

in a major industry. But it specifically does not allow for any tax increase or tightening of financial markets.

INVENTORY INVESTMENT

According to preliminary data for April (the latest month for which information is available), inventory investment was proceeding at an annual rate of only about \$1 billion. It could even move below this depressed level in the months to come. Although inventory-sales ratios have improved considerably in trade, they are still very high in many manufacturing areas. In interpreting the ratios of inventories to sales, it should be noted that a significant part of the accumulation of manufacturing inventories has been in the defense sector. Moreover, it is important to remember that the sales of some manufacturing industries have been temporarily depressed by the inventory adjustments of their customers, and this makes the ratios look unfavorable. For the overall economy, the ratio of stocks to final sales is still high; but it actually declined in the first quarter, and further progress is likely in the current quarter.

Judging from recent performance and from surveys of businessmen's expectations, there is no reason to expect the typical firm to jettison inventories in the months ahead. Most of the further adjustment of inventories should be achieved through the growth of sales rather than through any significant actual decline in stocks. It is, of course, impossible to know just how low the rate of inventory investment will go. But it should "bottom out" in the second half of the year and at that point no longer be a restraining force. After touching bottom, inventory investment should begin a gradual climb toward its normal prosperity rate of about \$7 billion. In the first half of 1968, the recovery of inventories should be a stimulative force in the economy.

RESIDENTIAL CONSTRUCTION

Against the background of our expectations at the start of the year, we are encouraged by the recent recovery of housing. We anticipated in January that housing starts would rise gradually to 1.4 million by the end of 1967, yielding an increase in expenditures for residential structures of between \$5 and \$6 billion from the end of 1966 to the end of 1967. Housing starts, which rose to a rate of 1.3 million in May, have been running consistently above the track of our projection, and our initial estimates for this year may turn out to be a bit conservative.

After a spurt in housing starts in January and a dramatic inflow of funds to thrift institutions, some observers began predicting a rate of 1½ million starts by midyear. Those who climbed on that optimists' bandwagon are now disappointed with the pace of recovery in housing. But we judged throughout that the rebound from last year's mortgage famine was most likely to be slow and gradual, perhaps even at times uncertain and unsteady.

There are strong forces helping to support an upward trend in homebuilding. The large flow of funds into thrift institutions so far this year has greatly improved the availability of mortgage finance. Vacancy rates, demographic factors, and the healthy performance of consumer incomes assure that there will be demand in 1968 to support