



# Business Trends

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## SPOTLIGHT ON WHOLESALE PRICES

The behavior of wholesale prices during the past year has generated increasing concern in some quarters over the possibility of a resurgence of inflation. Some observers believe the economy has started to emerge from its cocoon of relative price stability and that there will be an intensification of upward price pressures; others view recent price developments within the context of special circumstances and offer reassurances that there is little reason to sound the inflationary alarm.

Such divergent views regarding the outlook for prices stem largely from various opinions on past and future patterns of economic activity. The question of prices is particularly significant at this time because the existence of actual or potential inflation is a strategic consideration in the shaping of monetary and fiscal policies, both of which influence the course of business conditions. An assessment of recent wholesale price changes and of factors that have a bearing on the price climate may help to clarify the issue.

Wholesale Prices at Record High. Although the comprehensive Wholesale Price Index of some 2,200 commodities currently is at a record high, the reading is only 3% above the 1957-59 average. Most of that gain in the WPI has occurred within the past nine months, due to a convergence of rising prices for both foodstuffs and for industrial commodities. For several years prior to this year's experience,

there were frequent periods when prices of foodstuffs and industrial commodities moved in opposite directions, thus tending to keep the total index on a dead level.

Beginning in January of this year foodstuff prices began to rise in response to supply shortages that were caused by poor weather conditions and by reductions in livestock marketings. Prices of farm products and processed foods, taken together, rose 6 1/2% during the first six months of this year, but have remained generally steady since June. As increased supplies came to market during the summer months, agricultural analysts noted that the upsurge in foodstuff prices had largely run its course.

Industrial Prices More Critical. Business analysts attach greater significance to industrial prices than to agricultural prices for the purpose of detecting inflationary symptoms. Industrial commodities account for roughly three-fourths of the Wholesale Price Index, while the remainder of the index (farm and food products) is more heavily influenced by government support policies, by the weather, and by livestock cycles that are largely independent of general business conditions.

In September, industrial prices were at a record high of 102.7% of the 1957-59 average--up 1.6% from a year earlier. That was the largest annual gain in industrial prices during

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the past six years. Although most of the major commodity groups registered increases from a year ago, the upward push on industrial prices is attributable chiefly to metals and metal products, refined petroleum products, and nonelectrical machinery and equipment. Much of the rise from a year ago had occurred in the closing months of 1964.

Price Expectations. To some degree, the near-term climate for prices is conditioned by recent price patterns. Very rapid or prolonged swings in prices of crude industrial materials are likely to be transmitted to prices of intermediate materials and supplies, and ultimately to prices of finished goods. On this account, the daily spot market index of 13 raw industrial prices is considered one of the barometers of current and prospective price developments--as appraised by experienced traders on the commodity exchanges.

The record shows that prices of raw industrials underwent a significant upswing beginning two years ago and culminating last May with the spot market index at its highest point since the early years of the Korean conflict. Since May, however, spot prices of raw industrials declined moderately and then remained relatively steady to date.

Initially, the upswing in spot prices was reflected in a moderate firming of the Federal Reserve Board's broadly based price grouping for industrial materials, which accounts for a little more than half of the industrial commodities index. Prices of finished industrial products subsequently began to firm upwards with the gains becoming most pronounced between September 1964 and January 1965. (During the September-January period, industrial prices usually increase about 0.4% on a seasonal basis.) In recent months, the price indexes for both industrial materials and industrial products have shown little net change.

Capacity Utilization. Factors other than recent price behavior must be considered in appraising possible inflationary developments. The price question, in essence, hinges on the likelihood of previous patterns that were associated with inflationary periods reasserting themselves. Those patterns, simply stated, were large increases in output over relatively short spans or significant shifts in the composition of demand, either of which was usually accompanied by rising rates of capacity utilization. Experience suggests that as the economy approaches full capacity of both physical plant and labor force, the risk of inflation becomes more real.

During the past year, rising economic activity has raised the operating rate in manufacturing from an estimated 88% to 90%, which is not excessively high, and reduced the unemployment rate from 5.1% to 4.4% of the civilian labor force. Of course, there will be additions to capacity stemming from the well-balanced and record volume of current plant and equipment outlays. It is widely anticipated that next year's added capacity will be large enough so that the operating rate is not likely to increase. And if the operating rate is not increased, there is an increasingly large chance of avoiding an inflationary situation.

The pace of economic activity in coming months is subject to the unknowns that are always associated with forecasting; in this case there is a special complication arising from the still unknown dimensions of military spending for Vietnam. The fact that the general indexes of prices have up to this point continued to indicate relative stability constitutes, in itself, no assurance of stability for the future. The shaping of public and private policies toward the goal of price stability will need to be maintained, and perhaps intensified, if the benign trend toward economic growth without inflation is to continue.