The advance estimate for second-quarter GDP growth is a strong 4.2%, up more than 2 percentage points from the first quarter and almost twice the growth rate anticipated by most analysts when the quarter began. Virtually every major sector of the economy posted a healthy increase last quarter, a sign that the prolonged business expansion remains vigorous. The largest increase was in residential construction, which grew 15.1%. Business activity in this sector appears to have spilled into the current quarter: Housing starts have been fluctuating near the relatively high level of 1.5 million units since early spring.

Other areas of spending strength last quarter included consumer durables, business equipment, and the government sector. Of the domestic spending categories, only commercial construction showed a decline from the first quarter.

When the second quarter began, economists expected a first-half growth rate of slightly less than 2%. Then, following the strong monthly data that came out between April and June, they revised their first-half growth projections upward by more than one-third (to 3%). From mid-year, however, the prevailing view among analysts has the economy's growth rate moderating back to about average—or perhaps slightly below—by early 1997. Economic growth in the second half of 1996 is expected to be slightly under 2 1/2%, falling to just below 2% in 1997.

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Perhaps the biggest change in economic growth during the past six months has been a sharp revival in industrial activity. After showing only a small net increase in 1995 (about 1%), industrial output expanded an annualized 5% during the first half of 1996. Reports from industrial purchasing managers suggest that manufacturing strength is likely to continue over the near term. While 55% of purchasing managers (up from only 45% in January) reported output rising in June, more than 60% indicated higher orders. This is the largest proportion noting orders growth in almost two years.

In the capital goods area, where business activity in the past several years has been phenomenal, growth indicators have shown some recent signs of leveling off. Nondefense capital goods orders have been fluctuating around $45 billion per month for about eight months now, and the backlog of capital goods has been slowing its rate of increase since January. Still, the plateau in business investment is occurring at a historically high level, perhaps a sign that these industries have finally neared their capacity.

The outlook for the industrial sector is reasonably bright. Nearly 70% of economists surveyed in July anticipate growth in 1996 industrial output to be in the 2% to 3% range, while about 25% expect 3% to 4% growth. For 1997, about 45% of those surveyed foresee industrial growth in the 2% to 3% range, versus around 40% who expect 3% to 4%.