

Real Gross Domestic Product (GDP) is a measure of the value of the final goods and services that an economy produces in a year. In this definition, the word final means that it only counts the end product. That is, it counts the value of the bread you buy at the bakery, but not the value of the flour the baker uses to make the bread. The term "Real" means that the effects of inflation are removed from this measure of output.

In recent decades, Real GDP has increased on average about 3% a year. Knowing this average is important because it gives us a useful benchmark to determine how the economy is doing. For instance, if the economy grows at 2.8% a year, we should be disappointed since this performance is lower than the typical growth rate. On the other hand, if the economy is growing at 4.1% a year, the economy is performing much better than it typically does. The annualized Real GDP growth rates in 2018 were 2.1% in the first quarter, 4.2% in the second quarter, and 3.4% in the third quarter. We are still living in the fourth quarter of 2018, so we will have to wait for the numbers for this quarter. However, it looks like the annual growth rate, including data from all four quarters, will not be too different from 3%.

If we do indeed end up with a 3% annual growth rate, it will be tempting to claim that the economy is experiencing typical economic conditions. After all, the average growth rate in real GDP is around 3% a year. However, the old benchmark of a 3% annual growth in Real GDP may be too high of a target. Recent data suggests that a lower growth in Real GDP may be the norm in the U.S.

The 3% growth in Real GDP can be split into two parts. Two percentage points of this growth comes from changes in per capita Real GDP. That is, it comes from the changes in output per person. The remaining percentage point in the growth of Real GDP comes from population growth. In other words, we get the growth rate in Real GDP by adding the per capita growth in Real GDP and the growth rate in the population. In this case, 2% + 1% gives us 3%.

According to the Census Bureau, the growth rate of the U.S. population has been remarkably stable at 1% a year for quite some time. However, over the last year, the population growth rate has dropped to 0.6%. If this population growth rate persists, and this is a big if, we can probably expect Real GDP growth to average around 2.6%. This figure assumes that our economy will produce the same output per person. Now the typical person will be just as well off when the economy grows at 2.6% as he or she was when the economy was growing at 3% in recent years. In either case, the amount of output per person available to be split up is growing at 2%.

If 2.6% growth in Real GDP becomes the new average, then a future growth rate of 2.8% will represent better than normal economic times. If pundits continue to use a 3% growth rate as a benchmark, they will erroneously label the 2.8% growth in real GDP as a subpar outcome.

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