9	1.8	3.9	3.1	2.6	–5.9	6.1	3.0	4.0	4.3
Medical care	9.9	12.5	11.0	6.4	6.1	6.8	7.7	5.8	6.9	8.5	8.1
Entertainment	9.7	7.2	5.6	4.0	4.2	3.1	3.4	4.0	4.6	5.1	5.1
Other goods and services	10.1	9.9	12.1	7.9	6.0	6.3	5.5	6.1	7.0	8.2	7.9



holding the money stock at the low end of the Board's target range raised interest rates, resulting in a higher price of borrowing for homes and automobiles which was reflected immediately in the CPI. With the exception of the 3-month period beginning July 1980, mortgage interest rates were monotonically increasing from December 1977 through January 1982, and during this 49-month period surged 74.6 percent, a 14.6-percent annual rate. Automobile finance charges, subject to dealer discounting to stimulate sales, did not show the steady progression that characterized mortgage interest rates and spurted at a 17.1-percent annual rate from December 1977 through January 1982.

The moderation in the CPI came 3 months after the July advent of the 1981 recession. In October, the housing component decelerated sharply, largely due to a decline in home purchase costs. The fourth-quarter increase was the smallest quarterly change since the first quarter in 1976, and brought the annual CPI increase below 10 percent. The moderation was most notable in the food, energy, and shelter components. Energy and shelter continued to increase at double-digit rates, but by substantially less than in the prior 3 years. Food prices slowed more drastically. Together these three groups accounted for 56 percent of the 8.9-percent advance in the 1981 CPI. Excluding food, shelter, and energy, the CPI showed virtually no deceleration in 1981.

1982

Until November 1982, the economy was mired in a recession that had begun in mid-1981. The recovery did not begin until shortly after the Federal Reserve changed the target of its policy in early October from monetary aggregates back to interest rates, allowing interest rates to continue to drop at a time when the money supply was expanding sharply. The July meeting of the Federal Open Market Committee had resulted in lower interest rates, but monetary aggregates were increasing slowly. The severe recession had held consumer price increases below even the most optimistic forecasts issued at the end of 1981.

The 3.8-percent increase in the CPI for 1982 was the smallest annual increase since a 3.4-percent rise when price controls were in effect in 1972. While the price slowdown in 1982 was broadly based, it was most apparent in those components which had been largely responsible

for the substantial increase in the previous 4 years. In particular, the decline in mortgage interest costs and the moderation in energy prices accounted for about three-fourths of the overall slowdown recorded between December 1981 and December 1982. Or viewed in another way, the food, shelter, and energy components, which had accounted for 10.2 percentage points of the 13.3-percent increase in 1979, were responsible for 1.4 points of the 3.8-percent rise in 1982.

A major change in CPI methodology occurred with the release of the January 1983 index. A flow-of-services approach to measuring the shelter costs of homeowners replaced the asset approach.[2] Because the remainder of the analysis will discuss the revamped CPI, figures from a forerunner, the CPI–U, X–1, are given for the purposes of consistency. The inherent volatility of the unrevised treatment of assets is evident from annual comparisons of the official CPI with the CPI–U, X–1 (12 months ended in December):

	CPI	*CPI–U, X–1*
1979	13.3	10.7
1980	12.5	10.7
1981	8.9	8.5
1982	3.8	5.1

While the overall picture of deceleration is not substantially altered, the peak of inflation is lower and the moderation not as sharp in the experimental (X–1) index.

1983

The 3.8-percent increase in the CPI–U for 1983 was the same as in 1982. This moderate rate of inflation accompanied a vigorous economic resurgence after a period of virtually no net growth from late 1979 through late 1982. The upturn was paced by expanded consumer spending, facilitated by increased personal income. Encouraged by this release of pent-up consumer demand, business firms stopped liquidating their inventories during 1983 and tried to rebuild them, further stimulating the economy. Residential housing construction registered its best year since 1978, even though interest rates remained at an unusually high level. Wage increases were moderate, because the severe recession had raised unemployment rates above double digits in late 1982 and through the first half of 1983. Employment security became the focus of bargaining rather than higher wages, particularly with the sustained moderation in prices.

For the year as a whole, the increases in the major components of the CPI were generally similar to those in 1982. The rate of food price increase slowed somewhat more, and energy prices actually declined, reflecting a deceleration in charges for gas and electricity, coupled with another drop in prices for petroleum-based energy items. Shelter costs showed an acceleration with the asset measure used in the official CPI in 1982. (However, a comparison using similar flow-of-services measures in both 1982 and 1983 would show further moderation in 1983.) The CPI excluding food, shelter, and energy continued to slow, but other price increases remained larger than in these three groups.

1984

The 3.9-percent CPI–U increase in 1984 continued the moderate pattern of price movement evident since the slowdown in prices began in the fourth quarter of 1981. Food prices moved

Table 2. **Percent change in Consumer Price Index for All Urban Consumers, by special index, 1979–89**

[12 months ended December]

Category	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Average annual change
All items	12.5	8.9	3.8	3.8	3.9	3.8	1.1	4.4	4.4	4.6	5.1
Energy	18.0	11.9	1.3	–.5	.2	1.8	–19.7	8.2	.5	5.1	2.2
Energy commodities	19.2	10.6	–5.0	–3.2	–1.8	3.4	–30.5	17.8	–2.3	7.9	.6
Energy services	15.9	14.7	14.1	4.1	3.5	–.6	–3.3	.2	3.2	2.8	5.3
All items less energy	11.7	8.5	4.2	4.5	4.4	4.0	3.8	4.1	4.7	4.6	5.4
Food	10.2	4.3	3.1	2.7	3.8	2.6	3.8	3.5	5.2	5.6	4.5
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	5.7
Shelter	15.0	9.9	2.4	4.7	5.2	6.0	4.6	4.8	4.5	4.9	6.2
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	5.4
Other commodities	9.3	8.0	5.5	5.0	3.1	2.2	1.4	3.5	4.0	2.7	4.4
Other services	10.6	11.1	7.3	4.9	6.0	5.4	5.6	4.3	5.6	5.5	6.6

Table 3. **Rankings of percent changes for December indexes of consumer prices, 1979–89**

Item	December 1979	December 1989	Change (percent)
Hospital room	63.2	165.5	161.9
Elementary, high school tuition	69.7	177.4	154.5
Tobacco and smoking products	68.2	171.9	152.1
Prescription drugs	68.5	172.0	151.1
College tuition	67.9	169.1	149.0
School books and supplies	68.2	164.0	140.5
Other fresh fruits	75.5	179.7	138.0
Airline fares	58.6	134.8	130.0
Automobile insurance	78.0	171.5	119.9
Cereal	70.1	152.4	117.4
Potatoes	64.8	140.0	116.0
Physicians' services	71.7	153.7	114.4
Water/sewerage maintenance	70.4	144.7	105.5
Telephone – main station service	71.4	146.0	104.5
Dental services	73.7	149.9	103.4
Used cars	59.4	119.7	101.5
Oranges including tangerines	68.8	138.5	101.3
Other intercity public transportation	69.3	139.2	100.9
Internal and respiratory over-the-counter items	70.9	141.5	99.6
Intracity public transportation	63.2	125.9	99.2
Other automobile-related fees	74.3	143.1	92.6
Fresh/frozen fish,seafood	81.2	156.3	92.5
Lodging while out of town	69.8	133.8	91.7
Magazines, periodicals, and books	71.2	133.3	87.2
Other laundry, dry cleaning apparel	73.1	134.1	83.4
Other fresh vegetables	74.0	135.6	83.2
Cookies, fresh cakes and cupcakes	75.9	139.0	83.1
Lettuce	74.3	135.8	82.8
Admissions	81.0	146.0	80.2
Automotive body work	74.5	133.9	79.7
Automobile registration, licenses and inspection fees	76.1	135.4	77.9
Alcoholic beverages – away from home	79.1	140.3	77.4
Nonprescription medical equipment supplies	75.8	134.4	77.3
Newspapers	74.5	131.6	76.6
Other bakery products	78.2	137.5	75.8
Rent of dwelling	77.3	135.5	75.3
Tenants' insurance	74.4	129.7	74.3
Auto drive train, front end repair	75.9	129.6	70.8
Frozen vegetables	73.4	124.6	69.8
Other meals and snacks	77.0	130.6	69.6
Electricity	67.2	113.4	68.8
Auto power plant repair	75.8	127.3	67.9
Other toilet goods and personal care appliances	74.9	125.4	67.4
Laundry and cleaning products including soap	76.2	127.3	67.1
Other apparel services	77.3	128.6	66.4
Snacks	76.3	126.2	65.4
Sugar and artificial sweeteners	69.9	114.8	64.2
Postage	76.2	125.1	64.2
Fresh other breads/biscuits/rolls/muffins	81.0	132.7	63.8
Lunch	79.5	130.2	63.8
Seasonings/condiments/sauces/gravies	76.5	124.9	63.3
Maintenance and repair services	74.9	122.2	63.2
Utility (piped) gas	60.0	97.8	63.0
White bread	81.9	133.2	62.6
Beauty parlor service – female	79.9	129.7	62.3
Apples	77.0	124.7	61.9
Fruit juices and frozen fruit	78.3	126.3	61.3
Miscellaneous prepared foods including baby food	79.3	127.9	61.3
Dinners	80.1	129.1	61.2
Canned, packaged soup	82.2	132.4	61.1
Haircuts, other barber service – male	80.2	129.2	61.1
Frozen prepared foods	81.6	131.3	60.9
Cosmetics, bath and nail preparation and manicure and eye	77.3	123.9	60.3
Sweets including candy	77.7	123.6	59.1
Tomatoes	88.5	140.3	58.5
Miscellaneous household products	76.6	120.9	57.8
Appliance and furniture repair	78.7	123.1	56.4
Pet expense	78.7	122.9	56.2

Table 3. **Continued—Rankings of percent changes for December indexes of consumer prices, 1979–89**

Item	December 1979	December 1989	Change (percent)
Fresh/frozen chicken parts	83.5	130.2	55.9
Automobile maintenance and servicing	78.8	122.5	55.5
Pork chops	79.6	123.7	55.4
Other processed vegetables	81.0	125.4	54.8
Floor and window coverings	77.4	119.8	54.8
Ice cream, related products	79.8	123.1	54.3
Fresh whole chicken	85.4	130.3	52.7
Photo supplies, equipment	83.5	127.2	52.3
Household paper products and stationery	80.6	122.1	51.5
Cheese	84.0	126.9	51.1
Bedroom furniture	78.9	118.8	50.6
Men's furnishings and specialty	78.2	117.4	50.1
Beer and ale at home	80.4	120.0	49.3
Other beef and veal	89.6	133.3	48.8
Bacon	71.2	105.0	47.5
Canned and dried fruits	81.3	119.6	47.1
Other noncarbonated drinks	81.8	120.2	46.9
Rice, pasta, cornmeal	82.5	120.1	45.6
Textile housefurnishings	78.3	113.9	45.5
Other pork including sausage	79.9	115.9	45.1
New cars	84.6	121.8	44.0
Alcoholic beverages at home	83.4	119.5	43.3
Women's nightwear, underwear, hosiery, accessories	81.5	116.3	42.7
Motor oil, coolant, and others	77.1	109.8	42.4
Infants', toddlers' apparel	81.2	115.3	42.0
Bananas	86.6	122.6	41.6
Toys, hobbies, and music equipment	81.3	115.1	41.6
Fats and oils	86.2	121.6	41.1
Distilled spirits at home	87.0	122.2	40.3
Men's footwear	87.5	122.0	39.4
Canned fish, seafood	85.8	119.4	39.2
Eggs	97.0	134.9	39.1
Ham	88.0	121.9	38.5
Tableware, serving pieces, nonelectrical kitchenware	80.2	111.0	38.4
Men's shirts	88.8	122.9	38.4
Sport vehicles including bicycles	82.2	113.6	38.2
Carbonated drinks	79.7	109.8	37.8
Other dairy products including butter	82.7	113.4	37.1
Other maintenance and repair commodities	81.5	111.7	37.1
Other fresh milk and cream	89.2	122.0	36.8
Automobile finance charges	74.6	102.0	36.7
Fresh whole milk	90.2	123.0	36.4
Clocks, lamps, and decorator items	82.8	112.8	36.2
Sirloin steak	91.4	123.4	35.0
Men's suits, sport coats, coats and jackets	92.7	124.7	34.5
Boys' and girls' footwear	88.2	118.5	34.4
Laundry equipment	79.9	105.9	32.5
Other poultry	91.8	121.1	31.9
Wine at home	84.7	111.6	31.8
Other meats	91.1	119.5	31.2
Other furniture	82.6	107.9	30.6
Men's dungarees, jeans, trousers	89.6	116.7	30.2
Chuck roast	95.3	123.4	29.5
Living room chairs, tables	87.2	112.5	29.0
Boys' apparel	87.2	111.4	27.8
Sofas	90.0	116.1	27.7
Other sporting goods	86.6	110.4	27.5
Refrigerator, home freezer	81.5	103.3	26.7
Round steak	95.9	118.8	23.9
Women's dresses	99.6	122.5	23.0
Lawn equipment, power tools, and other hardware	82.1	100.7	22.7
Girls' apparel	95.4	116.1	21.7
Women's footwear	90.6	107.5	18.7
Women's separates and sportswear	100.7	118.7	17.9
Round roast	98.3	113.9	15.9
Other parts and equipment	92.7	107.3	15.7
Fuel oil	76.8	88.7	15.7
Telephone intrastate toll calls	86.6	96.6	11.5

Table 3. **Continued—Rankings of percent changes for December indexes of consumer prices, 1979–89**

Item	December 1979	December 1989	Change (percent)
Tires	89.7	99.1	10.5
Ground beef excluding canned	104.0	112.2	7.9
Women's coats and jackets	102.3	108.9	6.5
Motor fuel	82.9	85.8	3.5
Women's suits	114.5	117.4	2.5
Coffee	113.3	115.7	2.1
Sound equipment	96.7	94.3	–2.5
Telephone interstate toll calls	82.1	70.0	–14.7
Television	103.8	75.8	–27.0

up somewhat in 1984, largely as a result of increases in beef and pork prices. The drought in the summer of 1983 had a major impact on prices in both 1983 and 1984. Higher feed costs induced owners to market their livestock early, which resulted in meat price reductions in 1983. The effect of accelerated slaughtering in 1983, however, led to some liquidation of stocks, lower marketings, and higher prices in 1984.

Petroleum-based energy prices continued to decline, but by less than in the preceding 2 years, and coupled with a small increase in gas and electricity, the energy index was virtually unchanged. Shelter costs also registered a moderate acceleration in 1984. The slightly larger advances in food, shelter, and energy prices in 1984 were offset by the continued slowdown in the increases for the CPI excluding food, shelter, and energy.

A variety of factors helped to hold inflation in check. The strong and increasing value of the U.S. dollar helped to keep prices of traded goods lower than they would have been otherwise. Increases in interest rates in the spring helped slow the domestic expansion. Wage restraint continued and, coupled with productivity improvements, held down unit labor costs and minimized the onset of wage-push inflation.

1985

The 1985 3.8-percent rise of the CPI marked the fourth consecutive year in which the advance was just under 4 percent. Although the annual increases were virtually identical, the composition of each was somewhat different. The energy, shelter, and food components showed sharp deceleration beginning in late 1981. Throughout the 1982–85 period, however, the moderation became more broadly based, with price increases for all other items slowing steadily. In 1985, petroleum-based energy prices turned up for the first time since 1981, reflecting in part compliance with the Environmental Protection Agency's tighter standard for lead content in leaded gasoline. Food prices moderated as beef and pork prices, which had risen substantially the year before, were virtually unchanged in 1985.

For the first time since inflation abated, the increase in the CPI excluding food, shelter, and energy slowed to the rate of the overall index. This was particularly evident in prices for "other" commodities—up only 2.2 percent for the year—and was due in part to competition from imported goods. This occurred even with the depreciation of the dollar vis-a-vis foreign currencies. The Federal Reserve, which had tightened money in mid-1984 as output grew sharply, eased money at the end of 1984 and continued to allow the money supply to expand substantially above the upper bound of its target range throughout 1985. The rate of growth in the economy remained relatively moderate throughout the year, and capacity utilization was no higher at the end of the year than at the beginning.

1986

For the 12-month period ended in December 1986, the CPI advanced 1.1 percent, the smallest annual change since a 0.7-percent rise in 1961. A sharp drop in energy prices was almost entirely responsible for the deceleration from the near constant rate of change during the prior 4 years. The Organization of Petroleum Exporting Countries' (OPEC) decision in late 1985 to formally abandon production quotas led to plunging crude oil prices and resulted in sharp declines in consumer prices for energy commodities. Retail gasoline prices plunged 30.7 percent, and fuel oil prices fell 33.3 percent. The decline in the total energy component limited the CPI increase to 1.1 percent, or by 2.2 percentage points. That is, if energy prices had been unchanged, the CPI would have risen 3.3 percent in 1986. Food prices accelerated in the

A turnaround in energy prices in 1987 was responsible for an acceleration in the overall index.

second half of the year due to a severe drought in the Southeast during the late spring. This increase was largely concentrated in the indexes for meats, poultry, fish, and eggs and fruits and vegetables. The indexes for shelter and the CPI excluding food, shelter, and energy each rose less than in 1985. The latter group showed a marked deceleration only in the commodities component. This continued divergence in price behavior between commodity and service components occurred despite the depreciation of the dollar that began in March 1985.

By the end of 1986, the expansion had entered its fifth year with no signs of resurgence in inflation. With unemployment and capacity utilization well below full employment levels, these factors offered little in the way of cost pressure on prices.

1987

For the second successive year, a sharp swing in petroleum-based energy prices dominated the movement in the CPI, which rose 4.4 percent in 1987. The turnaround in energy prices—up 18 percent in 1987, following a 30.5-percent decline in 1986—was almost entirely responsible for the acceleration in the overall index. The surge in petroleum-based energy prices was the result of the steady drawing down of the tremendous glut of crude oil produced over a period beginning in late 1985, during which production quotas were formally abandoned by OPEC. Pricing discipline was generally reestablished towards the end of 1986. Thereafter, inventories dropped lower than expected, at times putting upward pressure on motor fuel and fuel oil prices.

Excluding energy, the CPI increased 4.1 percent after advancing 3.8 percent in 1986. Food and shelter costs in 1987 increased at about the same rates as in 1986. The CPI excluding food, shelter, and energy rose slightly more than in the preceding year. Within this group, however, price movements for commodities and services differed substantially between 1986 and 1987. The "other" commodities component, in part reflecting the declining value of the dollar in international markets, accelerated in 1987. Prices for apparel, wine, and entertainment commodities rose substantially more than in 1986. Charges for "other" services, however, slowed in 1987, particularly those for medical care and transportation. While measures of labor costs were not accelerating in 1987, the 0.9-percent reduction in unemployment in the 12 months ended in December was beginning to lead to upward pressure on wages that would be evident in 1988. The sharper rate of economic growth which occurred in 1987 was also accompanied by increased capacity utilization.

1988

While the overall rates of change in the CPI were the same in 1987 and 1988, the composition was notably different. The 4.4-percent rise in 1987 was largely the result of the partial rebound in petroleum-based energy prices from the 1986 oil glut. In 1988, these prices declined slightly. A further acceleration in the growth rate during 1988 was accompanied by increased utilization of resources, both labor and plant and equipment. The Employment Cost Index, which had bottomed out in mid-1987, accelerated substantially in 1988, advancing nearly 50 percent faster in the fourth quarter of 1988 than in the corresponding period in 1987. Food prices registered their largest increase since 1980, reflecting in part the impact of the drought of 1988. The adverse weather significantly cut the yields in a number of crops. This not only affected retail food prices directly but also led to higher costs for livestock feed. The latter increased the slaughter rates for cattle and hogs, resulting in stable or declining beef and pork prices in the second half of the year. Shelter costs rose about the same as in 1987. The index for all items excluding food, shelter, and energy continued to advance from its recent low in 1986. Prices for other commodities and other services both increased more than in 1987. Within the other services group, each of the components contributed to the larger advance in 1988. Price increases for apparel and tobacco accounted for nearly 40 percent of the rise in the other commodities index.

1989

The 4.6-percent advance in the 1989 CPI was the largest since 1981. While increases in the food, energy, and shelter components were each larger than in the preceding year, the slight acceleration was principally due to sharp increases in petroleum-based energy product prices in the first half of the year. OPEC cohesion in the early part of the year, temporary supply disruptions due to the Valdez oil spill, and an interruption in North Sea oil supplies were responsible for the increases. By the end of 1989, OPEC's failure to maintain production quotas and an absence of supply shocks had eroded about half of the increase registered in the first 5 months of the year. Food prices, reflecting the residual effect of the drought in 1988 and bad weather early in 1989, also rose substantially more in the first 5 months than later in the year.

Shelter costs increased at about the same rate as in each of the 3 preceding years. The rate of increase in the CPI excluding food, shelter, and energy slowed somewhat from its 1988 rate, in part a consequence of the rising value of the dollar. Economic growth slowed from the rates in 1987 and 1988. Capacity utilization figures reflected this moderation, although unemployment rates for civilian workers remained unchanged between December 1988 and 1989. Employment costs increased at a faster rate—4.8 percent—than the CPI for the second consecutive year, principally due to rising employer costs for health care.

1990

During the first 3 months of 1990, the CPI rose at an 8.5-percent seasonally adjusted annual rate. This was the largest first-quarter advance since a 10.6-percent annual rate in 1981. The unusually cold weather in December boosted heating oil demand and disrupted refinery production, causing petroleum-based energy prices to soar in January. The December freeze also sharply reduced supplies of fresh produce, with a resulting jump in prices. Earlier introduction of higher priced spring and summer apparel in February more than offset the moderation in food and energy prices which resulted from the mild weather in early 1990.

Postscript

What are the prospects for consumer prices as we enter the 1990's, given the present economic setting? On the cost side, unemployment has been fairly stable even with a slowdown in economic activity, but the Employment Cost Index has continued to accelerate from a 3.0-percent annual rate in mid-1987 to more than 5 percent in the first quarter of 1990. As reflected by the finished goods component of the Producer Price Index, material costs registered their largest increase in 1989 since 1981. The acceleration between 1988 and 1989, however, was largely due to rising food and energy prices.

Excluding these three components, the finished consumer goods index rose 4.5 percent in 1989, following a 4.8-percent rise in 1988. The acceleration in the first quarter of 1990—at a 6.7-percent annual rate—was also due to sharp increases in food and energy prices, as prices of finished consumer goods less food and energy increased at a 3.3-percent annual rate. The slow growth in output in the early 1990's should help to keep inflation in check, but the large deficit in the Federal budget will continue to curtail aggregate demand. The Federal Reserve, of course, bears a substantial part of the responsibility for managing aggregate demand. While it is on record as targeting zero inflation within 5 years, given the slow growth in the economy, it is unlikely to tighten monetary policy in the near term and thus stimulate demand. Barring supply shocks like an energy crisis, the overall CPI increases at the start of the 1990's are unlikely to deviate much from those at the end of the past decade. □

Footnotes

[1] *Economic Report of President*, January 1981, p. 31.

[2] "Changing the Homeownership Component of the Consumer Price Index to Rental Equivalence," *CPI Detailed Report*, January 1983, pp. 7–11. An experimental index, the CPI-U, X-1, was the predecessor to the revamped CPI and is available for the period from 1967 through 1982.