The growth of a country’s labor force, the expansion of its capital stock, and the pace of its technological improvement determine its capacity for economic advancement over the long term. To be sure, calculating such a path is difficult and imprecise work. Recent estimates generally put the U.S. growth potential at 2% to 2.5% per year—somewhat below our 30-year average. Economists believe that this rate is consistent with the full employment of both labor and capital. Year by year, the actual pace of economic activity may exceed or fall short of its potential rate, but when this happens, forecasters generally expect that the deviation will be short-lived. A slowing in the pace of economic activity that brings growth into line with its potential need not upset a nation’s prosperity. In fact, it may prolong the business expansion.

Economists participating in the latest Blue Chip survey generally expect economic activity to slow in the current quarter and throughout 1998 until it reaches a pace consistent with the economy’s potential. A year ago, the prognosis for 1997 was similar, with quarterly growth projections falling between 1.8% and 2.1%. Actual GDP growth for the year far exceeded these projections, however, reminding forecasters of their craft’s precarious nature.

(continued on next page)
Economic Activity (cont.)

The Commerce Department lowered its assessment of fourth-quarter real GDP growth from 4.3% to 3.9%. Its decision was based on a large upward revision in imports coupled with small downward adjustments to consumer spending, residential investment, government spending, and exports. Business inventories did jump substantially, but not enough to offset these negative factors.

The manufacturing sector, which traditionally accounts for about 18% of total GDP, demonstrated strong growth in 1997. Overall industrial production rose 5.5% last year, with the manufacturing subcategory advancing nearly 6.3%. (The total index includes production at mines and utilities.)

At year’s end, the manufacturing sector seemed well poised for sustained growth in 1998. Despite the fourth-quarter advance in business inventories, the level of stocks does not seem inordinate when compared to sales. Only at the wholesale level has the inventory-to-sales ratio been rising, but it remains below typical levels. New orders for manufactured goods were strong throughout last year, especially for durables. Moreover, the ratio of unfilled orders to shipments has held steady. Manufacturers now hold just under three months’ worth of orders, and durable-goods producers are operating with slightly more.