

National Economic Trends

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During the past three years, falling oil and energy (fuels and related products and power) prices have boosted productivity and real GNP contributing, temporarily, to slower price increases. When the cost of a factor of production such as energy declines relative to the price of the product, firms have an incentive to increase the use of that resource and produce more output. The productivity of existing employed resources is enhanced, and firms bid for more resources to produce more output. The increase in the supply of national output, given the money stock, tends to result in lower nominal prices.

Though cyclical factors also have been important over the past three years, the effect of declining energy prices on productivity has been observable nonetheless. The rapid 3.4 percent rate of productivity growth since the end of the recession in the fourth quarter of 1982 largely reflects the strong cyclical rebound of the economy. The 1.8 percent trend rate since mid-1981, however, has not been raised by cyclical influences. In both the first quarter of 1984 and the second quarter of 1981, cyclical measures were about the same. Moreover, even during the earlier period (II/1981 to IV/1982), productivity growth at a 0.5 percent rate was unusually strong, given the sharp cyclical downturn.

The 1.8 percent trend rate of productivity growth during the past three years compares quite favorably to its dismal 0.7 percent rate of increase during the previous eight years (I/1973 to II/1981), a period that contained three major surges in relative energy costs. The apparent turnaround in productivity growth is important primarily because it is the principal determinant of growth in real income.

Energy Price and Productivity Growth Rates^{1/}

	<u>I/1973-II/1981</u>	<u>II/1981-I/1984</u>	<u>II/1981-IV/1982</u>	<u>IV/1982-I/1984</u>
Relative price of crude oil ^{2/}	17.7 %	-11.4 %	-13.1 %	-9.4 %
Relative price of energy ^{2/}	14.2	-7.0	-5.5	-8.8
Output per hour	0.7	1.8	0.5	3.4

^{1/} Compounded annual rates

^{2/} Measured using the producer price indexes and the business sector implicit price deflator

—John A. Tatom

