Economic Activity

The advance estimate for the national income and product accounts, released July 27, reported that gross domestic product grew at a meager annualized rate of 0.7% during 2001:IIQ. This growth was slightly weaker than expected; the Blue Chip forecast for the quarter was 0.9% growth. The major factor in the second-quarter slowdown was business fixed investment, which fell 13.6% (annualized) from 2001:IQ and 1.7% from 2000:IIQ.

The quarter’s decline in business investment was partly offset by personal consumption and government spending, which rose 2.1% and 5.5%, respectively. Personal consumption was up 3.2% from 2000:IIQ, while government spending increased 3.0%. Residential investment remains strong and has even accelerated recently.

Blue Chip forecasters are more optimistic about the last two quarters of 2001; they expect GDP growth of about 2% in the third quarter and 3% in the fourth. The anticipated increase may reflect this year’s many reductions in the intended federal funds rate, whose effects usually are felt some time after the rate reductions.

Almost all sectors of the economy slowed in the second quarter, but manufacturing took an especially severe beating. Manufacturing’s slump is reflected in industrial production, which has declined steadily over the last nine months. In June, industrial production fell 0.7% from its May level—a hefty 8.7% annualized decline. Growth in industrial production was considerably lower than in 2000.

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The sharp drop in industrial production seems partially due to a considerable decline in the rate of productivity growth over the past few months. Consistent with an unanticipated drop in productivity growth, manufacturing inventories have fallen precipitously over the past two quarters. And given the fall in productivity growth, it is no surprise that growth in manufacturing workers’ earnings has also been declining over the last year, or that it continues to lag growth in total nonfarm earnings. An earlier drop in manufacturing wages (relative to the U.S. average), which began late in 1998, occurred at a time when manufacturing productivity growth was outstripping the rest of the economy. This suggests that a decline in the demand for manufactured goods was responsible for that earlier earnings gap.

Although the growth rate of manufacturing productivity has declined recently, productivity remains stronger in the manufacturing sector than in the U.S. as a whole. But lower overall productivity growth has damaged corporate manufacturing profits, which have also fallen steadily over the last few quarters. While the deceleration in profits is evident in almost all sectors of the economy, the manufacturing sector has been especially hurt. The next few quarters remain critical for manufacturing and should show whether the sector’s slump will continue or whether it has bottomed out.

NOTE: All data are seasonally adjusted and annualized.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; and Board of Governors of the Federal Reserve System.