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"ECONOMIC ROUNDUP"

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(Following is the complete text of a talk given by Mr. Hickman in Ashland, Kentucky, on Wednesday, October 13, 1965, at a dinner meeting attended by 200 local bank directors, businessmen and industrialists)

The purpose of my talk tonight is to sketch out in the broadest way possible just what has happened to business this year and what can reasonably be expected next year. The experts who will follow me will then discuss what is happening in their respective industries. My task is a good deal easier than theirs, simply because the aggregate behavior of our diversified economy is always smoother and more predictable than the individual industries that make up its parts. Nevertheless, I have learned that economic prediction is hazardous. I have also learned that for an economist it is even more hazardous not to make any prediction at all. As one of my good friends has said of me: "Hickman has often been wrong but never in doubt."

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To give you some idea of the hazards of prediction, let me review with you the standard forecast for the economy of just six months ago. In April, steel production and shipments were running at record volumes as customers stocked up in anticipation of a possible strike. The outlook then was for a sharp decline in the steel industry following a wage settlement. Although spending by consumers and businesses was expected to remain at high levels, stimulated by the 1964 cuts in individual and corporate income taxes, the key question of the moment was whether these strong factors would be enough to offset declines in the steel industry, in residential construction, and in other lagging sectors of the economy. Total spending by state and local governments was increasing steadily, as it has throughout the postwar period, but Federal spending was leveling and was not expected to provide any particular stimulus to the economy.

During the intervening six months, what has happened? Gross National Product increased by \$10 billion in the second quarter of 1965, and by another \$10 billion (estimated) in the third quarter, about as much as the average quarterly gain for 1964. In brief, actual results for the past six months were about as far from the standard forecast as it is possible to get in a period as short as six months.

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Why did the economy do so much better than expected in the spring and summer months? Most importantly, the steel deadline was postponed from May to September with the result that the expected drag from steel was considerably delayed. And there were other unforeseen events. Because of excise tax reductions and stepped-up spending for Vietnam and Great Society programs, the Federal budget was more stimulating than had been expected, as was also consumer and business spending. As a result of these developments, plus a generally accommodating monetary policy, Gross National Product reached a record high of \$675 billion (estimated) in the third quarter, the unemployment rate receded to 4.4%, and plant utilization reached about 90% of capacity. The economy had narrowed the gap between actual performance and its potential, and had done so without general price inflation. True, the Wholesale Price Index moved up sharply this spring, largely because of higher prices for farm products and processed foods, but the index has been virtually stable since June.

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Now, what lies ahead? For this, the fourth quarter of 1965, the recent strength and momentum of the economy provide a strong foundation for meeting the test of the steel inventory liquidation now under way. We expect that advances in other sectors of the economy--increased consumer takings of goods and services, further increases in capital spending by business firms, and larger outlays by the Federal government for Vietnam and nondefense purposes--will more than offset steel. Nevertheless, the expected liquidation of steel inventories and related items should restrict the gain in GNP in the fourth quarter to roughly half the quarterly average of the past year--something in the order of \$5 or \$6 billion.

Looking even further ahead--and here the forecast becomes very hazardous--the outlook for 1966 seems to add up to continued and sustainable growth, with quarterly gains in GNP again averaging about \$10 billion. However, growth during the year will probably not be even. During the first half of 1966, the increase in social security taxes may offset most of the expansionary effects of the Federal budget, and there could be some further adverse effects from the hangover of steel inventory liquidation. These developments should partially offset strong and rising consumer and business spending, and the still unknown impact of the escalated defense effort in Vietnam.

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If Federal spending for defense increases dramatically next year, it could create serious inflationary pressures for the economy. As Secretary of the Treasury Fowler indicated last week, if defense spending were to increase by \$10 to \$15 billion as a result of Vietnam, it might be necessary to cut back some of the Great Society programs or even to raise income taxes. A third alternative, one with which the Federal Reserve is directly concerned, would be to impose a restrictive monetary policy. It would be our duty to do this, if for any reason aggregate spending got out of hand.

The real challenge facing monetary policy today is to help keep the economy moving forward. We are now approaching the end of the fifth consecutive year of economic expansion, and each month sets a new record. But we must be on our guard at all times, watching for signs of either inflation or deflation. The Federal Reserve System, in my opinion, should continue to provide the credit needed to support orderly, balanced growth in the economy without price inflation. If these conditions are met, there is no reason why the business expansion should not continue throughout 1966.

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