

declining, which we believe to be an important objective if economic stability is to be reestablished. We regard some slowing down of the rate of expansion in the first half of the year as probable, although the evidence is still uncertain. Much of the case for the slowdown rests on fiscal impacts which have proved in the past to be smaller, or at least slower, than was expected. The effects of the monetary restraints imposed in the latter part of 1968 may be felt only gradually in the first half of 1969. It is worth noting that the unemployment rate remained at the December level of 3.3 percent in January. The slowdown in the first half may, therefore, turn out to be smaller than the economic report assumes. Particularly, it seems unwise to count on the slowdown in the first half exerting such a cooling effect on the economy that the rate of inflation in the second half would continue to decline even though the rate of the economic advance generally would be accelerating.

The record of 1967 may be instructive. There was a bigger slowdown in the first half of 1967 and an upturn in the second half roughly comparable to that apparently implied in the last Council's projections for 1969. Still we find it significant and worrisome that by the end of 1967 the rate of inflation was again accelerating.

We think that the rate of expansion consistent with our economic goals in the second half of the year may be less than the economic reports imply. The goal should be to assure that the rate of inflation declines persistently throughout the year. This result would be consistent with President Johnson's estimate that the unemployment rate for the year would average less than 4 percent. It would also be consistent with a gross national product for 1969 which would differ from President Johnson's estimate of \$921 billion by much less than the usual margin of error for such estimates. It would, however, mean a slower rate of expansion in the latter part of the year.

Our view of the outlook and goal for 1969 implies the need for continuation of a budget whose expenditures are at least matched by the revenues from the tax system—assuming reasonably full employment. Whether this will require extension of the tax surcharge depends on the outcome of the current review of expenditure programs. We are aware of the opinion held by some that fiscal actions in general, and the extension or expiration of the surcharge in particular, have little or no effect on total spending, prices, and employment. However, in the present state of our knowledge, and in the present state of inflationary psychology, it would be rash to act on the assumption that the return to a budgetary deficit would have negligible direct inflationary effects. Moreover, the reemergence of a large Federal deficit would create greater strains on the economy—particularly in financial sectors—in effectuating a stabilizing monetary policy. Aside from the inflationary effects, we would be concerned about the probable consequences of a renewed Federal deficit on the supply of funds for private investment, especially housing.

As you know, the administration is now engaged in a review of the budget for fiscal 1970 submitted by President Johnson, particularly in a search for opportunities to cut spending. The Director of the Bureau of the Budget will testify about this tomorrow. We want to make only two observations on this subject. First, we do not foresee probable changes from the budget submitted earlier that would have a major effect on the economic outlook for calendar 1969. Nevertheless,