

The Economy in Perspective

Swelling up ... We made it! The economy just completed its seventh year of expansion, entering month 85 with no sign of major trouble. Just the opposite, in fact. The latest labor market report revealed that employers added 310,000 new jobs to their payrolls in February, the fourth consecutive month that jobs growth has topped 300,000. Nearly 1.5 million new jobs have been created since last November. What's more, the unemployment rate fell to 4.6 percent last month, its lowest reading since 1970.

We could try to whip everyone into a frenzy over inflation, but who would listen? After all, inflation remains at rates not seen since the early 1970s, in the days before the U.S. economy turned itself upside down. Fine, you say, but what about future inflation? The growth of the M2 money supply has been accelerating for a year, reaching an annualized rate of 8 percent last month. Potentially disturbing, but hasn't money been an unreliable predictor of inflation for many years now?

There are signs that labor compensation rates are picking up, but there are also reasons to think that the true rate of productivity growth is doing the same. As long as these forces keep pace with one another, price pressures are likely to stay in check, despite concern about labor market tightness. Capital spending remains vigorous, outpacing the growth of total output and suggesting that capacity and productivity will continue to expand.

No matter how you slice it, we have to be feeling pretty good about the U.S. economy right about now. And, as if we didn't have enough intrinsic evidence that our economic system is a lean, mean, growth machine, we now can pit our statistics against those of almost any nation in the world and come away the winner. Amazing, isn't it, that only a few years ago we worried about being eclipsed by Japan and other Asian countries? The U.S. economy has been restored to its rightful place in the pantheon of nations.

Time to come back down to earth. Sure, our economy seems to be in excellent health. Yes, consumers and businesses register great confidence in the future. Banks undeniably hold a lot of capital and have sustained few loan losses. Granted, the Federal Reserve has shown its willingness to act preemptively against inflation, and the federal government has finally demonstrated

some fiscal restraint. But even with all of these positive signs, we still have economic concerns to address.

The length and strength of the current expansion notwithstanding, the business cycle has not been abolished. We cannot know when the next recession will hit—although private forecasters put the odds near zero for the next 12 months—but destructive excesses and imbalances can build up for many reasons. For example, long expansions increase the temptation to take on more debt to finance acquisitions, but those who do so will be particularly vulnerable in the next downturn.

There is also the risk that inflation will accelerate again, contrary to the widely held view that it is no longer a threat. The Consumer Price Index probably understates fundamental price pressures in today's markets because the food and energy components have a moderating influence. Trimmed CPI measures—estimates designed to minimize the influence of extremely large or small price changes on core inflation—have been tracking about one-half to one whole percentage point above the official CPI. Should these transient factors reverse course, we could see inflation quicken just when business cycle dynamics are intensifying price pressures.

We also face dangers other than cyclical fluctuations. In the longer term, we must recognize that our nation's Social Security program is not structured appropriately. The large surplus that the Social Security Trust Fund now carries will evaporate in about 20 years. Many proposals have been advanced to meet this impending crisis, from small changes in tax rates and retirement ages to privatizing some or all of the Social Security System. Whatever course we choose, the importance of making changes immediately should be clear: The longer we postpone needed reforms, the more likely that when corrections do come, their economic impacts will be bigger than they would be today.

For the past 50 years, the U.S. economy has shown itself capable of responding well to the disturbances that inevitably accompany modern life. Nonetheless, we have sometimes flirted with the notion that competing economic systems might hold more promise than our own. Looking around the world today, our confidence renewed, let's not allow success to swell our heads.