Economists participating in the Blue Chip survey anticipate a 2.4% rate of real economic growth in 1995:1IVQ — well below last quarter’s 4.2% advance. The recent flatness in industrial production and hours worked seems consistent with this slowdown. For all of 1995, the Blue Chip panel foresees a growth rate of approximately 3.2%. Economists estimate the nation’s long-term growth potential at roughly 2.5% per year.

A boom in business fixed investment has accompanied the current business expansion, but curiously, the underlying factors have not ignited residential construction. Despite some improvement in the third quarter, new home construction has been a relatively weak component of GDP this year. Real residential investment fell 1.4% in the four quarters ended in 1995:IIIQ. With single-unit housing starts remaining generally weak, residential construction will most likely stay soft. Housing starts declined 1.7% in October, the second consecutive monthly drop.

Nevertheless, a substantial deterioration in the housing sector seems unlikely. Housing sales, which rose dramatically between February and July, remain strong, and the number of months that unsold homes (continued on next page)
Economic Activity (cont.)

stay on the market has declined 13.6% from its April peak.

A continuing boom in investment spending and advances in productivity growth brighten the nation's long-term economic prospects. Real business fixed investment, which has risen 13.3% over the past four quarters, has equaled 14% of the nation's output this year—1.4 percentage points higher than last year's record level. The rapid pace of investment is welcome in an economy thought to be operating at high levels of capacity, since business fixed investment fosters productivity growth. The current expansion has witnessed above-average increases in output per hour worked, following a lengthy period (1974-91) of below-average postings.

The new chain-weighted GDP methodology will reduce the magnitude of recent productivity gains by eliminating an upward price bias in the real output data. Nevertheless, numerous downward biases also hinder our capacity to measure productivity growth accurately. Chief among these is the difficulty of measuring services, which represent a large and growing component of national output. A substantial amount of anecdotal evidence indicates that productivity growth is advancing above trend. Corporate profits, for example, have risen 10.4% annually since 1991, well above the rate of inflation. Such increases would seem unlikely and unsustainable without the support of strong productivity growth.