Higher Productivity the Key

By **Harlan Green**, Special to *VOICE*

THERE IS A MAJOR REASON THE U.S. ECONOMY IS DOING WELL in so many ways—with plunging inflation, surging consumer spending, and the highest economic growth of developed countries—that is often overlooked in economic reports.

Economic VOICE By Harlan Green

Labor productivity has been surging lately. It is the seed of our present prosperity as well as future growth. Non-supervisory workers are producing more per hour in the last three quarters that at any time since the COVID pandemic.

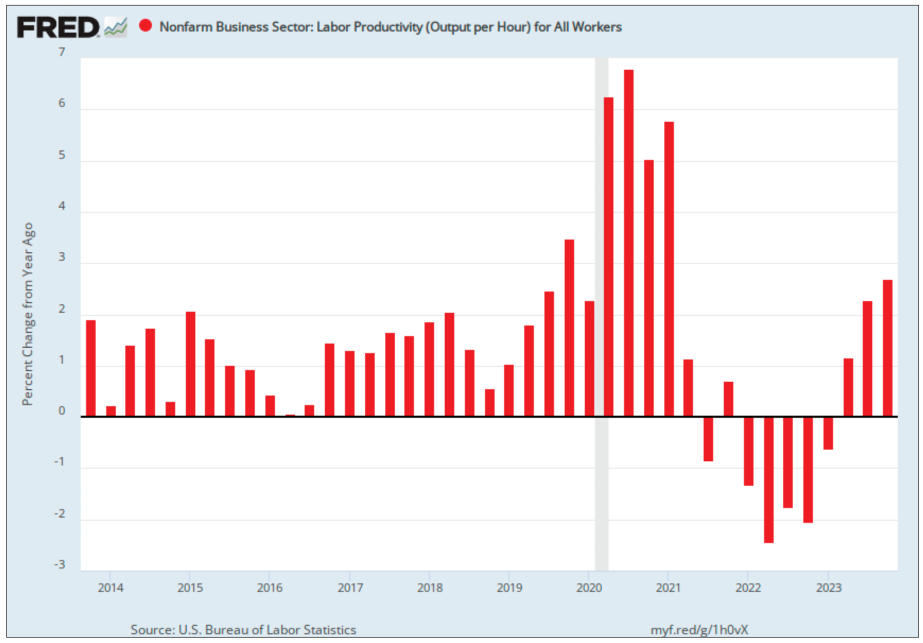
Non-farm labor productivity has soared from a low of -2.4 percent to +2.7 percent annually in 18 months (Q2 2022 to Q4 2023) as portrayed in the above FRED graph.

Why? Most economists say it's because the U.S. economy has been fully employed for so long—more than two years—that there's a scarcity of workers, so employers have needed to invest more in capital expenditures—whether it is AI or more efficient factories—to meet the demand for their products. This translates to workers being more productive, as they are running the new machines and software services.

Average employee salaries are also higher, and are now rising faster than inflation, which means even more demand for products, thus creating a positive loop. Higher salaried employees spend more, so companies will produce more.

That is why James Bullard, former St. Louis Fed President, believes Powell's Fed Governors need to begin to shrink interest rates sooner rather than later.

Bullard, in an interview with MarketWatch's Greg Robb, said Powell doesn't want to wait until inflation is actually at the two percent rate. "That would be the 'Honey I forgot to shrink the policy rate.'" It is a phrase credited to Chairman Powell, who feared that the Fed would react too slowly to the rapidly plunging inflation rate, perhaps causing a recession.



The Fed's benchmark rate is now in the range of 5.25 percent to 5.5 percent. The neutral rate is below four percent. There are only three Fed policy meetings before the third quarter of the year. "The math is not adding up that the [interest rate] is going to be at the right level," said Bullard.

Another reason for the Fed to move more quickly in dropping rates is that wholesale prices are now falling more quickly due in part to higher productivity.

The Producer Price Index (PPI) for wholesale goods and services continues to plunge. PPI Final Demand is now up just 0.9 percent in 12 months, far below the Fed's two percent target. It jumped 0.6 percent in January but monthly prices declined 0.1 percent in December 2023 and advanced just 0.1 percent in November.

And it is still trending downward. So where is risk of higher inflation down the road if the cost of raw materials is declining? There's a disconnect in the reasoning of those who see a danger of higher inflation ahead, so let us hope that Powell means what he says and doesn't forget to shrink the policy rate.

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'14	142	132	141	186	207	174	196	179	171	160	137	170
'15	**142**	**113**	**235**	**202**	**226**	**210**	**207**	**217**	**155**	**149**	**124**	**150**
'16	126	118	153	166	220	195	174	214	187	161	158	159
'17	**142**	**132**	**164**	**149**	**189**	**257**	**193**	**224**	**178**	**173**	**172**	**170**
'18	101	121	172	179	234	211	165	225	184	171	145	163
'19	**128**	**168**	**190**	**179**	**210**	**208**	**259**	**209**	**173**	**157**	**152**	**212**
'20	144	125	141	101	84	168	219	244	295	283	225	255
'21	**154**	**151**	**264**	**250**	**225**	**223**	**228**	**247**	**202**	**216**	**175**	**187**
'22	124	160	204	160	168	179	125	160	138	112	113	101
'23	**81**	**94**	**110**	**115**	**126**	**131**	**122**	**120**	**112**	**109**	**91**	**96**
'24	107											

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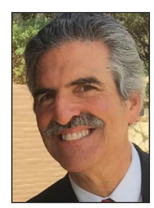

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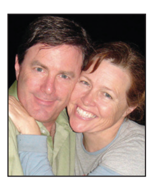

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