

1966—YEAR OF EXCESSIVE DEMANDS AND THEIR CONTROL*

Nineteen sixty-six was the sixth consecutive year of expansion in spending and production. In each year since 1960 total demand for goods and services has risen rapidly enough to reduce the proportion of workers unemployed and the proportion of plant capacity unused. The year 1966 differed from the previous five, however, in several significant respects.

Aggregate demand for goods and services was excessive during most of the year. In the 1961-64 period demand rose sufficiently to bring the economy steadily closer to its potential output and, on the whole, in a moderate and orderly fashion, avoiding the creation of undue problems of resource allocation and inflationary pressures. During 1965 there was a much more rapid growth of total demand, accompanying the acceleration of activity in Vietnam, but most of the rise was matched by an increase in output. During most of 1966 the rise in demand continued to be rapid and significantly outpaced the ability of the economy to produce.

The year 1966 was one of inflation. During the first 4 years of the business expansion, sales and production rose in parallel fashion, and overall prices changed little on balance. Beginning about mid-1965 total demand rose more vigorously than real output, and rises in price indexes became notable. In 1966 demand continued to rise rapidly, and, with the economy at virtual capacity, about half of the rise was translated into higher prices.

Federal budget policy was more stimulative to total demand in the last half of 1965 and in 1966 than it had been in over a decade. From a relatively restrictive stance in 1960 budget policy became progressively more expansionary through tax cuts, additional welfare programs, and acceleration of the war in Vietnam. Such developments are believed to have been major forces in the growth of total demand from an inadequate level in the early 1960's to the excessive level of 1966.

Monetary trends changed markedly during the year. In mid-1960, several months before the cyclical upturn, the money stock began rising moderately, at about a 3-percent annual rate compared with an average 2-percent rate in the previous decade, and continued to rise at this pace until mid-1964. From the summer of 1964 to the spring of 1965 money rose at an expansionary 4-percent rate, and from the spring of 1965 to the spring of 1966 it went up at a very stimulative 6-percent rate. This marked expansion was probably a significant factor in the strong rise in total demand during 1965 and 1966. From April through November money declined on balance, acting as a restraining force on total demand in the last half of 1966.

Interest rates rose rapidly from mid-1965 to the spring of 1966 and then spurted yet more rapidly until September, reaching the highest levels in over thirty years. Higher yields were reflected in a decline of bond prices and exerted a depressing influence on the value of common stocks, real estate, and other capital assets. The rise in

*Reprinted from Federal Reserve Bank of St. Louis Review, December 1966.