The Daily Dish

The Status of Economic Growth

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Eakinomics: The Status of Economic Growth

The growth of the U.S. economy is tremendously important. But it is crucial to look for indicators of that growth in the right places. In the aftermath of the Great Recession, most people looked at the number of jobs as the best indicator of good growth performance, but that measure will be less informative as time passes. When recovering from a recession, it is possible to grow by putting people back to work. But when the population is fully employed, it grows by making every worker more productive.

To put some meat on this observation, note that population growth in 2018 will be 0.71 percent. If the labor force participation rate (the fraction of the population looking to work) remains constant and the unemployment rate (the fraction of those looking for work who cannot find a job) remains constant, then the number of employed people — that is, the number of jobs — will also grow at that rate. In December of 2017, employment was 147.6 million. Adding another 0.71 percent requires only 87,500 jobs per month. Obviously, the actual number has been much higher than that — more than twice as high — in recent months. This growth was achieved by reducing the unemployment rate and raising the labor force participation rate. Both are welcome developments because people who want to work are finding jobs. But there are limits to how high labor force participation can go and, likewise, how low unemployment can fall. In the end, job growth will inexorably move toward the population growth rate.

If counting jobs is not the way to measure growth, what metric should one watch? The first is to make sure that spending by households, firms, and governments increases quickly enough to keep up with the additional productive capacity each year. On this front, the first couple of months of 2018 were a bit troubling. There were relatively weak retail sales, soft surveys of business activity, and first quarter growth in gross domestic product (GDP) came in at 2.3 percent (although it was up 2.9 percent from the first quarter of 2017). Now, however, growth is clearly accelerating. Retail sales in April were quite brisk, all six regional Fed surveys released in May have rebounded, industrial production growth is strong, and the Atlanta Fed's GDPNow estimate of 2nd quarter growth is at 4.1 percent.

The beneficial impacts of the tax reform law signed in December are clearly emerging.

The second place to look is investments in future capacity. If business investment is strong, this translates into more rapid productivity growth. With no productivity growth, GDP would simply grow as fast as the population — a meager 0.71 percent — but more rapid growth permits faster growth in real wages and overall GDP. This will be the key route for faster growth in the future. On this front, the impact of the tax bill is promising as well. The minutes of the most recent Federal Reserve Board policy meeting, for example, note the following: "[F]orward-looking indicators of business equipment spending — such as the backlog of unfilled capital goods orders, along with upbeat readings on business sentiment from national and regional surveys — continued to point to robust gains in equipment spending in the near term."

Looking forward, the outlook for growth is promising and likely to come in strongly above 3 percent in the 2nd quarter. For the same reason, the early returns to the tax reform are quite high as well.