Recent Developments and the Near-term Outlook Despite a sharp drop in the average workweek last month--which may be, in part, an artifact of the survey-week storms along the eastern seaboard--aggregate hours rose at an annual rate of 1.7 percent in the fourth quarter. This gain was the largest quarterly increase in this series during the current expansion, and barring a significant weakening of productivity gains from recent trends, it points to a sizable increase in real GDP. Spending indicators for the fourth quarter, while incomplete, generally support the impression provided by the labor market data. Unit sales of light motor vehicles advanced strongly in the fourth quarter, and so did retail sales at outlets other than auto dealers. By all indications, residential construction also moved up smartly last quarter; single-family starts increased in December for the fifth consecutive month, reaching the highest level in nearly three years. Among other components of spending, business fixed investment likely posted a sizable gain in the fourth quarter, reflecting higher spending for both equipment and nonresidential structures. As a partial offset to the stronger outlays for consumption and private fixed investment, we believe that defense spending tumbled last quarter and that the pace of inventory accumulation slowed; net exports appear to have been about unchanged. Overall, the spending data, in combination with the labor market figures, point to fourth-quarter growth in real GDP at an annual rate of 3-1/2 percent or so. Direct information on first-quarter activity is limited to a couple of weeks' data on unemployment insurance claims and on developments in the motor vehicle sector. Claims have remained below the 400,000 mark and, based on recent patterns, appear consistent with further slow gains in payroll employment. In addition, motor vehicle production during the first three weeks of the month increased roughly 7 percent from the already high December rate, as the stronger sales in recent months have caused automakers to stick closely to their ambitious assembly schedule. These data, along with relatively upbeat anecdotal reports, suggest that the economy has retained considerable forward momentum. Nonetheless. we continue to expect that the growth of real GDP will slow somewhat this quarter, to about a 2-3/4 percent annual rate.2 We expect consumer spending to decelerate in the current 1. Although we expect some shortfall from the announced schedules, the projected rise in motor vehicle production still contributes about 3/4 percentage point to real GDP growth in the current quarter, a contribution similar to that in the fourth quarter. 2. From a production-side perspective, about half of the projected slowing in GDP growth between the fourth quarter of last year and the current quarter stems from the widely anticipated dropoff in agricultural output during the 1993 growing season. Rather than try to guess how BEA might wedge in the production decline over the current year, we simply adjusted down the level of agricultural output in each quarter; with this approach, the full negative impact on GDP growth occurs in the current quarter. In our forecast, this negative effect shows up mainly as a slowdown in the rate of farm inventory investment. I-4 quarter. Signs point to only a little near-term improvement in the labor market, which implies that gains in labor income likely will remain moderate. And, despite the more bullish tone of sentiment indicators, we doubt that households will continue to push spending up as aggressively relative to income as they apparently did in the second half of 1992. Accordingly, growth in real PCE is anticipated to drop back to roughly a 2-1/2 percent annual rate this quarter. Regarding other sectors, the continued uptrend in single-family housing starts, as well as optimistic attitudes expressed by both households and builders, bodes well for another double-digit rise in real residential investment this quarter. The tenor of information on business fixed investment points to continued strong gains in equipment spending and little change in nonresidential construction. Government purchases are likely to be dragged down again by falling defense spending, and the indications are that the external sector will contribute negatively as well, given the relative weakness of other industrial economies and the appreciation of the dollar since last summer. The recent data on prices and labor costs generally support the view that disinflationary trends remain in place. The CPI rose only 0.1 percent in December, as did the index excluding food and energy. Although the price declines recorded last month for apparel and some other commodities suggest that holiday discounts may have been deeper than usual, anecdotal reports do not indicate this phenomenon was widespread. Accordingly, we interpret the December report as a signal of ongoing deceleration in retail prices. With regard to labor costs, the fourth-quarter rise in the ECI for hourly compensation--at an annual rate of 3-1/2 percent--was slightly higher than that during the previous six months. Nonetheless, the increase in the ECI over 1992 as a whole was nearly 1 percentage I-5 point less than the rise over 1991. Given the continuing efforts to improve labor productivity, the recent ECI data suggest that the increases in unit labor costs remain quite small.