

B U S I N E S S S I T U A T I O N

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 1.8 percent in the second quarter of 1998, according to the “final” estimates of the national income and product accounts (NIPAs) (table 1 and chart 1).¹ The deceleration from a 5.5-percent increase in the first quarter was more than accounted for by a downturn in inventory investment and by a slowdown in business spending for equipment.

1. Quarterly estimates in the NIPAs are expressed at seasonally adjusted annual rates unless otherwise specified. Quarter-to-quarter dollar changes are differences between the published estimates. Quarter-to-quarter percent changes are annualized and are calculated from unrounded data. Real estimates are calculated using a chain-type Fisher formula with annual weights and expressed both as index numbers (1992=100) and as chained (1992) dollars. Price indexes (1992=100) also are calculated using a chain-type Fisher formula.

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					Percent change from preceding quarter			
	Level	Change from preceding quarter				1997		1998	
		1998	1997			III	IV	I	II
	II	III	IV	I	II	III	IV	I	II
Gross domestic product	7,498.6	74.7	53.4	100.1	33.9	4.2	3.0	5.5	1.8
Less: Exports of goods and services	972.1	24.5	10.7	-6.9	-19.8	10.6	4.4	-2.8	-7.7
Plus: Imports of goods and services	1,217.3	35.3	17.3	42.6	26.9	13.5	6.3	15.7	9.3
Equals: Gross domestic purchases	7,718.6	83.7	59.0	142.8	73.7	4.6	3.2	7.8	3.9
Personal consumption expenditures	5,130.2	74.3	34.0	74.1	75.1	6.2	2.8	6.1	6.1
Durable goods	729.4	25.8	5.2	25.5	19.1	16.8	3.1	15.8	11.2
Nondurable goods	1,540.9	18.6	-1.4	26.9	19.7	5.1	-4	7.4	5.3
Services	2,866.8	31.8	29.4	24.5	37.5	4.7	4.3	3.5	5.4
Gross private domestic fixed investment	1,264.1	32.3	10.2	55.4	39.2	12.0	3.6	20.4	13.4
Nonresidential fixed investment	960.4	34.0	4.0	45.7	28.5	17.0	1.8	22.2	12.8
Structures	201.9	5.9	.5	-2.6	-1.2	12.4	.9	-4.9	-2.3
Producers' durable equipment	771.3	28.8	3.8	52.4	32.5	18.8	2.2	34.3	18.8
Residential investment	309.1	-2	5.6	10.6	10.6	-4	8.2	15.6	15.0
Change in business inventories	38.2	-28.0	15.5	24.9	-53.2	.....	.....	.....	.....
Nonfarm	29.9	-28.1	18.7	23.2	-56.0	.....	.....	.....	.....
Farm	8.7	28.8	3.8	52.4	32.5	.....	.....	.....	.....
Government consumption expenditures and gross investment	1,294.8	4.5	.3	-6.2	11.8	1.4	.1	-1.9	3.7
Federal	454.1	-1.5	-2.4	-10.4	8.0	-1.2	-2.1	-8.8	7.3
National defense	300.3	-1.5	-1.5	-15.4	7.0	-1.8	-2.0	-18.5	9.9
Nondefense	152.9	0	-9	4.6	1.0	-1	-2.3	13.1	2.6
State and local	840.9	5.9	2.8	4.2	3.8	2.9	1.3	2.1	1.8
Addenda:									
Final sales to domestic purchasers	7,676.4	109.7	44.1	120.1	124.2	6.2	2.4	6.6	6.7
Final sales of domestic product	7,456.4	100.8	38.5	77.7	83.9	5.8	2.1	4.3	4.6

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.

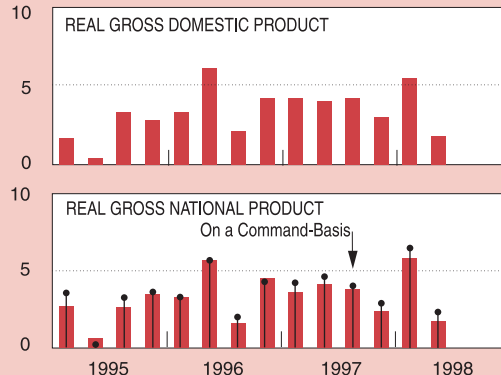
The “final” estimate of the change in real GDP is 0.2 percentage point higher than the 1.6-percent increase indicated by the “preliminary” estimate reported in the September “Business Situation” (table 2). The revision is close to the average revision—0.3 percentage point, without regard to sign—from the preliminary estimate to the final estimate for 1978–97. Revisions to the components of GDP were small. Upward revisions to consumer spending, net exports, and business spending for equipment more than offset a downward revision to inventory investment. The largest revision was to consumer spending; the revision mainly reflected the incorporation of revised Census Bureau retail sales data and newly available Federal Deposit Insurance Corporation data on bank service charges. In net exports, the incorporation of revised Census Bureau and BEA data on international trade in goods and services resulted in a larger downward revision to imports than to exports. (Imports are subtracted from final expenditures in the calculation of GDP.)

Real final sales of domestic product increased 4.6 percent in the second quarter, 0.2 percentage

CHART 1

Selected Product Measures: Change From Preceding Quarter

Percent



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

point more than the preliminary estimate.² Real gross domestic purchases increased 3.9 percent, 0.1 percentage point more than the preliminary estimate.³

The price index for gross domestic purchases increased 0.4 percent, the same as the preliminary estimate; in the first quarter, the index decreased 0.2 percent. The price index for GDP increased 0.9 percent, 0.1 percentage point more than the preliminary estimate; in the first quarter, the index also increased 0.9 percent. The larger second-quarter increase in GDP prices than in gross domestic purchases prices was due to

2. Final sales of domestic product equals GDP less change in business inventories.

3. 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.

**Table 2.—Revisions to Real Gross Domestic Product and Prices,
Second Quarter 1998**

[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
Gross domestic product	1.6	1.8	0.2	3.7
<i>Less:</i> Exports of goods and services	-7.4	-7.7	-.3	-.8
Goods	-11.7	-11.3	.4	.7
Services	3.6	1.7	-1.9	-1.2
<i>Plus:</i> Imports of goods and services	10.0	9.3	-.7	-1.9
Goods	11.7	11.4	-.3	-.7
Services	1.8	-6	-2.4	-1.1
Equals: Gross domestic purchases	3.8	3.9	.1	2.9
Personal consumption expenditures	5.8	6.1	.3	2.9
Durable goods	11.1	11.2	.1	.3
Nondurable goods	5.0	5.3	.3	1.2
Services	5.2	5.4	.2	1.5
Gross private domestic fixed investment	13.2	13.4	.2	.6
Nonresidential	12.6	12.8	.2	.5
Structures	-1.6	-2.3	-.7	-.4
Producers' durable equipment	18.1	18.8	.7	1.1
Residential	14.8	15.0	.2	.1
Change in business inventories .....	.....	.....	.....	-.9
Nonfarm .....	.....	.....	.....	-.8
Farm .....	.....	.....	.....	-.1
Government consumption expenditures and gross investment	3.6	3.7	.1	.2
Federal	6.6	7.3	.7	.7
National defense	9.5	9.9	.4	.2
Nondefense	1.5	2.6	1.1	.4
State and local	2.1	1.8	-.3	-.5
Addenda:				
Final sales of domestic product	4.4	4.6	.2	4.5
Gross domestic purchases price index .....	.4	.4	0	.....
GDP price index .....	.8	.9	.1	.....

NOTE.—The final estimates for the second quarter of 1998 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, hospital expenses for May, residential electricity usage for May, residential volume gas usage for May, and data on bank service charges for the second quarter.

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.

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 goods and services for the second 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 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 second quarter.

a larger decrease in the prices of imports than in the prices of exports. (Import prices are included in gross domestic purchases prices but not in GDP prices, and export prices are included in GDP prices but not in gross domestic purchases prices.)

Real disposable personal income (DPI) increased 2.6 percent, 0.3 percentage point less than the preliminary estimate. The downward revision reflected an upward revision to personal tax and nontax payments. (Disposable personal income is personal income less personal tax and nontax payments.) The upward revision to personal tax and nontax payments reflected newly available data on State and local tax receipts from the Census Bureau. The personal saving rate was 0.4 percent, 0.2 percentage point less than the preliminary estimate.

Gross national product (GNP).—In the second quarter, real GNP—goods and services produced by labor and property supplied by U.S. residents—increased 1.7 percent, 0.1 percentage point less than real GDP (chart 1 and table 3).⁴

4. 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.

Table 3.—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				1997		1998	
		1998	1997	1998		III	IV	I	II
	II	III	IV	I	II				
Gross domestic product	7,498.6	74.7	53.4	100.1	33.9	4.2	3.0	5.5	1.8
<i>Plus:</i> Receipts of factor income from the rest of the world	241.0	4.6	-8.0	3.4	0	7.8	-124	5.9	0
<i>Less:</i> Payments of factor income to the rest of the world	252.8	11.4	1.6	-9	3.2	20.6	2.6	-1.4	5.2
Equals: Gross national product	7,485.9	67.7	43.7	104.5	30.7	3.8	2.4	5.8	1.7
<i>Less:</i> Exports of goods and services and receipts of factor income from the rest of the world	1,213.7	29.0	1.6	-3.0	-191	10.0	.5	-1.0	-6.1
<i>Plus:</i> Command-basis exports of goods and services and receipts of factor income	1,283.4	31.2	3.0	16.3	-131	10.4	.9	5.2	-4.0
Equals: Command-basis gross national product	7,556.6	70.0	45.0	123.8	36.7	3.9	2.5	6.9	2.0
Addendum:									
Terms of trade ¹	105.7	.1	.1	1.6	.5	.4	.4	6.3	1.9

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.

Receipts of factor income from the rest of the world were unchanged, and payments of factor income increased; more than half of the increase in payments was in interest income. The revised estimate of the growth in second-quarter GNP is 0.1 percentage point higher than the preliminary estimate.

Real GNP on a command basis, which measures the goods and services produced by the U.S. economy in terms of their purchasing power, increased more than real GNP—2.0 percent, compared with 1.7 percent—reflecting an improvement in the terms of trade.⁵ In the first quarter, real GNP on a command-basis increased considerably more than real GNP—6.9 percent, compared with 5.8 percent—reflecting a substantial improvement in the terms of trade.

Corporate Profits

Profits from current production decreased \$8.6 billion in the second quarter after increasing \$8.4 billion in the first (table 4).⁶ Profits of domestic nonfinancial corporations decreased \$6.1 billion after no change, as a decrease in unit profits more than offset an increase in a real product; the decrease in unit profits, in turn, resulted from an increase in unit costs, while unit prices were unchanged. Profits of domestic financial corporations decreased \$1.2 billion after increasing \$1.8 billion. Profits from the rest of the world decreased \$1.3 billion after increasing \$6.6 billion; payments increased, and receipts changed little.⁷

Cash flow from current production, a profits-related measure of internally generated funds

5. 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.

6. 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 as corporate profits with inventory valuation and capital consumption adjustments in NIPA tables 1.9, 1.14, 1.16, and 6.16C (which are part of the "Selected NIPA Tables," which begin on page D-2 of this issue).

7. 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 are derived from BEA's international transactions accounts.

available for investment, decreased \$5.8 billion after increasing \$21.9 billion. 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 for the fourth consecutive quarter (and for the ninth time in the last 11 quarters), to 84.8 percent from 87.3 percent.⁸ The ratio, which averaged 91.9 percent in 1991-97, was last below 85 percent in the fourth quarter of 1990.

Industry profits and related measures.—Industry profits decreased \$13.0 billion after increasing \$3.6 billion.⁹ Profits of domestic nonfinancial

8. The recent annual revision of the NIPA's included a redefinition of dividend payments; see Eugene P. Seskin, "Annual Revision of the National Income and Product Accounts," SURVEY OF CURRENT BUSINESS 78 (August 1998): 29. This redefinition raised undistributed corporate profits (calculated as profits after tax less dividends), which are a major component of cash flow. Accordingly, cash flow was raised, as was the ratio of cash flow to nonresidential fixed investment. Prior to the annual revision, the ratio's level in the first quarter of 1998 was 80.1 percent, and its average for 1991-97 was 85.5 percent.

9. Industry profits, which are estimated as the sum of corporate profits before tax and the inventory valuation adjustment, are shown in NIPA table 6.16C (on page D-16 of this issue). Estimates of the capital consumption

Table 4.—Corporate Profits

[Seasonally adjusted at annual rates]


	Level		Change from preceding quarter			
	1998		1997		1998	
	II	III	IV	I	II	
Billions of dollars						
Profits from current production	820.6	25.4	-20.1	8.4	-8.6	
Domestic industries	723.3	28.4	-9.8	1.8	-7.3	
Financial	130.1	-2	6.2	1.8	-1.2	
Nonfinancial	593.2	28.5	-15.9	0	-6.1	
Rest of the world	97.3	-3.1	-10.3	6.6	-1.3	
Receipts (inflows)	146.0	3.9	-14.7	3.6	-1	
Payments (outflows)	48.7	6.9	-4.2	-3.1	1.2	
IVA	7.8	-5.5	-5	21.0	-17.5	
CCAadj	89.4	1.7	2.9	4.8	4.5	
Profits before tax	723.5	29.1	-22.5	-17.3	4.4	
Profits tax liability	241.6	12.3	-4.9	-9.4	1.7	
Profits after tax	481.8	16.9	-17.6	-7.9	2.6	
Cash flow from current production	798.7	19.7	-9.7	21.9	-5.8	
Profits by industry:						
Corporate profits with IVA	731.3	23.6	-23.0	3.6	-13.0	
Domestic industries	633.9	26.7	-12.7	-2.9	-11.9	
Financial	134.4	-1	6.1	1.6	-1.9	
Nonfinancial	499.5	26.8	-18.8	-4.6	-9.9	
Manufacturing	194.6	13.4	-16.6	-15.2	-2.5	
Transportation and public utilities	87.5	1.3	.3	3.1	-4.2	
Wholesale trade	53.5	2.2	-5.1	3.9	2.0	
Retail trade	67.4	3.6	-5	5.2	0	
Other	96.5	6.3	3.3	-1.6	-5.3	
Rest of the world	97.3	-3.1	-10.3	6.6	-1.3	
Dollars						
Unit price, costs, and profits of nonfinancial corporations:						
Unit price	1.061	0	0	-0.002	0	
Unit labor cost .....	.699	-.003	.007	.002	.002
Unit nonlabor cost .....	.226	-.002	-.001	-.001	0
Unit profits from current production .....	.136	.004	-.006	-.002	-.003

NOTE.—Levels of these and other profits series are in NIPA tables 1.14, 1.16, 6.18C, and 7.15.

IVA Inventory valuation adjustment
CCAadj Capital consumption adjustment

corporations decreased more than in the first quarter, reflecting weakness in the nonmanufacturing industries: The transportation and public utilities group (which includes communications) turned down, retail trade was unchanged after an increase, and "other" nonfinancial corporations decreased more than in the first quarter. In contrast, manufacturing profits decreased much less than in the first quarter; the improvement mainly reflected upturns in industrial machinery and equipment, in fabricated metal products, and in food and kindred products. Profits of domestic financial corporations and profits from the rest of the world both decreased after increasing.

adjustment are available only for total financial and total nonfinancial industries.

Profits before tax (PBT) increased \$4.4 billion after falling \$17.3 billion. The difference between the \$4.4 billion increase in PBT and the \$8.6 billion decrease in profits from current production was more than accounted for by smaller inventory losses, as reflected in a \$17.5 billion decrease in the inventory valuation adjustment.¹⁰ 

10. 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 used to adjust corporate profits before tax and nonfarm proprietors' income (both of which are mainly based on data from tax returns). Inventory profits are shown as the inventory valuation adjustment with the sign reversed.

Upcoming Comprehensive Revision of the NIPA's

Next year, BEA will undertake its 11th comprehensive, or benchmark, revision of the national income and product accounts (NIPA's).

Comprehensive revisions are prepared about every 5 years and incorporate three major types of improvements: (1) Definitional and classificational changes that update the accounts to more accurately portray the evolving U.S. economy, (2) statistical changes that update the accounts to reflect the introduction of new and improved methodologies and the incorporation of newly available and revised source data, and (3) presentational changes that update the NIPA tables to reflect the aforementioned changes and to make the tables more informative.

Comprehensive revisions, and to a lesser extent annual revisions, provide the opportunity to introduce the major changes that are outlined in BEA's strategic plan for maintaining and improving its economic accounts. BEA periodically updates its strategic plan, which is available on our Web site at <www.bea.doc.gov>; click on "What's New."

For the upcoming comprehensive revision, BEA is considering several major improvements—including the capitalization of invest-

ments in computer software, the treatment of government retirement plans symmetrically with private plans, and the integration of BEA's wealth estimates with the NIPA estimates. However, constraints on time, resources, and source data will play a role in deciding which improvements will be implemented.

During the next year, BEA will provide additional information on the comprehensive revision and will solicit input through comments on the SURVEY OF CURRENT BUSINESS articles that preview the proposed changes and through discussions at group meetings of experts. If you have comments or suggestions on the strategic plan or on the comprehensive revision, please contact

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