

# Business Situation

## Final Estimates for the Second Quarter of 2005

ACCORDING to the “final” estimates of the national income and product accounts (NIPAs), real gross domestic product (GDP) increased 3.3 percent in the second quarter of 2005 after increasing 3.8 percent in the first quarter (table 1 and chart 1).<sup>1</sup> The final estimate of growth is the same as the “preliminary” estimate released in August. In the final estimates, a small upward revision to consumer spending on services and a downward revision to imports of services were

1. Quarterly estimates in the NIPAs are expressed at seasonally adjusted annual rates, unless otherwise specified. Quarter-to-quarter dollar changes are differences between these published estimates. Percent changes are calculated from unrounded data and are annualized. “Real” estimates are presented in chained (2000) dollars, and price indexes are chain-type measures.

**Table 1. Real Gross Domestic Product and Components**

[Seasonally adjusted at annual rates]

	Change from preceding period (percent)				Contribution to percent change in real GDP (percentage points)				Share of current-dollar GDP (percent)
	2004		2005		2004		2005		2005
	III	IV	I	II	III	IV	I	II	II
<b>Gross domestic product (GDP)</b> .....	<b>4.0</b>	<b>3.3</b>	<b>3.8</b>	<b>3.3</b>	<b>4.0</b>	<b>3.3</b>	<b>3.8</b>	<b>3.3</b>	<b>100.0</b>
<b>Personal consumption expenditures</b> .....	<b>4.4</b>	<b>4.3</b>	<b>3.5</b>	<b>3.4</b>	<b>3.05</b>	<b>3.01</b>	<b>2.44</b>	<b>2.35</b>	<b>70.1</b>
Durable goods.....	10.8	5.5	2.6	7.9	0.88	0.45	0.22	0.64	8.4
Nondurable goods.....	3.9	5.5	5.3	3.6	0.78	1.09	1.07	0.74	20.5
Services.....	3.4	3.6	2.8	2.3	1.39	1.47	1.15	0.97	41.3
<b>Gross private domestic investment</b> .....	<b>4.6</b>	<b>6.8</b>	<b>8.6</b>	<b>-3.7</b>	<b>0.75</b>	<b>1.11</b>	<b>1.42</b>	<b>-0.63</b>	<b>16.6</b>
Fixed investment.....	8.4	7.2	7.0	9.5	1.31	1.13	1.12	1.51	16.6
Nonresidential.....	11.8	10.4	5.7	8.8	1.15	1.04	0.58	0.90	10.6
Structures.....	1.4	4.7	-2.0	2.7	0.04	0.12	-0.05	0.07	2.6
Equipment and software.....	15.5	12.4	8.3	10.9	1.12	0.92	0.64	0.83	8.0
Residential.....	2.6	1.6	9.5	10.8	0.15	0.09	0.54	0.62	6.0
Change in private inventories.....					-0.56	-0.03	0.29	-2.14	0.0
<b>Net exports of goods and services</b> .....					<b>-0.17</b>	<b>-0.98</b>	<b>-0.40</b>	<b>1.11</b>	<b>-5.6</b>
Exports.....	5.5	7.1	7.5	10.7	0.53	0.70	0.74	1.07	10.5
Goods.....	8.2	3.7	5.3	16.0	0.55	0.25	0.37	1.08	7.3
Services.....	-0.6	15.5	12.5	-0.4	-0.02	0.44	0.37	-0.01	3.2
Imports.....	4.7	11.3	7.4	-0.3	-0.70	-1.68	-1.14	0.04	16.1
Goods.....	4.7	13.0	8.2	-1.1	-0.59	-1.60	-1.05	0.15	13.4
Services.....	4.6	3.1	3.7	4.4	-0.11	-0.08	-0.10	-0.11	2.6
<b>Government consumption expenditures and gross investment</b> .....	<b>1.8</b>	<b>0.9</b>	<b>1.9</b>	<b>2.5</b>	<b>0.35</b>	<b>0.17</b>	<b>0.35</b>	<b>0.47</b>	<b>18.9</b>
Federal.....	3.6	-0.6	2.4	2.4	0.25	-0.04	0.17	0.17	7.0
National defense.....	9.0	-3.3	3.0	3.7	0.41	-0.16	0.14	0.17	4.7
Nondefense.....	-6.4	5.2	1.1	-0.2	-0.16	0.12	0.03	-0.01	2.3
State and local.....	0.8	1.8	1.6	2.6	0.10	0.21	0.19	0.31	11.9

NOTE: Percent changes are from NIPA table 1.1.1, and contributions to percent change are from NIPA table 1.1.2. Shares are from NIPA table 1.1.10.

offset by small downward revisions to exports of services and to inventory investment (table 2).<sup>2</sup>

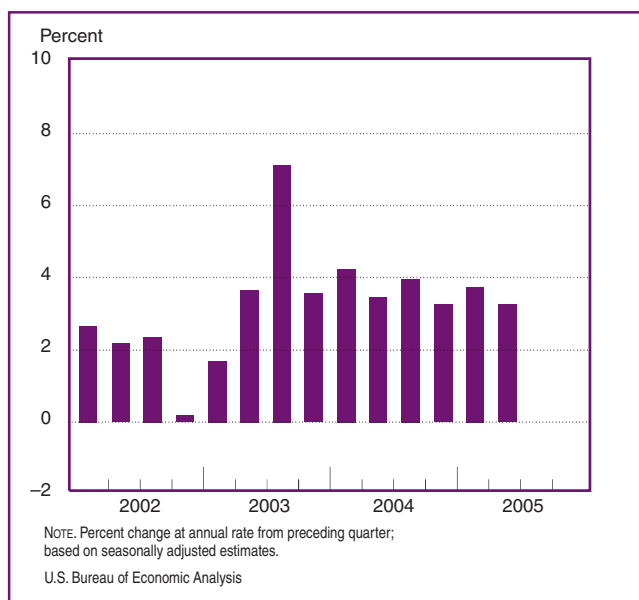
- Prices of goods and services purchased by U.S. residents increased 3.3 percent, 0.2 percentage point more than in the preliminary estimate. In the first quarter, prices had increased 2.9 percent. The acceleration mainly reflected an acceleration in energy prices.
- Real disposable personal income (DPI) increased 1.5 percent, 0.5 percentage point less than in the preliminary estimate. Real DPI had decreased 3.4 percent in the first quarter.

The deceleration in real GDP growth in the second quarter primarily reflected a downturn in private inventory investment that was partly offset by a

2. In this article, “consumer spending” is shorthand for the NIPA series “personal consumption expenditures,” “government spending” is shorthand for “government consumption expenditures and gross investment,” and “inventory investment” is shorthand for “change in private inventories.”

*Christopher Swann prepared this article.*

**Chart 1. Real Gross Domestic Product**



downturn in imports and by accelerations in business investment in equipment and software, in exports, in government spending, and in residential fixed investment.

- Inventory investment subtracted 2.14 percentage points from real GDP growth after adding 0.29 percentage point in the first quarter. Real inventory stocks decreased \$59.9 billion in the second quarter; stocks had increased \$8.1 billion in the first quarter.
- Consumer spending decelerated slightly, increasing 3.4 percent after increasing 3.5 percent; it added 2.35 percentage points to real GDP growth after adding 2.44 percentage points in the first quarter.

**Table 2. Final and Preliminary Estimates for the Second Quarter of 2005**  
[Seasonally adjusted at annual rates]

	Percent change from preceding quarter			Contribution to percent change in real GDP		
	Final estimate	Preliminary estimate	Final minus preliminary	Final estimate	Preliminary estimate	Final minus preliminary
<b>Gross domestic product (GDP)</b> .....	<b>3.3</b>	<b>3.3</b>	<b>0.0</b>	<b>3.3</b>	<b>3.3</b>	<b>0.0</b>
<b>Personal consumption expenditures</b> .....	<b>3.4</b>	<b>3.0</b>	<b>0.4</b>	<b>2.35</b>	<b>2.12</b>	<b>0.23</b>
Durable goods.....	7.9	7.7	0.2	0.64	0.63	0.01
Nondurable goods.....	3.6	3.5	0.1	0.74	0.71	0.03
Services.....	2.3	1.9	0.4	0.97	0.79	0.18
<b>Gross private domestic investment</b> .....	<b>-3.7</b>	<b>-3.3</b>	<b>-0.4</b>	<b>-0.63</b>	<b>-0.57</b>	<b>-0.06</b>
Fixed investment.....	9.5	8.9	0.6	1.51	1.42	0.09
Nonresidential.....	8.8	8.4	0.4	0.90	0.86	0.04
Structures.....	2.7	2.7	0.0	0.07	0.07	0.00
Equipment and software.....	10.9	10.4	0.5	0.83	0.79	0.04
Residential.....	10.8	9.8	1.0	0.62	0.56	0.06
Change in private inventories.....				-2.14	-1.99	-0.15
<b>Net exports of goods and services</b> .....				<b>1.11</b>	<b>1.22</b>	<b>-0.11</b>
Exports.....	10.7	13.2	-2.5	1.07	1.30	-0.23
Goods.....	16.0	15.9	0.1	1.08	1.07	0.01
Services.....	-0.4	7.3	-7.7	-0.01	0.23	-0.24
Imports.....	-0.3	0.5	-0.8	0.04	-0.08	0.12
Goods.....	-1.1	-1.1	0.0	0.15	0.15	0.00
Services.....	4.4	8.9	-4.5	-0.11	-0.23	0.12
<b>Government consumption expenditures and gross investment</b> .....	<b>2.5</b>	<b>2.7</b>	<b>-0.2</b>	<b>0.47</b>	<b>0.51</b>	<b>-0.04</b>
Federal.....	2.4	1.6	0.8	0.17	0.11	0.06
National defense.....	3.7	2.4	1.3	0.17	0.11	0.06
Nondefense.....	-0.2	-0.1	-0.1	-0.01	0.00	-0.01
State and local.....	2.6	3.3	-0.7	0.31	0.40	-0.09
<b>Addenda:</b>						
Final sales of domestic product.....	5.6	5.4	0.2	5.45	5.27	0.18
Gross domestic purchases price index.....	3.3	3.1	0.2			
GDP price index.....	2.6	2.4	0.2			

NOTE: The final estimates for the first quarter of 2005 incorporate the following revised or additional major source data that were not available when the preliminary estimates were prepared.

*Personal consumption expenditures:* Retail sales for June (revised), electricity data (newly available), and telephone revenue data (newly available).

*Nonresidential fixed investment:* Construction put-in-place data for May and June (revised) and manufacturers' shipments of machinery and equipment for June (revised).

*Residential fixed investment:* Construction put-in-place data for May and June (revised).

*Change in private inventories:* Manufacturers' and trade inventories for June (revised).

*Exports and imports of goods and services:* International transactions data for the first and second quarters (revised).

*Government consumption expenditures and gross investment:* State and local government construction put-in-place data for May and June (revised).

*Wages and salaries:* Employment, average hourly earnings, and average weekly hours for June (revised), and data on employer costs for employee compensation for the second quarter (newly available).

*GDP prices:* Export and import prices for April through June (revised), unit-value index for petroleum imports for June (revised), and prices of single-family houses under construction for the quarter (revised).

- Net exports added 1.11 percentage points to real GDP growth after subtracting 0.40 percentage point in the first quarter. Imports turned down, decreasing 0.3 percent after increasing 7.4 percent, and added 0.04 percentage point to real GDP growth after subtracting 1.14 percentage points in the first quarter. Exports increased 10.7 percent after increasing 7.5 percent and added 1.07 percentage points to real GDP growth after adding 0.74 percentage point. The acceleration in exports resulted from an acceleration in exports of goods that was partly offset by a downturn in exports of services.<sup>3</sup>
- Business investment in equipment and software accelerated, increasing 10.9 percent after increasing 8.3 percent in the first quarter, and added 0.83 percentage point to real GDP growth after adding 0.64 percentage point.
- Government spending accelerated, increasing 2.5 percent after increasing 1.9 percent, and added 0.47 percentage point to real GDP growth after adding 0.35 percentage point.

- Residential fixed investment accelerated, increasing 10.8 percent after increasing 9.5 percent, and contributed 0.62 percentage point to real GDP growth after contributing 0.54 percentage point.

The final estimates for the second quarter also show the following:

- Real final sales of domestic product (real GDP less the change in private inventories) increased 5.6 percent in the second quarter after increasing 3.5 percent in the first quarter.
- Real gross domestic purchases (GDP less net exports) increased 2.1 percent after increasing 4.0 percent.
- Real gross national product (GNP) increased 3.2 percent after increasing of 3.9 percent.<sup>4</sup> The second-quarter increase in GNP is 0.1 percentage point less than the increase in GDP; an increase in income receipts to the rest of the world more than offset an increase in income payments from the rest of the world.
- The gross national saving rate (saving from all sources as a percentage of gross national income)

3. Imports include the value of goods and services that are produced abroad and therefore are not considered domestic production. However, in calculating GDP as the sum of final expenditures, it is necessary to subtract imports because the domestic component categories of expenditures—consumer spending, business investment in equipment and software, inventory investment, and government spending—include imported goods and services.

4. GNP is a measure of the goods and services produced by labor and property supplied by U.S. residents regardless of where they are located; in contrast, GDP is a measure of the goods and services produced by labor and property in the United States, regardless of nationality. The two measures are related as follows: GNP equals GDP plus income receipts from the rest of the world minus income payments to the rest of the world.

was 13.5 percent in the second quarter and 13.4 percent in the first quarter, and the net saving rate increased to 1.7 percent from 1.5 percent.<sup>5</sup>

- The personal saving rate decreased to 0.1 percent in the second quarter from 0.5 percent in the first quarter.

### Corporate Profits

Profits from current production increased \$59.3 billion (4.6 percent at a quarterly rate) in the second quarter after increasing \$68.7 billion (5.6 percent) in the first quarter (table 3).<sup>6</sup> In the second quarter, profits of domestic industries increased \$55.5 billion after

5. Net saving, which excludes the consumption of fixed capital, is a measure of the saving that is available for augmenting the stock of fixed assets.

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 1.7.5, 1.10–1.12, 1.14–1.16, and 6.16D. Percent changes in profits are shown at quarterly, not annual, rates.

**Table 3. Corporate Profits**  
[Seasonally adjusted]

Level	Billions of dollars (annual rate)					Percent change from preceding quarter (quarterly rate)			
	Change from preceding quarter								
	2005	2004			2005	2004		2005	
	II	III	IV	I	II	III	IV	I	II
<b>Current production measures:</b>									
Corporate profits .....	1347.5	-44.8	102.3	68.7	59.3	-3.9	9.2	5.6	4.6
Domestic industries .....	1150.3	-53.8	109.6	53.9	55.5	-5.5	11.8	5.2	5.1
Financial .....	350.7	-74.1	77.2	36.0	-26.9	-21.9	29.2	10.6	-7.1
Nonfinancial .....	799.6	20.3	32.4	17.8	82.5	3.1	4.9	2.5	11.5
Rest of the world .....	197.2	9.0	-7.3	14.9	3.7	5.1	-3.9	8.3	1.9
Receipts from the rest of the world .....	328.2	6.4	23.2	-19.1	14.7	2.1	7.5	-5.7	4.7
Less: Payments to the rest of the world .....	131.0	-2.5	30.4	-33.9	10.9	-2.0	24.6	-22.0	9.1
Less: Taxes on corporate income .....	372.5	-15.7	34.0	69.6	9.9	-5.7	13.1	23.7	2.7
Equals: Profits after tax .....	975.0	-29.1	68.2	-0.8	49.4	-3.3	8.0	-0.1	5.3
Net dividends .....	506.3	15.0	113.4	-94.4	11.4	3.2	23.8	-16.0	2.3
Undistributed profits from current production .....	468.7	-44.1	-45.1	93.5	38.0	-10.3	-11.8	27.7	8.8
Net cash flow .....	1280.9	10.2	-75.3	95.4	41.7	0.8	-6.2	8.3	3.4
<b>Industry profits:</b>									
Profits with IVA .....	1393.3	-35.2	98.4	259.5	54.1	-3.5	10.0	24.0	4.0
Domestic industries .....	1196.1	-44.2	105.6	244.6	50.4	-5.3	13.3	27.2	4.4
Financial .....	349.5	-73.3	76.6	57.8	-27.7	-23.2	31.5	18.1	-7.4
Nonfinancial .....	846.6	29.1	29.0	186.8	78.1	5.6	5.3	32.1	10.2
Utilities .....	26.4	-0.3	2.7	9.6	2.7	-2.0	23.2	68.3	11.4
Manufacturing .....	204.7	8.9	38.5	15.5	34.5	8.2	33.2	10.0	20.3
Wholesale trade .....	98.1	7.8	-2.2	14.5	16.7	12.7	-3.2	21.7	20.5
Retail trade .....	109.1	-11.0	5.8	16.9	4.5	-11.8	7.0	19.4	4.2
Transportation and warehousing .....	27.9	-8.9	-4.4	21.2	5.0	.....	.....	.....	.....
Information .....	53.5	12.7	-12.0	25.7	6.8	.....	.....	.....	.....
Other nonfinancial .....	326.9	19.9	0.6	83.3	8.0	9.3	0.3	35.4	2.5
Rest of the world .....	197.2	9.0	-7.3	14.9	3.7	5.1	-3.9	8.3	1.9
<b>Addenda:</b>									
Profits before tax (without IVA and CCAAdj) .....	1412.2	-46.7	105.9	254.2	33.9	-4.4	10.4	22.6	2.5
Profits after tax (without IVA and CCAAdj) .....	1039.7	-31.0	71.9	184.6	24.0	-3.9	9.5	22.2	2.4
IVA .....	-18.9	11.4	-7.5	5.3	20.2	.....	.....	.....	.....
CCAAdj .....	-45.8	-9.6	4.0	-190.8	5.2	.....	.....	.....	.....

NOTE: Levels of these and other profits series are shown in NIPA tables 1.12, 1.14, 1.15, and 6.16D.  
IVA Inventory valuation adjustment  
CCAAdj Capital consumption adjustment

increasing \$53.9 billion, but profits from the rest of the world decelerated.

The second-quarter increase in profits of domestic industries was accounted for by profits of domestic nonfinancial corporations, which increased \$82.5 billion after increasing \$17.8 billion in the first quarter. In contrast, profits of domestic financial corporations decreased \$26.9 billion after increasing \$36.0 billion. Real gross value added of nonfinancial corporations increased. Profits per unit of real product increased, reflecting an increase in unit prices and decreases in both unit labor costs and unit nonlabor costs.

Profits from the rest of the world increased \$3.7 billion (1.9 percent) in the second quarter after increasing \$14.9 billion (8.3 percent).<sup>7</sup> The second-quarter increase reflected a larger increase in receipts from foreign affiliates of domestic parents than the increase in payments by domestic affiliates to foreign parents. Receipts from foreign affiliates of domestic parents increased \$14.7 billion (4.7 percent) after decreasing \$19.1 billion (5.7 percent). Payments by domestic affiliates to foreign parents increased \$10.9 billion (9.1 percent) after decreasing \$33.9 billion (22.0 percent).

Taxes on corporate income increased \$9.9 billion (2.7 percent) in the second quarter. After-tax profits from current production increased \$49.4 billion (5.3 percent).

Net dividends increased \$11.4 billion (2.3 percent) after decreasing \$94.4 billion (16.0 percent).<sup>8</sup> Undistributed corporate profits (a measure of net saving that equals after-tax profits less dividends) increased \$38.0 billion (8.8 percent) in the second quarter.

Net cash flow from current production, a profits-related measure of internally generated funds available for investment, increased \$41.7 billion (3.4 percent) in the second quarter after increasing \$95.4 billion (8.3 percent) in the first quarter.<sup>9</sup> The ratio of cash flow to nonresidential fixed investment, an indicator of the extent to which the current level of investment could be financed by internally generated corporate funds, increased to 97.5 in the second quarter from 96.8 in the first quarter.

7. Profits from the rest of the world is the difference between (1) receipts by U.S. residents of earnings from foreign affiliates plus dividends received by U.S. residents from unaffiliated foreign corporations and (2) payments by U.S. affiliates of earnings to 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.

8. The large decrease in net dividends in the first quarter followed the large fourth-quarter increase in net dividends that resulted from a special dividend payment by the Microsoft Corporation. For more information, see "The Microsoft Special Dividend" at <[www.bea.gov/bea/faq/national/FAQ.htm](http://www.bea.gov/bea/faq/national/FAQ.htm)>.

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

**Industry profits.** The current-production measure of profits is not available at the detailed industry level, because estimates of the capital consumption adjustment (CCAdj) at the detailed level are not available.<sup>10</sup> (Estimates of the CCAdj are only available for total financial industries and for total nonfinancial industries.) Consequently, industry profits are best measured by profits with inventory valuation adjustment (IVA).<sup>11</sup>

In the second quarter, industry profits with IVA increased \$54.1 billion after increasing \$259.5 billion. For domestic nonfinancial corporations, profits with IVA increased \$78.1 billion; the increase was wide-

spread, and the largest increases were in manufacturing industries and in wholesale trade. For domestic financial industries, profits with IVA decreased \$27.7 billion (chart 2).

The increase in industry profits is somewhat smaller than the increase in profits from current production, reflecting the differing estimates of depreciation that underlie the two measures. Profits from current production includes the CCAdj, which increased \$5.2 billion in the second quarter.<sup>12</sup> The CCAdj had decreased \$190.8 billion in the first quarter. In the first quarter, the large increase in industry profits and the large decrease in the CCAdj reflected the expiration of the “bonus” depreciation provisions of both the Job Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Relief Reconciliation Act of 2003; these acts had increased the immediate depreciation writeoff that corporations could claim.

10. The CCAdj is the difference between consumption of fixed capital (the decline in the value of the stock of assets due to wear and tear, obsolescence, accidental damage, and aging) and capital consumption allowances (tax-return depreciation).

11. The IVA adjusts the NIPA estimates of business income for inventory profits or losses; the IVA is the difference between the cost of inventory withdrawals valued at acquisition cost and the cost of inventory withdrawals valued at replacement cost.

12. The CCAdj converts the depreciation of fixed assets reported on a tax-return, historical-cost basis to a current-cost basis.

**Chart 2. Corporate Profits with Inventory Valuation Adjustment: Change From 2005:I to 2005:II**

