

and in the third. Apart from this report, there is little else available for gaging short-term inventory developments. Technicians have developed a variety of econometric equations; some of them at times have predicted well, and progress is being made in this area. Nevertheless, at the present time the use of relationships leaves much to be desired; they often break down just when a reliable guide is most needed.

Therefore, in forecasting inventories we must analyze all available relevant information and then use our best judgment to assess the likely prospects.

Viewing the demand forces as they are now shaping up in the public and private sectors, it appears that economic activity will gain momentum in the second half of this year. How much stronger the pace will be over the first half is still a question, and, on this point, there is a wide difference of opinion due to the varying assumptions made for the war expenditures, housing demand, consumer buying, and other factors. Assuming a stronger second half, the following points may be made with respect to the inventory situation and near-term prospects:

One, inventories held by durable goods producers and wholesalers are now rather high relative to their sales; on the other hand, most retail durable goods stocks and nondurable goods inventories at all levels appear to be about in line with sales.

Two, in the first quarter of this year, the total inventory accumulation amounted to \$5½ billion (GNP basis, at annual rate). Judging from current production rates, surveys, and other evidence, the second quarter accumulation may be of the order of \$2 billion, or even less. Inventories may show little change in the third quarter, and a moderate rise—\$2 billion or more—in the fourth quarter.

I hold no brief for these numbers, although I feel they are in the right ball park. In view of the current large overhang of inventories, this pattern may appear to be quite optimistic. However, it should be pointed out that when the trend of sales is upward, which I am assuming for the months ahead, wholesalers' and manufacturers' orders will expand and a buildup of materials and supplies will occur. Excessive inventories under these circumstances would not be viewed so ominously as in periods when sales are sluggish.

The important point is that during the last three quarters of this year, shifts in inventory investment may be expected to have much less of an impact on the growth of output than was the case in the first quarter of this year. At that time, real GNP and industrial production dropped from the fourth quarter 1966 rates, mainly because of the \$11 billion reduction in inventory investment.

Three, the foregoing pattern implies that inventory demand will not contribute much to a rise in real GNP in the second half of this year. However, this pattern could be materially altered if major strikes or threats of strikes should occur in any major industry.

Four, finally, because of a lag between inventories and sales, a stronger inventory demand may develop in the first half of 1968, if economic activity accelerates later this year.

Chairman PROXMIRE. Thank you, Mr. Paradiso. You certainly opened my eyes to a different view than we got yesterday and I think it was documented beautifully.