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UNITED STATES DEPARTMENT OF AGRICULTURE

Statement by William F. Butler
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I agree with the general conclusions set forth in Rex Daly's admirably concise and comprehensive review of the business outlook. It is my view that the advance in business activity will continue at least through the middle of next year and probably well through the year. GNP and consumer incomes for the year 1965 are virtually certain to top this year, and the gains could approach 6% in current dollars.

However, I find myself somewhat less sanguine about prospects for late 1965 or early 1966. I am aware that it is quite imprudent for a business forecaster to talk in public about possible developments a year or more hence. I also wish to make it clear that I am not seeking to trade in my reputation as an optimist for one as a prophet of gloom and doom.

Nonetheless, I believe it is possible that developments in the course of the next twelve months or so could bring the advance in business to a halt, and even lead to another downturn in economic activity. I do not think a downturn is inevitable--it could be averted by proper public and private actions. I also think there are cogent reasons why a recession, if it should develop, would prove relatively moderate.

It has become fashionable of late to stress the fact that there have been few serious excesses in the current business expansion. Indeed, the latest issue of my favorite publication, BUSINESS IN BRIEF issued bimonthly by The Chase Manhattan Bank, points to a "strong and balanced expansion." And it is quite clear that the economy has so far managed to avoid many of the imbalances typical of a business expansion--notably in such areas as inventories, labor costs and capacity expansion.

Yet I believe that forces are now at work which could produce some significant imbalances during the next year. If the nation is to enjoy continuing prosperity without inflation or recession, we shall have to take action to avoid excesses in a number of important fields.

The first of these is wages and salaries. Now it is quite clear that wages and salaries should rise in an expanding economy. But the rise must be kept in line with the advance in the economy's productivity, as has been generally the case for more than six years. However, the increase in wages is accelerating--settlements in autos and other industries are well in excess of the long-term growth in productivity. Meantime, forces are at work which could slow the advance in productivity. Unemployment on the part of skilled and experienced workers is quite low, while production in may lines is approaching the point where standby capacity must be brought on line. All of this points to increasing unit labor costs.

Rising labor costs place upward pressure on prices or downward pressure on profits. If enough money and credit are provided to finance the rise in prices, then we have the familiar wage-price spiral. If prices are held down, then profits are placed in a squeeze, reducing the incentive to make capital expenditures. It is possible that corporate profits after tax have already reached their peak for the current cycle, though they should stay high for some time.

These developments have an important bearing on our balance of international payments, where we are now in our seventh successive year of deficits. We have made progress in dealing with this problem, mainly because our industrial prices have been stable since 1958 while Western Europe has been undergoing inflation. Thus our exports have moved up in very encouraging fashion. However, our deficit, which will run to $2 billion or possibly more this year, remains as a serious problem. To deal with it, we must avoid a wage-price spiral. And I also believe we need a moderate increase in our interest rate structure to reduce the capital outflow.

This leads into a third area of possible problems--monetary policies. The past 3 3/4 years of business expansion have been marked by a massive increase in the supply of money and credit. With policies of easy money, commercial bank loans and investments have been increasing about 8% per annum, as against a rise of about 4½% a year in real GNP. This sort of credit expansion was beneficial so long as unused resources could be put to use by creating additional demand.

However, it seems to me that we are at the point, if indeed we have not already passed it, where continued easy money policies could do more to raise prices than to boost production. Thus, both domestic and international considerations would appear to call for a smaller increase in money and credit. I would hope that we could avoid the sort of credit squeeze which developed in late 1959. But I believe the increase in money and credit in the year ahead needs to be kept in line with the increase in real production.

To turn to a fourth area, I believe the remarkable restraint on the inventory front is beginning to give way. Steel users are beginning to build stocks as a hedge against a possible steel strike next year. With some prices rising, and delivery dates lengthening in some lines, incentives to build inventories more generally are increasing. Thus, it is possible that we shall see the sort of inventory build-up which has characterized all periods of business expansion, though it could prove relatively smaller than in the past.

I have stressed so far a series of basic problems which could develop during the year ahead. To round out the picture, it is necessary to mention briefly a number of items of strength in the picture, most of which have been cited by Rex Daly. For lack of time, I can only list some of the major points:

1) None of the problems I have discussed appears to involve a maladjustment as difficult as in many past periods. In fact, they probably could be handled with minimal impacts, granted good management and good luck.

2) I believe the nation's longer-term potential for economic growth is very impressive, and this should help moderate the impact of any short-term adjustments.

3) The underlying demand for capital goods appears very strong, and this argues against any sharp and prolonged decline in business investment even in face of a profits squeeze which proved temporary.

4) There appears to be a growing acceptance of the use of monetary and fiscal policies to deal with business cycle fluctuations. While there will be debate, and mistakes will be made, I believe we shall make better use of such policies in the period ahead than in the past decade.

To sum up, I look for the expansion in general business activity to continue though at a slackening rate of advance, well through 1965. I believe it is possible that in the process some maladjustments may appear which could give us some trouble late next year or early in 1966. However, I believe we can weather any such adjustments in good fashion and move on into a period of great and good growth for the remainder of the decade.