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U.S. Economy Headed in Right Direction

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The U.S. Bureau of Economic Analysis reported on Friday, October 27 that U.S. real gross domestic production (GDP) grew at an annual rate of 2.5 percent during third quarter 2011. That represents much stronger growth than seen in the previous three quarters (Table 1).

Consumption and business fixed investment both contributed considerably to the growth in real GDP. Together, they contributed 3.26 percentage points in increased real GDP. Government spending contributed nothing to the growth; a slight increase in defense spending was offset by reductions in other aspects of government spending. Residential investment contributed only 0.05 percentage points. Net exports also contributed to an expanding economy as a weak dollar and strong economic activity outside the United States led to bigger increases in U.S. exports than imports.

Quite favorably, the only negative contribution to growth in U.S. real GDP came from reduced inventories because businesses met increased domestic sales from inventory rather than production. This inventory drawdown sets the stage for stronger growth of real GDP during fourth quarter 2011. Businesses will have to produce more or face the difficulty meeting growing sales with depleted inventories.

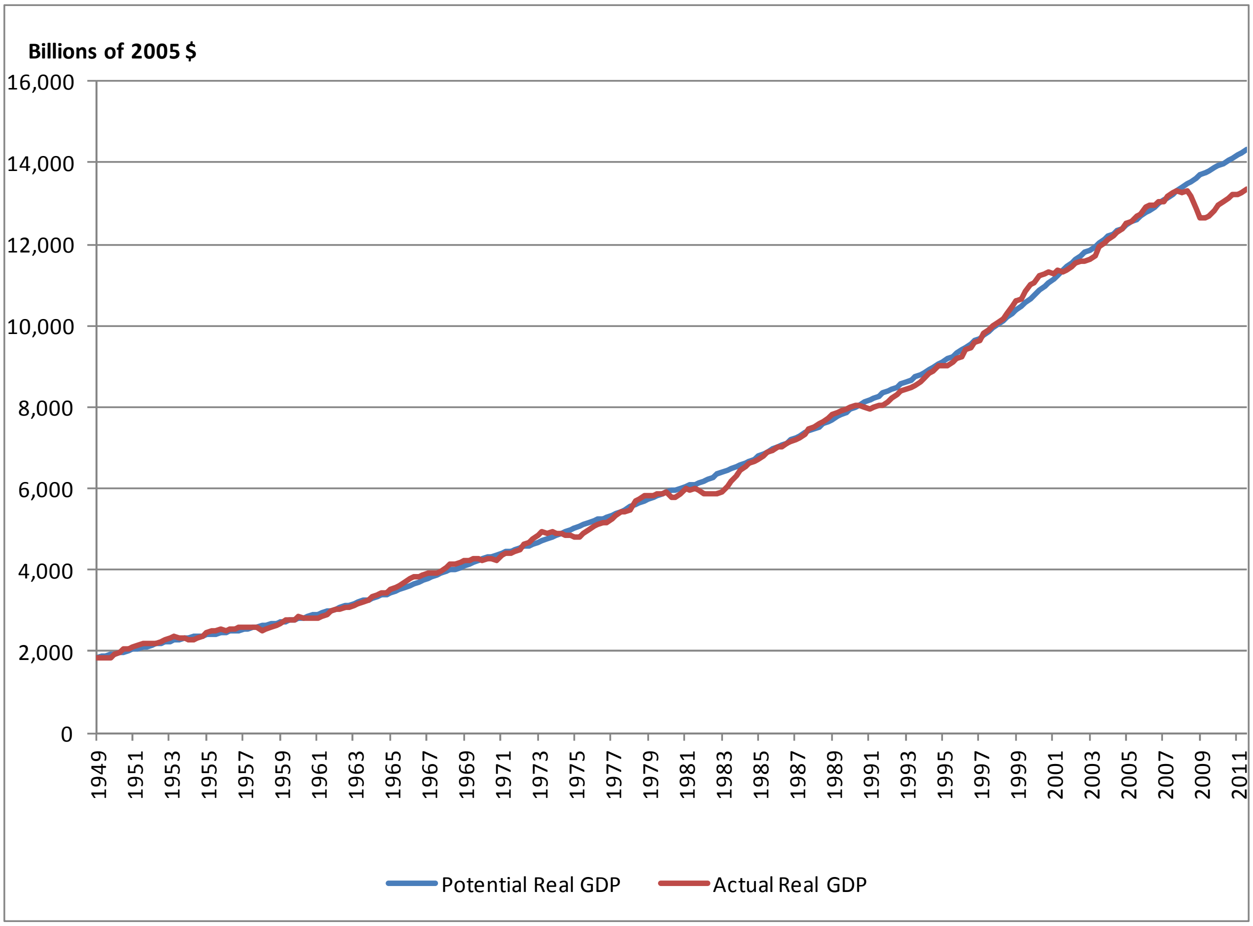
Table 1. Contributions to the Growth of Real GDP

	2010Q4	2011Q1	2011Q2	2011Q3
Real GDP (percent change annual rate)	2.3	0.4	1.3	2.5
Contributions to Real GDP Growth				
Final Domestic Sales	2.78	0.38	1.38	3.32
Consumption	2.48	1.47	0.49	1.72
Business Fixed Investment	0.82	0.20	0.98	1.54
Residential Investment	0.06	-0.06	0.09	0.05
Government Purchases	-0.58	-1.23	-0.18	0.00
Net Exports	1.37	-0.34	0.24	0.22
Exports	0.98	1.01	0.48	0.55
Imports	0.39	-1.35	-0.24	-0.34
Inventory Investment	-1.79	0.32	-0.28	-1.08

Source: U.S. Bureau of Economic Analysis

Despite improving in third quarter 2011, the growth rate of U.S. real GDP remained below the post-World War II average of 3.2 percent and well below the 4.3 percent average recorded in those quarters that occurred during a recovery or expansion. Furthermore, U.S. real GDP remains 6.7 percent below the potential estimated by the Congressional Budget Office (Chart 1). So, the U.S. economy has a long way to go, but at least it is headed in the right direction, another recession is not looming, and the stage is set for stronger economic growth.

Chart 1. Potential and Actual U.S. Real GDP



Sources: Congressional Budget Office; U.S. Bureau of Economic Analysis

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