

some ways they have been puzzling and they cannot be counted on to continue with equal force during the summer months. It would not be surprising to see the unemployment rate drift upward to 4 percent in the next few months, even while the pace of activity speeds up.

Such a development would most probably be temporary, however. Assuming a GNP growth of around \$55 billion, the unemployment rate should be close to 3¼ percent most of the time in the next year, extending into a third year the best employment performance since the end of the Korean war. Job opportunities should improve in manufacturing without going so far as to recreate last year's bottleneck problems. Indeed, we may expect an increase in the supply of skilled and highly educated workers to ease some existing shortages. An unemployment rate of about 3¼ percent is consistent with balance in our labor markets.

A higher rate of growth of demand would undoubtedly bring about some further reduction in unemployment. But there would also be a marked intensification of labor shortages. The bulk of any increase in demand beyond the amount required to sustain the present level of unemployment would be matched by increases in prices and wages without adding to real output and employment.

In short, an excessive increase in demand will contribute to inflation while giving little benefit to the disadvantaged workers who still suffer from severe unemployment. The main route to a further reduction in unemployment rates over the longer run lies through our expanding and increasingly effective manpower policies.

PRICE PROSPECTS

The road back to price stability is a long and difficult one. One burst of price increases encouraged by an excessive increase in demand leads to a long series of additional ones. One producer's price increase raises the costs and the prices of others. Workers seek to get higher wages to make up for earlier cost-of-living increases and their wage increases are again reflected in cost and price increases. Fortunately, the spiral is not an endless one. After a burst of price increases the economy can gradually return to reasonable price stability. But it takes time and the right conditions to break the spiral. A return to price stability will be delayed if demand pressures generate labor, material, and capacity shortages which give new momentum to the cost-price spiral.

We have made good progress toward a return to reasonable price stability. The rise in prices during 1967 should be significantly smaller than last year. The progress we have made so far should, with the right demand conditions, lay the foundation for further progress. But that progress will occur only if demand moves ahead at a pace which does not much exceed the growth of our productive resources.

FINANCIAL OUTLOOK

Once there is assurance that fiscal actions will make a restrictive monetary policy unnecessary, there should be a change in the climate in financial markets. The pressures on long-term capital markets described earlier should ease and a more normal pattern of interest rates and borrowing will emerge. That pattern may involve some rise in short-term interest rates, accompanied by a downward movement in long-term rates.