BUSINESS SITUATION

Ralph W. Morris prepared the first section of this article, and Daniel Larkins prepared the section on corporate profits.

Real gross domestic product (GDP) increased 1.6 percent in the second quarter of 1999, according to the "final" estimates of the national income and product accounts (NIPA's), after increasing 4.3 percent in the first quarter (table 1 and chart 1).[1] The general picture of the economy that is indicated by the final estimates is little changed from that shown by the preliminary estimates. The slowdown in real

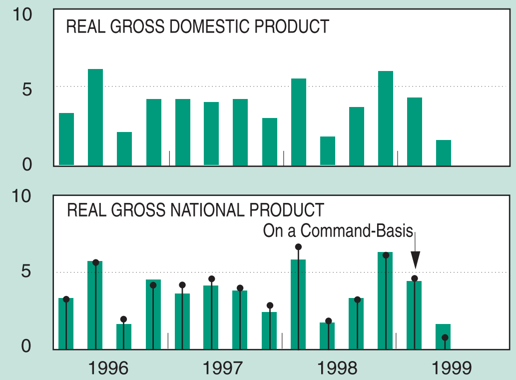
1. Quarterly estimates in the NIPA's are expressed at seasonally adjusted annual rates. Quarter-to-quarter dollar changes are the differences between the published estimates. Quarter-to-quarter percent changes are annualized and are calculated from unrounded data unless otherwise specified.

Real estimates are calculated using a chain-type Fisher formula with annual weights for all years and quarters except those for the most recent year, which are calculated using quarterly weights; real estimates are expressed both as index numbers (1992=100) and as chained (1992) dollars. Price indexes (1992=100) are also calculated using a chain-type Fisher formula.

CHART 1

Selected Product Measures: Change From Preceding Quarter

Percent



Note.—Percent change at annual rate from preceding quarter; based on seasonally adjusted estimates.

U.S. Department of Commerce, Bureau of Economic Analysis

Table 1.—Real Gross Domestic Product, Real Gross Domestic Purchases, and Real Final Sales to Domestic Purchasers

[Seasonally adjusted at annual rates]

	Billions of chained (1992) dollars: Level	Change from preceding quarter				Percent change from preceding quarter			
	1999	1998		1999		1998		1999	
	II	III	IV	I	II	III	IV	I	II
Gross domestic product	**7,790.6**	**67.9**	**111.2**	**81.9**	**31.0**	**3.7**	**6.0**	**4.3**	**1.6**
Less: Exports of goods and services	1,008.5	−6.8	44.3	−13.1	12.0	−2.8	19.7	−5.1	4.9
Plus: Imports of goods and services	1,346.6	7.0	35.3	40.5	46.5	2.3	12.0	13.5	15.1
***Equals*: Gross domestic purchases**	**8,085.8**	**80.2**	**102.5**	**126.5**	**58.0**	**4.2**	**5.4**	**6.6**	**2.9**
Less: Change in business inventories	7.4	17.5	−11.5	−5.5	−31.3	....	....	....	....
Nonfarm	5.0	17.1	−9.5	−2.4	−30.1	....	....	....	....
Farm	2.6	.4	−1.9	−3.6	−1.0	....	....	....	....
***Equals*: Final sales to domestic purchasers**	**8,069.2**	**63.4**	**112.7**	**131.1**	**85.6**	**3.3**	**6.0**	**6.8**	**4.4**
Personal consumption expenditures	5,394.8	51.6	64.2	85.9	62.9	4.1	5.0	6.7	4.8
Durable goods	817.5	4.3	41.3	23.9	18.6	2.4	24.5	12.9	9.7
Nondurable goods	1,612.1	8.2	16.0	35.8	11.2	2.1	4.2	9.5	2.8
Services	2,981.2	38.0	12.4	29.6	34.4	5.4	1.7	4.1	4.7
Gross private domestic fixed investment	1,375.6	6.8	40.1	33.0	31.6	2.2	13.2	10.5	9.7
Nonresidential fixed investment	1,038.5	−1.7	33.2	20.3	26.3	−.7	14.6	8.5	10.8
Structures	207.3	.1	3.0	2.8	−.5	.2	6.0	5.7	−1.0
Producers' durable equipment	849.5	−2.0	32.2	18.3	29.7	−1.0	17.8	9.5	15.3
Residential investment	341.8	7.4	7.6	11.8	5.9	9.9	10.0	15.4	7.1
Government consumption expenditures and gross investment	1,317.5	4.8	10.7	13.6	−6.4	1.5	3.3	4.2	−1.9
Federal	454.2	−1.6	8.1	−2.2	−4.2	−1.4	7.3	−1.9	−3.6
National defense	296.8	3.2	1.1	−5.2	−2.6	4.3	1.3	−6.6	−3.5
Nondefense	156.5	−4.5	6.8	2.8	−1.5	−11.5	19.8	7.4	−3.8
State and local	863.5	6.4	2.7	15.8	−2.3	3.1	1.3	7.7	−1.1
Addendum: Final sales of domestic product	**7,773.6**	**51.2**	**121.3**	**86.5**	**58.2**	**2.8**	**6.6**	**4.6**	**3.1**

NOTE.—Chained (1992) dollar series are calculated as the product of the chain-type quantity index and the 1992 current-dollar value of the corresponding series, divided by 100. Because the formula for the chain-type quantity indexes uses weights of more than one period, the corresponding chained-dollar estimates usually are not additive. Chained (1992) dollar levels and residuals, which measure the extent of nonadditivity in each table, are in NIPA tables 1.2, 1.4, and 1.6. Percent changes are calculated from unrounded data. Percent changes in major aggregates are in NIPA table 8.1. (See "Selected NIPA Tables," which begin on page D-2 of this issue.)

Table 2.—Contributions to Percent Change in Real Gross Domestic Product

[Seasonally adjusted at annual rates]

	1998		1999	
	III	IV	I	II
Percent change at annual rate:				
Gross domestic product	3.7	6.0	4.3	1.6
Percentage points at annual rates:				
Personal consumption expenditures	2.78	3.48	4.56	3.26
Durable goods	.20	1.90	1.09	.81
Nondurable goods	.42	.84	1.77	.56
Services	2.15	.74	1.70	1.88
Gross private domestic investment	1.22	1.42	1.31	.06
Fixed investment	.33	1.95	1.58	1.47
Nonresidential	−.08	1.52	.91	1.15
Structures	.01	.17	.15	−.03
Producers' durable equipment	−.09	1.35	.76	1.18
Residential	.41	.43	.66	.32
Change in business inventories	.89	−.53	−.27	−1.41
Net exports of goods and services	−.62	.52	−2.23	−1.36
Exports	−.32	2.02	−.58	.53
Goods	.04	1.76	−.68	.40
Services	−.36	.26	.10	.13
Imports	−.30	−1.50	−1.65	−1.89
Goods	−.32	−1.46	−1.42	−1.74
Services	.01	−.04	−.23	−.15
Government consumption expenditures and gross investment	.27	.60	.70	−.34
Federal	−.09	.44	−.08	−.22
National defense	.17	.06	−.23	−.14
Nondefense	−.26	.38	.14	−.08
State and local	.35	.16	.78	−.12

NOTE.—NIPA table 8.2 also shows contributions for 1998:I and 1998:II.

GDP mainly reflected a deceleration in consumer spending, a larger decrease in inventory investment, and a downturn in government spending; these changes were partly offset by an upturn in exports.

The largest contributors to the second-quarter increase in real GDP were consumer spending, private investment in equipment, and exports (table 2). The increase in GDP was moderated by an increase in imports, which are subtracted in the calculation of GDP, and by a decrease in inventory investment.

Table 3.—Revisions to Change in Real Gross Domestic Product and Prices, Second Quarter 1999

[Seasonally adjusted at annual rates]

	Percent change from preceding quarter		Final estimate minus preliminary estimate		
	Preliminary estimate	Final estimate	Percentage points	Billions of chained (1992) dollars	Contribution to percent change in real GDP (Percentage points)
Gross domestic product	**1.8**	**1.6**	**–0.2**	**–3.7**	....
Less: Exports of goods and services	4.3	4.9	.6	1.4	.07
Goods	4.8	5.3	.5	.8	.03
Services	3.1	4.0	.9	.6	.03
Plus: Imports of goods and services	14.4	15.1	.7	2.1	–.08
Goods	16.9	16.6	–.3	–.6	.03
Services	1.9	7.2	5.3	2.3	–.11
***Equals*: Gross domestic purchases**	**3.1**	**2.9**	**–.2**	**–3.4**	....
Less: Change in business inventories	....	....	....	–4.7	–.22
Nonfarm	....	....	....	–.3	....
Farm	....	....	....	–4.4	....
***Equals*: Final sales to domestic purchasers**	**4.3**	**4.4**	**.1**	**.9**	....
Personal consumption expenditures	4.6	4.8	.2	3.0	.17
Durable goods	9.5	9.7	.2	.3	.01
Nondurable goods	2.9	2.8	–.1	–.5	–.02
Services	4.3	4.7	.4	3.0	.16
Private fixed investment	10.1	9.7	–.4	–1.3	–.06
Nonresidential	11.2	10.8	–.4	–.9	–.03
Structures	–1.2	–1.0	.2	.1	0
Producers' durable equipment	15.9	15.3	–.6	–1.1	–.04
Residential	7.7	7.1	–.6	–.4	–.03
Government consumption expenditures and gross investment	–1.7	–1.9	–.2	–.9	–.05
Federal	–3.5	–3.6	–.1	–.2	–.01
National defense	–3.4	–3.5	–.1	0	0
Nondefense	–3.5	–3.8	–.3	–.1	0
State and local	–.7	–1.1	–.4	–.8	–.04
Addenda:					
Final sales of domestic product	3.0	3.1	.1	.4	....
Gross national product	1.5	1.6	.1	2.2	....
Gross domestic purchases price index	2.1	1.9	–.2	....	....
GDP price index	1.5	1.3	–.2	....	....

NOTE.—The final estimates for the second quarter of 1999 incorporate the following revised or additional major source data that were not available when the preliminary estimates were prepared.

Personal consumption expenditures: Revised retail sales for June, bank service charges for the quarter, residential gas usage for April, and electricity usage for May.

Nonresidential fixed investment: Revised construction put in place for May and June and revised manufacturers' shipments of machinery and equipment for June.

Residential fixed investment: Revised construction put in place for May and June.

Change in business inventories: Revised manufacturing and trade inventories for June and mining inventories for the quarter.

Exports and imports of goods and services: Revised data on exports and imports of goods for June and revised balance-of-payments data on exports and imports of services for the quarter.

Government consumption expenditures and gross investment: Revised State and local construction put in place for May and June.

Wages and salaries: Revised employment, average hourly earnings, and average weekly hours for the April through June.

GDP prices: Revised export and import prices for April through June, revised values and quantities of petroleum imports for June, and revised prices of single-family homes under construction for the quarter.

The "final" estimate of the change in real GDP is 0.2 percentage point less than the 1.8-percent increase indicated by the "preliminary" estimate reported in the September "Business Situation" (table 3). For 1978–98, the average revision—without regard to sign—from the preliminary estimate to the final estimate is 0.3 percentage point. The downward revision to real GDP reflected a downward revision to inventory investment and an upward revision to imports of services; these revisions were partly offset by an upward revision to consumer spending for services. In inventory investment, much of the downward revision reflected the incorporation of revised and newly available Census Bureau data on manufacturing and mining inventories. In imports, the upward revision reflected the incorporation of revised quarterly data from BEA's international transactions accounts. In consumer spending on services, the upward revision reflected the incorporation of newly available data on bank service charges for the quarter from the Federal Deposit Insurance Corporation and newly available data on residential electricity usage for May from the Energy Information Administration.

Real gross domestic purchases increased 2.9 percent, 0.2 percentage point less than the preliminary estimate; in the first quarter, this measure increased 6.6 percent.[2] Real final sales of domestic product increased 3.1 percent, 0.1 percentage point more than the preliminary estimate; in the first quarter, this measure increased 4.6 percent.[3]

The price index for gross domestic purchases increased 1.9 percent, 0.2 percentage point less than the preliminary estimate; in the first quarter, the index increased 1.2 percent. The price index for GDP increased 1.3 percent, also 0.2 percentage point less than the preliminary estimate; in the first quarter, the index increased 1.6 percent. The price index for gross domestic purchases increased more than the price index for GDP in the second quarter as a result of a sharp upturn in import prices (which are not included in GDP prices). The downward revisions to second-quarter prices mainly reflected revised prices of personal consumption expenditures (PCE) for services.

2. Gross domestic purchases—a measure of purchases by U.S. residents regardless of where the purchased goods and services were produced—is calculated as GDP less exports of goods and services plus imports of goods and services; it may also be calculated as the sum of personal consumption expenditures, private fixed investment, change in business inventories, and government consumption expenditures and gross investment.

3. Final sales of domestic product is calculated as GDP less change in business inventories.

Real disposable personal income (DPI) increased 2.6 percent, 0.2 percentage point more than the preliminary estimate. The upward revision to real DPI reflected the downward revision to PCE prices, which are used to deflate current-dollar DPI. Current-dollar DPI increased 4.8 percent, 0.1 percentage point less than the preliminary estimate. Personal income was revised down slightly.

The personal saving rate—personal saving as a percentage of current-dollar DPI—was a negative 1.3 percent, the same as the preliminary estimate; in the first quarter, the rate was a negative 0.7 percent.[4]

Gross national product (GNP).—In the second quarter, real GNP—goods and services produced by labor and property supplied by U.S. residents—increased 1.6 percent, the same as real GDP (chart 1 and table 4).[5] Income receipts from the rest of the world and income payments to the rest of the world increased about the same amount; both increases were mostly accounted for by corporate profits. Real GNP on a command basis, which measures the purchasing power of goods and services produced by the U.S. economy, increased less than real GNP—1.0 percent, compared with 1.6 percent—reflecting a deterioration in the terms of trade.[6] In the first quarter, real GNP on a command basis increased more than real GNP—4.7 percent, compared with 4.4 percent—reflecting an improvement in the terms of trade.

Corporate Profits

According to revised estimates, profits from current production decreased $9.5 billion (or 1.1 percent at a quarterly rate) in the second quarter after increasing $47.1 billion (5.7 percent) in the first (table 5).[7] Profits of domestic financial corporations decreased $7.7 billion (5.4 percent) after increasing $13.4 billion (10.3 percent). Profits of domestic nonfinancial corporations decreased $0.5 billion (0.1 percent) after increasing $29.0 billion (4.9 percent); in the second quarter, unit

4. For additional information, see "Note on the Personal Saving Rate" in the February 1999 SURVEY OF CURRENT BUSINESS.

For a discussion of the effects on personal saving of the definitional and classificational changes that will be introduced in the comprehensive revision of the NIPA's, see the preview article in the August 1999 SURVEY.

5. GNP equals GDP plus receipts of factor income from the rest of the world less payments of factor income to the rest of the world.

6. In the estimation of command-basis GNP, the current-dollar value of the sum of exports of goods and services and of receipts of factor income is deflated by the implicit price deflator (IPD) for the sum of imports of goods and services and of payments of factor income.

The terms of trade is a measure of the relationship between the prices that are received by U.S. producers for exports of goods and services and the prices that are paid by U.S. purchasers for imports of goods and services. It is measured by the following ratio, with the decimal point shifted two places to the right: In the numerator, the IPD for the sum of exports of goods and services and of receipts of factor income; in the denominator, the IPD for the sum of imports of goods and services and of payments of factor income.

Changes in the terms of trade reflect the interaction of several factors, including movements in exchange rates, changes in the composition of the traded goods and services, and changes in producers' profit margins. For example, if the U.S. dollar depreciates against a foreign currency, a foreign manufacturer may choose to absorb this cost by reducing the profit margin on the product it sells to the United States, or it may choose to raise the price of the product and risk a loss in market share.

7. Profits from current production is estimated as the sum of profits before tax, the inventory valuation adjustment, and the capital consumption adjustment; it is shown in NIPA tables 1.9, 1.14, 1.16, and 6.16C (see "Selected NIPA Tables," which begins on page D–2 of this issue) as corporate profits with inventory valuation and capital consumption adjustments.

Percent changes in profits are shown at quarterly, not annual, rates.

Table 4.—Relation of Real Gross Domestic Product, Real Gross National Product, and Real Command-Basis Gross National Product

[Seasonally adjusted at annual rates]

	Billions of chained (1992) dollars					Percent change from preceding quarter			
	Level	Change from preceding quarter							
	1999	1998		1999		1998		1999	
	II	III	IV	I	II	III	IV	I	II
Gross domestic product	**7,790.6**	**67.9**	**111.2**	**81.9**	**31.0**	**3.7**	**6.0**	**4.3**	**1.6**
Plus: Receipts of factor income from the rest of the world	252.2	–5.3	4.7	2.4	9.4	–8.5	8.1	4.2	16.4
Less: Payments of factor income to the rest of the world	264.3	1.8	–.7	1.4	9.0	2.9	–1.1	2.2	14.9
***Equals*: Gross national product**	**7,777.4**	**60.8**	**116.6**	**83.0**	**31.1**	**3.3**	**6.3**	**4.4**	**1.6**
Less: Exports of goods and services and receipts of factor income from the rest of the world	1,261.6	–12.6	48.1	–9.8	22.2	–4.1	17.0	–3.1	7.4
Plus: Command-basis exports of goods and services and receipts of factor income	1,332.3	–8.3	49.1	–3.4	11.5	–2.5	16.3	–1.0	3.5
***Equals*: Command-basis gross national product**	**7,848.1**	**65.1**	**117.5**	**89.5**	**20.4**	**3.5**	**6.3**	**4.7**	**1.0**
Addendum: Terms of trade [1]	**105.6**	**.5**	**–.2**	**.6**	**–1.0**	**1.9**	**–.8**	**2.3**	**–3.7**

1. Calculated as the ratio of the implicit price deflator for the sum of exports of goods and services and of receipts of factor income to the corresponding implicit price deflator for imports with the decimal point shifted two places to the right.

NOTE.—Levels of these series are in NIPA tables 1.10 and 1.11.

profits decreased, reflecting a smaller increase in unit prices than in unit costs. Profits from the rest of the world decreased $1.2 billion (1.2 percent) after increasing $4.6 billion (4.7 percent); the downturn was largely accounted for by a slowdown in receipts of earnings from foreign affiliates.[8]

The revised estimate of profits from current production is $0.3 billion lower than the preliminary estimate. A downward revision to profits of domestic financial industries ($4.7 billion) was largely offset by upward revisions to profits of domestic nonfinancial industries ($3.3 billion) and profits from the rest of the world ($1.0 billion).

Cash flow from current production, a profits-related measure of internally generated funds available for investment, decreased $13.2 billion after increasing $34.7 billion.[9] The ratio of cash flow to nonresidential fixed investment, an indicator of the share of the current level of investment that could be financed by internally generated funds, decreased from 87.1 percent to 83.9 percent, its lowest level since 1990; its average level for 1990–98 was 89.9 percent.

Domestic industry profits and related measures.— Domestic industry profits decreased $12.4 billion after increasing $38.1 billion.[10] (The first-quarter increase had partly represented a rebound from a fourth quarter in which profits were depressed by payments by tobacco companies to States under the terms of various settlement agreements.)

Profits of domestic financial corporations decreased $8.0 billion after increasing $13.2 billion. About two-thirds of the downturn was accounted for by commercial banks.

8. Profits from the rest of the world is calculated as (1) receipts by U.S. residents of earnings from their foreign affiliates plus dividends received by U.S. residents from unaffiliated foreign corporations minus (2) payments by U.S. affiliates of earnings to their foreign parents plus dividends paid by U.S. corporations to unaffiliated foreign residents. These estimates include capital consumption adjustments (but not inventory valuation adjustments) and are derived from BEA's international transactions accounts.

9. Cash flow from current production is undistributed profits with inventory valuation and capital consumption adjustments plus the consumption of fixed capital.

10. Domestic industry profits are estimated as the sum of corporate profits before tax and the inventory valuation adjustment; they are shown in NIPA table 6.16C (on page D–16 of this issue). Estimates of the capital consumption adjustment do not exist at a detailed industry level; they are available only for total financial and total nonfinancial industries.

Table 5.—Corporate Profits

[Seasonally adjusted]

	Billions of dollars (annual rate)					Percent change (quarterly rate)			
	Level	Change from preceding quarter				1998		1999	
	1999	1998		1999					
	II	III	IV	I	II	III	IV	I	II
Profits from current production	**859.3**	**6.4**	**–5.3**	**47.1**	**–9.5**	**0.8**	**–0.6**	**5.7**	**–1.1**
Domestic industries	759.1	13.7	–12.1	42.5	–8.3	1.9	–1.6	5.9	–1.1
Financial	135.8	–.6	.6	13.4	–7.7	–.4	.5	10.3	–5.4
Nonfinancial	623.3	14.3	–12.7	29.0	–.5	2.4	–2.1	4.9	–.1
Rest of the world	100.2	–7.4	6.9	4.6	–1.2	–7.6	7.6	4.7	–1.2
Receipts (inflows)	168.3	–5.5	10.1	10.9	6.8	–3.8	7.2	7.2	4.3
Payments (outflows)	68.1	1.8	3.3	6.3	8.0	3.9	6.4	11.7	13.4
IVA	–17.4	3.9	1.7	–1.8	–29.0	....	....	....	....
CCAdj	108.7	5.4	5.4	4.4	4.1	....	....	....	....
Profits before tax	768.0	–3.0	–12.4	44.5	15.4	–.4	–1.7	6.3	2.0
Profits tax liability	257.0	1.6	–7.6	15.1	6.3	.6	–3.1	6.4	2.5
Profits after tax	511.0	–4.5	–4.8	29.4	9.1	–1.0	–1.0	6.2	1.8
Cash flow from current production	834.3	9.2	4.9	34.7	–13.2	1.2	.6	4.3	–1.6
Domestic industry profits:									
Corporate profits of domestic industries with IVA	650.4	8.3	–17.5	38.1	–12.4	1.3	–2.7	6.1	–1.9
Financial	138.2	–1.2	–.2	13.2	–8.0	–.9	–.1	9.9	–5.5
Nonfinancial	512.2	9.5	–17.3	24.9	–4.4	1.9	–3.4	5.1	–.9
Manufacturing	197.3	.4	–10.5	11.0	1.8	.2	–5.4	6.0	.9
Transportation and public utilities	89.8	5.2	–3.0	4.4	–4.3	6.0	–3.2	4.9	–4.6
Wholesale trade	50.0	.4	–7.6	3.7	0	.7	–14.1	7.9	.1
Retail trade	72.2	–.3	–.3	6.2	–.8	–.4	–.6	9.4	–1.2
Other	102.9	3.7	4.2	–.5	–1.0	3.9	4.2	–.5	–1.0
	Dollars								
Unit price, costs, and profits of nonfinancial corporations:									
Unit price	1.064	0.001	–0.002	0.001	0.003	....	....	....	....
Unit labor cost	.704	0	.001	0	.004	....	....	....	....
Unit nonlabor cost	.225	–.001	.003	–.004	.001	....	....	....	....
Unit profits from current production	.136	.002	–.005	.004	–.001	....	....	....	....

NOTE.—Levels of these and other profits series are in NIPA tables 1.14, 1.16, 6.16C, and 7.15.
IVA Inventory valuation adjustment
CCAdj Capital consumption adjustment

Profits of domestic nonfinancial corporations decreased $4.4 billion after increasing $24.9 billion. Manufacturing profits increased substantially less than in the first quarter; the biggest contributors to the slowdown were food and chemicals. Profits in the transportation and utilities group turned down, as communications profits increased less than in the first quarter, and utilities profits decreased after increasing. In trade, profits of wholesalers were flat after increasing, and profits of retailers dipped a little after increasing. Profits of "other" nonfinancial corporations decreased somewhat more than in the first quarter.

Profits before tax (PBT) increased $15.4 billion after increasing $44.5 billion. The difference between the $15.4 billion increase in PBT and the $9.5 billion decrease in profits from current production mainly reflected a sharp decrease in the inventory valuation adjustment (IVA), which removes inventory profits and losses from business income.[11] In the second quarter, inventory profits amounted to $17.4 billion; in the first quarter, inventory losses had been $11.6 billion. A sharp upswing in energy prices was mainly responsible for the swing from inventory losses to profits; the companies that were most affected were in petroleum extraction and refining, in "other" retail, and in transportation.

11. As prices change, companies that value inventory withdrawals at original acquisition (historical) costs may realize inventory profits or losses. Inventory profits—a capital-gains-like element in profits—result from an increase in inventory prices, and inventory losses—a capital-loss-like element in profits—result from a decrease in inventory prices. In the NIPA's, inventory profits or losses are removed from business incomes by the IVA; a negative IVA removes inventory profits, and a positive IVA removes inventory losses.