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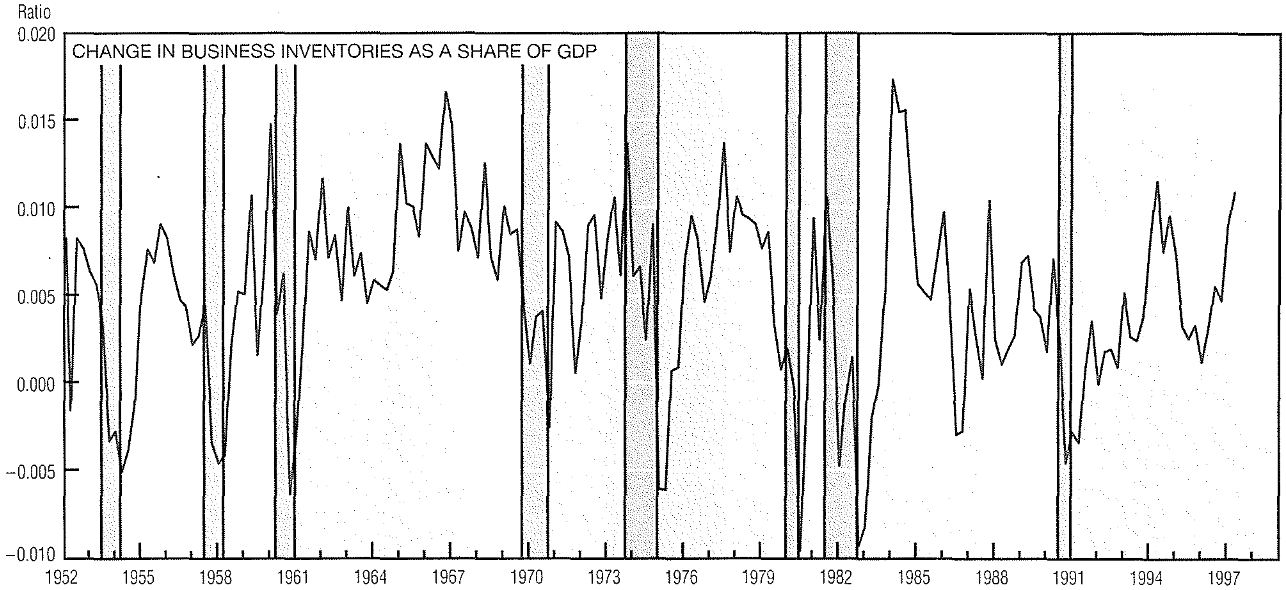
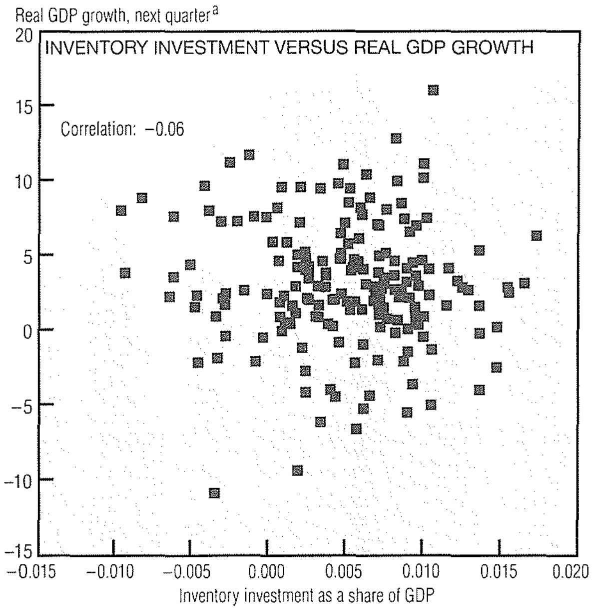
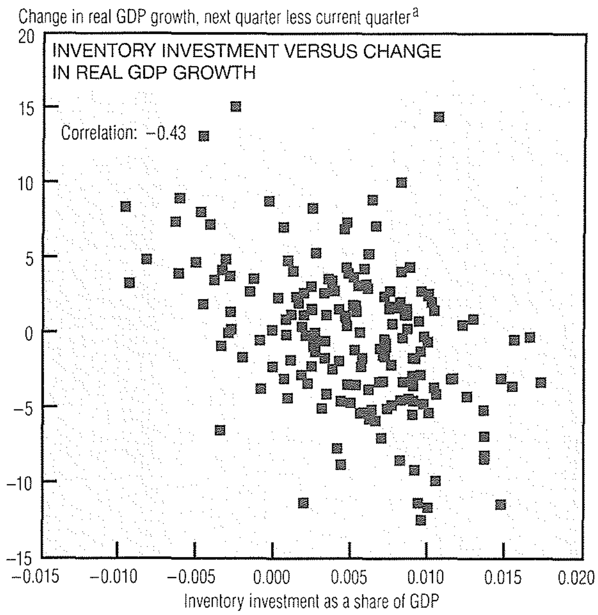
Inventories







a. Annualized percent change.
NOTE: Shaded areas indicate recessions.
SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

During the first half of 1997, real GDP rose by $142 billion, translating into a 4.1% annual growth rate. Over this same period, real investment in business inventories totaled $141 billion, almost equaling the rise in real output. Many analysts have characterized this rate of inventory investment as excessive or unsustainable, and have consequently predicted a marked slowdown in real output growth for the remainder of the year.

Looking back at the pattern of inventory investment over the past 45 years, one finds that its recent behavior is not unusual. Inventory investment was roughly 1% of GDP in each of the first two quarters of 1997, well above its long-run average of about 0.5% but well within its historical range during economic expansions.

A high level of inventory investment is not, by itself, a clear predictor of either fast or slow output growth. However, it is generally associated with a slowdown in output growth from its current rate. This association partly reflects the fact that high levels of inventory investment are related to high rates of GDP growth in the same quarter. Thus, a slowdown of output growth to rates closer to its historical average would produce the negative association. From experiences in the mid-1980s and in 1994, we see that strong inventory investment need not be a precursor to recession.