The original documents are located in Box 60, folder "1976/07/01 - Economic Policy Board" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA
8:30 a.m.
Roosevelt Room

Thursday, July 1, 1976

1.	Report on East European Trip	Simon
2.	Outlook for the CPI	MacAvoy
3.	Expropriation Policy	Parsky

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

ALAN GREENSPAN, CHAIRMAN
PAUL W. MACAVOY
BURTON G. MALKIEL

June 30, 1976

MEMORANDUM FOR: EXECUTIVE COMMITTEE - ECONOMIC POLICY BOARD

FROM: Paul W. MacAvoy

SUBJECT: The June-December Outlook for the CPI

The May increase of 0.6 percent in the CPI has caused some concern as to renewed price inflation at the retail level. This memorandum examines the CPI outlook for the remainder of the Calendar Year. The view taken here is that changes in supply or demand conditions in certain basic markets over the past several months will largely determine the changes in the CPI for the rest of the year. Our assessment of the most recent information is that the basic picture has not changed. The CPI should be expected to rise by about 3.9 percent through yearend - an annual rate of 6.8 percent from the end of May through December, compared with the 4.2 percent annual rate during the first five months of this year.

1. The June to December CPI Forecast

CPI month-to-month forecasts are made based on CEA staff projections of food and energy wholesale prices and of wage settlements, as well as on linear extrapolations of past industrial price changes. The forecasting procedure begins with assumptions as to wholesale prices for energy and food in future months. Applying estimated markups and weights to these assumptions generate CPI forecasts. Energy price forecasts are based on the assumption that the maximum increases allowed under oil and gas price controls will occur. Food price forecasts are based on futures prices as quoted in organized markets. Industrial price forecasts are based in good part on markups of forecast labor costs which, in turn, are based on analyses and judgments as to future wage settlements. The WPI projections not based on futures prices,

AMERICAN REVOLUTION BICENTENNIAL 1776-1976 energy or wage assumptions are linear extrapolations of past price changes.

The procedures are tentative, highly judgmental and probably subject to fairly high degrees of error. Nonetheless, they are based upon a systematic effort to draw out the implications of recent detailed price forecasts and cost changes for the pattern of overall price changes over the next six months or so. As new data are received the forecast index levels are revised. The forecast CPI increase for May using this procedure was 0.65 percent, and the forecast for June is 0.47 percent.

The projection of the passenger cars and iron and steel components of the WPI take into account special factors particular to these industries. Passenger car prices are assumed to rise at a 2 percent annual rate through August, then at monthly rates of 1-1/2, 2, and 1/2 percent in September through November, respectively, to reflect the phasing in of new model year cars. The iron and steel component reflects the steel price increases in June and July, and is assumed to rise at a 5 percent annual rate thereafter. Lastly, the CPI services index is forecast based on linear extrapolations of past price changes in the component indexes and reflects forecast wage settlements in the latter part of the year.

The forecast pattern of change in the CPI through December is as follows:

Consumer Price Index Percentage Change - 1976
(Seasonally adjusted)

	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
All Items	0.55	0.32	0.49	0.47	0.68	0.76	0.49
Food	0.64	-0.59	0.55	0.23	1.03	1.33	0.23
Nondurables less food	0.51	0.67	0.46	0.55	0.57	0.52	0.44
Durables	0.36	0.32	0.28	0.42	0.46	0.37	0.37
Services	0.61	0.66	0.60	0.59	0.62	0.70	0.74

Between the beginning of June and the end of December, the CPI is expected to rise by 3.9 percent, an annual rate of increase of 6.8 percent. This will mean a 5.7 percent increase in the CPI from last December to yearend 1976.

2. Risks in the Forecast

Food Prices. The grain futures prices, upon which the food price forecasts are based, have been subject to considerable gyrations in the past couple of months. Crops and growing conditions have progressed quite satisfactorily, yet the grain markets have not yet given full credence to the likelihood of a very large U.S. grain harvest and a considerable recovery in the USSR harvest as well.

On the supply side, the main risk of price increases is weather-induced shortfalls in one or more crops. On the demand side, the level of upcoming export sales is uncertain. Foreign demand will depend on crops abroad in both importing and exporting countries. A rough estimate is that any combination of U.S. grain crop shortfall or increased export demand that amounts to 1 million metric tons will increase the food at home CPI by 0.08 percent. Thus, a 10 million ton U.S. feed grain shortfall coupled with an unanticipated 5 million ton increase in grain exports would increase the food at home CPI by about 1 to 1-1/2 percent. The principal uncertainty concerns feed grain prices. If marketing of cattle slows up more than currently expected this summer, an even which could result from lower feed prices causing farmers to retain more cattle for feeding, beef prices could rise more than anticipated. An increase in demand for beef, which so far in the recovery has lagged somewhat, could have the same effect.

Energy Prices. Stabilization in fuel prices has persisted through the first half of 1976. There is now reason to believe that this stability may last through the end of the year. Seasonal price increases for gasoline and changes in pricing differentials in world oil markets may complicate the picture somewhat, but the situation looks less worrisome today than three months ago.

The price of domestically produced crude oil is now expected to remain relatively steady through the end of the year due to problems encountered in the initial determination of prices under EPCA. To offset the errors of the first months, lower prices than otherwise would have prevailed will be required through the end of the year. Decontrol of petroleum product prices is also expected to have little or no effect on consumer prices. The present surplus of refining capacity for production of distillate and residual fuel oils provides a substantial guarantee that refiner margins will not become excessive after decontrol.

The inflationary risks that might have resulted from adverse actions by OPEC nations have also been reduced, but not removed. Contrary to widely circulated stories, OPEC did not freeze the prices of all oil at Bali. Instead, the OPEC nations gave approval to a pricing system where crude values are determined by product prices in principal export markets. As a result, differences between heavy Arabian oils and lighter low sulphur West African oils will increase. This will increase U.S. prices because our imports have shifted towards the West African crudes and away from heavy Persian Gulf crudes.

The new issue in the energy price area is gasoline prices. Gasoline prices have experienced very substantial seasonal swings during 1974 and 1975, which are only partially offset by BLS seasonal adjustments. In 1974 they increased by 4.6¢ per gallon from April to their August peak while in 1975 they increased by 5.4¢ per gallon. Seasonal adjustments reduce the savings by about 1¢ per gallon.

In 1976 it appears that the same pattern will be repeated. Gasoline prices began increasing in April when rapid increases in demand forced unanticipated reductions in stocks. As a result, prices have already increased by 2 to 3¢. Further increases are expected over the next two months for two reasons. First, most refiners have substantial sums of unrecouped costs which they can and presumably will try to capture during the period of peak gasoline demand. Second, small independent refiners whose low prices until recently prevented most refiners from establishing prices at maximum levels have had their costs boosted substantially by FEA's adjustment in the EPCA mandated small refiner entitlement bias. The impact of the increase will be felt primarily during the summer months and should be gone by October or November. The effect of such an increase would be to add as much as a .3 percent increase in the CPI. In the worst case, a very tight summer gasoline market might cause the CPI to increase by .4 percent at the peak.

Wages. During the first quarter of 1976, first year increases under major collective bargaining agreements were about 10 percent overall. Compensation per man-hour for private employees increased at an annual rate of 7.5 to 8.0 percent. The adjusted hourly earnings index increased at a 7.7 percent annual rate during the first five months of 1976. These increases are 1.0 to 2.0 percentage points below the CEA forecasts made in December 1975.

Thus far this year strike activity has been at a relatively low level. The one important lengthy strike has been among rubber workers who did not have, and now seek, a COLA clause in their contract. Most of the important contracts that terminate later this year have COLA provisions. The lack of union militancy supports the view that collective bargaining settlements will be moderate this year.

With a rate of inflation of 5 to 6 percent, compensation per man-hour is not likely to exceed our forecast for 1976 (9.5 percent) and there is a strong likelihood that it will be one or two percentage points below this earlier forecast. Because of the large number of major collective bargaining agreements yet to come and the strength of the recovery, we prefer at this time not to lower our estimated range published in January. However, if current developments continue for another month or two, a downward revision would be warranted.

Summary. The combination of risks of further price changes than predicted are as follows. Food prices are as likely to fall short as to exceed the forecast based on futures markets prices. Energy prices are more likely to exceed, and wages to fall short, of the forecasts. Thus the "upside risk" cannot much exceed another 0.5 percent increase in the CPI beyond the 5 percent forecast.

EYES ONLY

MINUTES OF THE
ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

June 30, 1976

ATTENDEES: Messrs. Seidman, Greenspan, Lynn, Richardson, Dixon, Gorog, Porter, Perritt, Malkiel, Gerard, Kearney

1. New York City

The Executive Committee briefly reviewed the current financial condition of New York City. The discussion focused on the elements of the City's financial plan, the directive of the Control Board to the City to determine and implement specified additional spending reductions, and the status of the labor situation with regard to the five major unions.

Decision

The Executive Committee approved submitting to the President an information memo on the current New York City financial situation.

2. Presidential Statement on Taxes

The Executive Committee discussed the legislation extending the current withholding rates which is expected to reach the White House today. The Committee also briefly reviewed the most recent version of the draft presidential statement on taxes.

Decision

The Executive Committee unanimously agreed to recommend to the President that he issue the statement on taxes and sign the legislation today.

3. Economic Analysis of the Public Works Bill

The Executive Committee reviewed a memorandum, prepared by OMB and CEA, on an economic analysis of the public works bill (S.3201). Secretary Richardson reported that at the U.S. Conference of Mayors meetings there was

EYES ONLY

strong support for the legislation. The discussion focused on the elements of the bill and the changes in economic conditions since the President vetoed similar legislation last February.

Decision

The Executive Committee will provide its recommendations on the legislation in a memorandum to the President. Treasury, OMB, CEA and Commerce favor vetoing the legislation; the Department of Labor favors signing the legislation.

4. H.R. 12323

Mr. Seidman briefly reported on the recent extensive discussions with various government officials by interested outside parties on H.R. 12323 relating to telecommunications regulation. The Executive Committee also reviewed a letter from the Acting Director of the Office of Telecommunications Policy to Secretary Simon requesting that the Economic Policy Board establish a task force to consider the proposed legislation.

Decision

The Executive Committee unanimously agreed to recommend to the President that the Administration not take a position on the pending legislation at this time in order to more fully evaluate the merits of the bill and to consider public testimony that would emerge in hearings on the legislation.

The Executive Committee agreed that it was not necessary to establish an EPB task force on this issue but that individual departments and agencies would actively consider the advantages and disadvantages of the legislation.

The Executive Committee approved submitting an information memorandum to the President outlining the above recommendations.

5. Other

The Department of the Treasury was requested to prepare a paper outlining a recommended position on the amendment to the tax reform bill requiring withholding on interest and dividends.

RBP