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## THE ECONOMIC OUTLOOK

Erie, Pa. -- The economy has advanced very strongly since the first of the year -- in fact, more strongly than anyone had hoped for or wanted. In the first quarter, the Gross National Product -- the total value of the nation's output of goods and services -- increased by \$17 billion, the largest quarterly increase since the Korean War. As a result, GNP reached \$714 billion, exceeding the level that forecasters were predicting for the full year 1966, as recently as last December.

During the first quarter, most other major economic indicators confirmed the underlying strength of the economy. Industrial production surged upward, unemployment declined further, capacity utilization rates drifted higher, and order backlogs rose. Unfortunately, output began to press severely on the nation's capacity to produce, and prices at both consumer and wholesale levels moved up sharply. Over one-third of the increase in GNP in the first quarter was attributable to price inflation and less than two-thirds to growth in real output.

My research staff assures me that a more moderate advance in GNP is in the making in the second, or current, quarter. Of course, all of this is very tentative since we really won't know until mid-summer what happened in the second quarter. Nevertheless, it seems fairly clear that the pace of economic activity has lost some of its unsustainable steam, although the economy is still operating at an exceptionally high level.

There are a number of straws in the wind that suggest a slowing down in the pace of the economic advance. For example, wholesale food prices, which rose sharply in the first quarter, have eased downward in the second quarter. The same is true for prices of such sensitive materials as copper and steel scrap, hides, lumber, rubber, and tin. Auto sales turned downward in April at a time when inventories were at record levels and continued downward in May. Production schedules have been cut back, and there is talk that model changeovers will come earlier this year and last longer than in other recent years. These developments will in turn have inevitable effects in moderating the demand for various products that go into the making of the automobile, such as steel, glass, paint, rubber, and so forth. I hesitate to mention the behavior of the stock market, which has given all of us a few bad moments in recent weeks. Hopefully, however, the worst of the decline in stock prices is behind us.

Admittedly, another round of downward adjustments in autos and another backslide in stock prices could have serious repercussions for the economy. But we consider those that we have had as only temporary adjustments, and we are still impressed with the underlying strength of the economy. The major propellants of the economic advance this year are business spending for plant and equipment and Federal defense spending as well as the steady growth in consumer spending. And these show no signs of abating.

Our basic economic forecast, then, is for continued advances in Gross National Product through the second, third, and fourth quarters of 1966, but without the steam of the first quarter -- which, in my opinion, is all to the good.

But no economic forecaster worth his salt -- that is, no economist who wants to hold on to his job -- ever makes a forecast without suitable qualifications. The main concern among economists at this juncture is the future course of defense spending. I have assumed in my forecast that defense spending will stabilize at a high level, but no one outside of the Defense Department really knows what will happen. (Incidentally, off the record, I suspect that the experts in the Defense Department don't know the answer either.) Until we have a better fix on what is planned for defense spending, any forecast must remain highly tentative. As I am sure you are aware, the really important question is what public policy should be in this environment. This is an extremely sensitive area, and I am glad that I don't have the time to discuss it.

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