Economic Activity

The final estimate of 1999:IVQ real GDP growth is 7.3%, up 0.4 percentage point from February’s 6.9% estimate, itself revised up 1.1 percentage points from January’s advance estimate. The dominant factors in the revision were lower imports, higher exports, and stronger investment in nonresidential structures. Blue Chip forecasters continue to expect that this year’s economic growth will return to rates more consistent with past experience.

The record-breaking longevity of the current U.S. business expansion is widely noted. Less attention has been devoted to the even longer-lived secular reduction in the volatility of economic activity. The standard deviation of quarterly GDP growth rates since 1984:IIQ is slightly less than half what it was for the 25 previous years. One speculation is that modern information technology has reduced volatility by making production and inventory management more sensitive to incipient variations in demand. Indeed, inventory investment accounts for half the reduction of 2.3 in the standard deviation of GDP growth rates from 4.4 to 2.1. However, the other half of the reduction in GDP volatility must be attributed to an equal reduction in the combined volatility (net of cross-correlation) of all other GDP components.

The most recent GDP release includes first estimates of 1999:IVQ corporate profits. After adjustments for capital consumption and inventory valuation, profits rose $35.3 billion, compared with only $3.6 billion (continued on next page)
in 1999:IIIQ. One-time losses reduced each of these two quarterly estimates about equally. Hurricane Floyd cost $10 billion in the third quarter; the tobacco settlement took $1 billion in the third quarter and another $11 billion in the fourth. The substantial increase in fourth-quarter profits is attributable both to higher prices and to lower unit labor costs.

Much attention has been focused on the unremitting strength of the current economic expansion, but certain sectors are exceptions. In particular, expenditures on nonresidential structures declined throughout 1999, and growth in expenditures on residential structures has been moderating for the past year. These patterns should be no surprise in a period when increased real interest rates, reflecting productivity increases in high-tech industries, are driving up the opportunity cost of investing in more traditional long-lived assets.

Quarterly sales of existing single-family homes are down almost 10% from a year ago. Sales of new single-family housing—including units completed, under construction, and not yet started—may eke out only a nominal increase in 2000:IQ relative to the same quarter last year. New housing sales and housing affordability peaked almost simultaneously in 1998, and both new and existing sales have declined with declining affordability since then. Changes in affordability roughly mirror changes in mortgage interest rates. The slowdown in markets for new and existing residential housing is not restricted to traditional houses. Shipments of mobile homes have plummeted since early last year; while inventories of completed units on dealers’ lots have skyrocketed.