

**The Nation and the
Southeast in the New Year**

Remarks of
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to the
Atlanta Rotary Club
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It is indeed an honor and a pleasure for me to keep alive a tradition that extends several decades into the past. I refer, of course, to the customary appearance of the president of the Federal Reserve Bank of Atlanta at the Atlanta Rotary Club's first meeting every year to suggest how the economy may behave during the coming 12 months.

In the past, I have enjoyed listening to a number of these economic projections from Monroe Kimbrel and Bill Ford, and I am happy to be taking my turn at the speaker's rostrum. My pleasure is enhanced by the fact that I can offer you quite an encouraging forecast; on the whole, the outlook for 1984 is extremely promising. I certainly would hate to make my debut as the Atlanta Fed's spokesman to this prestigious audience by sounding like an Old Testament prophet of doom, despair, and destruction.

On the other hand, I find myself wishing that it were possible for me to herald the dawning of an Economic Millennium — a thousand years of plenty and prosperity. Later on, I will share with you some thoughts about why the outlook for the coming year is merely good, rather than great. But, first, let's look at the positive news about our prospects for 1984, starting with the national economy.

The National Scene

The year just past, obviously, was an encouraging one for our national economy. The recovery seemed to break from the starting line even before the gun sounded the arrival of New Year 1983, and it had reached full speed by midyear. I am hopeful that we can continue this momentum right through 1984, and possibly well beyond. This afternoon we can find signs of economic strength all around us. The nation's economy grew in real terms in the second and third quarters of 1983 at rates of 9.7 and 7.6 percent and at 4.5 percent in the fourth quarter based on preliminary data. Those ringing cash registers you heard in our department stores during the holidays were only the more visible signs of the renewed economic vigor. Retail sales, in fact, have been growing impressively for the past several months. What's more, consumers aren't limiting their purchases to stereos and household goods; they are committing themselves to major investments as well, putting their money down on acquisitions such as automobiles -- and even homes. With mortgage interest rates stabilized, for example, the number of housing permits late in 1983 continued the upward climb that has kept builders, tradesmen and realtors smiling all year.

Clearly, the consumer's new-found willingness to spend is a sign of improving national confidence. It offers indisputable evidence that Americans, who generally were reluctant to commit their hard-earned money during the recession months of 1981 and 1982, now are convinced that better times lie ahead. They are encouraged, for instance, by a cooling of the inflation that eroded our economy for so many years. Inflation, which surged as high as 13.5 percent in 1980 (as measured by the consumer price index) had ebbed to the 3-4 percent range late last year.

The public's new optimism spells good news for those who manage manufacturing industries, or who work for them. It is their happy lot to produce the goods sought by these purchasers. Predictably, industrial output has been gaining strength for months, with business equipment production leading the way. Idle plants across the country are

reopening or are recalling furloughed workers. We are seeing this happy trend in our own region, as I'll discuss in just a moment.

With more people returning to their jobs, our worrisome unemployment picture is improving. Total employment, which had remained nearly flat throughout 1982, began to edge upward once again near the end of 1983. The jobless rate fell to 8.4 percent in November, the lowest rate since the same month of 1981. That means more of America's workers are taking paychecks home, which helps to explain both the holiday spending binge and the renewed national confidence that it reflects. In fact, personal income increased nearly 2 percent in the two-month October-November period; the figure for November was more than 7 percent higher than in November a year earlier.

Do we need more evidence that the recovery is moving ahead at full speed? Consider that corporate profits have risen by one-third over the last two reported quarters, an increase that is having a profound effect in generating new business investment. Business inventories and new factory orders are both gaining. And the Commerce Department's Index of Leading Indicators, which monitors our overall economic health, increased for 14 consecutive months before it paused to catch a breath in November.

So much for the year gone by. What's ahead for the national economy in 1984? More of the same, I believe, except that we can look for some cooling of the torrid pace of the recovery. That might be the best thing that could happen at this stage. Real economic growth seems likely to settle down to a more sustainable growth than the rapid expansion of early 1983. A realistic projection seems to be something in the neighborhood of 5 percent, give or take a few tenths of a point. That is well below the growth rate for the first half of 1983, and it should help ease the upward pressure on interest rates caused by more rapid growth. Interest rates, in this eventuality, may be fairly stable, not straying too far above or below their present levels.

Prices seem likely to behave quite respectably over the year, although they probably will rise a bit more than they did in 1983. Even the most pessimistic economic prophets expect consumer prices to rise little more than 6 percent in 1984, while the more optimistic predict an inflation rate of 5 percent or below. An unexpected decline (of 2.1 percent) in producer prices, announced about a week before Christmas, suggests the optimists may be closer to the truth, at least in the short run. Finally, with real economic growth continuing -- even though at a moderate pace -- the national unemployment rate should decline further. It may even dip below 8 percent by the end of the year, and conceivably could edge nearer the 7.5 percent level. With a continued decline, consumer spending should continue to fuel the recovery into 1985.

The Southeastern Recovery

Turning now to the regional economy, we find the Southeast poised to enter a new stage of the recovery. While the entire nation faces rather bright prospects for 1984, some parts of our region seem likely to grow even more vigorously. I am glad to confirm what most of you are seeing in your own businesses: that Georgia is one such area promising vigorous growth, and that Atlanta's prospects seem particularly bright.

The Southeast, like the nation, began a strong upturn in the first half of 1983. The revival in residential construction that became evident even before the end of 1982 stimulated the Southeast's construction-related industries. Our substantial furniture and carpet manufacturing industries began to expand rapidly to meet the renewed demand for the things that help to make a house a home. As unmistakable signs of recovery encouraged consumers to resume spending, sales of autos and textiles grew briskly. More recently, the recovery has spread to the Southeast's heavy concentration of auto parts and textile manufacturers.

As we round the corner into 1984, the recovery seems to be gathering strength. Employment continues to grow at an encouraging clip, and unemployment is declining,

although Alabama, Louisiana, and Mississippi — the Southeastern states hardest hit by the recession — still suffer from jobless rates in the 11-12 percent range. The average rate for the region has dropped from near 11 percent at the beginning of 1983 to about 9 percent by yearend. A second year of economic expansion nationally almost certainly will bring further improvement in the Southeast's unemployment rate. And that, in turn, suggests that there will be money in local consumers' pockets to keep merchants restocking their inventories.

In our own home state of Georgia, unemployment has already fallen to near 7 percent. The picture is almost the same in Florida, another state enjoying brisk economic activity. The mix of service-related industries in these two states has protected them from the more painful layoffs that afflicted neighboring states with economies dominated by manufacturing. Yet even the manufacturing industries of Alabama, Mississippi, and Tennessee are beginning to rehire workers in response to the nation's recovery. On the other hand, Louisiana, whose economy remains heavily dependent on the sluggish petroleum industry and international trade, has begun to show improvement only recently.

Earlier, I suggested that some parts of the Southeast seem likely to grow faster than the nation in 1984. The strongest rebounds seem likely to occur in areas that produce consumer goods or defense materials. Defense spending will stimulate the local economies surrounding the region's many defense installations. However, the greatest benefits should go to those areas producing sophisticated defense hardware. Florida will get the alligator's share of the contracts, but Georgia stands to benefit as well. The service industries in Georgia and Florida promise to attract a continuing influx of new residents to both states. As employment rises in the service industries, increased spending for housing and consumer durables will help give a boost to economies of both states.

On the other hand, emerging strength in business investment should help other parts of the region share in the recovery. Alabama, Louisiana, Mississippi, and Tennessee will benefit from manufacturing plant reopenings and from increased mining activities. If the national recovery can sustain its strength through 1984, all four of those states could achieve sharp gains in employment. That would extend the healthy growth pace to virtually all southeastern states. Of course, we in Atlanta will enjoy our best economic health when the surrounding states and the nation as a whole have fully recovered, because in many respects we service the entire region.

Although the Carolinas are not a part of the Sixth Federal Reserve District, the area served by the Atlanta Fed, their economies are so closely linked to ours that a few words about their outlook seem appropriate. Both North and South Carolina are sharing in the current recovery and seem likely to continue to do so through 1984. For the first three quarters of 1983, virtually all of North Carolina's economic indicators posted healthy increases over 1982. South Carolina — heavily dependent on textiles and related products — suffered badly in 1982, when over 40 production facilities closed their doors. However, conditions improved quite rapidly last year, as the national recovery gave an important boost to the state's consumer-oriented manufacturing sectors.

A continuation of the national economic recovery through 1984 should set other sectors of our regional economy to humming. The airline, tourism, and convention businesses, important throughout the Southeast, should grow sharply as conventioners and vacationers flow into attractions like Atlanta's convention facilities, Disney's EPCOT Center, and the 1984 World's Fair in New Orleans. It could be a banner year for Southern hospitality industries.

One troubled sector is our region's agriculture and agribusiness. A severe drought across most of the Southeast in 1983 left our farmers hard pressed to repay the debts they had accumulated over several years of adversity extending back to 1977. For the survivors, however, the outlook is brighter for 1984. Since crops were short in 1983,

farmers are likely to resume full-scale planting. That means the merchants who sell them seed, fertilizer and equipment should see a resurging demand for their wares. The demand for farm products should be strengthened by the general improvement in our nation's economy and by growing international trade that should boost agricultural exports.

That's a thumbnail description of the outlook, as I see it. The southeastern economy, which has done its share of sputtering since 1980, finally has begun to hum like a race car. If consumer and business spending remain strong, more plants should resume full operations, brightening the employment picture further. Construction and manufacturing firms are gearing up for what they are confident will be a second consecutive year of growth. Virtually all sectors and all areas of the Southeast show promise for the new year. Metropolitan Atlanta, which has retained its strength right through the recession, certainly should be a nice place to do business in 1984. Statewide, Georgia should not be far behind Florida, whose economic growth seems likely to set the pace for the entire South. Alabama, Louisiana, and Mississippi, on the other hand, have more catching-up to do than Georgia and the rest of the region.

All in all, that is quite a rosy economic picture. Yet, somehow, a good many of us find ourselves dissatisfied with it. Good as it is, we know it could be better. And we wonder what is holding us back.

Problems Remain

Clearly, the nation's economy retains some worrisome trouble spots. The international trade and energy sectors, which slumped in the 1981-1982 recession, remain somewhat sluggish even now. A strong dollar and world recession cut into international trade flows throughout most of 1983, including the flow of agricultural and energy products at most ports of our region. The economic recovery in the United States and elsewhere in the world should help to increase the volume of crucial exports, such as coal, phosphate, pulp and paper, and chemicals. It should also increase imports of oil

and machinery into the United States. That would be good news for Savannah and Brunswick, as well as for other Southeastern ports. Of course, increased imports may not be such good news in view of our persistent deficits in world trade; we must hope to balance them with a rising level of exports.

In the new year, our nation's widening merchandise trade deficit should help reduce the dollar's value in terms of other key currencies on foreign exchange markets. If that happens, the export of goods manufactured in the United States should grow steadily — although slowly — over the year. That would supplement the increased trade flow arising from economic growth elsewhere around the world.

Another global problem that could cause us trouble locally is the plight of indebted less-developed countries — the so-called "LDCs" that have been so much in the news recently. The list of nations hard-pressed to pay their national bills is long and seems to be growing longer — nations such as Brazil, Mexico and Argentina in our own hemisphere and Poland a world away. They may be remote in terms of mileage, but their financial crises carry momentous significance to us both in political and in financial terms.

What about other problems that still trouble us?

High interest rates and unemployment are two of those problems. In both cases, we can take comfort in the fact that their levels have retreated from the peaks that they reached not so long ago. Yet real interest rates remain high by historic levels, and any renewal of an upward trend could help squelch the recovery that we are enjoying. Unemployment, though continuing to decline, also remains high; our 8.4 percent rate represents 9.4 million willing workers out of jobs — an affront to our national productivity.

I noted earlier the success that our nation has achieved in standing up to another problem, the menace of inflation. We in the Federal Reserve take pride in our contribution to that effort; and I believe that it demonstrates the great importance of

an independent central bank that can take appropriate monetary action without regard to political considerations or pressures. The fight against inflation has been a painful experience for many, yet it had to be waged to halt the truly terrifying erosion of our national resources that we saw during the 1970s. But has the job been completed? Many in the marketplace are skeptical. They question our willingness as a nation to keep a rein on wage settlements and price hikes, and they question the determination of the Federal Reserve to stick by its guns. But I can assure you that we will continue to fight inflation with vigor. We will not surrender the gains that have been won at such considerable cost and pain to many in our society.

But, if our monetary policy is to remain resolute, what about the other side of the coin? What about fiscal policy? Can the federal government regain control of our budget and its persistent deficits? Monetary and fiscal policy must operate hand in hand if we are to achieve our goal of smooth economic growth. You simply cannot drive with one foot on the brake and the other on the accelerator.

Do Deficits Matter?

One of the debates in contemporary economics is centered around the question of whether federal budget deficits matter. I am convinced that they do, indeed, matter. When the federal government must borrow heavily from the limited pool of credit that must also meet the needs of business people like yourselves, it has important implications for the economy. It affects your ability to obtain the credit you need -- at an interest rate you can afford. I am not suggesting that the deficit problem should be solved by levying a tax or surtax to offset the projected deficit. That would simply exchange one problem for another. The consumers who are playing such an important role in fueling our recovery cannot spend money that has been transferred into the federal coffers. By the same token, funds taxed out of the private sector are no longer available to fund our crucial capital investment. In any event, our experience over the last half century suggests that increased tax revenues are unlikely to be used for

debt reduction. The temptation to channel them into increased federal spending seems difficult to resist.

In the long run, then, the solution to the deficit problem must come in the form of better control of federal spending. We must learn to prevent problems, not try to spend ourselves out of them. To gain that kind of control, we must be more sensitive to the need for national priorities. Instead of heeding the countless special interest groups clamoring for increased federal spending, our representatives must stay attuned to one overriding truth: if we commit ourselves to an expenditure — whether it is for defense or for social programs — we will have to find ways to pay for it. We simply cannot continue a system that promises our people increased social spending, increased defense spending, low inflation and full employment — and at the same time lower taxes.

I am reminded of a comment made by a foreign visitor to the Federal Reserve Bank of Atlanta a few years ago that suggests one aspect of the problem rather pungently. In his country, tourism had dwindled because a hostile, anti-capitalist atmosphere pervaded the resort areas, prompting potential visitors to seek friendlier climes for vacations. Our young visitor summed up his nation's woes in these words:

"What our government does not seem to understand is that, before you divide the cake, you must first bake the cake."

Of course, our nation is a far cry from that ravaged economy. Yet I suspect that most of us find ourselves wondering whether we, in the United States, are baking the economic cake as efficiently as we might. In our commendable zeal to improve the equity with which we divide our cake, we may have devoted inadequate attention to the cooks and the kitchen. As a result, our nation's productivity has improved more slowly than that of some competitors in the world marketplace.

Let me emphasize that I thoroughly support the idea of dividing the cake — our national prosperity, if you will — fairly. History shows rather clearly that there have been serious inequities. A number of social institutions, such as labor unions, sprang to

life and were given considerable power because of a widespread recognition that those inequities were all too real. But I do want to suggest that the time has come to assure ourselves that, in our efforts to divide the cake fairly, we do not inadvertently tie the hands of the bakers and turn off the heat in their kitchen.

Improving productivity will involve not only technology but also the sociology of our economic world. For example, the recession helped some companies to see that substantial gains may be achieved through more cooperative labor-management relations, in good times or bad.

Both labor and management must continue to evolve. That message is clearly conveyed by our fascination with our former students, the Japanese. The relationship between labor and management can become more collaborative and productive.

Paul Volcker wondered aloud about what he called the stubborn problem of getting labor and management to act on their common interests -- to work together more closely and cooperatively to increase productivity and restrain costs. He raised several rhetorical questions about the labor-management polarization in our nation, and he concluded by asking:

"I wonder if managements have been as forthcoming as they might be in taking their own workers into their confidence in frankly discussing their financial results and their planning options -- and indeed whether, in some circumstances at least, labor members of a board of directors might not be useful."

Since then, Eastern Air Lines and its major unions have entered into an innovative agreement that may, in time, provide us all with some useful information about the performance of labor union representatives on a corporate board.

Obviously, anyone who has ever read a 10-K report would recognize that a frank discussion of the complexities of corporate finance is no simple task. Similarly, trying to explain some of the subtler points of long-range corporate planning to a group of assembly-line workers could be a formidable challenge. But key elements of finance

and planning can be translated into terms that most workers will comprehend. And the effort might produce surprisingly positive results that more than justify the effort.

Making the Transition

Just what are the long-run implications of our increasingly successful efforts to enhance productivity through robotics, computerization, and other technological innovations as yet undreamed of? How many programmers and computer technicians will we need? What percentage of our working population has the potential to acquire the needed skills? How frequently will we need to retrain them? Of those who cannot compete in those high-tech occupations, how many can be absorbed by our growing service industries?

How may our nation's businesses make this transition into a new era? How may private enterprise and government keep pace with this social revolution? The Atlanta Fed is looking into these questions, to see what we can contribute to public understanding. Our monthly magazine, the Economic Review, reports on our Research Department's studies with regard to such issues as the technological evolution taking place so rapidly all around us. We are also sponsoring a conference in April that may shed some light on the subject. This conference, our sixth since 1981, will consider how businesses can remain competitive beyond the 1980s. It will offer perspectives from chief executive officers of a number of successful, high-performance Southeastern corporations.

The Atlanta Fed will continue to serve as a forum for such crucial economic questions as those regarding productivity and competitiveness. But I hope that these questions also will be discussed earnestly in our universities and our state legislatures and, of course, on Capitol Hill. The discussion should occur in all the forums that collectively provide a basis for public policy decisions. If we fail to address these questions in seeking realistic policy decisions, we may find ourselves in the position of an astronaut trying to control a spaceship with a buggy-whip.

With a remodeled, more productive economic kitchen — and with a sense of partnership among the cooks and their helpers — we can bake an even tastier and more nutritious cake than I foresee for our economy in the year ahead.

Let me conclude by saying that my optimism about our nation and our region transcends the good economic news of 1983 and 1984 that I have just reported to you. To be sure, if history is any guide, we will have low as well as high points in the business cycles in the years ahead. However, we have just endured the worst economic recession since the Great Depression of the 1930s. Yet we have survived and weathered the storm with our political, business and financial institutions not only intact, but perhaps even stronger than before; and we have come through the recession without serious social disturbances or unrest.

I am convinced that this is due in no small measure to the strong will of the American people to rise above adversity and to continue with rugged determination to achieve a quality of life made rich not just by material goods but by justice and spiritual values as well.

That is why I am further convinced that our great nation will continue in its historic role as the leader of the Free World; and that essentially is why I remain constantly optimistic about our future and our destiny.