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acknowledged, but targets
dismissed on page 3.

WHCF

August 25, 1965

MEMORANDUM FOR THE PRESIDENT

Subject: The Price Situation and Outlook

1. Our price record is no longer perfect.

The wholesale price index has risen 2.5% in the past 12 months, after 5 years of complete stability.

The consumer price index in June was 1.9% above a year earlier, compared with an average increase of 1.3% over the previous 5 years.

2. Farm and food prices are the main cause of the recent rise. They are up 5-7%, mainly since April.

Industrial wholesale prices have risen a moderate 1.4% in the past year. The increase has not accelerated in recent months.

Among consumer prices, commodities other than food are up only 0.8% in the past year. Service prices are still on their long-term uptrend -- but without speedup.

3. Apart from farm products and foods, nonferrous metal prices have been the major trouble spots.

Copper in the volatile "secondary market" got in motion over Vietnam. But the basic producers' prices of all the major metals -- including copper and aluminum -- have remained stable this summer, after considerable rises earlier.

Gasoline, hides, pulp and paperboard, machinery, and tires are also up over a year ago.

4. New wage settlements in the first half of 1965 averaged 3.8% -- up slightly from 1964.

We have had some bad settlements recently. Aerospace is settling above the Guideposts; and this comes on top of excessive settlements in aluminum, cement, and glass. Local construction settlements are still going their merry way, with a few settlements really "way-out."

Yet average straight-time hourly earnings in manufacturing are up only 2.9% over the 12 months. Fringes would probably add another half percentage point.

Steel remains our major test. But the chances still look good for a Guidepost settlement.

5. With the economy moving ahead well, and the Vietnam buildup still to come, the danger of inflation increases. But it remains a threat, not a reality. ✓
6. The outlook for labor costs is still reasonably good.

With unemployment still at 4-1/2%, there are no important labor shortages. A few highly-skilled trades are getting hard to hire in some labor markets. But -- over-all -- if the economy creates more jobs, there will be plenty of people eager to fill them.

The step-up of draft calls will reduce teenage unemployment but still leave it too high. The draft won't affect the categories where unemployment rates are low.

After steel, no really big bargaining tests are on the calendar for a number of months. But unions will keep the Guideposts under heavy pressure.

Productivity gains continue at a good rate. We doubt that labor cost per unit of output in manufacturing will decline any further. But it's not likely to rise significantly.

7. On prices, the only really serious hazard is possible fear of war scarcities. But a repetition of the Korean scare psychology seems very unlikely.

So far, business has remained unruffled by the Vietnam step-up. But we will have to watch carefully for signs of changing expectations or behavior.

Farm and food prices appear to be levelling off and might even fall a little by year's end (but not at retail); but clothing and shoe prices will be up.

Industrial prices are still being kept in check in most fields by vigorous competition.

New orders flowing into industry are rising again; but production is keeping pace with orders.

Utilization of factory capacity could edge up slightly, but it is unlikely on the average to exceed the rates preferred by management. With all the new investment we've been having, capacity utilization may even decline.

Next January's payroll tax increases will raise costs. So would any rise in minimum wages.

Some people have been saying that the Administration no longer cared about the Guideposts. Your statements yesterday should have helped disabuse them.

8. In summary

The absolute price stability of recent years is probably over for a while.

But with productive capabilities rapidly expanding, the evidence does not point to any real inflation in the months ahead.

Maintaining international price competitiveness is more important as ever.

The Guideposts will be all the more necessary -- but all the harder to maintain.

Gardner Ackley