

This, then, is the general picture of the economy as it developed in 1966, and as it looks today. The expansion is moderating, and it is our task to see that this present less vigorous, but more sustainable pace, is maintained. At the same time we must see that those sectors which did not fare well last year participate more fully in the general progress of the economy, while those sectors of excessive demand which gave us problems last year continue to grow, but at a slower and healthier pace.

PROSPECTS AND PROBLEMS CONFRONTING US IN 1967

A prerequisite for intelligent planning by the Government as well as by business is a reasonably accurate forecast of economic activity. However, as we know, economic forecasting is still an art involving the use of a combination of sophisticated techniques and the experience and judgment of the forecaster.

The Economic Report forecasts for 1967 an overall growth rate of 4 percent in real GNP, a price rise of slightly more than 2.5 percent, and a rate of unemployment averaging about the same as in 1966 — a little below 4 percent. On the basis of the information we now have, these appear to be reasonable expectations.

A year ago, the Economic Report forecast for 1966 an advance in real output of 5 percent, but it turned out to be 5.5 percent. The degree of escalation in Vietnam and its impact on the private economy was not evident in January of last year, and the forecasting of war expenditures is inherently difficult. Partly as a result of the much larger rise in GNP which occurred in 1966, actual Government revenues were far above those estimated; at the same time, Government expenditures greatly exceeded the forecasts made a year ago.

There are some specific aspects of the report which are very important as we look ahead, and I would like to review them in greater detail.

Purchases of goods and services by the Federal Government have risen sharply over the past year, mostly due to the acceleration of spending for the Vietnam operation. Chart 2 shows the recent spurt in defense purchases compared with prior years when such purchases were rising. For calendar year 1966 as a whole, defense purchases amounted to \$60 billion—a rise of \$10 billion from 1965. The budget implies a further rise of about the same size in calendar year 1967. In the fourth quarter of 1966, the annual rate of defense purchases was \$65.5 billion, \$5.5 billion higher than the average for the year 1966.

We know that unfilled orders of companies producing defense products have risen sharply over the past year. These orders are currently equivalent to nearly 11 months of the rate of shipments, compared with a little over 10 months ago. Thus, it may be expected that defense purchases will continue fairly strong in the first half of this year with a slowing in the second half of the year. I believe that this pattern of defense spending is realistic, unless, of course, a significant change should occur in the Vietnam situation.

We should be aware, however, of the implications of any marked deceleration in the pace of defense purchases later this year. While it is true that defense production would continue at an exceptionally