dence on the business outlook comes from the leading indicators. Manufacturers' sales have exceeded new orders since March. This means that order backlogs are going down and, unless the trend is reversed very soon, production is bound to fall.

Inventory investment declined sharply in the second quarter of the year, suggesting that businessmen are already anticipating a slowdown in demand. The decline in inventory investment is not all due to the unusual steel situation; other industries are also exhibiting the same tendency. Fortunately, fixed investment—particularly construction—has continued to rise, but new orders of firms manufacturing machinery and equipment have been sliding off since January. This implies a weakening of investment demand and is perhaps the most disturbing sign of all.

I am not trying to suggest that a downturn in business activity in the near future is a certainty. We have had slowdowns before without experiencing a recession. The two most recent cases were 1951 and 1956—but, in both cases, there were good reasons for the pickup.

In 1951, defense expenditures continued to rise rapidly as the Korean war continued. In 1956, private investment remained strong and defense orders rose sharply while industry generally was operating close to capacity. Today, Federal expenditures are still rising, but at a declining rate; excess capacity at current rates of output is widespread; and there are no signs of a strong upward movement anywhere in the private economy.

We have had a good year in autos and housing, but these industries are hardly likely to go much higher with personal incomes leveling off. Inventory investment will continue to decline unless retail sales pick up, and the latter is not likely to happen unless incomes go up faster.

Profits are already falling, even though some specific companies have reported record earnings for the first half of the year. With the large amount of excess capacity throughout industry, it is hard to believe that we are about to see a significant increase in investment demand. (The more liberal depreciation allowances will certainly be helpful and so would the investment credit if it were enacted, but their effect probably will not be immediate.)

In brief, the situation looks more like mid-1957 than 1951 or 1956. Then, as now, inventory accumulation was low, manufacturers' new orders were declining, and order backlogs were going down. Without implying a forecast for this year, I simply record the historical fact that the peak of that cycle was reached in July 1957.

WHAT WENT WRONG?

Since proper diagnosis is an essential prerequisite to prescription, it is important to explain the premature slowdown in the rate of expansion. Until the turn of the year, the recovery was going along on schedule. There were differences of opinion over the outlook, but practically all informed observers expected the rise to continue vigorously at least until midyear.

In this situation, the administration submitted a budget for fiscal year 1963 that would be roughly in balance if the 1962 GNP turned out to be $570 billion. It is to be noted that the balanced budget was