
Price Developments

Inflationary pressures in the economy have been persistent since the mid-1960's, but they have become much more intense in the past few years. In 1974 the impact was particularly acute as prices continued to climb at an accelerated rate, operating through a number of channels to dampen demands for goods and services.

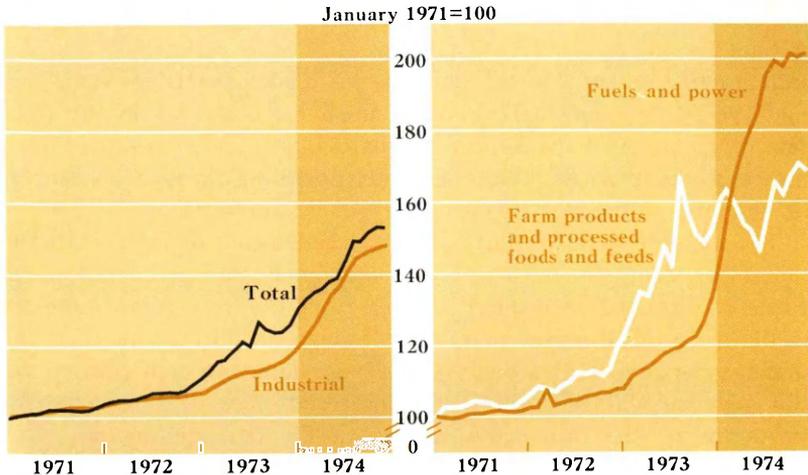
The increase in prices during 1974 exceeded to a significant degree the 9 per cent rise in wages, and the purchasing power of wage earners continued to drop. Revenues from the very large increase in the price of oil accrued largely to foreign producers—thereby reducing spending in this country; only a relatively small portion of this revenue was reflected in the increased sales of U.S. exports. Furthermore, the progressive feature of the personal income tax, combined with rising nominal incomes, served to reduce real incomes during the year. On a per-household basis real disposable income began to decline about mid-1973, and since then it has fallen more than in any comparable period since that immediately following World War II. Moreover, the real value of the financial assets held by consumers has been depressed by a falling stock market.

As a consequence, there was a substantial, adverse reaction to rising prices among most income groups during 1974, and consumption expenditures weakened considerably. Purchases of autos, mobile homes, and other consumer durable goods fell sharply, as higher and higher prices for essentials forced families to allocate a larger proportion of their budgets to food, fuels, and housing.

The business sector was also adversely affected by inflation. Corporate profits before taxes in 1974 were higher than in 1973 because of enormous inventory gains. However, since replacement of inventory stocks had to be made at inflated prices, the true corporate financial position was much less favorable than suggested by before-tax profits data. This probably had a significant impact on the realization of investment plans.

SOURCES OF INFLATION

The current inflation had its roots in a number of volatile and at times unanticipated developments, some originating in this country

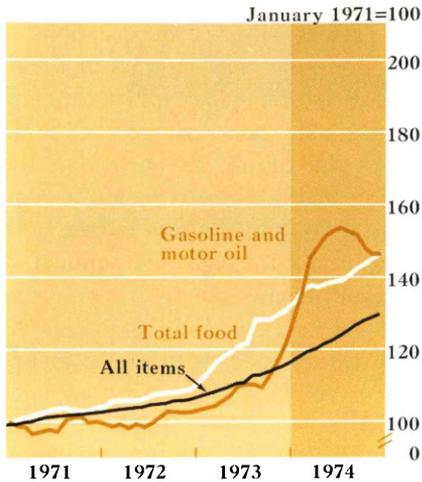
WHOLESALE PRICES


NOTE.—Dept. of Labor data.

and some abroad. World demands for U.S. farm products continued to be strong during 1974. Furthermore, with disappointing harvests in the United States, stocks of both food grains and feeds continued to be low, and prices remained at high levels. Food grains and feeds occupy a strategic position in food production, and their advanced prices have had far-reaching repercussions on prices of meat and other foods in this country.

More important in 1974, however, was the impact of the extraordinary increase in the price of fuel, which extended well beyond the rise in oil and gasoline prices—contributing substantially to the ongoing inflation and exerting a major influence in ending the 1971-73 economic expansion. By the summer of 1974 the price of imported crude oil had more than tripled from its pre-embargo level, and prices of domestically produced oil had risen sharply too. Since imports of crude and refined oil account for more than one-third of domestic consumption, the average cost of crude in U.S. markets more than doubled, and price increases for refined products exceeded 80 per cent. Prices of coal also soared, and natural gas and electric rates climbed by about a third during the year.

CONSUMER PRICES



High levels of international demand also helped to fan inflationary trends in the U.S. economy well into 1974. Foreign demands on U.S. suppliers—particularly for food, basic materials, and business equipment—remained exceptionally strong. These pressures arose from a number of factors, including the boom in industrial activity in the major industrialized nations, the continued impact of the dollar devaluations, and the effects of U.S. wage and price controls, each of which made U.S. products more attractive on the world market.

The phaseout of price and wage controls by the spring of 1974 was also a factor. Wholesale prices of major industrial commodities surged—particularly for metals, chemicals, producers' equipment, and some consumer goods. Metals contributed about as much to the rise in wholesale prices in 1974 as any other major commodity group. Wholesale prices of many consumer nonfood items, such as furniture, apparel, and household appliances, also moved up at a brisk pace, in part a response to the higher post-controls costs of materials.

Inflation was also intensified in 1974 by the exceptionally sharp jump in unit labor costs, which was noted earlier. In 1972 and 1973

such costs had risen by 2.7 and 5 per cent, respectively, but during 1974 the rate of increase was at a record 11.6 per cent.

The combination of these diverse factors—the special situation for fuels and food, continuing strong domestic and international demands, the removal of controls, high rates of capacity utilization, and accelerating labor costs—led businessmen and consumers alike to expect widespread price increases in the future. In particular, the higher rate of inventory accumulation undoubtedly reflected a good deal of hedge buying in anticipation of continued sharp increases in prices. Similarly, growth of unfilled orders through late summer—some of which may have been the result of multiple ordering—probably reflected efforts to circumvent shortages and rising prices. At times during the year consumers also attempted to purchase in advance of price increases. A striking example was the surge in sales of 1974-model cars after the announcement of large price increases for the 1975 models.

Inflation gathered momentum during 1974 in part because of these heightened price expectations. But late in the year, as demand weakened on a broad front and uncertainty increased, the inflationary expectations of businessmen probably became a less dominant force and rising costs a relatively more important one in sustaining the increases in prices. Consumer attitudes also shifted, and as noted above, by the end of the year many thought it was a bad time to buy because prices were too high.

PRICE MOVEMENTS

Inflation in 1974, as reflected by broad measures such as the implicit GNP deflator, the consumer price index, and the wholesale price index, increased substantially faster than in 1973—indeed faster than in any other year since early in the postwar period. By the end of 1974, the implicit deflator for GNP had risen 12 per cent from the end of 1973 compared with 7 per cent during the previous 12-month period. The consumer price index also showed a 12 per cent increase in 1974, compared with a rise of less than 9 per cent in 1973. Non-food commodities led the advance in consumer prices, but prices of services also accelerated significantly. Wholesale prices rose even more rapidly—21 per cent during 1974 compared with 15 per cent during the previous year.

Following the run-up of oil prices that began in the autumn of 1973, accelerating prices for industrial materials paced the rate of inflation. Wholesale prices of fuel and power rose at an annual rate of about 70 per cent from September 1973 to midyear 1974 but then slowed to about a 10 per cent rate by the fourth quarter. Higher fuel prices had a substantial impact on prices of other materials, which had been compounded by very large post-price-control adjustments and intense international demand pressures earlier in 1974. By September prices of steel mill products and nonferrous metals were more than 40 per cent above a year earlier. Prices of other materials rose sharply too—especially paper and paper products, and most chemicals. By the year-end, however, there were signs of considerable moderation in the materials component of the wholesale price index. This was in sharp contrast to the extremely rapid rates of gain that had been registered in the first three quarters.

The extraordinary increases in materials prices, as well as post-controls adjustments, led to sharp advances in prices of finished goods. Prices for producers' machinery and equipment accelerated during the year, influenced also by strong foreign demand; the annual rate of gain in such prices rose from 6 per cent in the fourth quarter of 1973 to more than 30 per cent during the third quarter of 1974. In the fourth quarter these price increases also began to slow.

Although food prices were not so important a factor in inflation in 1974 as they had been in 1973, advances continued at high rates during the year. Because the U.S. harvest of feed crops was disappointing and stocks were never rebuilt from depleted levels, prices of grains and feeds continued high during most of the year. Dramatic rises in sugar and sugar-based products as well as in fats and oils contributed disproportionately to the advance in food prices at retail; prices of sugar and sweets more than doubled during the year. However, late in the year prices of sugar and oils declined at the wholesale level. By the second quarter the farm-retail spread had increased to about one-fourth above its year-earlier level, and it continued high throughout the year, contributing also to the advanced levels reached by retail food prices despite declines at the farm level for livestock and other products.

Fuels led the advance in consumer prices of nonfood commodities in the early months of 1974. Although fuel prices peaked about mid-

year, accelerated advances for other goods led to sharp rates of rise in consumer prices in the third quarter. Prices of nonfood items at retail were up about 13 per cent in 1974; in addition to fuel, large increases were recorded for household durable goods, paper products, and a wide variety of other goods. Service costs also rose faster after the lifting of controls, and particularly large increases were registered for gas and electricity and for medical and household services.

In the last quarter of 1974 levels of economic activity fell and the impact of post-controls adjustments and rising materials costs tapered off. Prices of several industrial materials had actually declined since the spring—notably textiles, metal scrap, and copper, as well as lumber and hides, which were well below their 1973 highs. The rise in wholesale prices of industrial commodities was at an 8 per cent annual rate in the final 3 months of the year, down from the average annual rate of rise of about 30 per cent in the earlier three quarters; the gain in consumer prices slowed to a 10 per cent rate in the fourth quarter, compared with the 13 per cent average posted over the first 9 months of the year.

Table 4: PRICE CHANGES

In per cent

Group	Dec. 1971– Dec. 1972	Dec. 1972– Dec. 1973	Dec. 1973– Dec. 1974	1974 (seasonally adjusted compounded annual rates)			
				Dec.– Mar.	Mar.– June	June– Sept.	Sept.– Dec.
Wholesale prices, total.....	6.5	15.4	20.9	24.5	12.2	35.2	13.4
Industrial commodities.....	3.6	10.7	25.6	32.3	35.7	28.3	8.2
Farm products.....	18.7	36.1	-1.9	6.2	-48.0	56.6	7.4
Processed foods and feeds.....	11.6	20.3	20.9	13.1	-12.0	60.2	33.7
Consumer prices, total.....	3.4	8.8	12.2	14.2	10.3	14.2	10.1
Foods.....	4.7	20.1	12.2	19.4	3.1	12.3	14.6
Commodities less foods.....	2.5	5.0	13.2	16.0	13.7	16.2	7.3
Services.....	3.6	6.2	11.3	9.2	11.0	13.9	10.9

NOTE.—Based on data from Dept. of Labor. Services are not seasonally adjusted.