Producer price rises slowed in improving economy in 1993

A moderate economic recovery, industry cost-cutting to boost productivity, and weak overseas demand contributed to relatively small price increases for producers

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Prices received by domestic producers of finished goods moved up 0.2 percent in 1993, following a 1.6-percent advance in 1992 and a dip of 0.1 percent in 1991. The increase in the index for finished goods other than foods and energy, which includes consumer goods such as passenger cars and apparel as well as capital equipment such as trucks and machine tools, continued to slow in 1993. After gains of 2.0 percent in 1992 and 3.1 percent in 1991, this measure rose only 0.4 percent in 1993. In addition, the energy goods index, chiefly gasoline, home heating oil, and residential gas and electricity, decreased 3.8 percent, far more than its slight decline in the previous year, but not as much as its slump of 9.6 percent following Operation Desert Storm in 1991. Prices for foods such as meats, bread, and fresh produce, however, increased 2.4 percent in 1993, after a smaller climb in 1992 and a drop in 1991. (See table 1.)

The Intermediate Goods Price Index, which measures the movement of prices for goods such as flour, steel, lumber, industrial chemicals, diesel fuel, and paper boxes, advanced 1.0 percent in 1993, the same as during the previous year. The Crude Goods Price Index, which measures price movements for items such as wheat, scrap metals, logs, crude petroleum, and cotton, moved down 0.5 percent following an increase of 3.3 percent in 1992. In 1993, prices for food-related materials were up but energy items were down in the intermediate and crude stages. Prices for intermediate goods other than foods and energy rose 1.6 percent over the year, somewhat more than in 1992, while basic industrial material prices climbed 11.6 percent, about twice as much as in 1992.

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Economic background

The generally moderate rate of recovery from the last recession, the impetus of private industry cost-cutting that enhanced productivity, and weak foreign demand were among the factors contributing to the continuation of relatively low rates of price increases for most products in 1993.

After surging strongly at the close of 1992, the economy slowed considerably through much of 1993 before strengthening again toward the end of the year. By December, the Federal Reserve Board's capacity utilization index for mining, manufacturing, and utilities was up to 82.9 percent, a level not seen since mid-1989. Consumer demand for cars, light trucks, and some household durables was stronger than in recent years; however, demand for many other kinds of consumer goods was sluggish until employment and income gains in the fourth quarter boosted consumer confidence and retail sales. For the year as a whole, real income was up nearly 3 percent. The residential housing market was weak through the first half of the year, but improved later in the year, partly reflecting the impact of a sharp drop in mortgage interest rates. The general decline in interest rates during the year helped put more disposable income into con-

sumers' pockets, particularly by making possible new waves of refinancing that often dramatically cut required monthly mortgage payments.

Spending for capital equipment rose nearly 12 percent in 1993; to boost productivity, industry, as in other recent years, often concentrated capital expenditures in upgraded computer systems. Many firms, unable to impose lasting price hikes, continued to emphasize cuts in labor costs that often brought about significant reductions in their work force.

Manufacturing productivity advanced 5.3 percent in 1993, compared with 4.3 percent in the previous year, while unit labor costs in manufacturing dropped 2.4 percent, the first downturn since 1987. The Employment Cost Index for total compensation for workers in private industry was up 3.6 percent from December 1992 to December 1993, virtually the same as in 1992. Business spending on inventories remained tightly constrained, partly reflecting the spread of the "just-in-time" philosophy to minimize corporate funds locked up in inventory.

Efforts to reduce Federal spending, particularly in the defense budget, restrained the general recovery. The commercial construction market remained sluggish in most parts of the country because of the surplus of office space resulting from overbuilding in the 1980's. But public construction spending on infrastructure and other projects advanced over 1992 levels.

Although foreign demand for U.S.-made goods was somewhat constrained by the relatively weak economies of many major U.S. trading partners, such as Japan and Germany, exports to Great Britain, Canada, and some developing countries increased. Imports remained heavy for some products; however, market shares for cars and some other goods made in Japan were eroded by currency fluctuations and the continued trend by foreign producers to build manufacturing plants in this country.

Finished goods other than foods, energy

The index for finished goods other than foods and energy edged up 0.4 percent in 1993, following a rise of 2.0 percent a year earlier. This slowdown was overwhelmingly due to a dramatic cut in cigarette prices in mid-1993.

Prices for consumer goods fell 0.6 percent for the year, following a 2.1-percent increase in 1992. The index for capital equipment, however, rose slightly more (1.9 percent) than it had a year before (1.7 percent).

Tobacco products. The tobacco products index experienced a net decrease of 22.4 percent from December 1992 to December 1993. This index had increased approximately 13 percent annually for 5 consecutive years through 1991 before slowing to a 6.7-percent pace in 1992. The index accelerated again during the first 5 months of 1993, before dropping substantially in June, resulting in a seasonally adjusted annual rate of increase of less than 2 percent for the first half of the year. Prices for tobacco products then slumped about 25 percent in just 1 month, from July to August.

Apparel. In 1993, prices were generally weak for apparel, reflecting sluggish consumer demand and falling prices for some synthetic materials in the wake of lower crude oil costs. The index for women's apparel eased down 0.7 percent, after moving up 1.2 percent in 1992; similarly, the girls' and children's apparel index turned down 0.4 percent following a 2-percent increase in 1992. Prices for men's and boys' apparel rose 0.6 percent, compared with 2.5 percent a year earlier. Footwear prices were up 1.3 percent in

Table 1. **Annual percent change for major categories of goods in the Producer Price Index, by stage of processing, 1989–93**

Index	1989	1990	1991	1992	1993
Finished goods	4.9	5.7	–0.1	1.6	0.2
Foods	5.2	2.6	–1.5	1.6	2.4
Energy	9.5	30.7	–9.6	–.3	–3.8
Other	4.2	3.5	3.1	2.0	.4
Tobacco products	13.5	12.6	13.2	6.7	–22.4
Passenger cars	2.1	4.3	3.1	.6	3.3
Intermediate materials, supplies, and components	2.3	4.3	–2.6	1.0	1.0
Foods and feeds	0	–1.3	–.2	–.5	5.7
Energy	10.6	21.8	–11.6	.7	–4.8
Other	.9	1.9	–.8	1.2	1.6
Crude materials for further processing	7.1	6.0	–11.6	3.3	–.5
Foodstuffs and feedstuffs	2.8	–4.2	–5.8	3.0	6.6
Energy	17.9	19.1	–16.6	2.3	–13.7
Other	–3.6	.6	–7.6	5.7	11.6

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

1993, less than half the rise in 1992. The resurgence of consumer demand that was so marked for motor vehicles and household durable goods in 1993 was not as apparent in markets for apparel and several other consumer nondurable items.

Pharmaceuticals. Prices for pharmaceutical preparations moved up only about half as much as during the previous year. From December 1992 to December 1993, the prescription drugs category advanced 3.1 percent, well below its 1992 rise of 6.4 percent. The over-the-counter drugs grouping cut its increase nearly in half, from 5.2 percent in 1992 to 2.7 percent in 1993. Increasing pressure from institutional buyers on the major pharmaceutical firms to hold down drug price advances was effective for the second consecutive year after many years of sizable price boosts. The significant public scrutiny on pricing behavior of pharmaceutical companies in connection with the debates over possible changes in health care financing also served to encourage price moderation.

Motor vehicles. The index for motor vehicles advanced 3.7 percent in 1993, more than its 2.0-percent rise a year before and the same as its 1991 increase. Indexes for passenger cars and heavy trucks climbed 3.3 and 5.2 percent, more than 2 percentage points above the increases recorded for those categories in the previous year. Prices for light trucks, however, rose somewhat less in 1993—4.2 percent—than in 1992—4.8 percent. The tires and tubes index fell 1.7 percent after rising by about the same amount a year before.

The resurgence in demand for passenger cars and the continued swing of consumer preferences toward light trucks were among the primary causes of the general economic expansion in 1993, particularly in the second half. Sales of domestically produced automobiles were up 7.3 percent from 1992 levels. Light trucks captured nearly 43 percent of the light-vehicle market in 1993, compared with 40 percent the previous year. Much of the increased automobile sales represented pent-up demand: due to sluggish new car sales for several years, the average age of cars on the road was about 8 years, much older than normal.

Energy

Although prices for energy goods turned down at all stages of processing in 1993, the decline in prices at the crude level was the most dramatic, with a drop of 13.7 percent; this followed a 2.3-percent rise in 1992. The index for intermediate energy goods decreased 4.8 percent, following a rise of 0.7 percent in the previous year. Prices for finished energy goods moved 3.8 percent lower, after edging down 0.3 percent in 1992.

Among crude energy items, crude petroleum prices dropped 27.3 percent in 1993 after falling 2.4 percent in the previous year and 30.5 percent in 1991. The Organization of Petroleum Exporting Countries (OPEC) was again unable to stem the plunge in petroleum prices in 1993. OPEC was unable to rein in members' excess production and maintain pricing discipline, while some nonmember nations also expanded output and world demand remained sluggish. As a result, the spot market price for North Sea crude, a benchmark for the cost of foreign crude oil to American refiners, fell to a 5-year low of about $13.50 a barrel by the end of 1993. Domestic production of crude oil has accounted for a smaller proportion of domestic consumption over the past 10 years in the face of the longstanding price weakness, falling from 72 percent of the domestic crude oil market in 1983 to a 51-percent share in 1993.

Foods

Prices received by domestic producers of finished consumer foods climbed 2.4 percent from December 1992 to December 1993, somewhat more than their 1992 advance of 1.6 percent. The index for intermediate foods and feeds rose 5.7 percent over the year, following dips of less than 1 percent in 1991 and 1992. The crude foodstuffs and feedstuffs index moved up 6.6 percent, more than twice as much as during the previous year.

Among finished consumer foods, prices increased in 1993 for dairy products, fresh fruits, processed fruits and vegetables, roasted coffee, confectionery end products, pork, and milled rice after declining in the previous year. In addition, the index for shortening and cooking oil rose more than in 1992. By contrast, prices turned down after 1992 increases for beef and veal, fish, and soft drinks, and indexes for fresh and dry vegetables and for bakery products moved up less than they had in the year before.

Weather problems in 1993 had a major impact on the upward price movements of many food-related products. Persistent and widespread flooding in the upper midwest during the summer sharply curtailed production of feedstuffs, vegetables, and other crops, and disrupted barge, rail, and truck transportation networks. However, some meat prices dropped as livestock owners lowered their stocks when higher feed prices made their operations unprofitable. Production of fruits and vegetables in some parts of the country was severely affected by occasional outbreaks of unseasonably cold and wet weather.

Industrial materials

The PPI for intermediate materials other than foods and energy advanced 1.6 percent in 1993 after rising 1.2 percent from December 1991 to December 1992. The indexes for construction materials, durable manufacturing materials, and supplies rose more than in 1992. In contrast, prices for materials for nondurable manufacturing fell after rising slightly in the previous year, while the index for components for manufacturing rose 0.7 percent, about as much as the 0.8-percent increase in 1992.

Basic industrial materials. From December 1992 to December 1993, the Producer Price Index for crude nonfood materials other than energy climbed 11.6 percent, more than twice as much as the 5.7-percent advance in 1992. This index, usually considered an indicator of the future strength of the general economy, climbed at a 16.5-percent seasonally adjusted annual rate during the first half of 1993, but slowed to a 6.9-percent rate during the second half. This repeated the 1992 pattern that proved to be a precursor of a weaker economy in early 1993. But unlike the second half of 1992, when prices moved up modestly in the third and fourth quarters, basic industrial material prices turned down during the third quarter of 1993 before rebounding sharply in the fourth.

The index for ferrous scrap, which surged substantially higher after showing virtually no change in 1992, dominated the acceleration in the basic industrial materials index in 1993. The logs and timber index advanced sharply last year, following an increase about as large in 1992. Construction sand and gravel prices rose somewhat more than in the preceding year, and raw cotton and gold ore prices turned up substantially after decreasing in 1992. By contrast, nonferrous scrap and wastepaper prices turned down sharply, and prices for copper ores fell much more than in the previous year. The cattle hides index moved up far less than in 1992.

Selected industries

The Producer Price Index for the net output of the domestic manufacturing sector increased 0.8 percent during 1993, half as much as its 1.6-percent increase in 1992. The most dramatic difference between the two years was in tobacco manufactures: the index slumped 22.8 percent, following a 7.5-percent advance in 1992. In addition, the petroleum refining index dropped 12.8 percent, far greater than its 1.4-percent decrease in 1992. In contrast, the lumber and wood products index climbed 13.7 percent, compared with about 11 percent in the previous year. Indexes for other major manufacturing industry groups did not change by more than 3 percent in either direction during the year.

After increasing 1.8 percent in calendar 1992, the index for the net output of total mining industries decreased 9.4 percent in 1993. The downturn was paced by the oil and gas extraction industry group index, which dropped 12.8 percent, following a rise of 3.0 percent in the previous year. In addition, the metal mining industries group index moved down 7.2 percent, considerably more than in 1992.

The index for air passenger transportation climbed 13.1 percent from December 1992 to December 1993. This was a substantial contrast with the decline of 4.9 percent in 1992 during a series of major airfare wars. Discounting in 1993 was much more limited in size and duration than in the previous year. Despite stronger demand, the increase in air cargo transportation decelerated from 4.1 percent in 1992 to 2.3 percent in 1993.

The passenger car rentals index turned down following a sizable climb in 1992. The index moved down 4.8 percent from December 1992 to December 1993; a year earlier, this index surged upward by 18.3 percent.

The index for domestic deep sea freight transportation moved sharply lower after edging up in the previous year; and because of widespread flooding in 1993, the index for Mississippi River freight transportation fell much more than in the previous year.

Two new industry indexes moved in opposite directions. The hospitals index moved up in the year following its introduction in December 1992, but the index for cable and other pay television services declined between its initiation in June 1993 and the end of the year. The hospitals index rose 4.3 percent in 1993. The index for medicaid inpatient treatments at general hospitals moved up 4 percent over the year, somewhat more than the 2.3-percent rise registered for medicare patients but not as much as the 5.4-percent advance for patients outside either medicaid or medicare. The 1993 increase in the PPI for nonmedicaid or nonmedicare inpatients at general hospitals was considerably less than the 7.6-percent rise in its rough equivalent, the CPI-U for hospitals and related services. Rates for psychiatric hospitals were up 6.7 percent for the year, nearly twice as much as the increase for other types of specialty hospitals. □