Chairman PROXMIRE. Now taking a look at the situation in the last half of the year, we are going to have a tax increase which we have just been told will not have much effect on demand. If it has any effect, it would certainly be negative. At least that has been proposed. A slowdown in business investment because of the proximity of the resumption of the investment credit. We are going to have a slowdown in defense purchases.

You have indicated that we are going to have a profit, perhaps some profit squeeze. This will be true if the very large number of labor-management contracts are settled with the wage increases that we expect, and the difficulty for business to pass those on to the consumer.

On the other side we have only these factors; No. 1, a stepup in social security benefits. The testimony we had is that that is likely to have its main impact in increased demand for food, which is unlikely to be very inflationary, because food isn't too responsive on the demand side, production factors are more important, and possibly medical services. Also not demand sensitive.

Most of the elements in our economy, like home buying, automobile buying, won't be affected much by the increase in social security benefits.

And then No. 2, you are allowing the second biggest element in the latter half, a resumption of prosperity or at least some better conditions in homebuilding, in construction generally, because of lower interest rates.

Mr. TROWBRIDGE. Yes.

Chairman PROXMIRE. The testimony we had this morning was to me not very reassuring in that area. Chairman Martin indicated that there are many problems involved in getting at the long-term rate, bringing it down, and in doing much more than we have done on the short-term rate because of the international balance-of-payments situation. So under these circumstances, it would seem to me we have some pretty significant bearish elements in the second half of 1967, and the bullish elements are not very impressive.

Mr. TROWBRIDGE. Wouldn't you add, Mr. Chairman, to the bullish side of the equation the anticipated State-local government expenditures, which I think are projected to be at a higher level, whereas we say, "a tapering off in the rate of advance in defense purchases," it is most likely that those defense purchases still are going to be quite high.

Chairman PROXMIRE. But the advance is so important, because our whole economy is growing all the time, and our capacity to meet production improves every month, and improves so impressively, that unless the advance continues, we are likely to have even more slack in your resources.

Mr. TROWBRIDGE. I think there is some projection too as to the buildup of inventories, which at the end of 1966 was very high.

Chairman PROXMIRE. That is true, yes. The assumption there is that that will be taken care of in the first half of 1967. Why is that?

Mr. TROWBRIDGE. I think the projection is that the rapid or the tremendous buildup of inventories in the last quarter of 1966 will taper off, and in the first half of 1967. The resumption of an upswing though is projected in the second half, and I think this would be on the bullish side of the equation as well.