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THE OUTLOOK

Supply Side of the Economy Is Flashing Strength

Labor force and productivity gains raise the chances that faster economic growth can be sustained

Economists are optimistic about productivity growth. Seen here, a worker at a New Balance manufacturing facility in Massachusetts last year. **PHOTO:** SCOTT EISEN/BLOOMBERG NEWS

By Jon Hilsenrath

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For much of past year, it looked plausible that a faster-growing U.S. economy was simply running on a sugar high of temporarily elevated demand.

Now signs are emerging that the supply side of the economy—the workers and the tools and machines they use to produce goods and services—is becoming energized, improving the chances that faster growth can be sustained.

It's not a sure thing. It could fade. It's also not clear who or what deserves credit for driving it, but it's a great development for Americans if it continues, regardless of your political coloring. If sustained, it would mean more income growth in the long-run with less inflation eating away at those income gains.

You can boost economic growth in the short-run by juicing demand, such as with tax cuts or spending increases. But you can only sustain faster growth in the long-run with more workers producing goods and services more efficiently. Without labor force and productivity growth, demand dissipates on its own absent additional outside stimulus. Or the increased demand

strains the economy's resources, spurring inflation and a central bank response of higher interest rates that in turn slows growth or causes recession.

The Commerce Department's report Friday that the economy grew at a 3.2% annual rate in the first quarter suggested faster growth is being sustained with very little inflation. Two reports in the coming days will shed more light on whether the supply-side forces of the economy are kicking in and helping to drive that upturn.

On Thursday, the Labor Department will report its estimate of the productivity growth of U.S. workers in the first quarter. Given what's already known about how many hours Americans worked and how fast output grew, economists are optimistic. Macroeconomic Advisers, a modeling firm, estimates productivity was up 2.3% in the first quarter from a year earlier. If that proves correct, it would be the largest increase since 2010, when the economy was bouncing back from recession, a time in the business cycle when productivity growth tends to be high. Between 2010 and 2017, productivity growth averaged just 1% a year.

On Friday the Labor Department will release its monthly job market report. As always, much attention will be focused on hiring and unemployment. Also deserving attention are fresh estimates of the growth of the labor force. In the first quarter, it grew 1% from a year earlier, double the rate of growth it registered between 2010 and 2017. An aging population is weighing on growth, but rising wages and more job opportunities appear to be drawing people—particularly women—off the sidelines and into the workforce, and keeping older workers on the job longer than usual.

Add productivity growth of around 2% with labor force growth of around 1%, and you might have a formula for lasting 3% growth in economic output that doesn't require a Fed response to slow it.

The last time the economy experienced a supply-side acceleration, in the late 1990s, the Fed was able to avoid raising interest rates for much longer than many expected, and had room to trim rates in 1998 when global economies wobbled.

Who deserves credit for what's happening now? Can it be sustained?

Trump administration officials have long argued that their policies—lower business and individual taxes and less regulation—would spur a supply-side response, driving more workers into the labor force and more business investment into efficiency-producing equipment.

"Productivity is going up just like it should if you have a capital spending boom," said Kevin Hassett, chairman of the White House Council of Economic Advisers.

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Plenty of other factors could be in play.

For example, many economists have argued that the economy has been long overdue for productivity gains from technological advances unrelated to administration policies.

The Federal Reserve might also deserve some credit. Despite complaints from President Trump and others that the central bank raised interest rates too much, it has stopped and borrowing costs remain historically low. The Fed has allowed the jobless rate to fall to low levels that should have triggered higher inflation according to its traditional models, partly on the premise that a tighter labor market would draw more workers into the economy.

Michael Feroli, chief U.S. economist at JP Morgan, describes himself as a supply-side skeptic who doesn't think the labor force and productivity gains will be sustained. Business investment already shows signs of slowing after a spurt last year. That could damp productivity growth in the months ahead, he said. Business investment in equipment barely grew in the first quarter.

Moreover, he adds, demographic trends suggest growth in the working-age population will fall by half in the next two years, to 0.18% a year from 0.36%, without recovery in sight. That is bound to hold back labor force growth.

"I still think there are reasons to be skeptical that potential growth is about to shift into high gear," he said.

Mr. Hassett disagrees.

"The machines people bought last year, they are turning them on this year," he said. That means efficiency gains in 2019, he said. Moreover, he said cuts in corporate tax rates would drive business to the U.S. from abroad over a long period.

Growth of 3%, he said, could last three to five more years.

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