Economic Overview

What's in store for the Southeast in 1987? In this special issue of the Economic Review, *economists in the Atlanta Fed's regional section project growth patterns for each of the six states in the Sixth District, which includes Alabama, Florida, Georgia, and parts of Louisiana, Mississippi, and Tennessee. States are presented in descending order of population. Gene Sullivan, coordinator of this issue and Research Officer in charge of the regional section, offers an overview of economic prospects for the Southeast as well. The outlook for the Southeast depends, of course, on national economic developments. These forecasts for the region assume national growth about the same as last year's. They also anticipate a shift in emphasis away from reliance on consumer spending as a source of strength nationally and toward a more vibrant manufacturing sector stimulated by the dollar's decline. Mary S. Rosenbaum, the Research Officer in charge of the Atlanta Fed's macropolicy section, provides a closer look at national developments that will affect the economic tenor of the region.*

Prospects for the Southeast

In 1987 the Southeast could see a halt to last year's economic slowdown and perhaps even a modest upturn, given the right balance of regional, national, and international developments. How manufacturing and agriculture respond to the dollar's decline, the path of oil prices, the degree of weakness in construction, and consumer spending nationwide will determine whether the region's economy picks up or continues at the same pace as in 1986.

Regardless of the overall picture for the Southeast, any gains will be spread unequally across the states in the region, and no one state or area is likely to produce a spectacular performance. However, Louisiana's economy should finally bottom out after a three-year slide, and Alabama is expected to strengthen. Florida will probably continue, but not improve on, its strong expansion of recent years, and Mississippi seems likely to maintain its relatively weak pace. Georgia and Tennessee will struggle to match last year's good growth.

Continuing gains in population, employment, and income appear to be the source of the Southeast's economic strength. The regional rate of growth in these areas exceeded the nation's and stoked the demand for output in several of the Southeast's economic sectors. Attracted by a favorable climate, job opportunities, and amenities that contribute to the quality of life, people continue to migrate to the region, settling primarily in eastern metropolitan areas. Since 1980 population increases have averaged nearly 2 percent per year for the region and exceeded 3 percent in Florida. This growth has not been uniform throughout the Southeast, however. The western states of the region showed a meager increase of 0.7 percent or less in 1986 because of out-migration and negligible growth in Louisiana's population.

Services and Trade Show Strength

Responding to the needs of an expanding population base, service industries, wholesale and retail trade, residential construction, as well as finance, insurance, and real estate showed the most strength in 1986. Manufacturers of transportation equipment, textiles, and food also performed relatively well, meeting burgeoning demand for products from both the growing region and the nation.

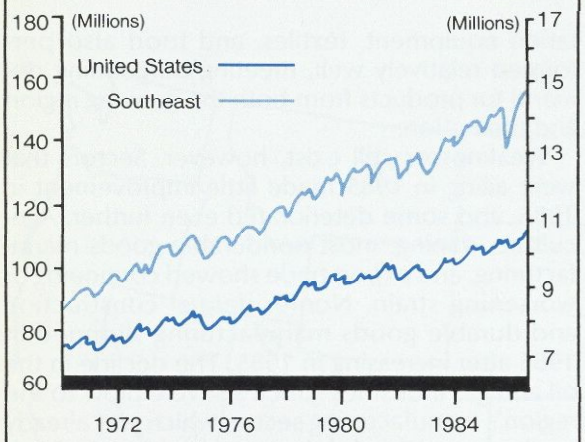
Weaknesses still exist, however. Sectors that were ailing in 1985 made little improvement in 1986, and some deteriorated even further. Agriculture, mining, most nondurable goods manufacturing, and export trade showed continuing or worsening strain. Nonresidential construction and durable goods manufacturing slumped in 1986 after increasing in 1985. The decline in the oil and gas industries struck a severe blow to the region's manufacturing sector, which was already hard-pressed by foreign competition in both domestic and export markets. Especially affected were those firms producing durable goods used in the drilling industry. Unfortunately, the side-effects from the troubled oil industry are likely to continue through 1987. A flattening of trends in the oil-dependent sectors, rather than a continuation of the downward slide, is about the best that can be hoped for.

In spite of these problems, overall job gains should continue in the range of 3 to 4 percent, as they were in 1986. This was slightly higher than the 2 to 3 percent growth for the nation (Chart 1). The trade, service, government, and financial sectors, which account for over two-thirds of the region's total employment, will provide the majority of the 500,000 new jobs expected for 1987.

Trade. Mirroring population trends in the Southeast, the trade sector continued to grow more rapidly than in the nation and remained the region's largest employer, with one-fourth of the total jobs (Chart 2). Personal income expansion slowed in 1986 as dividend and interest payments fell off and manufacturing income edged up only slightly; nonetheless, consumer spending showed sufficient strength to keep trade moving, albeit at a slower rate than in 1984 and 1985. Trade sector employment rose more than 3 percent in 1986, adding about 100,000 jobs, and should continue that pace into 1987.

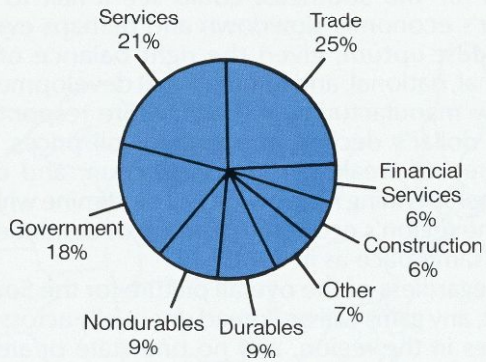
Services. Growth in the region's various service industries, which account for one-fifth of total employment, has surpassed even expansion in

Chart 1.
Total Employment, Southeast and United States



Source: Computed by Federal Reserve Bank of Atlanta from monthly data released by southeastern State Departments of Employment Security and U.S. Bureau of Labor Statistics (household survey).

Chart 2.
Employment in the Southeast by Sector
(As a percent of nonfarm employment, in thousands of workers)



Source: Computed by Federal Reserve Bank of Atlanta from data released by southeastern State Departments of Employment Security.

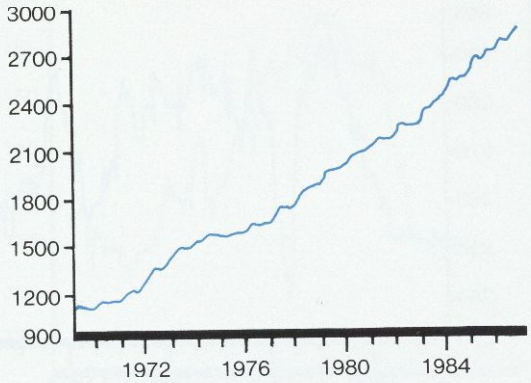
the trade sector (Chart 3). In 1986 services employment posted a 4 percent increase and added over 105,000 employees, compared with an increase of less than 3 percent for the nation as a whole. This sector appears destined to do at least as well in 1987. Spurred by increases in population and expansion of businesses, the region's health, education, and legal services benefited most from developments in the service sector. Amusement and recreational enterprises have prospered as more people explore ways to spend their leisure time. Firms that maintain and repair the exploding inventory of computers and related equipment, now standard fixtures in most businesses, have also contributed to rapid gains in service employment. The lodging industry prospered from increased numbers of tourists and conventions attracted to the Southeast, especially during 1986, and prospects look good for these areas in 1987.

Financial Services. Financial services, which are closely related to the service sector, expanded with similar verve in 1986. Business growth and accompanying real estate development, along with changes and extensions in the region's financial institutions, have stimulated employment in the financial services sector markedly, adding about 30,000 new jobs to total employment during 1986. Although it appeared to be slowing as the year drew to a close, financial services employment is still likely to contribute a significant number of new jobs in 1987.

Construction. In the past, expansion in services and trade has gone hand in hand with growth in construction. An increasing population has typically stimulated demand for residential housing as well as buildings for offices, stores, warehouses, and new or enlarging businesses. However, past overbuilding in the commercial area and changes in depreciation allowances on rental properties forced the region to adjust to overcapacity in office buildings and multi-family residential structures during 1986. Consequently, construction began slowing during the first quarter and was faltering from its pace a year earlier as 1986 ended. Even though total construction employment registered little or no increase for the year as a whole, single-family residential building continued to be strong. The decline in mortgage interest rates during the year no doubt contributed to the brisk upturn in single-family building permits, which rose by 8 percent in 1986 as contrasted with a decline of nearly 0.5 percent in 1985. Multi-family permits, on the other hand, declined between 1 and 2 percent from their 1985 level—a sharp drop from previous years.

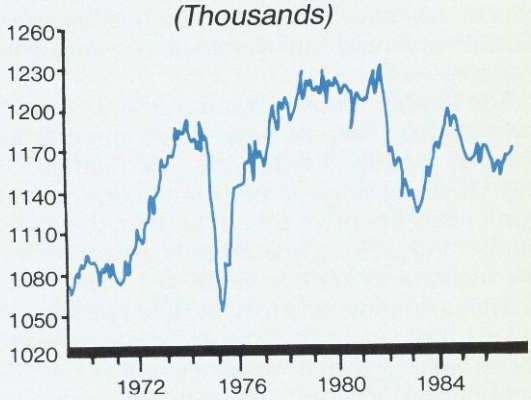
Government. The government sector, the region's third largest employer with 18 percent of

Chart 3.
Services Employment in the Southeast
(Thousands)



Source: Computed by Federal Reserve Bank of Atlanta from monthly data released by southeastern State Departments of Employment Security, January 1969 to December 1986.

Chart 4.
Nondurables Employment in the Southeast
(Thousands)



Source: Computed by Federal Reserve Bank of Atlanta from monthly data released by southeastern State Departments of Employment Security, January 1969 to December 1986.

the total number of jobs, held up rather well in 1986 despite earlier forebodings of a decline due to budget-cutting efforts. Even though employment gains slowed during the year, the government sector contributed nearly 45,000 additional jobs to the region's economy during 1986, and it should continue to provide support in 1987, although increases are likely to weaken.

Manufacturing Remains Vulnerable

The Southeast's major vulnerability is the nondurable goods component of its manufacturing sector. Loss of markets abroad for domestic products and continuing inroads of imports to domestic markets have reduced output and cut employment in these industries (Chart 4). Strengths in other areas of manufacturing have helped offset these weaknesses, however; since 1985 manufacturing has declined by less than 0.5 percent in the Southeast, as compared to 1 percent nationwide. Most of the losses nationally were in the durable goods industry.

Bright spots. Despite its overall lethargy, the region's industrial complex shows promise in several areas. Automobile manufacturing is one of the bright spots. Producers of transportation equipment such as tires, alternators, wiring harnesses, and other automobile components had a good year due to the continuing briskness of domestic auto sales. Airplane manufacturing has also strengthened this sector, though a slowdown in shipbuilding acted as a damper in the region. Job growth was not quite as robust in 1986 as in 1985 and fell far below the exceptionally high rate in 1984; nevertheless, the increase of 3.5 percent runs ahead of employment figures in any other area of manufacturing and exceeds national job gains in the transportation equipment industry as well.

Vigor in the Southeast's poultry and fish industries during 1986 also boosted total employment. The sharpened appetite of national consumers for these regional products has widened the market and opened opportunities for extending production and processing. Job increases in food manufacturing have approached the 1.5 percent rate of 1985, and prospects for 1987 may be even brighter if possibilities for increased food exports materialize as domestic prices drop to match prices abroad.

Paper and lumber products, keyed to the region's substantial forest products industry, remain areas of growth in manufacturing despite competition from abroad. Paper production climbed from 1985's plateau but has yet to regain 1984's pace. Ongoing expansion in the domestic economy and some cessation in paper imports from

abroad have helped to bolster regional output and employment. Further gains should be evident in 1987 as the dollar's decline begins to increase the U.S. share of the paper industry in export markets. Anticipation of a healthy national economy should spur domestic consumption of paper as well.

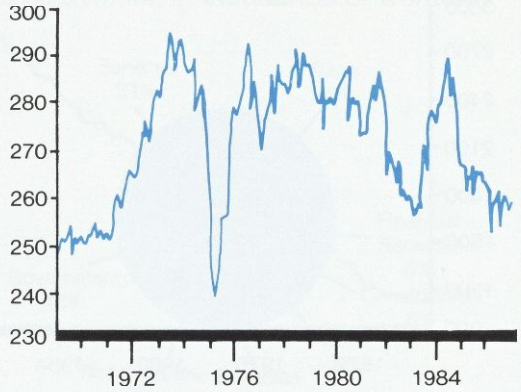
The lumber industry has done well to hold its own during the past year, when imports from Canada virtually flooded the U.S. market. Despite vitality in single-family home construction, a particularly intensive user of lumber, the region's lumber industries garnered only a small share of the increase in lumber demand. Lumber manufacturing employment rose by only 1 percent during the past year, about the same rate as in 1985. More rapid growth is not likely unless Canadian lumber products become more expensive relative to domestic lumber, or imports are restricted by some other means. (A Canadian export levy of 15 percent will be assessed in 1987.) The continuing demand anticipated for single-family homes should keep lumber use high in 1987.

Serious weaknesses. Even though strength in some areas has helped to prop manufacturing in the Southeast, weaknesses have dominated the sector as a whole. Total employment for 1986 fell by around 10,000 workers from 1985's level. Machinery manufacturing suffered the greatest job losses. The tailspin of the petroleum industry, and the attendant sharp reduction in demand for machinery and equipment used in oil and gas well drilling, contributed significantly to the drop in machinery manufacturing in 1986. The need for farm machinery remained weak as well because of economic pressures on farmers in the region. Last year the machinery sector lost around 6,000 workers, nearly 2 percent, following on the heels of a relatively slow 1985. Prospects are not favorable for much recovery in machinery demand for the year ahead.

Employment losses in primary and fabricated metals industries can be traced in part to languor in machinery manufacturing. As demand for machinery and equipment waned, metals manufacturing industries also slowed. In addition, competition from international markets in the aluminum industry has left domestic aluminum manufacturers hard-pressed, resulting in the closure of a number of plants in the Southeast.

Apparel. The apparel industry continues to slide, despite a sharp drop in 1985 (Chart 5). Although the rate of decline was somewhat slower during 1986, the recovery anticipated in response to the falling dollar was not much in evidence as the year drew to a close, largely because the dollar did not drop significantly in relation to the currencies of key Asian competitors other than Japan. Import prices did not rise sufficiently to generate a turnaround in domestic apparel employment; however, modernization now makes it possible to increase output with fewer employees, and industry reports indicate that some expansion of production has indeed occurred. Nevertheless, imports still dominated a large segment of the apparel market at the close of 1986. If the competitive position of domestic manufacturers improves as expected in 1987, apparel employment should at least level out and could even begin regaining some of its losses.

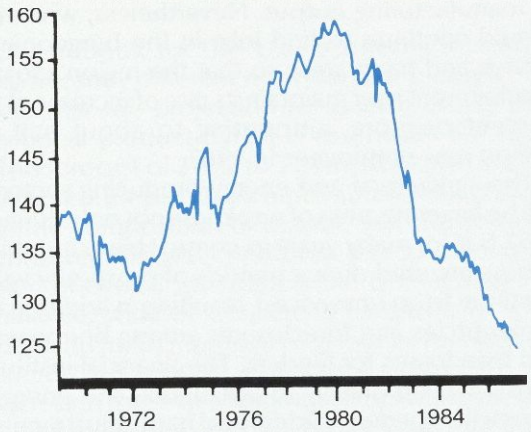
Chart 5.
Apparel Employment in the Southeast
(Thousands)



Source: Computed by Federal Reserve Bank of Atlanta from monthly data released by southeastern State Departments of Employment Security, January 1969 to December 1986.

Chemicals. Chemical production has been perhaps the bleakest area of manufacturing in the Southeast. In 1986, chemicals employment continued to crumble, a pattern almost uninterrupted since employment reached its peak in 1979 (Chart 6). In 1986 it slid by over 4 percent, more than double the drop in 1985, falling a total of 20 percent since 1979. Although the downward trend flattened during the latter portion of the year (in contrast to an upturn nationally) and could indicate the beginning of improvement, the industry is a long way from recovery in the Southeast. Domestic production has suffered market

Chart 6.
Chemicals Employment in the Southeast
(Thousands)



Source: Computed by Federal Reserve Bank of Atlanta from monthly data released by southeastern State Departments of Employment Security, January 1969 to December 1986.

losses due to noncompetitive pricing; and, to make matters worse, a significant share of the domestic market has shriveled due to hardship in the agricultural community. Financially burdened farmers have cut back on expenditures for fertilizers, insecticides, and herbicides in an effort to economize on production costs. Man-made fiber manufacturers have also reduced use of chemical raw materials as their former shares of domestic textile markets dwindle. Even with the dollar's decline, there was no evidence of substantial recovery in the Southeast's chemical manufacturing at the end of 1986.

Primary Sector

Agriculture. The agricultural sector in the Southeast, as already indicated, has been faltering since prices for agricultural commodities began to break under the weight of oversupplies and reduced markets in 1981. In 1986 this dilemma was compounded in the Southeast by severe drought that reduced production by one-third or more in some locations. In Georgia, where the drought was the most intense, average yields of the soybean crop were cut by nearly 40 percent. Forages for grazing livestock were all but eradicated by the dry, hot weather, and large portions of cattle herds had to be marketed for lack of feed. Although rains returned in August and September, the damage to most crops was irreversible, and farmers faced the dual problem of low market prices and low production. These difficulties have further eroded the financial condition of farmers, leaving increasing numbers of them with insufficient funds to make principal and interest payments on outstanding loans. Still dwindling land values have left some lenders seriously exposed because collateral values are no longer sufficient to secure loans outstanding to farmers. Lenders in the Farm Credit System and the Farmers Home Administration, especially, face heavy loan losses. The incidence of bankruptcies and foreclosures is likely to rise further in the aftermath of this unfortunate year for crop production.

On the brighter side, those farmers with little or no debt—about 45 percent— will be particularly helped by agricultural programs to provide supplemental income. The decline in corn prices sharply reduced feed costs to livestock and poultry producers, creating opportunities for profitable livestock feeding. Prices of feeder livestock increased in response to the prospects for profits, and incomes of southeastern herdsmen rose for the first time in several years. Thus, the livestock-producing sector can look forward to a significantly better year in 1987. Although crop surpluses are likely to hold down market prices and incomes for some time, large subsidy payments provided by commodity programs will make the crop income picture better than it would have been otherwise.

Oil. Debility in the oil sector pervaded the economy of the region's western area during 1986. The plunge in petroleum prices associated with the worldwide glut in energy supplies has had a major impact on energy-producing industries throughout the Southeast. Coal, natural gas, and oil production have dropped sharply, and employment in the mining sector has plummeted. Louisiana's economy has born most of the brunt of this breakdown. Not only have oil field workers been put out of work, but most other sectors of the state's economy have been pulled down by the virtual collapse of the oil sector. Sharp contraction in overall business activity and the shrinkage in the state government's budget necessitated by revenue reductions have caused an economic squeeze that weighs down statistics for the entire region. Financial institutions that loaned heavily either to the oil industry or to other businesses affected by problems in the petroleum sector face severe difficulties. While

prices of crude oil seem to have stabilized during the second half of 1986, recovery of the oil industry's previous prosperity does not appear in the cards, either in 1987 or in the foreseeable future.

Ongoing erosion of the export market share for the region's agriculture and manufacturing industries has continued to slow trade flowing through the region's shipping and port facilities. Cargo volume moving along the extensive waterways of the region, for example, has been far below earlier expectations and signs of improvement are scarce. The decline of the dollar and measures to subsidize agricultural trade should begin to improve export trade flows in 1987 as domestic products attain a more competitive status in international markets.

Improvement Likely to Continue

Overall, the economy of the southeastern region should continue to outdistance that of the nation in 1987. The continuing influx of population and corresponding gains in employment and personal income largely account for more rapid growth in the Southeast. Single-family residential construction should lead in the expected increases, while commercial construction is expected to remain lackluster until overcapacity has been absorbed. Manufacturing activities could expand to supply a larger share of domestic as well as foreign markets, although, because of technical efficiencies achieved during recent adjustments (in the apparel industry, for example), employment probably will not rise in proportion to manufacturing output. Nevertheless, workers should continue to find jobs in the burgeoning service and trade areas so that the region's total employment may maintain its rate of increase at 3 percent or more, amounting to about half a million new employees in 1987.

The agricultural and energy-producing sectors will be lingering areas of weakness not only during 1987 but for many years to come. Heavy indebtedness incurred during periods of prosperity will continue to go unserviced, resulting in additional bankruptcies and foreclosures among borrowers and loan losses for lenders. The financial institutions involved heavily in agricultural and energy loans will experience additional hard adjustments in the months and years ahead. For the preponderance of lenders across the region, however, encouraging economic prospects indicate opportunities for sound growth and improving prosperity. Overall, the Southeast seems likely to retain and perhaps enhance its appeal for new residents and businesses from elsewhere in the nation and abroad through 1987 and beyond.

— Gene D. Sullivan

National Outlook

Our outlook for the U.S. economy in 1987 is significantly different from last year's, despite the fact that the projection for growth in the gross national product (GNP) is essentially the same. This forecast of 2-1/2 to 3 percent growth in GNP, adjusted for prices, includes substantial changes in the composition of output. In 1987 domestic consumption will contribute less to the expansion of overall spending in the United States on balance, without weakening dangerously, while demand for U.S.-produced goods by foreign consumers will emerge as a source of strength. Advances in these two leading sectors will more than offset the slump affecting business investment in structures and the flat profile anticipated for federal government spending, yielding moderate but sustained real growth for 1987.

Given these modest prospects for expansion, substantial additional progress in reducing the rate of unemployment is not expected; 1987 is likely to end with the civilian unemployment rate only slightly below its current level. However, barring additional tightness in the labor market and assuming that inflationary expectations continue winding down, price pressures should also be quite moderate. Inflation, whether measured by consumer prices or the GNP deflator, should remain moderate in 1987. The extraordinary price performance of 1986 will probably not repeat itself though, since no additional declines in oil prices are anticipated and import prices are likely to be higher as a result of the dollar's depreciation. Nevertheless, the underlying current of inflation should not show any alarming resurgence before the year's end. Specifically, the GNP deflator will probably increase 3.5 percent over the four quarters of 1987, as compared to a surprisingly low 2.2 percent during the same period of 1986.

A Look at the Sectors

Consumer Spending. Household spending (personal consumption expenditure) accounts for nearly two-thirds of total spending in the economy. Because of its weight, even minor variations in the level and composition of consumer spending are extraordinarily important to the aggregate outlook.

In 1986, when the dollar level of indebtedness and the debt-to-income ratio had each reached unprecedented levels, it was common to describe the consumer as "debt-constrained." Economists generally supposed that at some point the burden of servicing the debt would begin to inhibit additional spending. However, other measures of the household debt burden, such as debt-to-asset levels and payment schedules, while rising, showed a less onerous obligation. Lower interest rates and lengthening maturities worked to keep monthly payments manageable. In fact, consumers continued spending and borrowing freely during 1986. Still, the assumption that increasing debt burdens will lead to a deceleration of spending is a reasonable one, and it is likely that debt levels will work to moderate consumer spending in 1987. The most important fundamentals of household spending—wage and salary growth, asset value growth, and consumer confidence—will also decline slightly in 1987. This slowdown should not be overemphasized, however: the fundamentals remain solid, and although household spending growth may be lower than in 1986, it will still lend strength to the economy.

Services will lead consumer spending, while demand for durable goods, especially autos, may fall below last year's level. Acceleration in purchases of durables and autos late in 1986 suggests less buying may be planned for 1987; but this slackening will probably have only a small impact on total household spending, and its effects should diminish after the first quarter.

Investment. Business fixed investment dropped off considerably in 1986 from its earlier pace, and continued weakness is expected in 1987. Several factors that determine investment in plant and equipment will not support additional spending in 1987. Investment in structures will be held down by fairly low and steady capacity utilization of plants, overbuilding in the office and retail space markets, continued difficulty and uncertainty in the energy sector, and certainly, the new tax laws, which treat such investments less favorably. The multiple negative factors influencing investment in structures make it easy to forecast marked contraction in this component. Investment in equipment is harder to predict. Though underutilization of plant implies some general

slack in equipment use, continuing automation and the decline in the value of the dollar bode well for equipment demand. Expenditures for investment in equipment will show moderate growth, with demand gaining strength toward the year's end.

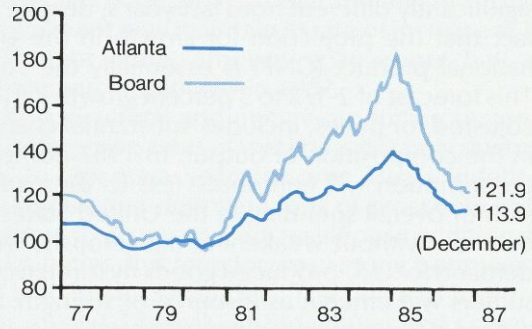
Inventory levels are typically lower during periods of low inflation than in times of high inflation or expected inflation. The continuation of only moderate inflation and tight inventory control measures put in place during the last recession should keep inventory levels down and fluctuations mild, thus making inventory spending a relatively neutral factor in the 1987 outlook.

Housing. Overbuilding and removal of tax incentives have already had an adverse impact on spending for multi-family housing. Since overbuilt markets are a problem in many areas, changes in the tax law will only exacerbate adjustments previously underway. The new tax treatment raises the break-even occupancy rate by lengthening the depreciation period for apartment and condominium units and restricting the usefulness of real estate partnerships.

The picture for single-family housing is much brighter, although still moderate. Building activity in this segment reached record-setting levels in early 1986 and subsided over the rest of the year. Construction should continue in 1987 at about the same speed as in late 1986. This slower pace, near 1.2 million units annually, is consistent with low mortgage rates working in a market with little remaining pent-up demand. While single-family housing activity for 1987 will fall below annual averages in 1986, no additional weakening over the year is expected.

Government Expenditures. In late 1985 and early 1986, government securities markets and interest rate forecasts responded to congressional moves to reduce federal government budget deficits through the Gramm-Rudman-Hollings Act. GNP forecasts also took into consideration government commitment to reduced debt, predicting lower real GNP growth on the basis that one source of aggregate demand, government spending, had been withdrawn without being completely offset by additions from other sectors. For good or for ill, the dramatic and rapid deficit reduction envisioned last year will not take place. (The 1986 deficit of $220.7 billion was a record.) Neither are continued record deficits expected in the future, however. The profile for the federal deficit in 1987 and beyond is for a steady, gradual decline. Such a pattern requires true fiscal restraint, but not in the stringent proportions of the Gramm-Rudman-Hollings plan. Although the downsized forecast for the federal government budget suggests no additional programs will be created, the reduction can still accommodate funding of current services. This means less stimulus from government expenditure than in the early 1980s; hereafter, government's contribution to aggregate demand will be neutral for the outlook.[1]

Chart 7.
Value of U.S. Dollar
Measured by Two Currency Indices
(1980 = 100)



Source: Computed from data released by the Federal Reserve Board of Governors and the Federal Reserve Bank of Atlanta.

Net Exports. The most important economic development in the United States during 1986 was the slowdown at year's end in the deterioration of the nation's net export position. Actual improvement is expected in 1987. The impact of the dollar's depreciation, which began in early 1985, was first felt in late 1986; but most of the adjustment has not yet materialized (Chart 7). The dollar's drop of nearly 35 percent since February 1985 will make goods produced in the United States relatively less expensive than foreign wares in both domestic and foreign markets, thus stimulating U.S. exports and moderating import demand (Chart 8).[2] This improvement in the trade picture has already begun to appear, but how much of the turnaround will be accomplished in 1987 remains to be seen. The average monthly change is likely to be small, and a number of factors argue against a rapid reversal. First, the dollar has not declined equally against the

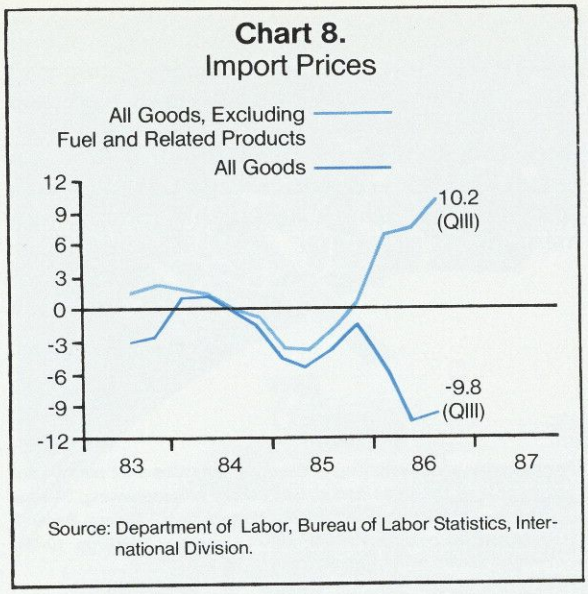


Chart 8.
Import Prices

Source: Department of Labor, Bureau of Labor Statistics, International Division.

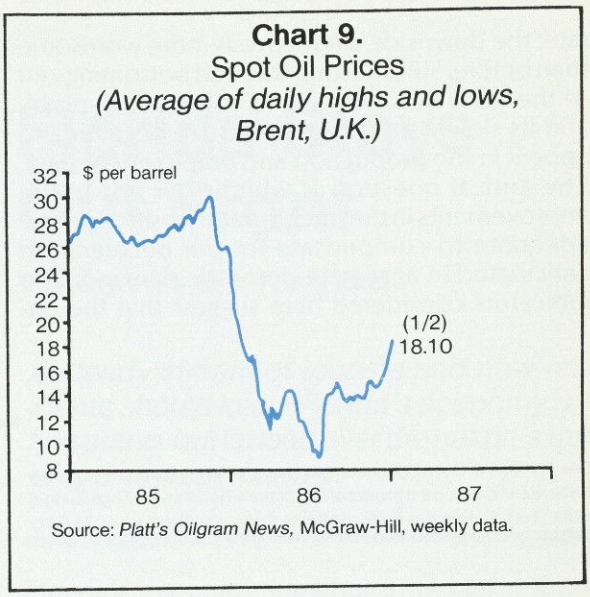


Chart 9.
Spot Oil Prices
(Average of daily highs and lows, Brent, U.K.)

Source: *Platt's Oilgram News*, McGraw-Hill, weekly data.

currencies of all U.S. trading partners. Importantly, the dollar has retained its strength or actually appreciated against the currencies of some of our major trading partners, such as Canada and the newly industrializing nations of the Pacific rim region. Secondly, currency movements are not the sole determinant of changes in trade patterns. Income growth within nations that import U.S. goods also affects trade. Western Europe currently lags behind the United States in economic expansion. Latin American nations remain burdened with financing external debt, and these countries also limit imports by various means. Finally, the petroleum-based economies of OPEC are in recession. Thus, the prospects are not good for a resurgence in demand for U.S. goods led by foreign income gains. Consequently, a narrowly-based dollar depreciation must produce a large adjustment. Still, this change is in the works, and its growing impact should be evident throughout 1987 and beyond.

Inflation and Unemployment

Real GNP growth of 2-1/2 to 3 percent, other things remaining equal, is not likely to lead to either a substantial increase in underlying inflationary pressures or a marked reduction in the unemployment rate. However, in 1987 a major shift will occur in the factors that contribute to price changes. Last year's extraordinary reductions in energy prices, especially in the price of petroleum products, led to very low measured inflation without materially changing fundamental price trends beneath the surface (Chart 9). Although the benefits of low oil prices will continue, no further declines below the 1986 average are expected for 1987. This year, then, actual measured inflation will more fully reflect latent price pressures. Moreover, dollar depreciation will lend some additional inflationary momentum by raising the cost of imports and loosening the constraints on prices of domestically produced goods that compete with foreign products. Taken together, however, these two factors will not lead to increases in the GNP deflator above 3 to 3-1/2 percent (as a year-over-year average), because other sources of inflation, especially wage and salary demands, will be quite subdued.

Job growth in 1987 may equal its rate in 1986 without having much impact on the civilian unemployment rate. As in recent years, the rate of labor force expansion may prevent healthy employment growth from being reflected in the jobless rate. The outlook for overall real growth suggests only minor additional declines in the level of unemployment unless the rate of increase in the labor force decelerates substantially.

The foregoing outlook is just as positive, albeit more cautious, than last year's. Although the forecast remains centered on a reasonable growth

rate, the downside alternative is more worrisome than before. Still, the long-awaited bottoming-out of the trade accounts seems to be taking place, and its slowly spreading effects are beginning to appear in the production and employment data. The critical question is whether or not future improvements in the foreign trade position will be adequate to compensate for the deceleration anticipated in aggregate domestic demand. The indicators considered here suggest that the answer is "yes." However, the challenges confronting an economy adjusting to major changes in both the composition of domestic activity and the external environment are great. This outlook does not discount these adjustments but concludes that the economy is capable of adapting while still maintaining acceptable forward momentum.

— *Mary S. Rosenbaum*

NOTES

[1]See Thomas J. Cunningham and Rosemary Cunningham, "Projecting Federal Deficits and the Impact of the Gramm-Rudman-Hollings Budget Cuts," Federal Reserve Bank of Atlanta, *Economic Review*, vol. 71 (May 1986), pp. 19-24.

[2]An alternative trade-weighting of the dollar indicates a 22 percent depreciation over the same period. See Jeffrey A. Rosensweig, "A New Dollar Index: Capturing a More Global Perspective," Federal Reserve Bank of Atlanta *Economic Review*, vol. 71 (June/July 1986), pp. 12-23.