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WHAT ARE THE COMPONENTS OF [US] GDP?

by

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About.com Guide

April 25, 2013

http://useconomy.about.com/od/grossdomesticproduct/f/GDP_Components.htm?p=1

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(2013)

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[In 2012, the US GDP was $15.68 Trillion; currently, 08 Oct 2013, the current debt ceiling (reached May 2013) is $16.699 Trillion - The debt ceiling is a cap on the total amount the US government can borrow, and is set by US lawmakers]

Question: What Are the Components of [US] GDP?

Answer: The components of Gross Domestic Product (GDP) tell you what a country is good at producing. That's because GDP is the country's total economic output for each year.

The BEA (Bureau of Economic Analysis) has subcategorized U.S. GDP into four major components:

1. Personal Consumption Expenditures

More than 70% of what the U.S. produces is for personal consumption. In 2012, $11.119 trillion of the $15.685 trillion produced went toward household purchases. The BEA sub-divides personal consumption expenditures into goods and services.

Goods contributed $3.783 trillion in 2012, more than one-fourth of total GDP. Goods are further sub-divided into two even smaller components. The first is durable goods, such as autos and furniture. This is the smallest sub-component, at only $1.219 trillion. The second is non-durable goods, such as food, clothing and fuel. This contributes $2.564 trillion. People are more likely to complain about the high price of goods, especially gasoline and groceries.

Services are a much larger sub-component of personal consumption expenditures. In 2012, $7.336 trillion in services was produced, a whopping 47% of GDP. This is much larger than in the 1960s, when services contributed less than 30% to the economy. A large driver of this growth has been the dramatic increase of the financial services and health care industries. Most of these services are consumed here at home, as they are difficult to export.

Why does personal consumption make up such a large part of the U.S. economy? America is fortunate to have a large domestic population within an easily accessible geographic location. It's almost like a huge test market for new products. That advantage means that U.S. businesses have become very good at knowing what consumers want.

2. Business Investment

Business investment includes purchases that companies make to produce consumer goods. However, not every purchase is counted. If a purchase only replaces an existing item, then it doesn't add to GDP and so isn't counted. Total business investment in 2012 was $2.062 trillion, lower than its pre-recession peak of $2.327 trillion in 2006, but higher than its post-recession low of $1.549 trillion in 2009.

As you might have already guessed, the BEA divides business investment into two sub-components. The first is fixed investment. Most of this is in non-residential investment. This consists of business equipment, such as software, business equipment, and manufacturing. It totaled $2 trillion in 2012.

Non-residential investment also includes commercial real estate. The BEA only counts the new construction that adds to total commercial inventory. Resales aren't included, since these structures were counted as contributing to the GDP in the year they were built. Commercial real estate's contribution to GDP went from its high of $586.3 billion in 2008 to its low of $376.3 billion in 2010. This represents a decline from 4.1% to 2.6% of GDP. In 2012, it rebounded a bit to $463.4 billion OR 3% of GDP.

You might wonder why so much commercial real estate was still being built during the recession. That's because the commercial real estate pipeline can take years from initiation, getting financing and zoning approvals, to final construction. Once a building gets into the pipeline, it will be completed, even if tenants can't be found or pull out, and the building is left vacant.

Fixed investment also includes residential construction, which includes new single-family homes, condos and townhouses. Just like in commercial real estate, the BEA doesn't count housing resales as contributing to GDP.

As you might guess, residential construction reached its peak in 2005, when it added $775 billion to GDP. It didn't hit bottom until 2011, when only $338.7 billion was added. Housing's contribution to GDP plummeted from 6.1% to 2.2% during this time. Residential construction has rebounded a bit in 2012, to $382.9 billion or 2.4% of GDP. All in all, construction's contribution (including both commercial and residential) went from a peak of $1.195 trillion, or 8.9% of GDP, in 2006 to a low of $716.9 billion, or 4.9% of GDP, in 2010. In 2012, it was $846.3 billion, or 5.4% of GDP.

The second sub-component of business investment is change in private inventories. The BEA measures how much businesses order to increase the inventories of the goods they are planning to sell. When orders for inventories increase, it usually means that companies are receiving orders for goods they don't have in stock, and so are ordering more to have enough on hand. It's important for companies to have enough inventory so they don't disappoint and turn away potential customers. These customers may find what they need elsewhere, and never return. Therefore, a business would rather have just a little too much on hand, than not enough. Therefore, an increase in private inventories is a contribution to GDP.

A decrease in inventory orders usually means that businesses are seeing demand slack off. As inventories build, companies will cut back production. If it continues long enough, then layoffs are next. Therefore, the change in private inventories is an important leading indicator, even though it contributes less than 1% of GDP. In 2006, companies added $60 billion to inventories. In 2007, they only added $29 billion. After the 2008 financial crisis hit, businesses depleted their inventories by $41 billion, and withdrew another $160 billion in 2009. Economists knew the recession was really over in 2010, when businesses added $66.9 billion to inventory. In 2012, inventories increased by $58.1 billion.

3. Government Spending

Government spending added $3.063 trillion to the economy in 2012, 19.5% of total GDP. This was up from 17% in 2000 and a bit more than the 19% it contributed in 2006. That makes sense, because one of the roles of Federal government spending is to boost economic growth enough to end any recession. The Federal Government added $1.2 trillion. Two-thirds of this, or $809 billion, was defense-related spending.

On the other hand, state and local governments can't spend more during a recession. They are usually mandated to balance their budgets, and so must cut spending when tax revenues drop. Now that the recession is over, state and local government contributed $405 billion.

4. Net Exports of Goods and Services

Imports and exports have opposite effects on GDP. Exports add, while imports subtract, from GDP. Imports are greater than exports, and so the net effect of trade is a deficit. Imports are growing faster than exports, thanks to jobs outsourcing in manufacturing. In 2012, imports were $2.7 trillion, while exports were $2.18 trillion. (Source: U.S. Bureau of Economic Analysis, National Income and Product Accounts Tables, Table 1.1.5., Gross Domestic Product) Article updated April 25, 2013

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