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ALABAMA
The Outlook, Problems, and Policies

Remarks of
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to the
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My comments this morning will relate to the economic outlook and monetary policy. I would like to begin by commenting on the outlook. With that as background, I will shift the focus to monetary policy, relating it to fiscal policy and related matters.

The recovery that took hold last year has matured into a solid expansion. The national economy should grow at a healthy rate this year, but the Southeast's economy as a whole should grow a bit faster. Alabama faces brighter prospects than it has for several years, although it suffered a sharp set-back furing the 1981-82 recession and entered the recovery with a great deal of catching-up to do.

Virtually all sectors and all areas of the Southeast show promise as we move into the second quarter of 1984. Florida's economic growth seems likely to set the pace for the entire South, with Georgia running a close second. Alabama, Louisiana, Mississippi, and Tennessee will all make good progress this year, although at somewhat slower rates.

The strongest rebounds seem likely in the southeastern areas that produce consumer goods or defense materials. Defense spending will stimulate the local economies surrounding the region's many defense installations. That, of course, bodes well for parts of Alabama.

Despite the generally rosy outlook, the nation will continue to face problems that are both complex and stubborn. We are plagued with lagging international trade and energy sectors. We are troubled by the woes of heavily indebted less-developed countries, whose burdens carry far-reaching implications for the global economy. We still wrestle with high interest rates and unemployment. And perhaps most disturbing of all, we have been unable to gain better control of federal spending to reduce the federal deficit.

I'll address those questions shortly. But first, let's take a closer look at 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, with recovery reaching full speed by the second quarter. 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, then cooled to about 5 percent in the fourth quarter. The recent "flash" report from the Commerce Department indicated a growth rate of more than 7 percent for the fist quarter of 1984 — a more rapid growth rate than many observers predicted; however, a significant portion of that growth rate — perhaps as much as a full percentage point — is attributed to increased inventory accumulation. Fortunately, this inventory accumulation does not suggest a build-up of inflationary pressures, as would be the case if real GNP growth were going directly into personal consumption. It now seems that

the growth rate will moderate settling down to a safe and sustainable rate for the remainder of the year.

Today we find signs of economic strength all around us. The ringing of cash registers is one of the most obvious signs of continued economic vigor. Retail sales slipped just a bit in February following their strong gain of almost 4 percent in January. What's more, consumers aren't limiting their purchases to stereos and household goods; they are putting their money down on big-ticket items such as automobiles — and even homes. Consumer credit expanded by $4.3 billion in January, after a record rise of $6.6 billion in December. Sales of automobiles have been very strong so far this year; auto sales in February were almost 30 percent greater than in February 1983. Though mortgage rates are beginning to feel some upward pressure, builders remain cautiously optimistic about prospects for the spring and summer. Housing starts rose over 11 percent in February, following a spurt of nearly 17 percent the month before. Overall, construction outlays — boosted primarily by housing — jumped by 6.9 percent in February; that was the largest monthly spurt since April 1946.

Clearly, the consumer's willingness to spend is a sign of continuing 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 averaged a frightening 13.5 percent in 1980 (as measured by the consumer price index) dropped to just 3.2 percent 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 welcome 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 7.8 percent in February, the lowest rate in over two years. That means more of America's workers are taking paychecks home, which helps to explain both the retail spending activity and the renewed national confidence that it reflects. In fact, personal income increased by just over 1 percent in October, by 0.7 percent in November, and by 0.5 percent in both December and January, after adjustment for both inflation and seasonal factors. That represents a solid gain in real buying power.

Do we need more evidence that the recovery is moving ahead at good speed? Consider that corporate profits rose by one-third over the second and third quarters of 1983 but then slipped a bit in the fourth quarter. Nonetheless, the overall increase is having a profound effect in generating new business investment. The "big three" automakers reported excellent profits for 1983, and we are now told they will soon announce record-breaking profits for the first quarter of 1984. Business inventories and new factory orders are both gaining and will continue to do so, since inventory-to-sales ratios remain very low. 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. It resumed its rise in December and continued it into the new year.

So much for the recent past. What's ahead for the national economy in the remainder of 1984? More of the same, I believe, except that we can look for a more moderate — and more sustainable — growth rate That might be the best thing that could happen at this stage. A realistic growth projection seems to be something in the neighborhood of 5 percent, give or take a few tenths of a point. That should help ease the upward pressure on interest rates that might be caused by more rapid growth. Of course, the persistent federal deficit problem also tends to provide upward pressure; more about that later.

Perhaps you are wondering what will slow the economy down to the moderate and sustainable growth rate I have been speaking of. We see four factors that should have this tendency. One will be an increase in the nation's savings rate as employment and incomes rise and as consumers finally get caught up on the buying they deferred during the recession. The second is that imports are increasing and will satisfy a greater share of consumer demand, thereby displacing domestic production. Third, we believe that growth in final sales — defined as GNP less inventories change — will slow. Finaly, growth in government expenditures will slow in the latter half of the year.

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 on a fourth-quarter-to-fourth-quarter basis, while the more optimistic predict an inflation rate of 5 percent or below. Finally, with real economic growth continuing, unemployment should decline further. With a continued decline, consumer spending should continue to fuel the recovery into 1985.

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The Southeastern Recovery

Turning now to the regional economy, we find the Southeast entering a new stage of the recovery. While the entire nation faces rather bright prospects for the remainder of 1984, some parts of our region seem likely to grow even more vigorously.

The Southeast, like the nation, began a strong upturn in the first half of 1983. The revival in residential construction that became evident late in 1982 stimulated the Southeast's construction-related industries. The substantial furniture and carpet manufacturing industries in parts of the Southeast 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 move into the second quarter of 1984, the recovery seems to be rolling along at a comfortable clip. Employment continues to grow nicely, and unemployment is declining, although the Southeastern states hardest hit by the recession — Alabama, Louisiana and Mississippi — were still suffering from jobless rates in the 10-12 percent range until quite recently. 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 picture. And that, in turn, suggests that there will be money in local consumers' pockets to keep merchants restocking their inventories.

In Georgia and Florida, unemployment had already fallen below 7 percent by January of this year. Both states have been enjoying brisk economic activity. The mix of service-related industries in Atlanta and Florida protected them, during the 1981-82 recession, from the more painful layoffs that afflicted neighboring areas, like

Alabama, whose economies are more heavily dependent on manufacturing. Yet even manufacturers in Alabama, Mississippi, and Tennessee are rehiring workers in response to the nation's recovery. Louisiana, whose economy remains heavily dependent on the sluggish petroleum industry and international trade, also is showing good improvement, although it began its turnaround later than the other southeastern states.

Earlier, I suggested that some parts of the Southeast, those that produce consumer goods or defense materials, seem likely to grow faster than the nation in 1984. While defense spending will stimulate the local economies surrounding the region's many military installations, the greatest benefits should go to areas producing sophisticated defense hardware. Florida will get the alligator's share of the contracts.

Since the near-term outlook is for continued strength in the housing market, our area's mills and other light industries that feed carpets, upholstery fabrics, furniture, lumber, and similar items to the nation's homebuilders and buyers should enjoy a profitable year. For the longer term, the national prospect for housing and for textiles and apparel generally is bright: the baby boom generation is entering the 25-to-45 age group that has traditionally spent a high proportion of its income on housing, home furnishings, and apparel.

With the recession behind us, our manufacturers' greatest challenge is posed by foreign competition, particularly in textiles and apparel. More than 14 percent of the U.S. textile market now is supplied through imports, while nearly 6 percent of apparel sales is foreign-produced. And, because foreign producers can produce stock textile items with much lower labor cost, these numbers are growing.

Yet a continuation of the national economic recovery through 1984 should set many sectors of our regional economy to humming. The airline, tourism, and convention businesses, important throughout the Southeast, should grow sharply as conventioneers 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.

There is even cause for optimism on the part of our region's troubled agribusiness sector. A severe drought across most of the Southeast in 1983, as you know, 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, most farmers have resumed full-scale planting — at least, those who can still get the credit they need to buy seed, fertilizer, and tractor fuel seem to be doing so. That means the merchants who sell such things to them 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 growth in agricultural exports.

What's ahead for Alabama

Let's take a closer look now at the way Alabama fits into this context of economic growth generated by high-technology industries, building trades, defense expenditures, exports, service industries, and tourism. Except for exports, those are the industries that have powered the Southeast's rebound from the recession. How much additional momentum will they provide for Alabama?

Alabama will share in the expected ~~high~~ growth ~~rate~~ of the region's economy in the years ahead. The resurgence in housing and new car sales last year gave Alabama's

manufacturing-based economy a badly needed boost. That helped cut the sate's unemployment rate from a peak of 16 percent in January 1983 to a seasonally adjusted level of less than 13 percent in February 1984. Clearly, there's still room for improvement, and improvement should continue through the remainder of the year.

In ~~both the nation and~~ Alabama, as throughout the Southeast, the outlook for electronic technology is especially bright. Electronic components are key ingredients in the burgeoning information age. Defense spending on electronic weaponry and surveillance and communications equipment will also spur demand. The Southeast should increase its share of high-tech industry because of its location advantages.

In Alabama, the high-tech industry ceneters around the Army's Redstone Arsenal and NASA's Marshall Space Flight Center in Huntsville. Altogether, about 180 high-tech industries in and around Huntsville count something like 18,000 employees and a payroll of over $380 million annually. The Universityof Alabama at Birmingham also is a major contributor to high-tech employm,ent. Several private firms have spun off from the pioneering research in biotechnology and genetics at the University.

The Sunbelt continues to attract migrants from other parts of the nation because of its climate and ecnomic vitality. That suggests a source of strength for the Southeast's forest-products industry, which supplies about 30 percent of the nation's lumber. Last year, that meant 5 percent more workers added to Alabama's lumber and sawmill payrolls. Employment in the state's brick, cement, and glass industries also rose in 1983.

The return of healthy economic growth in European, Canadian, and Japanese economies will be another source of strength for the Southeast's forest-products industry

and should also benefit mining and agriculture. Exports ofpaper, coal, chemicals, fertilizers, and farm products from the region are likely to grow at above-average rates as the economy expands.

Alabama accounts for much of the region's foreign trade in these products. Coal exports, inparticular, offer great promise. The McDuffie Coal Terminal in Mobile was expanded last year and is ready to handle the resumption of growth in coal exports that seems likely to occur. Farther down the road, we can see growing world markets and the completion of the Tennessee-Tombigbee Waterway furthr enhancing Alabama's export capabilities.

As more people return to work nationwide, they'll be taking vacation trips farther from home and with more spending money to scatter along the way. Tourism in Alabama should improve for that reason alone, but this year it will get an added lift as the New Orleans World's Fair draws motorists from the North and East along Alabama's interstate highways. The state's innkeepers should enjoy a banner year.

That's a thumbnail description of the outlook, as I see it. The Southeast's economy, which has done its share of sputtering since 1980, finally has begun to hum like a well-tuned automobile. Construction and manufacturing firms are enjoying what is shaping up to be a second consecutive year of growth.

All in all, the economic picture is quite encouraging. 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. ~~Over the next several months,~~ If our nation's widening merchandise trade deficit ~~should~~ helps to increase the value of key foreign currencies in terms of our dollar, ~~on foreign exchange markets. That would enable those nations to buy more goods from manufacturers in the United States. If that happens, the export of goods manufactured in the United States~~ U.S. exports should grow steadily ~~— although probably slowly —~~ over the year. That would supplement the increased trade flow arising from economic growth elsewhere around the world. The economic recovery in the United States and other nations should help to stimulate 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 Mobile, 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. On the other hand, if the exchange value of the dollar were to drop too rapidly, an outflow of capital might result, shrinking the pool of savings available for investment in the United States.

Another global problem that could cause us trouble locally is the plight of heavily indebted less-developed countries — the so-called "LDCs" that have been so much in the news recently. The recent increases in the prime rate have added to the pressure they feel. The list of nations hard-pressed to pay their national bills is a long one — including nations such as Brazil, Mexico and Argentina in our own hemisphere and Poland a world away. They may be remote in terms of miles, 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 remain below the peaks that they reached not so long ago. Yet real interest rates remain high by historic standards, and their current upward drift, if continued, ~~may~~ could squelch the expansion that we are enjoying. Unemployment, although continuing to decline, also remains high; our 7.8 percent rate for civilians represents around 9 million workers out of jobs — an affront to our national wish to see all citizens share in the nation's prosperity.

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. I believe that it demonstrates the great importance of an independent central bank that can take appropriate monetary action without regard to short-run political considerations or pressures. The fight against inflation has been a painful experience for many, yet it must be continued to prevent a return of the truly terrifying erosion of our national resources that we saw during the 1970s.

That war has not yet been won. Many in the marketplace are skeptical about the long run. 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. The 1984 monetary policy targets announced last month by ~~the~~ Fed's Chairman Volcker should reassure the nation on that score.

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 for long 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 repeated deficits in the hundreds of billions of dollars do, indeed, matter. When the federal government must borrow so 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 the ability of businesses and consumers to obtain the credit they need — at an interest rate they can afford. Repeated large deficits inevitably bloat the national debt, and the cost of debt service swells along with it; it is sobering to consider that interest on the national debt is already running at more than $100 billion a year — an amount equal to more than half of the projected deficit for the current fiscal year.

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 taxed out of their pockets and into the federal coffers. By the same token, funds taxed out of the private sector are no longer available to finance the crucial private capital investment needed to restore the productivity of U.S. industries. 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 irresistable.

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 and the political courage to stick by them. Instead of heeding the countless special interest groups clamoring for increased federal spending, our representatives must develop realistic national priorities. They must remember always to ask this essential question when considering an appropriation: Can we afford it? Too often, the only question asked has been: Do we want it? We simply cannot continue to promise our people increased social spending, increased defense spending, low inflation, full employment — and lower taxes at the same time.

But Congress does not deserve the full blame for this overspending. Our legislators reflect the pressures directed at them by their constituents. The solution must come, at least in part, in the form of public education efforts that cultivate a broad understanding of basic economic realities.

In our commendable zeal to improve the equity with which we divide our national wealth, we may have devoted inadequate attention to those who produce it. 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 fruits of our national prosperity 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 we must keep before us the fact that it

is economic growth that provides the resources we must have if we are to address our social problems.

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 they could achieve substantial gains 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 the lessons we are learning from our former students, the Japanese. The relationship between labor and management can become more collaborative and productive.

We must also continue the program of selective deregulation now underway. That program is intended to untie the hands of our economic producers whenever greater operating freedom will serve the broad public interest. We must judge regulations not only on the basis of their stated intentions, but also their actual, overall impact. And we must abandon regulations that serve only narrow special interests at the expense of the society as a whole.

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 not yet conceived? 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? I hope that these questions will be discussed earnestly in our universities and our state legislatures and, of course, on Capitol Hill — in all the forums that collectively provide a basis for public policy decisions. If we fail to address these questions in seeking realistic economic policies, we may find ourselves in the position of an astronaut trying to control a spaceship with a buggy-whip.

Let me conclude by saying that my optimism about our nation and our region transcends the good economic news of 1983 and 1984. To be sure, if history is any guide, we will have low as well as high points in the years ahead. However, we have just survived a serious recession with our political, business, and financial institutions not only intact, but perhaps even stronger than before. Equally important, we weathered the storm with less social unrest than we might have expected a few years ago.

I am convinced that our nation's ability to emerge from that recent ordeal in such good shape 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 destiny.