Departures of actual inventory levels from the relationship values (the levels which would have been attained if inventories had maintained the same relation to sales as in the years prior to 1966) were calculated for December 1966 and April 1967, the period during which inventory investment was greatly reduced.

A number of observations may be made from this analysis:

One, the inventory position in relation to sales at the end of April 1967 deteriorated from that of last December in all major manufacturing groups despite the greatly reduced rate of accumulation over this period. Except for defense companies, the inventory increase was largely involuntary, stemming from lagging sales, which declined 3 percent from December 1966 to April 1967.

Two, companies producing defense products held an even larger "excess" of inventories in relation to sales in April 1967 than 4 months earlier, even though their shipments had risen during the period. The bulk of these inventories, however, consist of materials and supplies and work-in-process. They do not present a problem.

Three, inventories held by producers of machinery and equipment and of consumer durable goods (excluding automobiles) in April 1967 appear to be one-eighth too high. A good rise in the sales of these firms would help unclog their inventories, but, as I have already indicated, the former group is not anticipating large increases in sales this year, and consumer durable goods demand continues to lag. Thus, the completion of the inventory adjustment by these companies may require a considerable number of months.

Four, manufacturing industries comprising the "other durable goods" category—such as primary metals, fabricated metals, motor vehicles and parts, and stone, clay and glass products—had an "excess" inventory of nearly one-sixth of their total holdings in April 1967. The adjustment of these inventories also may not occur in just a few months, since the activity of these industries depends largely on orders placed for capital goods and consumer durables.

Five, the "excess" inventories held by nondurable goods producers in April 1967 were relatively small in relation to their total holdings, except in the case of the chemical and rubber industries, where April inventories were unusually high.

Six, retailers' inventories have been drawn down since December of last year. Auto stocks, which were recently large relative to sales, are being adjusted as sales improve, and these stocks present no problem. Inventories of other retail outlets in April 1967 were about right in the aggregate.

Seven, stocks held by wholesale merchants were somewhat high at the end of April 1967, especially in durable goods establishments and particularly in electrical goods.

Thus, it appears that the inventory problem centers in the "excess" inventories held by manufacturing durable goods companies (other than defense products) and by wholesale durable goods firms, amounting to one-seventh of their total holdings of $54 billion at the end of April.

Near-Term Prospects

The manufacturing inventory anticipations reported by the Department of Commerce earlier this month indicate that producers expect some further modest increases in inventories in this quarter