Global Economic Research

FEBRUARY 11, 2022

Rebuilding Inventories

Restocking has resumed and will add to this year's economic growth.

By Ryan James Boyle

Those of us who have worked retail will recognize "inventory" as a demoralizing verb, the mundane task of physically counting every item in a store, often in late or early morning hours. The process is tedious but important to identify problems like theft, breakage and missing shipments.

Workers assigned to take inventory over the past year have had less to dread. Amid high demand and disrupted supply, inventories have been depleted at all points in the value chain.

Manufacturers have shipped goods to retailers as soon as they can find space in a container, and retailers are working hard to keep up with demand.

Finding the right balance of inventories is a challenge for most businesses. Finished goods and raw materials occupy space and absorb capital that could be deployed more productively. However, some inventories must be kept on hand to be ready to sell to customers.

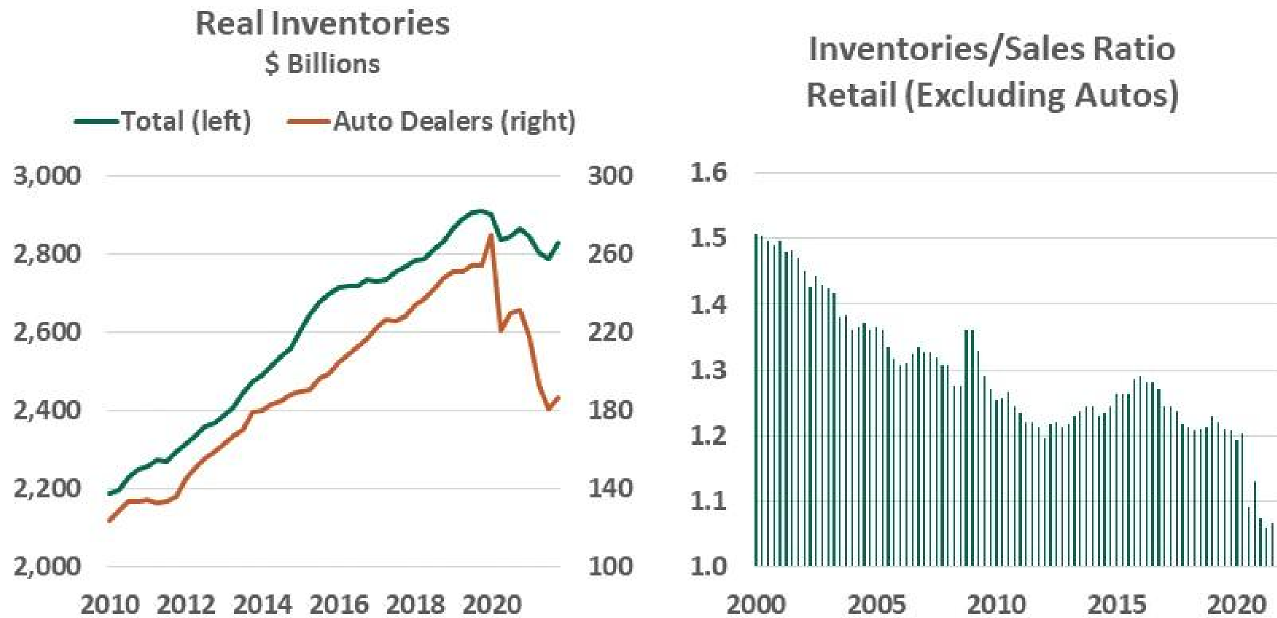
Inventories in recent quarters have clearly been too lean. The ratio of U.S. retail inventories to sales fell in the crisis from its norm of about 1.2 to a record low of 1.07. A value of 1 would indicate retailers are simply passing items through, without holding any inventory.

Inventories were the brightest point in the fourth quarter report of U.S. gross domestic product (GDP). After inventories ran down in the first three quarters of the year, a gain of $173.5 billion was the biggest contributor to strong headline GDP growth of 6.9%. At last, retailers were buying more than they were selling.

One quarter of growth does not represent a recovery following two years of depletion. Inventories had increased steadily throughout the prior cycle, consistent with an expanding economy. Inventories remain 3% below their 2019 peak on an inflation-adjusted basis, and far below the level they would have attained if growth had continued without pandemic interruptions.

Digging further into inventories reveals a mixed recovery. Retail inventories of food, general merchandise and other consumer goods have surpassed their pre-pandemic levels; but together, they represent only about 15% of total inventories. Automotive dealers are bearing a great burden of shortages: new car inventories were estimated to end the year below 60,000 nationwide, when the pre-pandemic norm was above 500,000. While the shortfall will not correct itself overnight, automakers are giving cautiously optimistic signals of better production in the year ahead, which will contribute to inventory growth.

Inventory accumulation will support growth in the year ahead.



Sources: BEA, Census Bureau, Haver Analytics

Many of the inventory shortfalls are less visible than empty auto dealer lots. Manufacturing and construction inventories are notably low, holding at levels last seen in 2018; their shallow recovery thus far sets the stage for a year of improvement ahead. This shortfall is a manifestation of the shortages experienced throughout the economy, especially for goods with complex supply chains.

Inventories can be a volatile measure, driven by unpredictable global trade factors as well as individual companies' strategies. We do not expect continual upside surprises to economic growth as we saw in the fourth quarter. The need to continue restocking will make inventories a helpful fundamental factor to support growth. It is a welcome development for everyone but the retail workers, who may need to plan on a few additional late nights.

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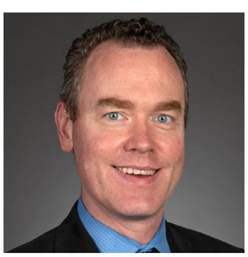

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