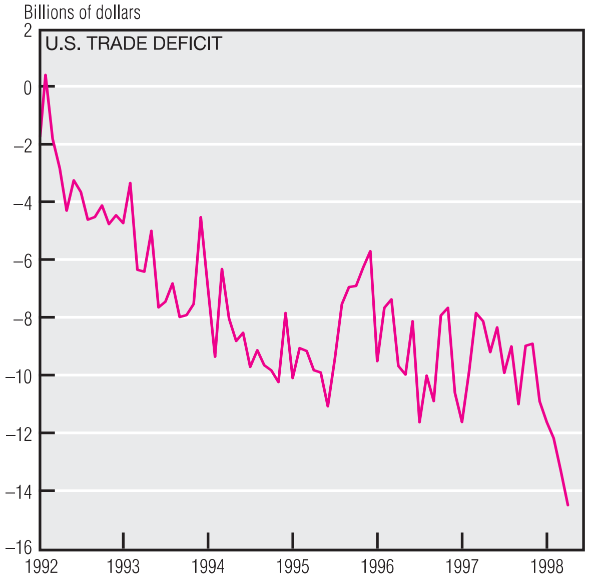
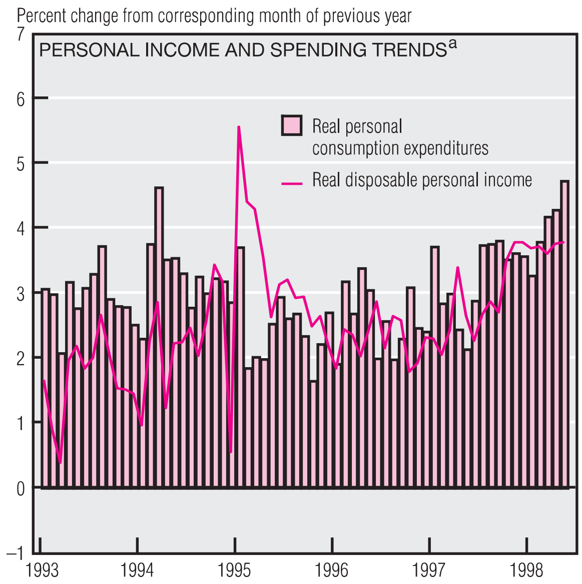
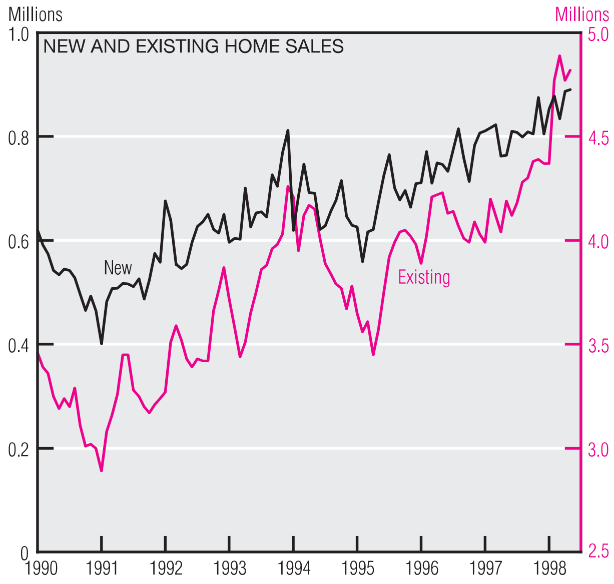
Economic Activity

Real GDP and Components, 1998:IQ[a]
(Final estimate)

	Change, billions of 1992 $	Percent change, last: Quarter	Percent change, last: Four quarters
Real GDP	95.7	5.4	3.9
Consumer Spending	72.6	6.0	3.7
Durables	23.4	15.0	7.0
Nondurables	23.5	6.6	1.8
Services	27.7	4.0	4.0
Business fixed investment	36.5	17.8	12.4
Equipment	41.3	26.4	17.8
Structures	–1.4	–2.8	–0.9
Residential investment	11.4	16.9	8.9
Government spending	–10.3	–3.2	0.3
National defense	–15.6	–18.6	–2.8
Net exports	–49.3	—	—
Exports	–3.1	–1.2	7.3
Imports	46.2	17.0	14.2
Change in business inventories	31.7	—	—







a. Chain-weighted data in billions of 1992 dollars.
NOTE: All data are seasonally adjusted.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; and National Association of Realtors.

According to the Commerce Department's final estimate, real GDP grew 5.4% in 1998:IQ, a substantial upward revision from the previous estimate of 4.8%. Much of the difference results from a larger-than-expected buildup of inventories, and a smaller-than-anticipated decline in net exports. Despite this revision to net exports, foreign trade is still an area of concern. In April, the U.S. trade deficit in goods and services continued to increase, reaching a record $14.5 billion, largely because of a deterioration in exports.

The consumer sector remains robust. Real personal consumption expenditures have jumped 4.7% since last May, while real disposable income has grown 3.8%. Consumers are generally optimistic that the economy will stay strong, as shown by vigorous sales of new and existing homes, which have also been buoyed by low interest rates and rising incomes.

Economists participating in the most recent Blue Chip survey expect economic growth to decelerate during the rest of the year from its recent dizzying pace. Concerns about excessive inventory accumulation and the worsening Asian economic climate underlie these lower projections.

Much of the worry about inventories centers on why they are growing and how companies will respond.

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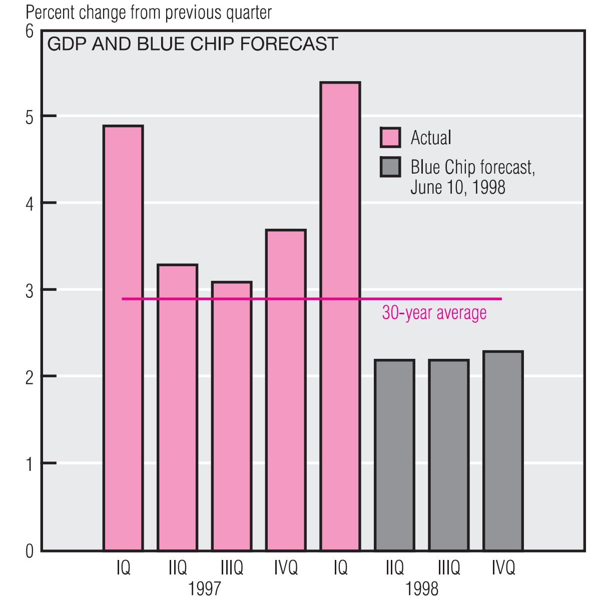
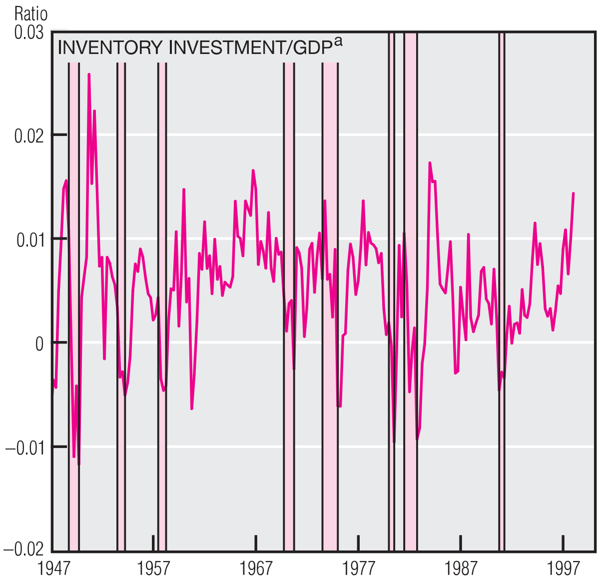
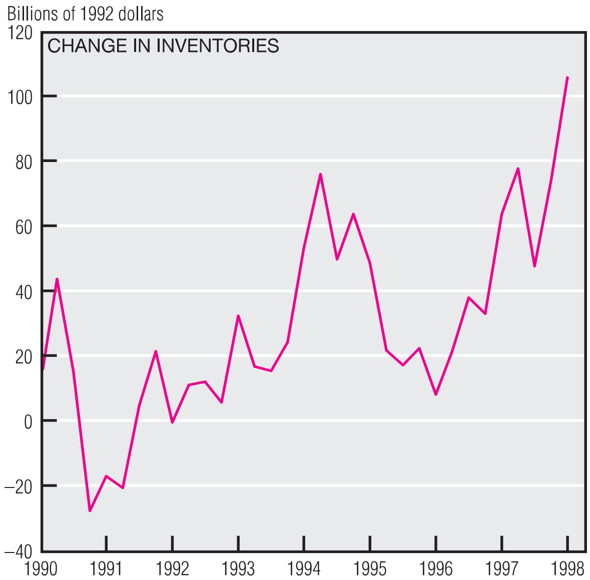
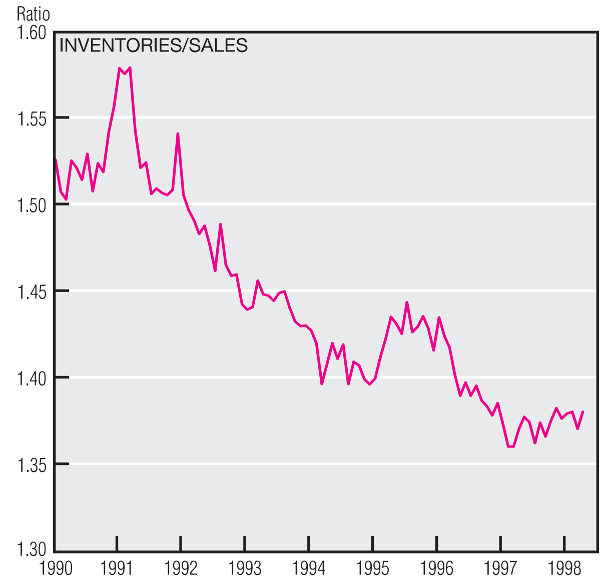
Economic Activity (cont.)









a. Shaded areas indicated recessions.
NOTE: All data are seasonally adjusted.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; and *Blue Chip Economic Indicators*, June 10, 1998.

The traditional view is that a shock to aggregate demand leads to deceased sales and an accumulation of inventories. Then, if companies expect the slowdown in aggregate demand to continue, they will cut production accordingly. However, although inventories decline relative to GDP during a recession, high inventory levels do not necessarily precede a slowdown, because they may be caused by other factors. For example, a firm could enjoy an unanticipated increase in productivity or a decrease in costs, leading to higher-than-expected production. Inventory investment could also rise because firms anticipate stronger demand. Both these scenarios support more optimism about the economy's future performance than does the traditional view.

Inventories grew by a record $105.7 billion in the first quarter. It is not yet entirely clear what this increasing inventory investment means. Ratios of inventories to sales are still quite low, but this trend has been apparent for quite a while because of the shift to just-in-time inventories.