

CONSUMPTION

After months of sluggishness, retail sales have most recently registered three monthly gains in a row, according to current provisional estimates. A pickup in automobile sales has been a major contributor. The saving rate is still unusually high, and such a situation has typically been followed by a return to a more normal level. The marked improvement in the liquidity position of households and some recent survey reports on consumer confidence also point in this direction.

It would not be prudent, however, to count on a swift reduction in the saving rate. More conservatively, there are sound grounds for conviction that the saving rate will not rise further. Thus, consumption gains will at least keep pace with advances in disposable incomes.

SUMMARY

Adding all these elements together, without a tax increase or tight money, the prospective increases in residential construction, State, local, and Federal purchases, and in business fixed investment would contribute between \$5 and \$7 billion a quarter to the advance in GNP. The associated gain in consumer outlays would be perhaps \$7 to \$9 billion a quarter, even assuming no significant reduction in the rate of personal saving. Once inventory investment turns around, advances in GNP well in excess of \$15 billion a quarter would seem likely for the end of this year and the first half of 1968.

This would be too rapid a pace of growth, inconsistent with the stability of prices and interest rates. The productive capacity of our economy is expanding at a rate of around 4 percent a year. Allowing for the price increases which we must expect, GNP would keep pace with the growth of capacity by advancing about \$50 billion over the coming year. Since there is some excess industrial capacity today and since a resurgence of the economy would yield a special bonus in productivity gains, we would welcome advances which slightly outpace a \$50 billion annual rate. But we could not welcome—indeed, we probably could not safely tolerate—an upsurge that consistently exceeded a \$60 billion rate. The experience of late 1965 and early 1966 showed that a very rapid expansion of demand can generate inflationary pressures even when there is still some excess of unused resources in the economy.

Par for the course over the coming year would surely be a gain in GNP somewhere between \$50 and \$60 billion. Without new policy restraints, the pace of advance would be likely to exceed the upper limit of this range. With an appropriate tax increase to moderate the growth of consumer and business demand, our advance should stay within safe speed limits.

With an appropriate tax increase, we can look forward to continued high employment, progress toward price stability, and a smooth flow of credit.

EMPLOYMENT PROSPECTS

The stability of the unemployment rate has been a remarkable feature of this year's economic record. Both the elasticity of the labor force in response to changing employment conditions and the stability of businesses' employment policies have been gratifying. However, in