

Consumer prices rose less in 2006 than in 2005

Lower natural-gas prices and a smaller increase in gasoline prices contributed to a lower rise in the all-items index

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The Consumer Price Index for All Urban Consumers (CPI-U), U.S. City Average, for All Items, increased 2.5 percent in 2006, compared with 3.4 percent during 2005.¹ A smaller rise in the energy index was responsible for the lesser increase in consumer prices last year. Shelter inflation was significantly higher, food inflation slightly lower. Table 1 lists those components of the CPI which had a large effect on the index for all items during 2006.

The CPI-U excluding food and energy increased more in 2006 than in 2005: 2.6 percent compared with 2.2 percent. The increase in this index was the highest in 5 years, reflecting higher shelter inflation. (Shelter costs represent about 42 percent of the index for all items less food and energy and 33 percent of the index for all items.) Increases in residential rents were higher in 2006 than in the previous year, mirroring a reduction in the number of residential rental vacancies. As a result, the indexes for owners' equivalent rent of primary residence and for rent of primary residence accelerated in 2006. Prices for commodities less food and energy have remained nearly unchanged over the past 3 years. Rising a total of 0.6 percent over the 3-year period, they were down 0.1 percent last year. In general, commodities are subject to greater global competition than are services, and in fact, the category of commodities less food and energy has registered smaller price increases than services less energy every year since 1984. Reflect-

ing primarily the acceleration in shelter costs, services less energy prices rose 3.7 percent in 2006, higher than during 2005, when they increased 2.9 percent. (See table 2.)

Other price measures

Like the CPI-U for commodities, the Producer Price Index (PPI) for finished goods rose less in 2006 (1.1 percent) than in 2005 (5.4 percent). Although the CPI-U for commodities less food and energy remained nearly unchanged in 2006, the PPI for finished goods excluding food and energy increased slightly, by 2.0 percent, compared with 1.7 percent in 2005. The PPI for intermediate materials less foods and energy increased 4.7 percent last year, and the PPI for crude nonfood materials less energy increased 16.7 percent. Prices for nonferrous metal ores, copper, and aluminum soared. Demand for metals continued to grow in developing countries.

The PPI does not include changes in import prices. As measured by the Import Price Index excluding petroleum, imported commodity prices advanced 1.7 percent in 2006, following a 2.4-percent advance in 2005.

Energy and food prices

Energy. Energy inflation slowed dramatically in 2006 and was most responsible for the lower increase in the all-items index. A double-digit decrease in utility (piped) natural-gas prices was the main factor behind this de-

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Table 1. CPI components having a large effect on all items during 2006

Expenditure categories	12-month percent change ending December 2005	12-month percent change ending December 2006
With lower inflation in 2006:		
Natural gas.....	30.2	-14.2
Gasoline	16.1	6.4
Used cars and trucks	1.4	-2.2
New vehicles.....	-4	-9
With higher inflation in 2006:		
Owners' equivalent rent of primary residence	2.5	4.3
Apparel.....	-1.1	.9
Rent of primary residence	3.1	4.3

celeration. A significant slowdown in motor fuel inflation was a key element as well. Lower world crude-oil inflation was the principal factor behind the slowdown in gasoline inflation last year. A double-digit increase in the energy index during the first 7 months of the year, reflecting higher motor fuel and electricity prices, followed the lead of world crude-oil prices, which peaked at \$69 per barrel in July. During the remainder of the year, oil prices turned downward, leading to lower prices for motor fuel and electricity. World crude-oil prices reached their lowest level of the year in November, \$54 per barrel. The price of oil advanced from \$53 per barrel in December 2005 to \$56 per barrel in December 2006.²

Energy prices increased 2.9 percent last year, after rising 17.1 percent in 2005. The energy index, which represents about 9 percent of the index for all items, comprises two fairly equally weighted components: motor fuel and household fuels. Prices for energy commodities, which include mainly gasoline and home heating (fuel) oil, increased considerably less in 2006 than in 2005: 6.1 percent, compared with 16.7 percent. Prices for energy services (delivery of natural gas and electricity) were nearly unchanged last year, with decreasing natural-gas prices offsetting increasing electricity prices.

During 2005 in the Gulf of Mexico region, Hurricane Katrina and, to a lesser extent, Hurricane Rita temporarily, but dramatically, reduced supplies of crude oil, oil products, and natural gas, causing the prices of these commodities to soar that year. In 2006, energy production capacities were restored and supplies recovered. As a result,

natural-gas prices declined sharply and inflation for crude oil and its products, including gasoline and fuel oil, slowed considerably. Oil inventories remained high in 2006 because there were no supply disruptions from hurricanes in the Gulf of Mexico that year.³ Another factor that contributed to lower energy inflation last year was that warmer-than-usual winter weather reduced the need for heating.

During 2006, as natural-gas production capacity was restored and as supplies recovered following the previous years' hurricanes, natural-gas prices decreased 14.2 percent, after increasing 30.2 percent in 2005. Warmer-than-normal weather at the beginning and end of 2006 led residential consumption of natural gas to decline by 8.5 percent last year, according to the U.S. Department of Energy. Total U.S. production of dry (not liquefied) natural gas increased 2.2 percent in 2006.⁴

The electricity index increased 7.5 percent last year, compared with 10.7 percent in 2005. The increases in 2005 and 2006 were the largest in this index since 1981. Low natural-gas prices, as opposed to fuel oil prices, led electric power companies to change from burning fuel oil to using natural gas.⁵ Although coal is the Nation's dominant fuel for creating electric power, natural gas is the fastest-growing fuel.

Gasoline prices increased 6.4 percent in 2006 after rising 16.1 percent in 2005. In December 2005, the average price per gallon of regular unleaded gasoline was \$2.19. By December 2006, the price had risen to \$2.33. Household fuel oil prices rose 2.3 percent last year, after increasing 27.2 percent in 2005.

Food. Food inflation in 2006 was 2.1 percent, nearly unchanged from the 2.3 percent registered during 2005. Decelerations in the indexes for beef and veal, dairy, and poultry were partially offset by accelerations in the indexes for fresh fruits, fresh vegetables, and pork. The index for food at home (grocery store food) grew 1.4 percent last year, down from a 1.7-percent advance the previous year. Grocery store food inflation has been declining for each of the past 3 years, on a December-to-December basis. The index for food away from home (restaurant food) rose 3.2 percent in 2006, the same as in 2005.

Beef and veal prices were nearly unchanged last year, up 0.5 percent, after rising 2.2 percent in 2005. Commercial cow slaughters rose nearly 12 percent in 2006, owing largely to drought in the west leading to poor winter and fall grazing conditions and rapidly declining hay stocks that were relatively low to begin with. Feeder cattle were placed in feedlots at lighter weights and higher numbers than usual. Soaring corn prices due in part to in-

Table 2. Annual percent change in the Consumer Price Index for All Urban Consumers (CPI-U), selected expenditure categories, 1997–2006

Expenditure category	Relative importance, December 2006	Percent change for 12 months ended December—									
		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
All Items	100.000	1.7	1.6	2.7	3.4	1.6	2.4	1.9	3.3	3.4	2.5
Food	13.885	1.5	2.3	1.9	2.8	2.8	1.5	3.6	2.7	2.3	2.1
Energy	8.715	-3.4	-8.8	13.4	14.2	-13.0	10.7	6.9	16.6	17.1	2.9
Household fuels.....	4.368	-1.1	-3.8	2.4	14.5	-3.4	1.0	7.1	8.4	18.0	-3
Motor fuel	4.347	-6.2	-15.4	30.2	13.9	-24.8	24.6	6.8	26.1	16.2	6.4
All items less food and energy	77.401	2.2	2.4	1.9	2.6	2.7	1.9	1.1	2.2	2.2	2.6
Commodities less food and energy	21.735	.4	1.3	.2	.6	-.3	-1.5	-2.5	.6	.2	-.1
All items less energy .	91.285	2.1	2.4	2.0	2.6	2.8	1.8	1.5	2.2	2.2	2.5
Services less energy services	55.666	3.0	3.0	2.7	3.4	4.0	3.4	2.6	2.8	2.9	3.7
Commodities	40.305	.2	.4	2.7	2.7	-1.4	1.2	.5	3.6	2.7	1.3
Durables	11.122	-1.5	-5	-1.2	.0	-1.3	-3.3	-4.3	.4	-5	-1.4
Furniture and bedding .....	.981	-.7	1.4	-1.3	.4	-3.1	-1.1	-1.6	-.2	.6	-.7
Televisions .....	.124	-4.3	-4.8	-7.3	-10.7	-10.8	-10.6	-14.3	-12.3	-14.4	-22.6
New vehicles.....	4.982	-.9	.0	-.3	.0	-.1	-2.0	-1.8	.6	-.4	-.9
Used cars and trucks	1.716	-4.9	3.5	1.2	3.4	-1.9	-5.5	-11.8	4.8	1.4	-2.2
Personal computers and peripheral equipment.....	.203	-	-35.8	-26.5	-22.7	-30.7	-22.1	-17.8	-14.2	-15.8	-12.0
Nondurables	29.183	.8	.7	4.1	3.6	-1.4	3.1	2.4	4.8	3.9	2.4
Energy commodities.....	4.685	-6.9	-15.1	29.5	15.7	-24.5	23.7	6.9	26.7	16.7	6.1
Gasoline	4.303	-6.1	-15.4	30.1	13.9	-24.9	24.8	6.8	26.1	16.1	6.4
Fuel oil .....	.231	-11.7	-15.2	30.9	40.5	-26.7	14.7	7.8	39.5	27.2	2.3
Apparel.....	3.726	1.0	-.7	-.5	-1.8	-3.2	-1.8	-2.1	-.2	-1.1	.9
Medical care commodities.....	1.446	2.3	4.1	4.0	2.8	4.4	3.1	2.1	2.2	3.7	1.8
Prescription drugs and medical supplies	1.018	2.5	4.9	6.1	3.6	6.0	4.5	2.5	3.5	4.4	1.9
Services.....	59.695	2.8	2.6	2.6	3.9	3.7	3.2	2.8	3.1	3.8	3.4
Shelter.....	32.776	3.4	3.3	2.5	3.4	4.2	3.1	2.2	2.7	2.6	4.2
Owners' equivalent rent of primary residence.....	23.830	3.1	3.2	2.4	3.4	4.5	3.3	2.0	2.3	2.5	4.3
Rent of primary residence	5.930	3.1	3.4	3.1	4.0	4.7	3.1	2.7	2.9	3.1	4.3
Hotels and motels ..	2.493	6.2	3.7	1.7	2.7	-.8	.0	3.1	5.0	3.3	3.9
Natural gas	1.280	3.3	-3.5	2.1	36.7	-15.1	6.7	17.4	16.4	30.2	-14.2
Electricity	2.750	-1.3	-3.2	.7	2.6	6.1	-1.9	2.6	2.1	10.7	7.5
Medical care services.....	4.834	2.9	3.2	3.6	4.6	4.8	5.6	4.2	4.9	4.5	4.1
Airline fares .....	.649	-4.8	4.1	10.9	5.9	-3.9	-2.4	-.1	-1.5	6.4	-1.0
Telephone services.....	2.225	-	.3	.4	-2.3	1.3	.2	-2.7	-2.5	.4	1.7
Motor vehicle insurance	2.261	2.4	-.3	.5	1.8	7.3	9.0	4.5	3.4	1.0	.8
Medical care	6.281	2.8	3.4	3.7	4.2	4.7	5.0	3.7	4.2	4.3	3.6

NOTE: Data are not seasonally adjusted. Dash indicates data not available.

creased ethanol production led to an increase in feeder steer slaughters.⁶

Prices for dairy products decreased 1.2 percent last year, after increasing 1.7 percent in 2005. Milk prices declined 2.5 percent in 2006, following a 3.5-percent rise the previous year. Milk production rose in 2006, the result of a rise in the milk-cow population and an increase in milk output per cow.⁷ Over the past several years, farm expansions and relatively few farm exits have led to rising numbers of milk cows.⁸ The prices of cheese and related products decreased 1.9 percent last year, after increasing 0.5 percent in 2005.

The poultry index declined 0.7 percent in 2006, following a rise of 0.3 percent the previous year. Chicken prices fell 0.9 percent last year, after decreasing 0.3 percent in 2005. Broiler production rose in 2006, due to both a rise in the number of birds slaughtered and an increase in the average live weight per bird.⁹

Fresh-fruit prices advanced 4.3 percent in 2006, following a 1.3-percent increase in 2005. Apple prices rose 10.0 percent last year, compared with 4.2 percent in 2005. Higher apple prices accompanied a smaller crop in addition to stronger-than-usual demand. The index for oranges, including tangerines, rose 11.8 percent in 2006, after rising 5.7 percent the previous year. In the spring of 2006, a frost in California reduced the orange harvest. A heat spell that followed during the summer then led to relatively small-sized oranges. Nearly three-quarters of California oranges are navel oranges and account for the majority of fresh oranges sold in the United States during winter months.¹⁰

Prices of fresh vegetables decreased 0.8 percent last year, compared with a 2.3-percent drop in 2005. Higher potato and lettuce prices were offset by lower prices for tomatoes and other fresh vegetables.

Pork prices have hardly changed over the past 2 years. The pork index increased 0.7 percent in 2006, after decreasing 0.1 percent in 2005. During the past 2 years, pork exports have increased significantly, yet pork prices have remained about flat, due to rising pork production, an increase in the number of pigs per litter, a growing number of hog imports from Canada, and declining domestic per capita pork consumption.¹¹

Items other than food and energy

Shelter. Shelter inflation accelerated last year, with the shelter index rising 4.2 percent, compared with a 2.6-percent increase in 2005. Owners' equivalent rent of primary residence, rent of primary residence, and hotels and motels each accelerated in 2006.

The index for rent of primary residence increased 4.3 percent last year, after rising 3.1 percent in 2005. In 2006, higher mortgage interest rates and rising home prices together made buying a home less affordable. These factors stopped the shift from renting to buying, reduced rental vacancies, and allowed landlords to raise rents at a faster pace than during 2005.

According to the Federal Reserve Board of Governors, in mid-2005 demand for new and existing homes began to slow. During the first half of 2006, declining demand for homes accelerated. By mid-2006, new- and existing-home sales declined dramatically to a level roughly 15 percent less than that of the previous year.¹²

In July of last year, the average 30-year conventional fixed mortgage interest rate rose to 6.41 percent, its highest level in 4 years, before declining steadily throughout the remaining months. In June 2003, this interest rate had registered a 40-year low of 5.82 percent.¹³

The index for owners' equivalent rent advanced 4.3 percent in 2006, up from a 2.5-percent rise in 2005. This index represents approximately 73 percent of the shelter index and approximately 24 percent of the index for all items.

Charges for hotels and motels rose 3.9 percent in 2006, after rising 3.3 percent the previous year.

New and used motor vehicles. In 2006, both new- and used-vehicle prices declined. The index for new vehicles decreased more in 2006—0.9 percent—than it decreased in 2005, when it fell 0.4 percent. The index for used cars and trucks decreased 2.2 percent last year, after rising 1.4 percent in 2005.

New-car prices rose 0.2 percent in 2006, while new-truck prices decreased 2.0 percent. During 2005 and the first half of 2006, sharply rising gasoline prices led to a reduction in consumer demand for new light trucks, including sport utility vehicles. Simultaneously, demand for smaller, more fuel-efficient vehicles, such as hybrids, increased.

Fewer new light vehicles (cars, sport utility vehicles, and pickup trucks) were sold last year (16.5 million), compared with an average of nearly 17 million per year sold in the previous 2-year period.¹⁴ Truck prices have been decreasing steadily since 1999 and are now at 1994 levels. In addition to high motor fuel prices, factors that held down new-vehicle prices included intense competition among automakers, higher interest rates, and higher inventories of new vehicles.¹⁵

Medical care. The medical care index increased 3.6 percent last year, the smallest increase since 1998, after rising 4.3 percent in 2005. Lower inflation for prescription drugs and medical supplies and for profes-

sional medical services was partially offset by higher inflation for hospital and related services.

Medical care commodities prices rose 1.8 percent last year, the smallest increase in this index since 1995. In 2005, prices for medical care commodities rose 3.7 percent. Prices for prescription drugs and medical supplies rose much less in 2006 (1.9 percent) than during the previous year (4.4 percent). Indeed, the 2006 increase was the smallest calendar-year rise in that index since 1973. In January 2006, Medicare introduced a prescription drug benefit “Part D,” which contributed to a slower rate of price growth in the index for prescription drugs. The prices that Medicare Part D beneficiaries pay for these drugs are typically less than those paid by other health insurance providers and by the uninsured.

The Bureau of Labor Statistics handled the introduction of this new Federal drug benefit plan by recording any price changes between estimated Medicare-approved discount card prices in the final collection periods of 2005 and the full Part D benefit prices recorded in January and February of 2006. The implementation of the Medicare Part D program did not affect the CPI prescription-drug index after the release of the February 2006 data.

Another factor behind the lower rise in the index for prescription drugs occurred during the fourth quarter, when many pharmacies offered certain generic medications at dramatically reduced prices. As a result, for the 3-month period ended December 2006, the unadjusted index for prescription drugs decreased 1.7 percent. Finally, a number of popular, name-brand drugs, including medications for high cholesterol, depression, and blood thinning, lost their patent protection during the summer of

2006. The ensuing substitution by consumers from higher priced name-brand medications to the new lower priced generic equivalents was felt acutely in the last quarter of 2006, when the CPI reflected such substitutions.

The medical care services index rose 4.1 percent in 2006, down from a 4.5-percent increase the previous year, reflecting a deceleration in the indexes for physicians’ services, dental services, and eyeglasses and eye care. Following a 3.1-percent rise in 2005, fees for physicians’ services increased 1.7 percent last year, the smallest annual advance in this index since 1949. Physicians implemented very few fee changes in 2006. Among those fees which did change, dental service fees increased 5.0 percent, after rising 5.7 percent the previous year, and charges for hospital services rose 6.2 percent, compared with 5.2 percent in 2005.

Apparel and airline fares. Apparel (clothing, footwear, watches, and jewelry) prices rose 0.9 percent in 2006, following a 1.1-percent decrease in 2005. The 0.9-percent increase was the first in this index since 1997. Apparel retailers have had a difficult decade. Consumers increasingly have been purchasing more electronics items, leaving less disposable income for clothing and other apparel. Intense competition from discount apparel stores has resulted in closures and consolidation within the industry. The lifting of Chinese import restrictions has provided the United States with a source of relatively inexpensive clothing, and Chinese clothing has been increasing its share of the apparel market. Airline fares declined 1.0 percent in 2006, after rising 6.4 percent in 2005. Airlines have been able to lower fares by laying off workers and revising union contracts, thereby lowering their costs. □

Notes

¹ Annual percent changes are calculated from December to December.

² World crude-oil prices are officially called “Refiner Acquisition Cost of Crude Oil, Composite (of both Domestic and Imported Oil).” Prices cited here were published in *Petroleum Marketing Monthly, February 2007* (Energy Information Administration, U.S. Department of Energy, February 2007).

³ *Short-Term Energy Outlook* (Energy Information Administration, U.S. Department of Energy, Dec. 12, 2006).

⁴ *Short-Term Energy Outlook* (Energy Information Administration, U.S. Department of Energy, Feb. 6, 2007).

⁵ *Short-Term Energy Outlook* (Energy Information Administration, U.S. Department of Energy, Jan. 9, 2007).

⁶ *Livestock, Dairy, and Poultry Outlook* (U.S. Department of Agriculture, Jan. 23, 2007).

⁷ *Livestock, Dairy, and Poultry Outlook* (U.S. Department of Agriculture, Dec. 18, 2006).

⁸ *Livestock, Dairy, and Poultry Outlook* (U.S. Department of Agriculture,

Dec. 16, 2005).

⁹ *Livestock, Dairy, and Poultry Outlook* (U.S. Department of Agriculture, Dec. 18, 2006).

¹⁰ *Fruit and Tree Nuts Outlook* (U.S. Department of Agriculture, November 30, 2006).

¹¹ *Livestock, Dairy, and Poultry Outlook* (U.S. Department of Agriculture, Jan. 23, 2007).

¹² *Monetary Policy Report to the Congress* (Board of Governors of the Federal Reserve System, Feb. 14, 2007).

¹³ *Mortgage Interest Rate, 30-Year Conventional Mortgages, Fixed-Rate* (Federal Home Mortgage Corporation, February 2007).

¹⁴ Sales figures for new vehicles are from *Automotive News* (Crain Communications, Inc., January 2007).

¹⁵ New model-year cars and trucks are phased into the sample as they begin outselling the older model-year vehicles in the sampled CPI dealerships and are adjusted for changes in quality. For more details, see “Report on Quality Changes for 2007 Model Vehicles” (Bureau of Labor Statistics, Nov. 14, 2006), on the Internet at www.bls.gov/ppi/ppi07car.pdf.