

## Consumer inflation in 1997 at 11-year low

*Factors underlying the slowdown in consumer prices included falling prices for energy and moderating food costs; if food and energy are excluded, the index shows the smallest increase in 32 years*

Todd Wilson

The Consumer Price Index for All Urban Consumers (CPI-U) All Items for the U.S. city average increased 1.7 percent in 1997, down from a 3.3-percent advance during the prior year.<sup>1</sup> The 1997 rise was the smallest annual increase since the 1.1-percent advance in 1986, when oil prices collapsed. A combination of declining energy prices and moderating food inflation contributed to last year's relatively low consumer inflation. Lower prices for consumer energy followed falling world crude oil prices, as oil supplies outpaced usual demand, and as demand for oil turned out to be weaker than expected. Decelerating food inflation accompanied decreasing prices for animal feed and wheat.

The CPI-U excluding food and energy prices (often called the core CPI-U) increased 2.2 percent, the smallest calendar-year rise in 32 years. Decreasing commodities prices across a wide variety of items, including new and used cars and housefurnishings, contributed to the slowdown in inflation in 1997. Commodities prices, subject to greater global competition than those for services, rose just 0.2 percent. Within commodities, prices for durable goods decreased 1.5 percent; nondurable goods increased 0.8 percent. Services fees, which increased 2.8 percent in 1997, decelerated as well, although not nearly as much as did commodities prices. (See table 1.)

### Other economic measures

After adjustment for inflation, the economy expanded 3.7 percent during 1997 on a fourth-quarter to fourth-quarter basis. Last year's increase in real gross domestic product was the largest calendar-year rise during the current economic expansion, which began in 1991. The unemployment rate decreased more than one-half percentage point this past year to 4.7 percent in December, the lowest yearend level since 1969.

The combination of last year's record-low consumer inflation and record-low unemployment rate is unusual. Generally, a sustained unemployment rate under 5 percent has been accompanied by accelerating, not decelerating, inflation. Although a slight acceleration in wages and salaries has accompanied the relatively low unemployment rate, the acceleration has been weaker than the past would indicate. The Employment Cost Index (ECI) for wages and salaries for private industry workers increased 3.9 percent last year (more than twice the rate of consumer inflation), after rising 3.4 percent during 1996.

On balance, the Producer Price Index (PPI) declined as well during 1997, adding further downward pressure to business' materials costs and consumer prices. Excluding energy from each of the following PPI's, finished consumer goods decreased

Todd Wilson is an economist in the Office of Prices and Living Conditions, Bureau of Labor Statistics.

**Table 1. Annual percent change in the Consumer Price Index for All Urban Consumers (CPI-U), selected expenditure categories, 1988-97**

Expenditure category	December 1996 relative importance	Percent change for 12 months ended December—									
		1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
All items .....	100.000	4.4	4.6	6.1	3.1	2.9	2.7	2.7	2.5	3.3	1.7
Energy .....	7.049	.5	5.1	18.1	-7.4	2.0	-1.4	2.2	-1.3	8.6	-3.4
Food .....	15.913	5.2	5.6	5.3	1.9	1.5	2.9	2.9	2.1	4.3	1.5
All items less food and energy .....	77.038	4.7	4.4	5.2	4.4	3.3	3.2	2.6	3.0	2.6	2.2
Commodities less food and energy .....	23.364	4.0	2.7	3.4	4.0	2.5	1.6	1.4	1.7	1.1	.4
Commodities less food .....	26.960	3.2	3.3	7.4	.8	2.4	.6	1.9	1.1	2.6	-.5
All items less energy .....	92.951	4.7	4.6	5.2	3.9	3.0	3.1	2.6	2.9	2.9	2.1
Commodities .....	42.873	3.8	4.1	6.6	1.2	2.0	1.5	2.3	1.4	3.2	.2
Durables .....	10.242	2.5	1.2	.9	2.4	2.5	2.7	2.9	1.7	.7	-1.5
Furniture and bedding .....	1.117	3.5	-1.4	1.1	1.0	4.5	3.6	1.6	4.2	1.0	-.7
Video and audio products .....	0.407	-1.4	-.5	-3.6	-.8	-1.8	-.8	-2.1	-3.9	-2.2	-3.8
Major household appliances .....	0.284	3.6	-1.4	-.3	-2.1	.5	1.5	3.6	-1.8	1.4	-1.9
Information-processing equipment .....	0.074	( <sup>1</sup> )	-7.3	-2.6	-4.1	-6.1	-7.6	-9.1	-10.7	-11.6	-12.1
New vehicles .....	4.955	2.2	2.4	2.0	3.2	2.3	3.3	3.3	1.9	1.8	-.9
Automobile parts and equipment .....	0.529	2.3	2.2	.9	1.6	-.6	-1.6	.5	.5	-.1	-.9
Sporting goods and equipment .....	0.399	4.4	2.1	1.8	3.7	.1	.3	3.2	-.6	-.1	-.4
Nondurables .....	32.631	4.4	5.2	8.5	.8	1.9	1.1	2.0	1.4	4.0	.8
Energy commodities .....	3.596	-2.3	7.9	35.4	-16.1	1.2	-5.1	5.2	-3.3	13.8	-6.9
Gasoline .....	( <sup>2</sup> )	-1.8	6.5	36.8	-16.2	2.0	-5.9	6.4	-4.2	12.4	-6.1
Fuel oil .....	0.293	-6.3	19.5	29.9	-19.9	-3.4	-4.6	.0	1.5	23.3	-11.7
Textile housefurnishings .....	0.329	5.8	-.3	2.5	1.9	-1.9	6.6	-3.6	.5	-.7	-3.3
Apparel commodities .....	4.786	4.8	.7	5.0	3.4	1.2	.8	-1.9	-.1	-.5	-.9
Medical care commodities .....	1.273	6.9	8.2	8.4	7.5	5.2	3.1	3.0	1.8	2.6	2.3
Toys, hobbies, and music equipment .....	0.372	4.1	2.4	1.5	1.1	2.5	1.5	-.9	1.0	2.8	-1.6
Services .....	57.127	4.8	5.1	5.7	4.6	3.6	3.8	2.9	3.5	3.3	2.8
Shelter .....	28.194	4.5	4.9	5.2	3.9	2.9	3.0	3.0	3.5	2.9	3.4
Airline fares .....	1.108	3.3	5.3	22.7	-6.0	6.6	17.0	-9.5	1.8	14.7	-4.8
Medical care services .....	6.073	6.9	8.6	9.9	8.0	7.0	5.9	5.4	4.4	3.2	2.9
Medical care .....	7.346	6.9	8.5	9.6	7.9	6.6	5.4	4.9	3.9	3.0	2.8

<sup>1</sup> Data are not available.

<sup>2</sup> No relative importance is published for gasoline. The relative importance

for motor fuel, which includes gasoline and diesel fuel, is 3.171.

NOTE: Data are not seasonally adjusted.

0.1 percent, intermediate materials rose 0.2 percent, and crude materials declined 2.7 percent. Much of the decline in crude materials reflects sharp decreases in prices for nonferrous metal ores, copper base scrap, cotton, cattle hides, and foodstuffs and feedstuffs. The PPI does not reflect changes in import prices.

## Energy and food prices

*Energy.* The behavior of energy prices changed significantly in 1997, compared with 1996. The 1996 energy markets reflected tight supply and demand conditions. World crude oil prices reached \$23 per barrel in October, the highest level since the Persian Gulf War. Prices of all petroleum-based products followed oil prices and rose sharply as well in 1996; gasoline prices increased 12.4 percent and fuel oil costs rose more than 23 percent.<sup>2</sup>

The situation changed significantly in 1997. The Organization of Petroleum Exporting Countries (OPEC) began to exceed production quotas, resulting in increased inventories and falling prices. Non-OPEC production rose as well, especially from Mexico, Brazil, and other Latin American nations. By yearend, crude oil prices were less than \$17 a barrel.

In the first quarter of 1997, milder-than-expected winter weather resulted in reduced demand for fuel oil. Meanwhile, oil production outpaced demand. As increased production flooded oil markets, world petroleum prices plummeted through April.<sup>3</sup>

Later in the year, beginning in October and lasting through December, petroleum and gasoline prices again moved sharply lower. Factors behind these decreases included a weakening in demand from the troubled economies of East Asia, a milder-than-usual autumn in much of the northern

hemisphere that accompanied the El Niño weather system, and an increase in OPEC oil production, particularly from Venezuela.

In 1997, the decrease in crude oil prices translated into sharply lower prices for gasoline and home heating oil. Gasoline charges declined 6.1 percent in 1997. Last year's sharp decrease largely reflects declining petroleum prices, lower gasoline demand due to cooler-than-normal driving weather during the spring and early summer, and rising crude oil and gasoline stocks, which reached levels not seen for several years. Because 1997's autumn and early winter weather was milder than usual, many oil refiners did not switch production from gasoline to heating oil, as they usually do at that time of year. Consequently, gasoline inventories climbed quite high.

At the same time, charges for household fuel oil decreased 11.7 percent in 1997. Energy services (electricity and natural gas) rose just 0.2 percent in 1997, after increasing 3.8 percent during the preceding year. Electricity prices decreased 1.3 percent. Natural gas costs increased just 3.3 percent, down sharply from an 11-percent rise in 1996.

*Food.* Food inflation decelerated sharply last year, with prices increasing just 1.5 percent, following a 4.3-percent advance in 1996. Grocery store food prices (food at home) rose 1.0 percent in 1997, after rising 4.9 percent during the previous year. Declining prices for beef and veal, dairy products, pork, poultry, eggs, and fresh fruits led the deceleration.

Beef and veal charges decreased 0.7 percent last year, after rising 2.4 percent in 1996. The number of cows slaughtered increased in 1997, mainly a result of disappointing forage conditions, a number of winter storms, and record-high hay prices. Furthermore, negative publicity on recalled E-coli-contaminated beef dampened domestic and international demand. Finally, declining pork prices acted to suppress beef and veal costs. Charges for dairy products declined 0.5 percent in 1997, after increasing more than 10 percent in the prior year. In contrast to 1996, in 1997, farmers spread out their available forage until new crop supplies became available, thereby avoiding a decrease in milk output per cow.

Pork prices decreased 1.5 percent in 1997, following an 11.3-percent rise during the prior year. Last year represented an expansionary phase of the pork production cycle, as both breeding stocks and the number of hogs slaughtered increased. A reduction in corn feed prices has encouraged the expansion to last longer than it otherwise would have. After peaking in July 1996, the PPI for corn decreased nearly 50 percent by December 1997. Other mitigating factors include lower-than-anticipated exports to Japan and increased imports.

Poultry costs were down 1.6 percent last year, following a nearly 8-percent rise in 1996. As with hogs, lower feed costs

resulted in increased flocks of chickens. Also, exports to Russia, China, and the European Union were lower than expected. After increasing 12 percent in 1996, the index for eggs decreased 7.2 percent last year. Following record wholesale egg prices in 1996, both the size of flocks and productivity per hen rose in 1997.

Fresh fruits prices decreased 4.7 percent in 1997, after increasing 12 percent during the previous year. Apple supplies were abundant, as the second-largest Washington crop on record went to market. Last year was also a record harvest year for grapefruit, for which demand has been decreasing since the 1992-93 season. Additionally, California had a record harvest of grapes; a large volume of imported Mexican grapes contributed to lower prices as well. Finally, there were bumper crops of California plums and strawberries, and California and Georgia peaches.

Lower charges for fresh fruits were offset by a 13.2-percent increase in fresh vegetable prices. Prices for tomatoes rose 31 percent, following freezing and cold weather in Florida, and cold weather and excessive rainfall in Mexico. Lettuce prices increased more than 18 percent.

Prices of cereals and bakery products increased just 1.5 percent last year, less than half as much as during 1996. Declining wheat prices were largely responsible for the moderation. After peaking in May 1996, the PPI for wheat decreased more than 40 percent by December of last year.

## Items other than food and energy

*Shelter, cable television, and housefurnishings.* The shelter index rose 3.4 percent last year, higher than a 2.9-percent rise during the prior year. Except for the household maintenance and repairs category, higher increases than in 1996 were registered in all categories within the shelter component, including residential rent, lodging while out of town, lodging while at school, tenants' insurance, owners' equivalent rent, and household insurance.

Charges for cable television increased 6.9 percent. Factors behind the rise included higher rates for both basic service and extended basic service, and installation fees that were returning from sale price levels.

Higher shelter and cable television costs were partially offset by a 1.4-percent decrease in housefurnishings charges. The following decreases were reported within this category: textile housefurnishings, -3.3 percent; furniture and bedding, -0.7 percent; and appliances including electronic equipment, -3.9 percent.

*New vehicles and used cars.* New-vehicle prices decreased 0.9 percent last year, the first calendar-year decrease since 1971. Demand for new vehicles weakened in 1997 largely as

a result of sharply declining used-car prices, owners holding on to their cars and trucks longer, and increasing demand for new vehicle leasing. This resulted in intensified domestic and foreign competition. Domestic manufacturers responded with cost-cutting techniques (for example, increased use of outsourcing and reductions in the numbers of models offered) and offered incentives to dealers and customers. The cost-saving measures enabled manufacturers of domestic vehicles to remain competitive, despite flat domestic demand (sales were up just 0.1 percent from 1996) and rising imports.

Between January and November of 1997, Japan's carmakers, for example, increased exports to the United States by more than 11 percent. The strengthening of the U. S. dollar, which makes imported goods less expensive, accounts for some of that increase.

Used-car prices decreased 4.9 percent in 1997, the largest decrease in 11 years. Record numbers of leased vehicles (most of them 2 or 3 years old) coming off lease in 1997 resulted in a large increase in supplies of used cars and trucks. From 1993 to 1997, the number of vehicles leased in this country nearly doubled, from 1.6 million to 2.9 million. Cars coming off lease added downward price pressure to used cars, which in turn dampened prices of competing new automobiles. Moreover, the increased incidence of leasing, as an alternative to buying, may have directly held down prices of new and used vehicles.

*Medical care.* Medical care inflation continued to decelerate in 1997 for the seventh consecutive year. The medical care index increased just 2.8 percent, slightly lower than the 1996 advance. Annual percent increases in these charges have not been this low since 1965. Increases in the indexes for most components of medical care were lower last year, including prescription drugs, physicians' services, and hospital and related services. Prescription drug prices increased 2.5 percent in 1997, down from a 3.2-percent rise in 1996. In 1997, a number of mergers took place that created economies of scale leading to a moderation of upward price pressure. The government took action in some cases to preserve the competitive environment by requiring the sale of some individual stores to competitors. Expiring patents led to an

increase in the number of lower priced generic drugs. Many new drugs were approved by the Food and Drug Administration in 1997, leading to a significant increase in the number of drug choices.

Fees for physicians' services rose 2.7 percent, the smallest increase since 1972. The practice by insurance companies of paying physicians a smaller percentage of their regular fees continued in 1997, as a result of the continued growth in managed care programs. Physicians' fees for noninsured patients also rose less than in recent years.

Charges for hospital and related services continued their 7-year trend of smaller increases. Charges for these services increased 3.2 percent, following a 4.1-percent rise in 1996.

*Other goods and services.* Prices for tobacco and smoking products rose 7.2 percent last year, the highest increase since 1992. Most of the rise in tobacco charges reflects increases in cigarette prices. Last year, leading tobacco companies raised these charges at the wholesale level, partially in an attempt to finance huge settlement costs stemming from lawsuits. Also, increases in State excise taxes on cigarettes raised such prices even further. Tuition and other school fees, and school books and supplies each increased more than 5 percent. Personal financial services rose 6.0 percent in 1997, reflecting higher costs for tax preparation services and electronic tax filing. Legal service fees increased 5.1 percent, in part because of higher fees associated with uncontested divorces, short will preparation, and legal briefs. Finally, the funeral expenses index rose 5.1 percent. Much of the increase can be attributed to higher costs for funeral services. Additionally, higher charges were reported for cremations, caskets, vaults, cemetery lots, and memorials. □

## Footnotes

<sup>1</sup> Annual percent changes are December to December, unless otherwise noted.

<sup>2</sup> See Todd L. Wilson, "Winter and Spring Gasoline Prices Show Highest Rise Since Persian Gulf War," *CPI Detailed Report*, June 1996, pp. 4-6.

<sup>3</sup> See "Motor Gasoline Assessment, Spring 1997" (Energy Information Administration, pp. 5-8), on the World Wide Web at: <http://www.eia.doe.gov/neic/press.html>