

# Federal Reserve Bank of San Francisco

May 11, 1973

## Phase 3<sup>1</sup>/<sub>2</sub>

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Beset by severe inflationary pressures on every side, the Administration last week unveiled Phase 3<sup>1</sup>/<sub>2</sub>—or perhaps we should say Phase 2<sup>1</sup>/<sub>2</sub>, in view of the tighter Phase 2 flavor of the new rules. The new regulations were announced shortly after Congress extended the controls for another year, and in the process, beat back the widespread demands for a renewed freeze.

The changes encompass a limited form of prenotification for price increases, and they apply to the 600 or so firms with annual sales in excess of \$250 million. Large companies that have raised or intend to raise prices more than 1.5 percent above the January 10 level hereafter must give the Cost of Living Council 30 days' notice before acting. If the COLC does not object, the price increase then becomes effective automatically.

The new prenotification requirement is not as stringent as the Phase 2 rules regarding advance notification. In particular, a firm is not affected by the rule until it has raised enough individual product prices to push its weighted-average price level more than 1.5 percent above the pre-Phase 3 (January 10) level. Also, the cutoff point for coverage is the \$250-million level of sales, rather than \$100 million as under Phase 2.

### **Bad price news**

This somewhat tighter price ruling

was accompanied by more bad price news, as well as a warning from the President that "Price increases will probably be higher than we like for some months." Earlier reports showed another surge in consumer prices in March, as well as a sharp first-quarter jump in the GNP price deflator—the broadest measure of price change. The 6.0-percent annual rate of increase in the GNP index led the Administration to raise its price forecast for the year to 4.0 percent, as against the 3.0-percent projection made last January.

The wholesale price report for April then indicated the worst jump in industrial-commodity prices since the panic-buying days of the Korean War period, but along with it, a stabilizing of farm and food prices after March's disastrous surge. For Phase 3 to date, farm and food prices have risen at a 37.3-percent annual rate—over twice as fast as during Phase 2—while industrial prices have increased 14.8-percent annually—over four times as fast as during Phase 2.

The spectacular rise in food prices reflects the continued strength of consumer income, which has boosted demand for all types of food, especially high-protein meat items. Another factor is the substantial growth in food exports, which jumped 30 percent in 1972 (partly on the basis of the mammoth Russian grain sale) and thus helped deplete domestic supplies

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just when needed at home. But the most important factor is today's poor growing weather; the farm community was badly hit by the 1970 corn blight, the 1971 Texas drought, and the 1972 California drought, and now it is affected in 1973 by the Midwest's freeze and floods.

## **Pervasive inflation**

Equally worrisome is the strong rise in industrial prices, which together make up three-fourths of the entire wholesale index. This increase reflects the pervasive inflation now working its way through the broad base of the national economy. The surging demands of the domestic boom are at work here, along with the demand forces operating in world markets under the influence of the boom overseas. Devaluation has helped aggravate the problem, since Americans are bidding for supplies in world markets with a dollar devalued by about one-third in terms of the German mark and the Japanese yen.

In their March survey, purchasing executives testified to the strength

of these boom pressures; 88 percent of the survey group reported paying higher prices, with most prices ranging 5 to 8 percent above the previous month's levels. These executives noted increasing difficulties in obtaining industrial materials, although such major industries as steel, autos, aluminum and oil refining were all producing at full capacity.

## **Curbing oil prices**

This situation has led the Administration to take a number of Phase 3 actions, in addition to the recent tightening of prenotification rules, in order to hold down the constant surge of prices. For example, it acted several months ago to curb prices of refined petroleum products, which now cost 20 percent more than a year ago.

In early March, the COLC limited wholesale price increases for crude oil and most refined products to a weighted annual average of 1.0 percent for the first year of Phase 3—or 1.5 percent if justified by higher costs. More recently, however, major oil companies have been complaining that price restrictions are curbing gasoline supplies, thus aggravating the shortages now beginning to appear throughout the nation. (Gasoline stocks today are about 10 percent below year-ago levels, reflecting in part the 6-percent increase in demand over that period.) With oil import costs soaring, the firms note that they must absorb higher costs to obtain what they want, or else hold off

buying needed supplies.

The Administration removed one major restriction on oil supplies last month, with the termination of the mandatory oil-import program. At that time, the President removed all existing tariffs on crude oil and products, and substituted a license-fee quota system for direct controls over the quantity of petroleum imports.

#### **Lumber and food supplies**

The Cost of Living Council moved about a month ago to improve the supply situation in the lumber industry, where wholesale prices have jumped 29 percent over the past year. In Senate hearings, COLC Director Dunlop announced an 18-percent increase for 1973 in the amount of logs sold from national forests, and added that he would attempt to persuade Japanese buyers to reduce their heavy buying of American logs. At the same time, he announced plans to make more freight cars available to get logs and lumber into the distribution stream. In this and later appearances, Dunlop claimed that the volatility of lumber prices would not be overcome until a better (less fragmented) distribution system was devised to bring lumber to market.

The Administration also took steps several months ago to improve the supply situation in food, especially by bringing back into production about one-half of the land idled in earlier years under crop-control

programs, and by opening much unused land for grazing to help expand beef supplies. Also, it attempted to divert available supplies into the domestic market by lifting all quotas on meat imports and by withdrawing export subsidies for such products as flour and chickens.

When meat prices continued to soar, however, the President imposed ceilings on prices of beef, pork and lamb, except at the farm level. With the help of this action—and the consumer boycott—wholesale meat prices actually declined during April.

The emphasis on improving the availability of supplies is a Dunlop trademark, since he has argued for years that policymakers should concentrate their efforts on expanding supplies in bottleneck areas which generate inflationary pressures. The problem today, however, is that supplies cannot be expanded rapidly in the worst bottleneck areas, such as meat and lumber, even as boom-fed demands continue to strengthen.

**William Burke**

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**BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT**

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 4/25/73	Change from 4/18/73	Change from year ago	
			Dollar	Percent
Loans adjusted and investments*	73,194	+1,289	+10,227	+16.24
Loans adjusted—total*	55,590	+ 948	+10,674	+23.76
Commercial and industrial	19,983	+ 20	+ 3,424	+20.68
Real estate	15,793	+ 47	+ 2,580	+19.53
Consumer instalment	8,128	+ 28	+ 1,389	+20.61
U.S. Treasury securities	6,272	+ 252	— 377	— 5.67
Other securities	11,332	+ 89	— 70	— 0.61
Deposits (less cash items)—total*	70,103	— 383	+ 8,157	+13.17
Demand deposits adjusted	20,448	— 948	+ 1,300	+ 6.79
U.S. Government deposits	866	— 18	— 16	— 1.81
Time deposits—total*	47,231	+ 159	+ 6,640	+16.36
Savings	17,915	— 2	— 49	— 0.27
Other time I.P.C.	19,148	0	+ 4,512	+30.83
State and political subdivisions	7,627	+ 130	+ 1,352	+21.55
(Large negotiable CD's)	8,720	+ 110	+ 3,809	+77.56
<b>Weekly Averages of Daily Figures</b>	<b>Week ended 4/25/73</b>	<b>Week ended 4/18/73</b>	<b>Comparable year-ago period</b>	
<b>Member Bank Reserve Position</b>				
Excess reserves	99	— 12		22
Borrowings	46	117		6
Net free (+) / Net borrowed (—)	+ 53	—129		+ 16
<b>Federal Funds—Seven Large Banks</b>				
Interbank Federal funds transactions				
Net purchases (+) / Net sales (—)	+1,229	+359		—829
Transactions: U.S. securities dealers				
Net loans (+) / Net borrowings (—)	+ 379	+ 71		+ 77

\*Includes items not shown separately.

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