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Philippine Inflation, 1967-1974

VICENTE B. VALDEPENAS, JR.

THE REALITY OF INFLATION

Consumer prices in the Philippines rose about 2 percent every year during 1967-1969, 8 percent during 1968-1970, 18 percent during 1969-1971, 15 percent during 1970-1972, 10 percent during 1971-1973, and 26 percent during 1972-1974. Over the last seven years, therefore, the rise in prices, or what economists call inflation, has accelerated. In 1974 alone, prices rose 40 percent over those of 1973. In fact, two-digit inflation, which now disturbs even the sturdy economies of West Europe, Japan and North America, has plagued the Philippines since 1967, virtually in the manner of the seven-year plague of biblical times. Because food prices, more often than not, have led the rise in prices over this period, the average Filipino family has become increasingly aware of inflation, and more acutely so in 1974 than at any other time in the last seven years.

Moreover, recent evidence shows that whenever inflation accelerates, prices in rural Philippines tend to outpace those of the urban Manila area. That is, accelerating inflation gnaws away at rural incomes far more quickly than it eats away urban incomes, even as the average incomes of rural Filipinos are generally smaller than those of the urban Filipinos. In short, the poor become even poorer in the course of a rapid inflation. In the same process, the rich of course become less rich. However, both inevitably writhe under the impact of a runaway inflation that persistently erodes their purchasing power as the logic of compound interest, which applies to all growth rates, pyramids more price inflation through time.

Part of the problem in trying to understand the nature of

inflation is freeing its discussion from a number of popular clichés about it. One is the notion that the peso today is worth only just so many centavos, say, 40 centavos. Of course, the peso is always worth 100 centavos. However, 100 centavos today buy less than they used to buy, say, ten years ago. Another misconception is the equation of inflation with a fall in the "purchasing power of the peso." While it is true that the buying power of the monetary unit necessarily falls as prices rise, it falls in less proportion than the rise in prices. Conceptually, it cannot fall more than 100 percent, that is, beyond zero. On the other hand, prices can rise to any level.

Table 1
Prices and Purchasing Power in the Philippines, 1967-1974
1965 = 100

Year '67-'74	Consumer Prices			Wholesale Prices	Purchasing Power of Peso*
	Philippines	Non-Manila	Manila		
1967	110.6	110.3	112.0	107.0	₱0.893
1968	113.0	112.4	114.6	109.9	0.873
1969	114.5	113.9	116.9	111.4	0.855
1970	131.5	130.9	133.7	137.7	0.748
1971	160.2	162.0	153.2	159.3	0.653
1972	173.4	174.5	168.9	175.4	0.592
1973	194.5	196.4	187.5	218.4	0.538
1974	271.9	277.0	251.9	337.5	0.397
<i>Period</i>	<i>Annual rates of change, percentages</i>				
1967/68	2.17	1.90	2.32	2.71	-2.24
1968/69	1.33	1.33	2.01	1.36	-2.06
1969/70	14.93	14.93	14.37	23.61	-12.51
1970/71	21.83	23.76	14.58	15.69	-13.97
1971/72	8.24	7.72	10.25	10.11	-9.34
1972/73	12.20	12.55	11.01	24.52	-10.17
1973/74	39.79	41.04	34.35	54.53	-25.52

*This is the reciprocal of the price index, multiplied by 100. The index used is the Consumer Price Index (CPI) for Manila

Source of data: Central Bank of the Philippines.

For all their ambiguity, however, such popular expressions do betray the fundamental source of all anxiety about inflation, that is, the persistent rise in the prices of goods and services that people buy. There is anxiety because of some lurking suspicion at the back of people's minds that the prices of the goods and services they sell, in short, their incomes, may not increase at all; or, if they do, that they fail to increase as fast as the prices of the goods and services they buy, with all the consequent diminution in personal well-being that this lag necessarily implies. The erosion in well-being depends on the extent of the lag between their incomes and the prices they pay for the goods and services they buy, while the magnitude of the lag between incomes and prices depends both on their initial levels and on their relative rates of change. Thus, it is crucial in all this discussion to have, among other things, some adequate measure of the price changes in the goods and services that people generally buy.

This brings us to a consideration of the alternative price indexes that have been devised to monitor movements in the purchasing power of a monetary unit over a period of time.

MEASURING INFLATION

One measure of inflation that has been used in the Philippines with some degree of regularity, or perhaps notoriety, is the Consumer Price Index or the CPI. Like all price indexes, the CPI is arithmetically a weighted average of the retail prices of a given mix of goods and services an average family or household in the Philippines buys at a given moment of time. Thus, the CPI does not measure the price level itself, but merely the changes in the level of prices over some arbitrarily selected reference point, which is usually described by price statisticians as the base year. In the concrete, it measures changes in the total peso cost of a specific market basket of goods and services. As statisticians would put it, the CPI is formulated on the basis of a Laspeyres index, which is a fixed-weight index and thus cannot account for changes in *relative* prices. Because it is an average,

the CPI can only roughly approximate the prices paid by any one individual or family.

Moreover, because it is an average at a given point in time, the CPI shares in all the shortcomings of such an average. It fails to account for quality changes in consumer products and services and for changes in consumer patterns of spending over time. In other words, it fails to capture the actual average price of consumer goods and in this sense, the CPI is not an accurate measure of changes in the cost of living.

For all its shortcomings, however, the CPI continues to be the most commonly used peg for union demands to revise labor contracts, for demands by unorganized labor to get wage and salary adjustments, and for others to escalate interest, rents, leases, annuities, and similar payments for different factors of production, all in the common effort of protecting one's real income from the erosion of inflation. Our own history with the CPI dates back to 1949, when the Central Bank of the Philippines first used it, although it was limited only to the Manila area and subsequently rebased to 1955. It was later extended in 1957 to cover regions outside Manila and the rest of the Philippines. In 1965, the weights were reconstituted to cover 325 consumer goods and services in Manila, and 295 in the regions outside Manila. Table 2 (p. 324) shows the weight distribution for the Manila CPI for 1955 and 1965. The Central Bank prepares three sets of CPI, one for Manila, another for the non-Manila regions, and a third covering the whole Philippines.

A second measure of the general price level and therefore of inflation is the Wholesale Price Index or the WPI, which is also prepared by the Central Bank. The WPI covers prices of goods at which sellers, i.e., producers or importers, accept orders for either spot or the earliest possible delivery, usually in large lots or bulk sales at various stages of bulk distribution. Prices are quoted with reference to Manila. A total of 242 commodities, in varying degrees of fabrication, are covered, and the system of weights reflects the proportion of domestically produced and imported goods to the available supply of products as of a given

Table 2

Percentage Distribution of Consumer Expenditures in Manila		
	1955	1965
Food	47.50	43.46
Housing	7.81	20.83
Clothing	8.32	5.24
Fuel, light, water	5.23	3.76
House furnishings & operations	6.85	6.01
Education	9.93	4.14
Transportation	4.89	4.46
Personal & medical care	5.14	3.74
Beverages & tobacco	4.87	3.98
Taxes & donations	0.20	2.57
Recreation	3.26	1.81
ALL ITEMS	100.00	100.00

Source of data: Central Bank of the Philippines.

base year. For 1965, domestic output comprised 84.3 percent of the available supply, with goods for home consumption accounting for 69.4 percent and exports for 14.9 percent. Imports made up the other 15.7 percent of the total supply of goods that year. Like the CPI, the WPI is also based on the Laspeyres index, which, as we have indicated earlier, is a fixed-weight index.

Our history with the WPI also dates back to 1949. Since then it has been reconstituted twice, once in 1955 and ten years ago, in 1965. The weight distribution of the different commodities is shown in Table 3, opposite. The Central Bank of the Philippines, which has pioneered in the preparation of most of our useful economic statistics, constructs eight variants of the WPI. However, for purposes of keeping track of the monthly changes in wholesale prices, the General Wholesale Price Index suffices.

Since 1955, wholesale prices of raw materials have been sub-

Table 3

Percentage Distribution of Wholesale Expenditures

	1949	1955	1965
Food	62.00	47.54	37.73
Beverages & Tobacco	4.54	8.08	6.45
Crude Materials	17.89	11.08	12.48
Mineral Fuels	2.17	3.31	7.30
Animal & Vegetable Oils	—	1.23	2.70
Chemicals	2.65	4.74	5.19
Manufactured Goods	8.26	12.19	14.59
Machinery & Transport Equipment	1.32	3.78	8.99
Miscellaneous Manufactures	1.17	8.05	4.57
ALL ITEMS	100.00	100.00	100.00

Source of data: Central Bank of the Philippines

ject to wider amplitudes of change than those of finished goods. This is partly due to the relative stability of labor and overhead costs, which account for most of the difference between prices of raw materials and those of finished goods. It is also partly due, however, to a greater degree of market imperfection in finished goods, the prices of which are frequently 'administered,' that is, determined by decisions of a few executives rather than by free market forces, which is often the case in the market for raw materials.

Because wholesale prices relate only to commodities and are frequently quoted at a discount from published list price depending on volatile negotiations and changes in market conditions, the WPI is not a very informative measure of the purchasing power of the peso. Its weights, moreover, are based on quantities purchased in all markets and thus fail to approximate closely the 'market basket' of any particular group of buyers.

Since both the CPI and the WPI are flawed in the ways that we have indicated above, economists in recent years have tried

to look for a more suitable gauge of inflation, with the help of the Gross National Product (GNP) statistic which is now compiled by the National Economic and Development Authority (NEDA). GNP, of course, is the market value of all goods, physical structures, and services which our economy produces in a year. Its principal elements are: (1) consumer purchases, (2) business investment (including residential construction plus changes in business inventories), (3) government purchases, and (4) the net purchases of foreigners. Only transactions in final goods are included, thereby avoiding in the process any double counting.

Since GNP data are collected in current market prices or pesos, changes in GNP in current pesos (or what is known as *nominal* GNP) reflect both changes in prices and changes in physical output. Thus, to get a measure of total real output (or what is known as *real* GNP) in pesos of constant purchasing power, the different elements that constitute nominal GNP are *deflated* by the appropriate price indexes for each element or type of GNP expenditures. Having deflated all the elements of nominal GNP, they are subsequently totaled to obtain real GNP. Dividing nominal GNP by real GNP results in a ratio that economists have come to describe as *the implicit price deflator*, alternatively as *the GNP deflator*, or simply *the deflator*. The deflator is weighted by the relative shares of the different elements of final expenditure in the GNP value for the year, the half year, or the quarter, as the case may be. This implies that the weights shift from one period of time to another, depending on actual shifts in the total product mix through time. The deflator therefore is a shifting-weight index. Because it is not a price index in the sense in which we have described price indexes above with reference to the CPI and the WPI, both of which are fixed-weight indexes, the GNP deflator is described as *the implicit price deflator*.

However, the GNP deflator is now increasingly accepted throughout the world as the most comprehensive measure of changes in the general level of prices or inflation, even as changes

in the deflator from one period to another reflect both the shifts in the composition of GNP and the changes in prices.

WHICH PRICE INDEX TO USE?

The availability of three different price indexes, while suggestive of the prowess of Filipino statisticians at generating statistics, can also be the source of an irritating confusion over the actual severity of inflation, especially if they tell three different, not to say conflicting, stories about the phenomenon of inflation. Part of the problem in our present case is the substantial difference we have already noted in the construction of the CPI and the WPI on the one hand, and the GNP deflator on the other. Both the CPI and the WPI are fixed-weighted indexes, which limit their capability at capturing effectively the changes in the actual prices charged by retailers and wholesalers. The GNP deflator, on the other hand, is based on shifting weights, which makes it more capable at registering the actual level of prices that prevail throughout the economy, but at the same time renders it less capable at specifying the extent of erosion in the buying power of the people for a customary level of living as defined with respect to a particular reference point in time.

In spite of all these reservations, however, movements of the CPI are continually invoked to justify all sorts of cost-of-living adjustments in take-home pay, whether one is an ordinary wage earner or a pedigreed executive. While movements in the WPI frequently hug the headlines, the GNP deflator remains the broadest measure of price performance which economists in increasing numbers now use to test the efficacy of avowed public policy at stabilization. Since all the three price indexes seem to be so much in currency, perhaps their movements taken together through time will give us a firmer idea of the kind of inflation that presently afflicts virtually all of us.

As an aid to this comparison, both the CPI and the WPI, which in the original form they were prepared by the Central Bank have 1965 as their base year, have been reconstructed with 1967 as the base year, which also is the base year for the GNP deflator. After putting all the three price indexes on a common

base year to make them comparable, their movements through time since 1967 are indicated in the following table:

Table 4
Three Measures of Inflation, 1967 = 100

Year	CPI Philippines	WPI General Manila	GNP Deflator
1967	100.00	100.00	100.00
1968	102.17	101.87	105.60
1969	103.53	104.11	111.60
1970	118.90	128.69	128.20
1971	144.85	148.88	146.50
1972	156.78	163.93	159.69
1973	175.86	204.11	182.38
1974	245.84	315.42	233.20

Sources of Primary Data: CPI and WPI, Central Bank of the Philippines. GNP Deflator, National Economic and Development Authority.

It is clear from the above tabulation of price data that the CPI and the GNP deflator, despite substantial differences in their statistical characteristics, do tend to move together fairly closely through time. The CPI, for example, rose by 145.8 percentage points in the seven-year period 1967-74, while the GNP deflator rose by 133.2 percentage points. But the WPI over the same period rose by 215.4 percentage points. Moreover, if one considers the annual rates of changes, either on a simple or compounded basis, the converging movements of the CPI and the GNP deflator, and the diverging movement of the WPI from both, become even more apparent. Thus, while the CPI rose annually by 13.7 percent compounded rate and the GNP deflator by 12.9 percent, the WPI on the other hand increased at the annual compounded rate of 17.8 percent.

It is also clear from these same price data that inflation on all fronts exploded in 1974 at the infamous rates of 39.8 percent over 1973 in the case of the CPI, 27.9 percent in the case of the

GNP deflator, and 54.5 percent in the case of the WPI. The erosion in purchasing power that such magnitudes of price increases necessarily imply easily qualify 1974 as the year of infamy in the annals of Philippine inflation. Moreover, the same price data tend to show that there has been a fairly persistent build-up since 1967 toward a booming inflation that finally erupted in 1974, in spite of an apparently growing sophistication over this period in the processes of economic planning and management, and therefore in the ability, among others, to control inflation. How could so much mindless inflation break out in the midst of so much pedigreed competence?

DECOMPOSING THE INFLATION

One way to explain inflation is to consider the price movements of the individual groups of goods and services that constitute the three broad measures of inflation that have been presented earlier. This process will at least identify the types of goods and services that account for most of the inflation on the CPI, WPI, and the GNP deflator, although it does not in itself explain why these goods and services have been subject to so much price change over the seven-year period 1967-74.

Consumer prices in the Philippines, insofar as their movements are captured by the CPI, have been rising at a compounded annual rate of 13.7 percent in 1967-74. Food prices accounted for 55.3 percent of the rise in consumer prices, personal services such as transportation, education, recreation and upkeep of the house accounted for another 23.5 percent, while housing itself accounted for 8.5 percent, clothing for 8.5 percent, and utilities such as fuel, light, and water for the final 5.4 percent of the rise in consumer prices (see Table 5, p. 330).

Wholesale inflation, which averaged an annual compounded rate of 17.8 percent in the period 1967-74, was also paced by continually rising food prices, which explain 36.5 percent of the inflation, even as prices of manufactures accounted for another 16 percent, and those of crude materials for 14.8 percent. Price increases in mineral fuels accounted for 9.1 percent of the wholesale inflation, machinery prices for 6.5

Table 5
Percentage Contribution to the Consumer Inflation
 1967-74

Food	55.3%
Personal Services (education, transportation, etc.)	23.5
Housing	8.5
Clothing	7.3
Utilities (fuel, water, light)	5.4
TOTAL	100.0%

Table 6
Percentage Contribution to the Wholesale Inflation
 1967-74

Food	36.5%
Manufactures	16.0
Crude Materials (inedible)	14.8
Mineral fuels	9.1
Machinery & transport equipment	6.5
Chemicals	5.6
Miscellaneous other manufactures	4.4
Animal & vegetable oils & fats	4.2
Beverages & tobacco	2.9
TOTAL	100.0%

percent, prices of chemicals for 5.6 percent, while prices of miscellaneous manufactures accounted for 4.4 percent, animal and vegetable oils for 4.2 percent, and beverages and tobacco for 2.9 percent.

Food prices, therefore, have led the persistent rise in consumer and wholesale prices in the last seven years, in spite of the prodigious efforts and money that have come to characterize the Government campaign for expanded food production and distribution over the same period. In fact, the behavior of food prices during the period seems to indicate almost a total frustra-

tion of the public policy on food. They also indicate, however, that only an effective food policy is likely to tame the virulence of the inflation that burst into its most disgraceful proportions in 1974.

Prices of GNP goods and services rose at a compounded annual rate of 12.9 percent over the same period. The continuing increase in the prices of consumer goods under the pressure of household spending accounted for 71.4 percent of the inflation on the GNP deflator, even as the rise in capital goods prices as a result of business spending accounted for another 27.9 percent. On the other hand, increases in the price of goods and services purchased by the Government for current consumption contributed 5.2 percent to inflation of the GNP deflator, while prices of net exports represented a negative contribution of 4.5 percent.

Table 7

Percentage Contribution to GNP Inflation

Household spending	71.4%
Business spending	27.9
Government spending for current consumption	5.2
Net export spending	-4.5
TOTAL	100.0%

THE CAUSES OF INFLATION

A decomposition of inflation such as we have just presented reveals which goods prices have been continually rising over the time period under review. However, it does not of itself tell us why those prices have been rising as rapidly as they have. At best, decomposing inflation suggests where the price pressures tend to concentrate, that is, which commodity markets are caught in the bind of a real economic scarcity or in the spell of an administered shortage. In a free market economy, prices are the result of interaction between supply and demand forces. In the course of this interaction, prices tend to allocate goods and

services either at the commodity or the factor market. High or low prices imply some disproportion either between the quantity that is supplied and the quantity that is demanded at a given point in time or between the levels of supply and demand in given markets, including in the latter some disproportion in the rates at which the level of demand adjusts to the level of supply through time. That is, when the quantity of goods or services demanded at prevailing prices exceeds the quantity that is supplied or made available, prices tend to rise, often after some lag. On the other hand, when the quantity of goods that are supplied or made available at prevailing prices exceeds the quantity that is demanded, prices tend to fall, again after some lag.

It is clear from all this that the prices adjust merely to match supply with demand in the given market. These are in the nature of a temporary or a once-and-for-all adjustment in the average level of prices; and, insofar as they are fairly short-lived episodes of price changes, they do not determine the subsequent rate of increase in the average level of prices. In short, in our notion of inflation as a persistent or continuing increase in the average level of prices, such episodic price adjustments due to such special or random events as typhoons, droughts, or other natural disasters, do not cause inflation. Nor do individual prices cause or trigger inflation. As a matter of fact, it is consistent with our notion of inflation that, at a given point in time, the prices of some individual goods or services increase, which they often do, at the same time that the prices of other goods or services decrease. Such isolated price changes do not constitute inflation. There is inflation only when prices, taken altogether, persistently increase through time. It must follow from all this that, in themselves, food prices or even oil prices do not cause inflation.

If typhoons and floods do not cause inflation and neither do rises in the price of food or of oil, then where is all this maddening inflation in the Philippines coming from? Following up on a point that has already been made, prices change over time because of disproportions between supply and demand. In the case of inflation, therefore, the average level of all prices persistently increases through time because of a disproportion

between overall or aggregate supply and overall or aggregate demand or spending for goods and services. The disproportion is the result of one variable moving in greater or in less proportion than movements of the other variable through time.

In the case of aggregate supply of goods and services or the potential productive capacity of the nation, it grows as a result of increasing labor force, longer working hours, and new technological breakthroughs that effectively reduce the unit cost of production, in the process raising productivity and efficiency. Aggregate demand or spending for goods and services, on the other hand, grows over time as a result of economic policies on money and credit, and on taxes and government spending. Because their origins and sources of growth differ, movements in aggregate demand or spending over time do not necessarily converge with those of aggregate supply or the nation's potential productive capacity. Whenever they diverge, therefore, the disproportion results in an inflation of prices. However, what is important to remember in all this is the fact that aggregate demand or spending grows out of man-made decisions on monetary and fiscal aggregates, and because man makes the decisions or policies, he can make them any time he wants, nay, he can even *make them up*, indeed, fake them. But aggregate supply or productive capacity is altogether a different phenomenon. It grows by dint of hard work, good breeding, imagination, and requires plenty of such hardware as machinery, physical structures, and all manner of infrastructure, all of which take some time, perhaps generations, to deliver in workable form. There is, therefore, some inherent tendency for aggregate demand to outpace aggregate supply. The lag between demand and supply depends on (1) the ability to manage total spending and (2) the speed with which productive capacity responds to changes in the level of total spending in the form of larger volumes of goods and services. The fundamental job of a stabilization or an effective anti-inflation policy is to align the expansion in aggregate demand with the rate of expansion in aggregate supply. In other words, inflation thrives in a climate of excessive growth in aggregate demand or spending relative to aggregate

Table 8

Money, Spending, Output, and Prices in the Philippines, 1967-1974

Terminal semester 1-67/2-74	Money supply*	Total spending (Nominal GNP)	Total output (Real GNP)	Prices (GNP Deflator) 1967 = 100
<i>Millions of Pesos</i>				
1-67	3,440	13,082	13,254	99
2-67	3,782	14,240	14,068	101
1-68	3,699	14,713	14,050	105
2-68	3,982	15,719	14,770	106
1-69	4,029	16,171	14,881	109
2-69	4,754	17,918	15,655	114
1-70	4,631	19,696	15,849	124
2-70	5,047	21,483	16,260	132
1-71	5,200	23,897	16,823	142
2-71	5,567	26,192	17,367	151
1-72	5,377	27,764	17,765	156
2-72	6,797	29,105	17,848	163
1-73	7,101	32,918	19,384	170
2-73	8,152	38,396	19,754	194
1-74	8,959	44,847	19,860	226
2-74	10,220	49,953	20,791	240

*June and December figures.

Note: Nominal GNP is Gross National Product at current prices, while Real GNP is Gross National Product at 1967 prices. The GNP deflator is obtained by dividing Real GNP into Nominal GNP and multiplying the result by 100.

Source of data: Money, Central Bank of the Philippines; spending, output, and prices, National Economic and Development Authority.

supply or productive capacity. The test, therefore, of any effective effort at controlling inflation is whether the growth in total output keeps pace with the growth in total spending.

How has Philippine economic policy performed against this test? In the period 1967-74, as the economic data in Table 8 show, total spending in the Philippines rose at the compounded rate of 8.7 percent every six months, while total output managed to grow by only 2.8 percent every six months. In short, aggregate

Table 9
 Consumer and Wholesale Prices in the Philippines, 1967-1974
 1965 = 100

Terminal semester*	Consumer Prices			Wholesale Prices Manila
	Philippines	Non-Manila	Manila	
1-67	109.7	109.6	110.1	105.6
2-67	114.0	113.5	116.1	113.3
1-68	113.3	112.8	114.2	109.8
2-68	113.4	112.5	116.1	109.7
1-69	114.1	113.7	115.7	109.5
2-69	119.6	119.2	121.1	119.0
1-70	129.7	128.8	133.4	138.5
2-70	145.3	146.0	142.6	150.3
1-71	156.1	157.9	149.1	157.2
2-71	171.1	173.8	160.7	169.3
1-72	170.9	172.0	166.6	176.7
2-72	169.0	169.3	167.9	177.4
1-73	187.3	188.8	181.4	210.6
2-73	225.5	228.9	213.8	267.4
1-74	272.3	277.7	251.3	352.3
2-74	291.1	295.5	273.9	350.7

*June and December figures.

Source of data: Central Bank of the Philippines.

demand was allowed to increase far more rapidly than aggregate supply. The disproportion generated, as a matter of course, an inflation which grew every six months by 5.7 percent on the basis of the GNP deflator, by 6.3 percent every six months on the CPI basis, and by 7.8 percent every six months on the WPI basis. And as we have noted previously, inflation actually accelerated between 1967 and 1974. That is, inflation by the end of 1974 was far more virulent than at the start of 1967. It seems that what started out as an inflation flu in 1967 took seven full years to develop into the debilitating epidemic that it has become in 1974.