

the second half of 1967 stepped up to a 3.8-percent annual rate after an earlier gain of only 2.2 percent. Wholesale industrial prices had been rising only 1 percent, but quickened their advance to a 2.7-percent rate in the latter half of 1967. These rates of price increases are rapid, and most alarming.

There is considerable evidence that these price trends are not merely temporary but will continue and strengthen if left unchecked. For example, the unemployment rate has been running well below 4 percent during the past 12 months and declined to 3.5 percent in January, revealing the pressures on our available labor force. Utilization of industrial capacity has risen in recent months close to the preferred operating rate for many industries. Recent wage negotiations have led to wage increases of 6 percent or more, well above productivity gains, setting an inflationary pattern for key labor contracts scheduled for bargaining in 1968. Minimum wage levels have advanced another notch, raising costs of production in many lines of business. In short, the stage is set for a wage-cost-price spiral during 1968 which could gain dangerous momentum if excessive demands are permitted to develop.

At the beginning of this year, the standard forecast developed by the majority of private economic analysts was that activity in the first half of the year would be quite strong, but that lesser gains in GNP were to be expected after midyear. The smaller gains foreseen for the second half were attributed primarily to the anticipation of a steel strike in August, a tapering off in the rise in defense spending, and assumptions that a continued high rate of personal saving would mean less-than-buoyant consumer spending. On these assumptions, many private forecasters predicted a GNP of about \$845 billion in 1968, fairly close to the forecast of the Council of Economic Advisers.

It is our judgment that predictions of a second-half slowdown in GNP will prove to be in serious error and that the outlook clearly points to a continued strong advance and possibly an acceleration of GNP in the latter half of 1968. The temporary influence of a steel strike can easily be offset by other factors, as witnessed in similar periods in the past, with little effect on the rise in GNP. For example, the \$1½ billion Government pay increase scheduled for the third quarter will provide a sizable boost in spending power. The accumulation of consumer savings during the past year provides a very large reservoir of potential spending, especially if consumers decide to speed up their buying in anticipation of substantial price increases on consumer products. Signs of serious inflation would stimulate further spending and add further to the pressures of demand.

Of perhaps greatest importance in the current outlook is the clear evidence that military spending will be much larger in the coming months than had been expected a few weeks ago. Recent developments in Vietnam and in North Korea are now expected to lift defense outlays by \$4 to \$5 billion more than had been estimated in the January budget figures. The second-half slowdown in GNP that had earlier been projected has been outmoded by these later developments.

It must be recognized that we are in a wartime economy, and our economic policies must be shaped to take account of the drain on our resources that the war requires. In contrast to goods produced for civilian use, military goods are not available to satisfy civilian de-