

The recent large expansion in capital goods demand has added substantially to our capacity to produce—manufacturing capacity, for example, increased 6 percent during 1965 and a further 7 percent last year. The investment surge was accompanied by much higher prices for machinery and equipment, by enlarged requirements for skilled labor, and by sizable accumulations of inventories.

The capital goods expansion also contributed to the strains in money markets, as the internal funds generated by corporations were insufficient to finance their 1966 capital goods programs, and external sources of funds were resorted to more extensively than in the prior 5 years.

As the year progressed, it became clear that investment demand could not be sustained at such a fast pace without causing further strains on an economy operating at close to capacity. New orders received by machinery and equipment companies, which foreshadow capital expenditures, expanded sharply, particularly after September 1965, and reached a peak in July 1966. These are shown on chart 3. It was not possible at that time to predict that the uptrend would not continue.

(Chart 3 follows:)