

UNEVEN SHARES IN INVESTMENT

Although the share of investment in GNP was normal, the pattern of the major investment components was unusual when compared with other post-Korean years. Business fixed investment was at a record high of 10.7 percent of GNP, surpassing its previous peak of 10.5 percent in 1957 and considerably above its post-Korean average of 9.8 percent. Because of the scarcity of mortgage funds, housing starts fell steadily from an average of 1.5 million units in the first quarter of the year to 1 million in the fourth; at 3.5 percent, the share of residential construction was at a post-Korean low. Inventory investment, at 1.5 percent, matched its previous post-Korean high of 1955. Excess demand at home generated a spurt in demand for goods from abroad, pulling down the share of net exports to the lowest level since 1959.

The record share of business fixed investment in 1966 occurred despite the need for a much greater volume of external financing at unusually high borrowing costs. Incentives to invest were provided by a continuation of the forces that had spurred business to expand and modernize facilities in 1964 and 1965: growing sales, orders, and profits, and high operating rates. These were further strengthened by the rise in defense spending.

INVENTORY INVESTMENT

A high rate of inventory investment in relation to GNP during 1966 reflected many of the same factors that stimulated business fixed investment. Inventory-sales ratios generally crept up after years of stability or decline. Nonfarm stocks expanded by 8 percent over the year, considerably above the rate of growth of real output or sales. Inventories rose especially rapidly in durable goods manufacturing; these stocks grew by nearly \$7 billion during the first 11 months of 1966. Within durables, goods-in-process inventories rose by about \$4 billion over the period, reflecting, in part, the buildup of defense and business equipment in the pipeline.

The long production times that are essential for many durable goods were largely responsible for the growth of stocks of goods-in-process. From the time a company begins to build an airplane or a machine, it may take 6 months or a year to produce a finished good and complete a shipment. While the piece of equipment is being fabricated, the value of the completed portion shows up in inventories of goods in process. Thus, if orders rise sharply for items with long production times, inventories grow; the ratio of inventories to shipments also tends to increase until shipments can catch up.

In late 1965 and in 1966, orders for business equipment and defense hard-goods rose sharply, and shipments did not keep pace. The economic impact of this stepup in orders was not fully reflected in Government purchases or in business fixed investment; some of it showed up as inventory investment. The impact of defense orders on inventories cannot be quantified precisely. But it can be estimated by two approaches: one uses data on progress payments made by the Department of Defense, and the other rests mainly on the statistics of defense-oriented industries. Both approaches suggest that, from the beginning of the fourth quarter of 1965 through the third quarter of 1966, defense contractors and their suppliers added about \$2 billion to their stocks as a result of defense orders.