BUSINESS SITUATION

Ralph W. Morris prepared the first section of this article, and Daniel Larkins prepared the section on corporate profits. **R** EAL GROSS domestic product (GDP) increased 3.7 percent in the third quarter of 1998, according to the "final" estimates of the national income and product accounts (NIPA'S), after increasing 1.8 percent in the second quarter (table 1 and chart 1). The acceleration was more than accounted for by an upturn in inventory investment.

The largest contributors to the third-quarter increase in real GDP were personal consumption

Real estimates are calculated using a chain-type Fisher formula with annual weights for all years and quarters except those in 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.

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		1998		n./	1		
	III	IV	1	Ш	Ш	IV	'	II	III
Gross domestic product	7,566.5	53.4	100.1	33.9	67.9	3.0	5.5	1.8	3.7
Less: Exports of goods and services	965.3 1,224.3	10.7 17.3	-6.9 42.6	-19.8 26.9	-6.8 7.0	4.4 6.3	-2.8 15.7	-7.7 9.3	-2.8 2.3
Equals: Gross domestic purchases	7,798.8	59.0	142.8	73.7	80.2	3.2	7.8	3.9	4.2
Less: Change in business inventories	55.7 47.0 9.1	15.5 18.7 –3.6	24.9 23.2 1.6		17.5 17.1 .4				
Equals: Final sales to domestic purchasers	7,739.8	44.1	120.1	124.2	63.4	2.4	6.6	6.7	3.3
Personal consumption expenditures Durable goods Nondurable goods Services Gross private domestic fixed investment Nonresidential fixed investment Structures Producers' durable equipment Residential investment Government consumption expenditures and gross investment Federal National defense Nondefense State and local	5,181.8 733.7 1,549.1 2,904.8 1,270.9 958.7 202.0 769.3 316.5 1,299.6 452.5 303.5 148.4 847.3	34.0 5.2 -1.4 29.4 10.2 4.0 .5 3.8 5.6 3 -2.4 -1.5 9 2.8	74.1 25.5 26.9 24.5 55.4 45.7 -2.6 52.4 10.6 -6.2 -10.4 4.6 4.2	75.1 19.1 19.7 37.5 39.2 28.5 -1.2 32.5 10.6 11.8 8.0 7.0 1.0 3.8	51.6 4.3 8.2 38.0 6.8 -1.7 .1 -2.0 7.4 4.8 -1.6 3.2 -4.5 6.4	2.8 3.11 4 4.3 3.6 1.8 .9 2.2 8.2 .1 -2.1 -2.0 -2.3 1.3	6.1 15.8 7.4 3.5 20.4 22.2 -4.9 34.3 15.6 -1.9 -8.8 -18.5 13.1 2.1	6.1 11.2 5.3 5.4 13.4 12.8 -2.3 18.8 15.0 3.7 7.3 9.9 2.6 1.8	-1.0 9.9 1.5 -1.4 4.3
Addendum: Final sales of domestic product	7,507.6	38.5	77.7	83.9	51.2	2.1	4.3	4.6	2.8

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.

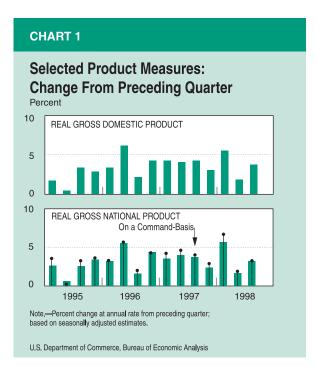


Table 2.—Contributions to Percent Change in Real Gross
Domestic Product

[Seasonally adjusted at annual rate]

[Seasonally adjusted at allitual fate]								
	1997		1998					
	IV	I	II	III				
Percent change at annual rate: Gross domestic product	3.0	5.5	1.8	3.7				
Percentage points at annual rates: Personal consumption expenditures Durable goods Nondurable goods Services	1.88 .26 08 1.70	4.09 1.23 1.41 1.40	4.09 .91 1.01 2.14	2.78 .20 .42 2.15				
Gross private domestic investment Fixed investment Nonresidential Structures Producers' durable equipment Residential Change in business inventories	1.34 .48 .16 .03 .13 .32	4.07 2.82 2.21 15 2.36 .60 1.22	75 1.95 1.35 07 1.42 .60 -2.66	1.22 .33 08 .01 09 .41				
Net exports of goods and services Exports Goods Services Imports Goods Services	30 .53 .67 14 83 71 12	-2.24 33 29 04 -1.94 -1.75 19	-2.08 92 98 .06 -1.18 -1.19	62 32 .04 36 30 32				
Government consumption expenditures and gross investment	.02 14 09 05	34 57 84 .26	.64 .44 .38 .06	.27 09 .17 26				

NOTE.—Contributions to percent change in major aggregates are in NIPA table 8.2.

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.

expenditures for services and inventory investment (table 2). The increase in GDP was moderated by decreases in exports of services and in Federal nondefense spending and by an increase in imports of goods.²

The "final" estimate of the change in real GDP is 0.2 percentage point less than the 3.9-percent increase indicated by the "preliminary" estimate reported in the December "Business Situation" (table 3). 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.

Table 3.—Revisions to Change in Real Gross Domestic Product and Prices, Third Quarter 1998

[Seasonally adjusted at annual rates]

	Percent cha preceding			ninus mate	
				e in real DP	Contri- bution to percent change in
	Preliminary estimate	Final estimate	Percent- age points	Billions of chained (1992) dollars	real GDP Percentage in age points
Gross domestic product	3.9	3.7	-0.2	-3.5	-0.20
Less: Exports of goods and services	-1.9 1.3	-2.8 2.3	9 1.0	-2.1 3.0	10 13
Equals: Gross domestic purchases	4.2	4.2	0	.7	
Less: Change in business inventories Nonfarm Farm				9 -1.4 .4	05
Equals: Final sales to domestic purchasers	3.3	3.3	0	1.6	
Personal consumption expenditures Durable goods Nondurable goods Services	4.1 2.4 2.1 5.4	4.1 2.4 2.1 5.4	0 0 0 0	1 .1 .2 2	0 0 .01 02
Gross private domestic fixed investment	1.4 -1.2 -1.5 -1.1 8.6	2.2 7 .2 -1.0 9.9	.8 .5 1.7 .1 1.3	2.2 1.3 .8 .2 1.0	.11 .06 .05 0 .05
Government consumption expenditures and gross investment	1.6 -1.6 4.3 -12.2 3.4	1.5 -1.4 4.3 -11.5 3.1	1 .2 0 .7 3	4 .3 1 .4 7	02 .01 0 .01 04
Addenda: Final sales of domestic product	2.9 .5 .8	2.8 .7 1.0	1 .2 .2	-2.6 	

^{1.} Based on chained-type annual (1992) weights.

Revisions to the components of gdp were small. A downward revision to net exports more than offset an upward revision to business fixed investment. In net exports, a downward revision to exports and an upward revision to imports reflected the incorporation of revised Census Bureau and Bureau of Economic Analysis (BEA) data on international trade in goods and services. In business fixed investment, the upward revision was primarily to residential and nonresidential structures and reflected the incorporation of revised Census Bureau data on the value of residential and nonresidential construction put in place for August and September.

Real gross domestic purchases increased 4.2 percent, the same as the preliminary estimate; in the second quarter, it increased 3.9 percent.³ Real final sales of domestic product increased 2.8 percent, 0.1 percentage point less than the preliminary estimate; in the second quarter, it increased 4.6 percent.4

The price index for gross domestic purchases increased 0.7 percent, 0.2 percentage point more than the preliminary estimate; in the second quarter, the index increased 0.4 percent. price index for GDP increased 1.0 percent, 0.2 percentage point more than the preliminary estimate; in the second quarter, the index increased 0.9 percent. The larger third-quarter increase in GDP prices than in gross domestic purchases prices was due to a larger decrease in the prices of imports than in the prices of exports.⁵ The upward revisions to third-quarter prices mainly reflected the incorporation of newly available Department of Transportation price data on airline transportation services purchased by consumers and of newly available Census Bureau price data on single-family structures.

Real disposable personal income (DPI) increased 3.2 percent in the third quarter, 0.1 percentage point more than the preliminary estimate. The upward revision was accounted for by an upward revision to personal income. The personal saving rate—personal saving as a percentage of current-dollar DPI—was 0.2 percent, the same as the preliminary estimate.

^{2.} Imports are subtracted from final expenditures in the calculation of

NOTE.—The final estimates for the third 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 September, hospital expenses for August, and residential gas usage

Nonresidential fixed investment: Revised construction put in place for August and September and revised manufacturers' shipments

of machinery and equipment for September.

Residential fixed investment: Revised construction put in place for August and September.

Residential inked investment. Revised constitution for its place of August and September.

Change in business inventiories: Revised manufacturing and trade inventories for September.

Exports and imports of goods and services: Revised data on exports and imports of goods for September and revised balanceof-payments data on exports and imports of goods and services for the third quarter.

Government consumption expenditures and gross investment: Revised State and local construction put in place for August and

Wages and salaries: Revised employment, average hourly earnings, and average weekly hours for September.

GDP prices: Revised export and import prices for July through September, revised values and quantities of petroleum imports for September, revised prices of single-family homes under construction for the third quarter, and airline transportation prices paid by consumers for the third quarter.

^{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.

^{4.} Final sales of domestic product equals GDP less change in business

^{5.} 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.

Gross national product (GNP).—In the third quarter, real GNP—goods and services produced by labor and property supplied by U.S. residents—increased 3.3 percent, 0.4 percentage point less than real GDP (chart 1 and table 4).⁶ Receipts of factor income from the rest of the world decreased, and payments of factor income increased; corporate profits accounted for most of the decrease in receipts and more than accounted for the increase in payments. The revised estimate of the growth in GNP is the same as the preliminary estimate; in the second quarter, GNP had increased 1.7 percent.

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—3.5 percent, compared with 3.3 percent—reflecting an improvement in the terms of trade. In the second quarter, real GNP on a command-basis also increased more than real GNP—2.0 percent, compared with 1.7 percent.

Corporate Profits

Profits from current production increased \$6.4 billion (o.8 percent at a quarterly rate) in the third quarter after decreasing \$8.6 billion in the second (table 5).8 An increase in profits of domestic nonfinancial corporations more than offset a decrease in profits from the rest of the world. Profits of domestic nonfinancial corporations increased \$14.3 billion (2.4 percent) after decreasing \$6.1 billion, as unit profits and real product increased; the increase in unit profits, in turn, reflected a small increase in unit prices and a small decrease in unit costs. Profits of domestic financial corporations decreased \$0.6 billion (0.4 percent) after decreasing \$1.2 billion. Profits from the rest of the world decreased \$7.4 billion (7.6 percent) after decreasing \$1.3 billion; the third-quarter decrease mainly reflected a drop in receipts of earnings from foreign affiliates.9

Cash flow from current production, a profitsrelated measure of internally generated funds available for investment, increased \$9.2 billion after decreasing \$5.8 billion. The ratio of cash flow to nonresidential fixed investment, an indicator of the share of the current level of investment that

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				1997	1998		
	1998	1997	1998			1997		1990	
	III	IV	1	II	III	IV	I	II	III
Gross domestic product	7,566.5	53.4	100.1	33.9	67.9	3.0	5.5	1.8	3.7
Plus: Receipts of factor income from the rest of the world	235.7 254.6	-8.0 1.6	3.4 9	0 3.2	-5.3 1.8	-12.4 2.6	5.9 -1.4	0 5.2	-8.5 2.9
Equals: Gross national product	7,546.7	43.7	104.5	30.7	60.8	2.4	5.8	1.7	3.3
Less: Exports of goods and services and receipts of factor income from the rest of the world	1,201.1	1.6	-3.0	-19.1	-12.6	.5	-1.0	-6.1	-4.1
come	1,275.1	3.0	16.3	-13.1	-8.3	.9	5.2	-4.0	-2.5
Equals: Command-basis gross national product	7,620.7	45.0	123.8	36.7	65.1	2.5	6.9	2.0	3.5
Addendum: Terms of trade ¹	106.2	.1	1.6	.5	.5	.4	6.3	1.9	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

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.

^{7.} 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.

^{8.} 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 (which are part of the "Selected NIPA Tables"; see 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.

^{9.} 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.

could be financed by internally generated funds, increased to 86.7 percent from 84.8 percent; the increase followed four consecutive decreases. The average quarterly ratio for 1991-97 was 91.9 percent.

Domestic industry profits and related measures.— Domestic industry profits increased \$8.3 billion after decreasing \$11.9 billion. 10 Profits of domestic nonfinancial corporations increased \$9.5 billion after decreasing \$9.9 billion, mainly reflecting upturns in the transportation and public utilities group (which includes communications) and in "other" nonmanufacturing. In manufacturing, profits increased slightly after a decrease; profits of durable goods manufacturers increased a little more than in the second quarter, and profits of nondurable goods manufacturers decreased somewhat less than in the second quarter.

Profits of domestic financial corporations decreased \$1.2 billion after decreasing \$1.9 billion.

Profits before tax (PBT) decreased \$3.0 billion after increasing \$4.4 billion. More than half of the difference between this decrease and the \$6.4 billion increase in profits from current production was accounted for by a \$5.4 billion increase in the capital consumption adjustment.11 The rest of the difference was accounted for by larger inventory losses, as reflected in a \$3.9 billion increase in the inventory valuation adjustment.¹²

Table 5.—Corporate Profits [Seasonally adjusted]

	Billions of dollars (annual rate)					Percent change (quarterly rate)				
	Level	Ch	ange from pr	eceding qua	rter	1997	1998			
	1998	1997		1998		IV	I	II	III	
	III	IV	I	II	III	1 17				
Profits from current production	827.0	-20.1	8.4	-8.6	6.4	-2.4	1.0	-1.0	0.8	
Domestic industries	737.0	-9.8	1.8	-7.3	13.7	-1.3	.2	-1.0	1.9	
Financial	129.5	6.2	1.8	-1.2	6	5.0	1.4	-1.0	4	
Nonfinancial	607.5	-15.9	0	-6.1	14.3	-2.6	0	-1.0	2.4	
Rest of the world	89.9	-10.3	6.6	-1.3	-7.4	-10.1	7.2	-1.3	-7.6	
Receipts (inflows)	140.5	-14.7	3.6	1	-5.5	-9.3	2.5	1	-3.8	
Payments (outflows)	50.5	-4.2	-3.1	1.2	1.8	-7.8	-6.1	2.4	3.9	
IVA	11.7	5	21.0	-17.5	3.9					
CCAdi	94.8	2.9	4.8	4.5	5.4					
Profits before tax	720.5	-22.5	-17.3	4.4	-3.0	-3.0	-2.4	.6	4	
Profits tax liability	243.2	-22.5 -4.9	-17.3 -9.4	1.7	1.6	-3.0 -1.9	-3.8	.7	4	
Profits after tax	477.3	-4.9 -17.6	-7.9	2.6	-4.5	-3.5	-3.6 -1.6	.6	-1.0	
FIUILS diter tax	411.3	-17.0	-1.9	2.0	-4.5	-3.3	-1.0	٥.	-1.0	
Cash flow from current production	807.9	-9.7	21.9	-5.8	9.2	-1.2	2.8	7	1.2	
Domestic industry profits:										
Corporate profits of domestic industries with IVA	642.2	-12.7	-2.9	-11.9	8.3	-1.9	5	-1.8	1.3	
Financial	133.2	6.1	1.6	-1.9	-1.2	4.7	1.2	-1.4	9	
Nonfinancial	509.0	-18.8	-4.6	-9.9	9.5	-3.5	9	-1.9	1.9	
Manufacturing	195.0	-16.6	-15.2	-2.5	.4	-7.3	-7.2	-1.2	.2	
Transportation and public utilities	92.7	-10.0	3.1	-4.2	5.2	.4	3.5	-4.6	6.0	
Wholesale trade	53.9	-5.1	3.9	2.0	.4	-9.7	8.3	3.8	.7	
Retail trade	67.1	5	5.2	0	3	8	8.4	3.0	4	
Other	100.2	3.3	-1.6	-5.3	3.7	3.3	-1.5	-5.2	3.9	
Otrici	100.2	3.3	-1.0	-5.5	3.1	3.3	-1.5	-5.2	3.9	
	Dollars									
Unit price, costs, and profits of nonfinancial corporations:										
Unit price	1.062	0	-0.002	0	0.001	l	l	l	l	
Unit labor cost	.699	.007	.002	.002	0.001					
Unit nonlabor cost	.225	001	001	0.002	001					
Unit profits from current production	.138	006	002	003	.002					
one prono nom ounone production		.000	.002	.000	1 .002					

NOTE.—Levels of these and other profits series are in NIPA tables 1.14, 1.16, 6.16C, and 7.15.

^{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.

^{11.} The capital consumption adjustment converts depreciation valued at historical cost and based on service lives and depreciation patterns specified in the tax code to depreciation valued at replacement cost and based on empirical evidence on the prices of used equipment and structures in resale markets. For information on depreciation in the NIPA's, see Arnold J. Katz and Shelby W. Herman, "Improved Estimates of Fixed Reproducible Tangible Wealth, 1929-95," Survey of Current Business 77 (May 1997).

^{12.} 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 reflected in business incomes (profits before tax and nonfarm proprietors' income) and are removed by the inventory valuation adjustment (IVA); a negative IVA removes inventory profits, and a positive IVA removes inventory losses.

IVA Inventory valuation adjustment CCAdj Capital consumption adjustment