3-3-1977

Toward Understanding Our Economy The Consumer Price Index and Inflation

Robert J. Antonides
South Dakota State University

COOPERATIVE EXTENSION SERVICE United States Department of Agriculture Cooperating

Economics Newsletter

Editor:
Robert J. Antonides
Extension Economist

Economics Department South Dakota State University Brookings 57006 (605) 688-4141

No. 107 March 3, 1977

TOWARD UNDERSTANDING OUR ECONOMY
The Consumer Price Index and Inflation

To no one's surprise, the Consumer Price Index (CPI) rose again in 1976, with an annual increase of 5.8 percent. The good news is that it didn't rise as fast as has been occurring in recent years. (See Table 1). The slowing trend is further shown in Table II which indicates changes month by month. Between December 1973 and December 1974, the monthly average rose 16.9 points or 12.2 percent. During the same months of 1974 and 1975 it rose 11.9 percent and between December 1975 and December 1976, it increased by only 4.8 percent.

The CPI is one of the indicators, mentioned in the last Newsletter, developed to measure changes in our economy. This one reflects changes in the prices of 400 goods and services that consumers normally buy. It is not a true cost of living index since it does not measure such things as taxes paid, changes in qualities, or total amounts spent. The index is currently being up-dated to more nearly reflect these, however.

It is also well to recognize that the month-to-month changes during a year are probably not as accurate as the annual changes since many, if not most, items have seasonal variations in prices throughout the year due to such things as weather, car model changes and holidays. There is a companion series that takes these variations into account for analyzing general price trends.

The individual items in the index are combined in two different ways. The usual combination is into groups of commodities and services. Commodities are subdivided into three major subgroups: food, other nondurable goods (such as apparel and fuels) and durable goods (such as furniture and cars). These are averaged and weighted to represent their importance in the spending of all wage earners. The weights currently allocate about 25 percent of the index to food, 23 percent to other nondurables, 16 percent to durables and more than 36 percent to services.

For some analysis purposes, the items are re-combined into expenditure classes. In December 1976 these were weighted: food, 25 percent; housing expenditures, 34 percent; apparel and upkeep, 9 percent; transportation costs, 13 percent; and health and recreation, 19 percent. It is relative price changes between items that cause changes in quantities purchased and make these percentages vary slightly.

A principal purpose of the CPI is to provide an indicator of the amount of inflation present in the economy. As such, it is used by a growing number of unions and businesses in contractual agreements and in determining compensation in pension plans, social security and similar uses. To the extent that compensation to some consumers is increased without accompanying increases in productivity, prices may again advance and the CPI will follow. Of course, consumers whose incomes do not increase will be at a disadvantage.

This, then, is one of the reasons that there may be some inflation. Most economists will agree that a major cause of inflation is a money supply that is greater than the supply of goods and services available. The reasons for the imbalance are the main causes of concern and contention. These are complex and change over time.

Table I. Annual Changes in CPI
1967=100.0

Year	Annual Average CPI	% Change from Year Earlier
1968	104.2	4.2
1969	109.8	5.4
1970	116.3	5.9
1971	121.3	4.3
1972	125.3	3.3
1973	133.1	6.2
1974	147.7	11.0
1975	161.2	9.1
1976	170.5	5.8

Table II. CPI-All Items
1967-100.0

	1973	1974	1975	1976
	Monthly Averages			
Jan.	127.7	139.7	156.1	166.7
Feb.	128.6	141.5	157.2	167.1
Mar.	129.8	143.1	157.8	167.5
Apr.	130.7	143.9	158.6	168.2
May	131.5	145.5	159.3	169.2
June	132.4	146.9	160.6	170.1
July	132.7	148.0	162.3	171.1
Aug.	135.1	149.9	162.8	171.9
Sept.	135.5	151.7	163.6	172.6
Oct.	136.6	153.0	164.6	173.3
Nov.	137.6	154.3	165.7	173.8
Dec.	138.6	155.4	166.3	174.3
Annual	133.1	147.7	161.2	170.5

Some of the reasons normally advanced are: wages in some industries are increasing faster than output (higher unit costs of production); increases in the supply of money due to easy lending policies; government budget deficits; increased world demand money devaluations; a lack of effective competition to keep prices down; and, unusual weather which can both reduce production and increase expenditures for housing.

One other cause of at least temporary inflationary pressures is often noted but not much can be done to measure it. It is the psychological impact of seeing prices rise and wanting to buy before they rise further.The temptation is to spend now instead of postponing the purchase until needed. This increase in the "velocity" of spending acts to create a short run increase in the supply of money. This "get-it-before-it's-all-gone" frenzy was disastrous to the German monetary system following World War I.

Robert J. Antonides,
Extension Economist--Marketing

AGRI-BUSINESS DAY,
TUESDAY APRIL 5

(3800 printed at an estimated cost of 1¢ each for educational purposes.)

Cooperative Extension Service
U. S. Department of Agriculture
South Dakota State University
Brookings, South Dakota 57006

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE $300

Postage and Fees Paid
U. S. Department of
Agriculture
AGR 101

Third class mail
(Bulk Mail)

Economics Newsletter