Real GDP increased at an annual rate of 2.2% in 2006:IIIQ, according to the Commerce Department’s preliminary estimate. This upward revision of 0.6% was largely unanticipated, the consensus growth estimate having been 1.8%. The largest revision was to inventories: They were estimated to have increased $4.3 billion from 2006:IIQ, compared with the advance estimate, which showed a $3.0 billion decrease. There was also a substantial revision to net exports (up $10 billion); this was largely the result of the change in imports, where the increase was revised from 7.8% to 5.6%.

Despite the upward revision, real GDP growth continues its slowdown from the beginning of the year and is nearly a full percentage point below the 30-year average of 3.17%. Contributions to the percent change in real GDP reveal that personal consumption, business fixed investment, imports (less negative), and government spending have outpaced their four-quarter averages; on the other hand, residential investment, change in inventories, and exports are all less than their four-quarter averages.

In their October 10 report, the Blue Chip panel of economists forecasted that annualized real GDP growth for 2006:IIIQ would be 2.3%. Although they were off by 0.7% according to the advance estimate, the preliminary estimate finds them off by only 0.1%. The panel forecasts an upward trend in each of the next three quarters (2.3%, 2.6%, and 2.7%).

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Business fixed investment, though nowhere near its late-2000 high, has steadily increased since 2004:IIIQ and is now 10.6% of GDP. In contrast, investment in residential structures has been trending down since 2005 and stands at 5.6% of GDP. Although the recent housing market downturn has received considerable attention, residential investment still accounts for a relatively high share of GDP.

Another gauge of the general business climate is the inventory-to-sales ratio. Nondurable goods inventories have been slowly creeping up since 2005. However, the inventory ratios for both durable goods and retail trade have been relatively flat.

Reflecting the economy’s overall slowdown, industrial production fell slightly from a high of 114.0 in August to 113.7 in October. Because its volatility is largely determined by the weather, the utilities industry’s performance must be viewed over a longer period; it appears to have leveled off in the last couple of years. Mining has recovered completely from the severe drop in oil and gas extraction caused by Hurricanes Rita and Katrina. Capacity utilization rates have eased slightly overall and for manufacturing; mining’s utilization rate, in contrast, is the highest since May 2001.

Worker productivity and compensation affect the economic climate as well. Real compensation was up more than 3% at an annual rate in the second and third quarters, far outstripping productivity gains. Were this situation to continue, it could lead to higher inflation if firms tried to raise prices in an attempt to recoup their costs. At this point, considering that real compensation has trailed productivity gains for most of the last five years, the more likely interpretation is that compensation is merely catching up with past productivity gains.