by machinery and equipment companies. From February to April of this year, these orders rose 6 percent, in contrast to the declining trend in the preceding 7 months.

I might say that in May there was also another good increase in these orders.

My judgment on the outlook for plant and equipment expenditures, based on the foregoing considerations, is as follows:

1. I expect that the increase in capital outlays in 1967 will be relatively small—perhaps even less than the 3 percent indicated by the recent Government survey. Expansion is being limited by the lower corporate profits expected this year compared with 1966, declining rates of capacity utilization, and other factors.

2. The modest increase in capital outlays anticipated in the second half of this year implies that real fixed capital goods demand will contribute little to a rise in real GNP, since most, if not all, of the projected increase in dollar outlays would reflect higher prices of capital goods.

3. On the basis of the large backlogs of unfilled orders still held by machinery and equipment companies—in April they were nearly 10 percent higher than a year ago—and a hopeful improvement in profits later this year, a further rise in capital outlays might occur in the first half of 1968, although a substantial increase in total demand would be necessary to justify a sizable capital goods expansion at that time. In view of the large increases in labor and other costs, which are developing this year, the emphasis of the 1968 capital programs may well be on cost-reducing facilities rather than on those designed to expand capacity.

Inventory Position and Prospects

Let us now turn to the inventory picture. First, I shall consider briefly the probable size of the inventory "excess" relative to sales, the areas in which it has occurred, and what progress, if any, has been made by business firms to adjust their inventories. Second, recognizing that forecasting inventory movements involves an element of judgment, I shall set forth some factors to consider as guides to their near-term course.

From 1961 to early 1966, inventory changes were closely geared with variations in sales and incoming orders. But after the first quarter of 1966, inventory accumulation greatly outstripped the sales performance so that inventory-sales ratios for most industries rose sharply. A major factor in this development was the failure of sales to materialize in accordance with producers' expectations during this period.

For example, last August manufacturers expected their sales to increase 5 percent from the second to the fourth quarter. The actual rise was only 2 percent. Another shortfall from anticipated sales occurred in the first quarter of this year.

During the first 4 months of 1967, businessmen attempted to adjust their inventories and sharply reduce the rate of accumulation. Even so, because of dampened sales, the inventory position of a number of industries did not improve. The process of adjusting inventories is often circular—lower inventory demand reduces production and sales, and, unless other demands pick up, there is the need for further inventory correction.