

Market Commentary

Supply-side Economics Makes a Comeback

I recently attended [The Economic Club of New York's luncheon](#), at which Treasury Secretary Janet Yellen received the Peter G. Peterson Leadership Excellence Award. Yellen's remarks focused on a topic that we haven't heard much about in recent years: supply-side economics, or as she framed it, "expanding our economy's capacity to produce over the medium and long-term..."

The core of supply-side economics has historically been that government policies oriented toward enhancing aggregate supply can help firms (1) produce more goods and services at lower prices and (2) expand employment as the economy grows. These policies could include decreasing regulation, building infrastructure, or supporting investment in research and development.

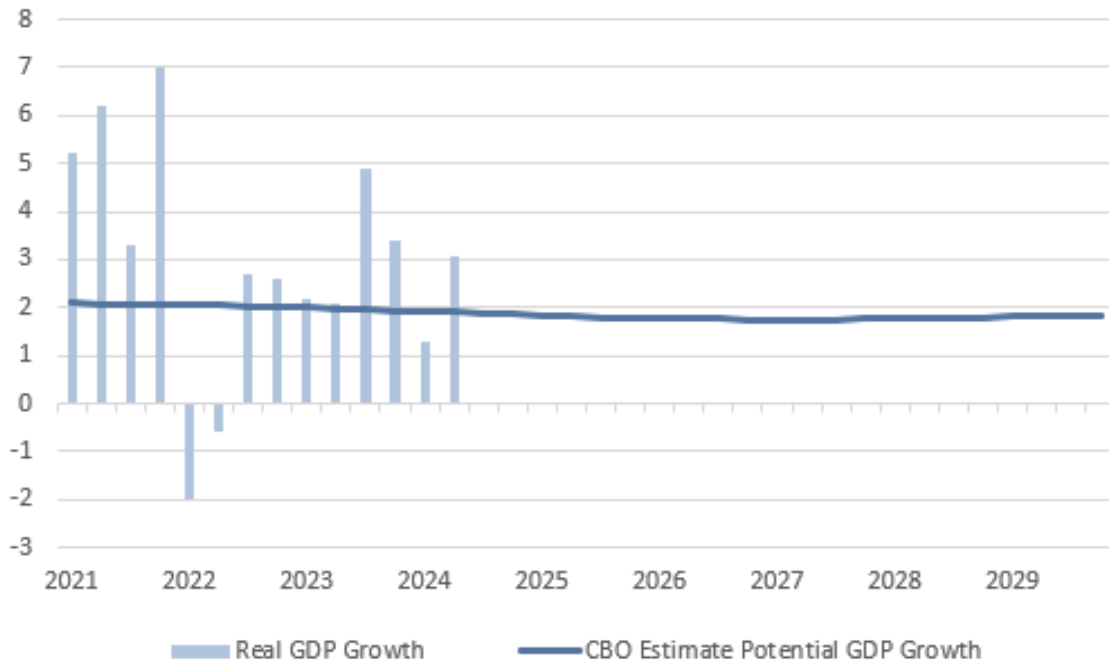
I was pleasantly surprised to hear Yellen focus on supply-side economics because demand-side subsidies have been much more popular recently. However, the US economy doesn't have a demand problem; it has a supply problem, and demand-oriented solutions can exacerbate the problems they are attempting to alleviate.

US inflation remains elevated for a simple reason – the real economy hasn't been able to expand fast enough to support real economic demand (Fig. 1). Too many dollars chasing too few goods and services creates generalized inflation. We can reduce inflation by restraining the economy until growth slows to our current capabilities, or we can orient policy toward creating a business environment that will expand supply to meet demand.

From an investment perspective, lower real economic growth results in lower interest rates and lower corporate earnings, whereas higher real economic growth results in higher interest rates and higher earnings. Expanding our economy's capacity to produce over the medium and long-term, presuming it is accomplished in a fiscally responsible way, will likely result in higher incomes for Americans and higher returns for investors in balanced portfolios. It's a win-win from a policy perspective.

Fig. 1: GDP growth has exceeded estimates of potential GDP over the last three years

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Source: Bloomberg, Congressional Budget Office (CBO), Mill Creek.

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