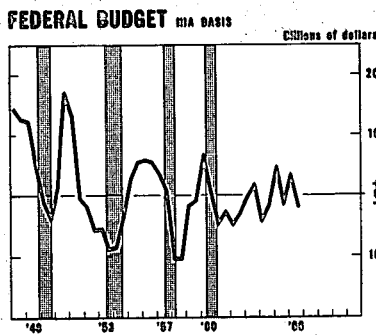
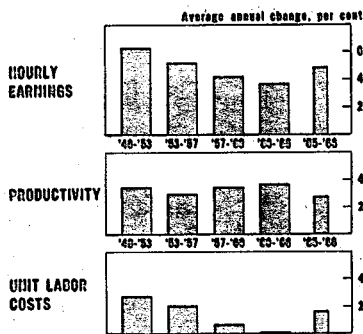




prices moved more or less in line with wholesale prices. After 1958, however, the two series began to diverge. The rise in consumer prices since then has reflected in large part increased costs of services.

An important factor moderating cost-price pressures over the postwar period has been the diminishing rate of increase in hourly earnings in manufacturing (including fringe benefits). The bars in the accompanying chart represent average annual rates of increase from one cycle peak to the next. In each successive cycle, the increase has been smaller. Meanwhile, productivity gains have continued to be rapid—averaging between 3 and 4 per cent per year. Unit labor costs, consequently, have increased progressively less, and between 1960 and 1966 they showed virtually no rise.

In the last year of the recent period, however, the pattern changed dramatically. Hourly earnings rose more rapidly—in the context of rising consumer prices, higher profits, and a tight labor market. And with gains in productivity slowing, unit labor costs rose significantly.

Avoiding inflation and recession depends on fiscal as well as on monetary policy. Deficits and surpluses in the Federal budget, as measured in the national income accounts, have contributed importantly to cyclical stability. The budget has moved toward deficit during recessions and back toward surplus during expansions.

In the most recent expansion the swing toward surplus was cut short by tax reductions, which played a significant role in prolonging economic growth. But when the expanded defense effort began in mid-1965, the rapid escalation of expenditures prevented the movement toward budget surplus that we needed to help maintain price stability.