Among connoisseurs of official economic statistics, the Commerce Department’s recent revision to the national income and product data for the last few years has already caused quite a hubbub. The Department releases its revised estimates of these data annually, incorporating fresh source data and new methodologies. The revision for 1998–2000 indicates that the U.S. economy grew less rapidly than it seemed to do on first report, investment spending in the high-tech sector was less buoyant, and corporate profits were less plentiful. Current information indicates that for 1988–2000, real GDP expanded about 0.3% per year less quickly than we thought, with 1998 now appearing stronger and the two subsequent years weaker.

The revised data still depict a vigorous economy, but not one on steroids. The Bureau of Economic Analysis’ news release informs us that instead of following a pattern of 4.6%, 5.0%, and 3.4%, the revised GDP growth rates are 4.8%, 4.4%, and 2.8%. GDP growth did not accelerate from 1998 to 1999—it decelerated. The factors accounting for the revisions differed from year to year, but the one factor common to all was downward revision to spending on computer equipment and software, especially software. Curiously, personal spending for the period was revised up, with wages and salaries especially robust in 2000, while corporate profits were revised down.

The picture that emerges shows that although the economy grew less rapidly during 1997–2000 than so-called final estimates had suggested, household income was somewhat better—and corporate profits somewhat worse—than imagined. This picture squares with news from the financial press, which has been riddled with reports of corporations restating their earnings for the period. Perhaps the enormous declines in many corporations’ stock market valuations during the past show that investors’ doubts about earnings potential extend beyond cyclical factors.

Although the revisions do not seem earth shattering, they will be grist for the macroeconomic policy mill, reviving debate about potential GDP and the nonaccelerating inflation rate of unemployment, or NAIRU. Now that output is believed to have expanded more slowly than previously thought, estimates of the growth rate in output per hour—productivity—will be downgraded; correspondingly, unit labor costs will increase more rapidly. Most important, because investment spending is so critical for the long-term path of productivity growth, some analysts will take near-term productivity revisions as evidence that the nation’s underlying productivity situation has been over-sold. We might find that the revised estimates point to an annual productivity growth rate near 2.5% for the three years ending in 2000. If so, the pace could be nearly a percentage point below some economists’ estimates of the underlying trend.

Those who think about “potential GDP” will probably argue that the economy’s actual performance is really closer to its potential than we might previously have thought, and that macroeconomic policy should take care not to be too aggressive. For example, if the NAIRU is really 5%, and not 4%, then the economy must now be approaching its equilibrium unemployment rate, rather than slipping away from it. The revised data will strengthen the voice of analysts who have contended all along that the U.S. economy did not change dramatically during the 1990s in terms of its potential or how policymakers should respond to its fluctuations.

On balance, Fed watchers might say that monetary policy should have been somewhat tighter than it was because the Fed counted on a higher growth potential than was warranted. Tighter policy might have fostered a more sober economic climate and prevented some of the worst excesses. But those desiring to second-guess monetary policy must first make up their minds about inflation. The CPI-based indexes indicated that inflation has accelerated lately, fluctuating around a 3% trend, while the PCE-based indexes suggest that it has been holding fairly steady around a 2% trend. Analysis of monetary policy requires an understanding not only of the real economy but also of inflation. As the GDP revisions themselves suggest, there are important aspects of this business cycle—and this economy—that we have yet to understand.