

## 1971 OUTLOOK

Now that revised first quarter GNP figures have been released, it is useful to take a further look at what the figures show and what the prospects are for the rest of the year. Real GNP rose more than 7% in the first quarter. Inflation continued at a relatively high rate, 4.8%, after allowing for an adjustment to take account of the government pay raise that boosted the rate of inflation in the first quarter. Rising GNP has been followed by increases of industrial production in April and almost certainly will be followed by an additional increase in May.

The economy appears to be strengthening at a relatively good rate. First quarter profits are encouraging. After tax profits reached 47-1/2 billion in the first quarter up 3 billion from 1970, a gain of about 6%. Since prices have risen about 6% real profits are back to the 1970 level. Only two industries showed a profit decline, aero-space and non-ferrous metals. All the others showed some gain from year to year.

All of the GNP gain was in final sales. Inventories, in fact, dropped by some 3.6 billion, so final sales rose by 33 billion dollars. Final sales have continued to increase, especially autos, during the spring. Colored television and regular television sets are now selling at a much faster rate; other durable sales seem to be picking up.

In short, there have been reasonable gains in retail sales during the spring. These gains have been accompanied by rising demands for credit and firming interest rates. There has been no substantial inventory accumulation and some decumulation. All of these factors suggest that the expansion will go at a somewhat more rapid rate in the second quarter than was previously expected.

Equally important, the money supply growth rate is substantially higher than the rate forecast or expected only a few months ago. The second quarter growth rate of the money supply appears to be 9% or more. Should this rate of increase in the money supply continue through the second and into the third quarter, output will grow much more rapidly than previously projected, and inflation will slow much less than previously anticipated.

The precise rate of growth in the money supply during the rest of the year or even during the rest of the quarter is, of course, unknown. Current policy seems to be one of retarding increases in interest rates. Such policies, in the past, have produced excessive expansion in money during periods of economic recovery.

There is every reason now to believe that should this policy continue the economy will be much more expansive the second half than was previously anticipated. Although it is difficult to predict Federal Reserve policy, I now wish to revise my projections for the rest of the year. I have in the past been more optimistic about the second half of the year than most forecasters. I would now revise upward on the assumption that the growth rate of the money supply will be 9% a year for the next two quarters. If such a growth rate materializes, second quarter GNP will be at least 22 billion dollars, substantially higher than the forecast only a few months ago. The second half of GNP will be at least 50 billion dollars even if there is a steel strike. In fact, I continue to assume that there will be a steel strike of from eight to ten weeks in duration.

If the excessively expansive monetary policies continue, interest rates will rise by the end of the year. Inflation for the year will be at a much higher rate than previously forecast, a minimum of 4-1/2% and probably 5%. Profits will rise at a much faster rate than I previously predicted. My third quarter profit estimate of 50 billion dollars in after tax profit consistent with Standard and Poor's 500 index of 99 now appears to be somewhat pessimistic. The 6% growth rate in the money supply on which this projection was based is not going to be reached. I would therefore raise the estimate of third quarter profits consistent with a 9% to 10% growth rate in the money supply during the second and third quarter of this year to 54 billion dollars.

These projections are, of course, subject to change if the Federal Reserve departs substantially from its current monetary policy. So far, in response to the international monetary crisis, the Fed has shown very little sign of deviating from the path that it established earlier this year.