

**The Economic Outlook for Atlanta, Georgia, and the Southeast
Remarks of Mr. Robert P. Forrestal, President
To the Officers and Directors of First Georgia Bank
Atlanta, Georgia
November 7, 1985**

Good morning! I am delighted to be here with you today for your annual corporate breakfast. My comments this morning will deal with the economic performance of the Southeast and the outlook for the year ahead. After reviewing the situation in the region, I shall focus on Georgia and Atlanta. I'm sure I don't need to remind the members of this audience of the importance of the interrelationship between the economy of our region and its financial institutions. Although I probably won't be able to cover every industry and sector in detail, if only because of the great diversity that characterizes the Southeast, I'll be glad to answer questions you might have after I've finished.

Southeastern Performance in 1985

In recent years we in the Southeast have become used to glowing growth statistics and a record of expansion that generally outshines the nation. This year, however, our performance, like that of the nation, is not a repeat of last year's booming expansion, and we have had certain trouble spots, although strengths continue to outweigh weaknesses, particularly in Atlanta.

Southeastern employment growth in 1985 has been buoyed by two major areas of strength -- production of automobiles and trucks and the manufacture of machinery and electronic equipment needed for national defense and space exploration. These strengths reflect robust sales of automobiles nationally in 1985 and the increased federal outlays for defense, many of which have just reached full implementation and production levels.

In addition to the momentum generated by these manufacturing industries, the region has been enjoying a continuation of the rapid growth in construction and the service sector that has marked its performance for a number of years now. Nonresidential construction has been especially strong; the number of square feet under construction through August was almost 9 percent ahead of last year during the same period. The current level of activity has not been exceeded since the early 1970s. In most of the major markets absorption is healthy, although new construction is strong, vacancy rates are rising and there is some softness in rental rates. In spite of these current negative factors, developers remain optimistic about the potential of southeastern markets as relocation or expansion sites for American and foreign businesses. Single-family building permits, however, are up much more modestly, and the number of multi-family permits is actually off 17 percent on a year-to-date basis. The housing sector slowed down in the second quarter and did not regain its lost momentum. Yet even the moderate growth of single-family construction, relative to last year's very strong performance, constitutes quite respectable expansion, and the decline in apartment and condominium building is probably a necessary retrenchment in view of current excess supplies.

Retail sales have been stronger than nationally and have provided the impetus not only for a vast number of new jobs but also for much building activity. Construction of new shopping centers and renovations of old ones has been proceeding at a brisk clip. At the same time, most of the region's airports are carrying substantially more passengers than last year. In part, this reflects the addition of new routes and carriers, a development that is especially important to those airports that lost service in the wake of deregulation five years ago followed by two recessions. This addition of service to cities such as Nashville and Memphis should make it much easier for local businesses to conduct their affairs. Other services, ranging from medical care to legal counsel, have

also been expanding. In fact, growth in service sector jobs has been sufficient to offset losses in some of the Southeast's troubled manufacturing industries. States such as Florida and Georgia that have large service sectors have had lower unemployment rates than other regional states that are more dependent on manufacturing and activities that are sensitive to world market condition.

Despite these strengths, many areas of the Southeast began to experience an economic slowdown earlier this year. At that time the generally high level of real, long-term interest rates and a continuing response to the strength of the dollar in recent years began to be reflected in employment data. The annual rate of increase in nonfarm jobs slowed from near 4.0 percent early in the year to near 2.0 percent by the end of summer. In spite of improvement recently, job growth for the year as a whole is likely to fall short of the 5.0 percent growth rate we had in 1984. As a result of sluggish economic growth and continued increases in the labor force, the region's unemployment rate actually increased intermittently from March on while the U.S. rate held steady for 6 months and then dipped in August. As of September, the Southeast's rate of 8.1 percent was above the nation's rate of 7.1 percent. Florida is the only southeastern state whose unemployment rate is now below the national level.

Certain sectors of the regional economy felt the brunt of this downturn more severely. Employment in residential construction dropped sharply as it did in manufacturing employment. Losses were particularly severe in the chemical and textile industries. Intense competition in domestic markets from imports and in overseas markets from foreign manufacturers caused problems for other regional industries, including paper, wood products, and primary metals, as well.

Weaknesses in the energy sector have been taking a heavy toll on Louisiana and southern Mississippi, both of which are quite dependent on the sale of these resources and their by-products. Comparatively slack worldwide demand relative to oil and natural gas supplies and falling prices have caused sharp reductions in the number of drilling rigs active in these areas. Coal producers in Alabama and Tennessee find their market opportunities limited by the same factors. Given the importance of these troubled industries in Louisiana and Mississippi, it is not surprising that unemployment in both states is in the double-digit range and thus worse than any other southeastern state.

Meanwhile, similar conditions of oversupply and low commodity prices in U.S. agriculture have diminished demand for fertilizers, thereby, adding to the troubles of Louisiana, where production of petrochemicals is an important industry. Florida's phosphate mines, which supply much the same market, have also felt the adverse effects of weaknesses in the farm sector. Although the circumstances of most southeastern farmers are not as distressed as many of their midwestern colleagues who rely more on grain exports, many farmers in this region face the prospects of reduced revenues this year after a lackluster year in 1984. Some also are heavily in debt with few prospects for relief. Thus, bankruptcies and liquidations are an added problem in the agricultural sector of the Southeast as well as the nation.

These conditions in agriculture and energy are reflected in the performance of southeastern ports, many of which are handling less cargo than last year or are expanding their volume more slowly than ports elsewhere in the country. Moreover, trade volume remains well below levels existing during the late 1970s. Fortunately, as 1985 draws to a close, the southeastern economy is showing some pickup from the slow growth that characterized the first half of the year, and the outlook for next year is somewhat

brighter. Before I turn to that subject, however, I would like to review briefly the performance of Georgia and Atlanta.

Performance of Georgia and Atlanta

While Atlanta's economy continues to shine, economic performance elsewhere in the state exhibits many of the troubles that are plaguing the rest of the Southeast. The state's unemployment rate actually rose from 6.1 percent in August 1984 to 7.2 percent this August, marking the first time in 3 years that Georgia's jobless rate exceeded the nation's! Since textile and apparel employment account for one-third of the state's manufacturing employment, it is not surprising that Georgia's manufacturing sector has been more a source of weakness than of strength despite the health of industries that produce autos and military aircraft. Even Georgia farmers in normally prosperous industries such as pork and egg production are likely to have lower revenues in 1985. Taxable sales are 9 percent ahead of last year and new auto vehicle registrations are well ahead of either the southeastern or national pace, but much of this growth in state figures reflects the strength of Atlanta.

Atlanta, like many large cities, is far less dependent on manufacturing. What's more, many of the factories and plants that are located in the metropolitan area are in rapidly growing industries. These include not only such massive facilities as the Lockheed plant, but also numerous small computer and electronics firms operating in the city and its environs. Population growth is another factor favoring Atlanta. According to preliminary estimates, it now seems that population growth in 1985 will exceed last year's high levels. New residents typically stimulate demand for housing, retail establishments including both stores and restaurants, services ranging from health care to entertainment, and economic activity generally. This relationship seems to be borne out in figures showing that department store sales for Atlanta grew by 10 percent from

January through July, more than twice the national average SMSAs. Some 18 new department stores will be entering the Atlanta market in the coming year or so because of the apparent potential for growth in retail sales here. Although construction of multi-family housing fell sharply in Atlanta as in the state, single-family housing has advanced 5 percent through August, a stronger growth rate than that prevailing generally in the Southeast. Traffic passing through Hartsfield rose by a vigorous 13 percent during the January-to-August period. Finally, I think it is significant, although somewhat anecdotal, that Atlanta is the home of several large banks that have been involved in recent mergers. In my opinion, the growing importance of Atlanta as a financial center is indicated by such developments.

Of course, Atlanta's economy is not without its blemishes. As in the state, the unemployment rate has been rising, from 5.4 percent last September to 5.7 percent in September of this year. This rise reflects both the influx of people to the city and a deceleration of employment growth from last year's phenomenal 9 percent rate. Another factor keeping unemployment from falling in Atlanta may be the fact that so much growth is occurring on the outskirts of the city. Because of the distance of many new jobs from job seekers living in older parts of the metro area, some people remain in need of work while employers elsewhere cannot fill vacant positions. Until our transportation systems, public and private, have time to catch up with this heady expansion on the city's perimeter, the area's unemployment rate may remain somewhat higher and localized pressure on wages somewhat greater than underlying economic conditions warrant. Whatever the causes of Atlanta's performance with regard to employment, it's important to bear in mind that the current jobless rate is low, and the 7 percent growth in employment that Atlanta has experienced thus far this year is about twice the pace of that in the nation.

Another potential weak spot in Atlanta's otherwise bright economic record this year pertains to inflation. Whereas last year prices here were advancing at a slower rate than nationally, this year that situation has been reversed and inflation is now higher than in the United States as whole. Prices in Atlanta rose at a 4.9 percent rate for the twelve-month period ending in August compared with a 3.4 percent pace in the United States. Perhaps this indicator also reflects the strains of rapid growth. The main components accounting for this increase were housing, transportation costs, and the price of food eaten outside the home. Many of these expenditures are for items that we associate with a rapidly growing--and prosperous--population.

A final sector that is a cause of concern for some is nonresidential construction. Office buildings, in particular, are being planned and built at a pace that is outstripping the currently strong level of absorption. Even in the suburbs vacancy rates are quite high, and rental rates reflect this fact. The large number of new department stores and shopping malls planned for the metro area could outstrip the city's potential for growth in retail sales over the next few years. Although plans on the drawing boards for both office and retail space indicate substantial momentum will continue into 1986, I feel that eventually some adjustment seems inevitable to allow the space now available to be absorbed. Despite these problems or potential problems, the areas of concern are relatively minor when we assess the overall performance of Atlanta in 1985. As I shall discuss in a moment, I expect Atlanta to maintain a respectable pace of growth next year.

Outlook for 1986

The economic outlook for Atlanta, Georgia, and the Southeast in 1986 will hinge largely on two factors--U.S. economic performance and the condition of key sectors in the southeastern economy. With regard to the first--U.S. economic performance--I

expect the moderate rebound we experienced in the third quarter to be sustained, on average, in the coming year. Preliminary reports indicate that we achieved a growth rate of 3.3 percent in the July-through-September period. That figure is close to the rate at which I think we can reasonably expect to grow at this stage of the business cycle without introducing serious inflationary pressures. If we can continue to expand at a rate in this neighborhood, I would view it as quite healthy and respectable growth. Probably some of you are asking, "Yes, but, can we sustain this growth?" I believe several factors suggest that we can. First, inventory levels are extremely low; businesses, both manufacturers and retailers, will have to produce and stock somewhat more just to replenish supplies. This will foster some employment and income gains. Second, government spending, particularly for defense projects, is likely to continue at a high level at least for the next 12 months, in view of the way military contracts and commitments are related to production and spending. Thus, the manufacturing sector, or at least certain portions of it, should receive ongoing stimulus from federal demand for goods. The strong growth in money supply and associated lower costs of credit that we have been experiencing for some time now are also likely to have positive effects on a variety of economic activities, especially those that are sensitive to interest rates such as home and auto buying by individuals and capital spending by businesses. Finally, the dollar has declined about 20 percent since its peak earlier this year. Although changes in exchange rates usually take six months or so to influence trade patterns, we should begin to see some favorable changes taking place soon.

However, I would caution against hoping too much for a further significant fall in the value of the dollar because a sharp drop could quickly reignite inflation. Import prices would rise, and our dependence on purchases from other countries is considerable in the short run. Also the nation is near capacity in some areas. This is especially true with regard to employment. As troubling as our current rate of 7.1 percent sounds to

many Americans, this is probably pretty close to a full-employment level given the very high labor force participation rates we are experiencing. A rapid or sharp fall in the dollar could easily create bottlenecks and price pressures during the adjustment period as resources are reallocated. On balance, I look for a continuation of national economic growth in the area of 3 percent, accompanied by only modest declines in the unemployment rate and a favorable outlook for inflation over the coming 6 to 9 months. This outlook should mean better conditions for the Southeast in general next year.

Of course, the expected strength in the economy in the year ahead will vary among individual states and from one sector to another. Residential construction in the Southeast is likely to manifest some strength into 1986 as a result of recent declines in mortgage interest rates and favorable demographic factors. The latter include both the large number of households now entering their child-rearing years and the expected continuation of migration to the Southeast, especially to Atlanta. On the other hand, office and other nonresidential construction may begin to decline. Many metropolitan markets are overbuilt, as I've remarked.

The region's service sector is likely to expand significantly again in 1986. The flow of businesses and residents into the Southeast even if it slows a bit, should further strengthen demand for service industries. One important service, business and tourist travel to the region, seems likely to expand during 1986. The anticipated moderate national economic rebound should spur travel by Americans generally, and the dollar's decline should discourage American travel abroad somewhat while fostering foreign travel to the United States. The latter should be especially important to Florida since that state attracts more international travelers than others in the Southeast.

As I noted earlier, manufacturing activity related to the auto, defense, and some parts of the building sectors seems likely to perform well in 1986. Unfortunately, prospects for many regionally important manufacturers and their employees remain clouded. Despite relief that might be expected from the decline of the dollar, the textile industry is unlikely to regain its status as a major employer of low-skilled southeastern workers. Jobs have been declining in this industry for well over a decade, and absorbing displaced workers will continue to be a challenge in the Southeast, particularly to small towns and rural areas, for the foreseeable future. Other industries into which importers have made significant penetrations over the past few years may not experience any dramatic relief from the decline in the value of the dollar because many importers have invested heavily in building a market presence in the United States. Such producers are likely to forgo profits before they sacrifice the market share that they worked so hard to build.

Similarly, the probability of substantial improvement in agriculture in 1986 does appear to be too high at this point. Bankruptcies and liquidations of heavily indebted farming operations seem likely to continue in the year ahead. These will pose growing problems for lenders who are again likely to sustain significant losses from write-downs of farm loans. The energy-producing sector may also face rather bleak prospects. A strong revival in regional production of natural gas must await a turnaround in global market conditions. For oil, the outlook is harder to gauge because of the recent firmness in spot prices. Although many people expect renewed price declines, it is important to keep in mind that inventories currently look low.

The outlook for Georgia is much the same as that for the rest of the Southeast. Notwithstanding the effects of a decline in the value of the dollar, textiles and other industries that either export substantially or are sensitive to import competition are

unlikely to experience a dramatic turnaround. In addition, some industries that have provided much momentum this year--autos and defense in particular--may have reached a peak and are unlikely to be the source of new jobs in the year ahead even though their employment levels will probably remain high. Even in the service sector, some observers fear that the growth in retail employment has been outstripping advances in retail sales. If true, some slowdown in jobs in this sector is likely. However, the improvement in national economic performance that seems to have begun is likely to continue through the next 12 months, and this development should have a broad beneficial effect on the Georgia economy.

In Atlanta, somewhat the opposite pattern seems likely. After two very strong years, Atlanta's growth seems likely to slow somewhat in 1986. Strength in single-family and office building, many services, and high tech manufacturing will probably be tempered by much slower job creation, especially in manufacturing and retail trade, and a further decline in apartment and condominium building. However, the health of Atlanta's economy is such that even this more moderate pace of growth will be respectable, perhaps even enviable from the perspective of some other cities. As we in Atlanta adjust to growth rates that are somewhat more modest and closer to the performance of the rest of the nation, I think it's important to keep in mind that this anticipated deceleration does not imply a level of performance that is by any means sluggish or weak. Such performance is actually quite healthy and probably is a necessary transition from a period of rapid, potentially inflationary expansion.

Conclusion

In summary, the slowing growth of the regional economy in the first half of 1985 has been followed by some signs of renewed strength in recent months. I expect this expansion to carry forward into 1986 and continue throughout the year. Not all sectors of

the southeastern economy will participate in the improved environment, of course, but defense and auto-related manufacturing as well as the service sector should enjoy a good year. Those sectors that are likely to remain in a weakened, albeit improved condition, include low-wage manufacturing such as textiles, agriculture, and energy. Outside Atlanta, Georgia's fortunes seem likely to follow the pattern of the Southeast generally, that is, of a moderate but broad rebound. In contrast, Atlanta will probably continue the slowing trend that it began to exhibit this year. However, the city's performance has been so stellar for the past several years that even the slower growth rate that appears on the city's economic horizon seems strong by comparison to the rest of the country. Thus, I would leave you with a note of optimism for the economic prospects of the Southeast, the state of Georgia, and particularly for Atlanta.