in 1966, as defense requirements kept rising. In retrospect, there is general agreement that a tax increase would have been desirable at that time.

The economy experienced a welcome slowdown late in 1966 aided by a strong dose of monetary restraint. From late 1966 to the summer of 1967, the trend of prices improved, although it was still pushed up by earlier cost increases. Consumer prices and the overall price index of GNP both rose at annual rates of less than 2½ percent in the first half of 1967. Interest rates retreated, reflecting both the change of pace of activity and the shift toward easier monetary policy.

As of mid-1967, when the economy began to emerge from an inventory adjustment, we were moving back onto the track of reasonable price stability, and we were preserving our prosperity. To head off a new upsurge, the President then urged immediate enactment of a 10-percent surcharge on income taxes. If that recommendation had been promptly accepted, the economic history of the past year and a half would have been considerably more favorable.

RECORD OF 1968

Without action on taxes, however, the Federal budget became an engine of inflation. In the first half of 1968, the new boom took hold and prices advanced at a disturbing 4-percent rate. This was accompanied by a jump in imports; nervousness in international financial markets; and pressures on financial markets at home, which could not be appropriately accommodated by monetary policy.

By the time the Revenue and Expenditure Control Act became law in June, private demand was very strong and it had developed great forward momentum. There was a significant slowdown in the second half but not as large or prompt as we had expected and hoped. Late in the year, business investment spending moved strongly upward from its earlier plateau. Housing rebounded in the face of tighter credit conditions. Consumer spending rose sharply in the summer months. But the marked slowdown of consumption in the fourth quarter showed that the tax surcharge had begun to exert a restraining impact.

Thus, in some respects, 1968 was too big a year. Yet, the unprecedented 8th consecutive year of expansion brought a 5-percent gain in real output, a 2.1-million rise in nonfarm payrool employment, and a decline in the unemployment rate of 3.6 percent—indeed, to 3.3 percent by yearend.

OUTLOOK FOR 1969

The outlook points to a further appropriate slowing of overall activity in the first half of 1969. Inventory investment is likely to retreat from its recent unusually high rate. Although, the saving rate of the consumer could move downward, the growth of consumer spending is likely to be moderate. Homebuilding will do well to stay near current levels in today's financial markets. And indeed the 15-percent decline in housing starts for December reported today indicates the problems that housing may be beginning to have in these markets.

Federal purchases should change very little. Current evidence suggests that, in the first half—GNP may rise at an annual rate between 5 and 6 percent—slowly enough to achieve a desirable cooling off, but rapidly enough to maintain distinct advances of output and development.