already underway. I think we can see this in some industries where mild declines in volume are generating an erosion in profits of significant amounts. So we will have an economy which will have areas of expanding profits and areas of declining profits, but on balance corporate profit should decline.

My feeling is that in 1967, higher unit labor costs will be accompanied by a narrowing of profit margins and by some increase in unemployment. Nevertheless, there will be some pressure for higher prices from labor costs. Higher labor costs could be the most inflationary force in 1967.

Indicators of Lower Prices

1. One important portent has been the movement of sensitive raw materials prices during the past year. Changes in these prices tend to precede those in the general price level. The raw materials index, which is fairly responsive to underlying pressures, rose about 11% in the year ending February, 1966, at which time it averaged 113.8 (1957–59=100), (the actual daily high was about 115). During the past year, despite the public concern with price inflation, this index has been drifting lower. On February 14, the index was 102.2 or about 10% below the February 1966 level. Every group of raw materials was below the level prevailing a year earlier. (See Table 13)

Wholesale industrial prices have recorded little change since last July. Moreover, as I noted earlier, four out of 13 groups of industrial prices declined between July 1966 and January 1967. Such behavior does not portend a higher rate of increase in consumer prices than we have been experiencing. Rather, it suggests that the increase will be at a lower rate.

2. There are indications that in the absence of further sharp escalation in Vietnam, the rate of increase in economic activity may slow down and may even come to a halt. The expansion which has lasted six years is looking tired, particularly in the civilian sector of the economy. Tighter credit was accompanied by sharp cutbacks in the building industry and this is affecting related lines of activity. There have also been reductions in automobile sales. It is improbable that inventories will continue to rise at the recent rate of more than $1 billion a month. Any reduction in the rate of accumulations would reduce significantly the pressures for higher prices.

3. The suspension of the 7% Investment Tax Credit and of accelerated depreciation for buildings combined with tight money helped to slow down the boom in plant and equipment spending. Narrower profit margins, which are probable for this year, will reduce the incentive as well as the funds available to finance new plant and equipment. On the other hand, higher labor costs will increase the incentive to substitute machinery for manpower. On balance, a leveling off and then a decline in plant and equipment spending are in prospect. Such a development would contribute to the easing of credit and would act to reduce the pressure for higher prices.

I don't think that the restoration of the 7% tax credit on January 1, 1968, if it takes place, will do very much to arrest such a decline which will reflect fundamental readjustments in our economy.

If the Vietnam war ends, the level of real gross national product should decline from the level prevailing at the end of the war. I think there would be a swing in inventories, which alone would eliminate $15 to $20 billion from the national product.

I see 1967 as a year in which there will be a slower rate of growth if the Vietnam war continues, and a moderate recession, similar to the post-Korean one, if the Vietnam war ends.

I do not believe that any recession that develops will be deep and prolonged. The built-in stabilizers and the developments in federal fiscal policy and monetary policy would be such as to contain its magnitude, as it has in each of the postwar recessions.

4. Plant capacity has been expanding at a faster rate than the demand for goods and services so that excess capacity may develop in some industries in 1967. Such a development would make it difficult to raise prices and, in fact, would create pressures for price declines in the affected industries. We have already seen signs of this tendency in the chemical industry, and I think this will spread.

Price outlook

Inflationary pressures are still present in the economy, particularly from higher labor costs. However, on balance there is a strong probability that we have seen the maximum rate of pressures for price inflation. Prices should