

**THE ECONOMIC OUTLOOK**  
**Remarks of Robert P. Forrestal, President**  
**Federal Reserve Bank of Atlanta**  
**To the Macon Chapter of the Association of Bank Women**  
**Executive Guest Night**  
**Macon, Georgia**  
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I am delighted to be here with you tonight for this special--and, I might add, very well run--get-together sponsored by the Macon Chapter of the National Association of Bank Women. Many of you in the audience, I understand, are affiliated with financial institutions in middle Georgia. I'm sure you have special interest in locally important economic activities like farming as well as textile, apparel, and paper manufacturing. To understand what has been going on in these industries, I think we need to look at national and even international developments. So most of my remarks tonight will focus on that larger scene. I will, however, have a few things to say about agriculture and also about the economy here in middle Georgia. When I've finished, I'll be happy to answer any questions you may have.

**Recent Economic Performance**

As we approach the end of 1986, it is natural to begin looking back and assess our nation's economic performance for the year. When we consider the first ten months, it seems--at least at first glance--that we haven't done all that well. Unemployment hasn't fallen appreciably but rather has fluctuated around 7 percent for two years. That's largely because growth has been rather modest. For the first three quarters our total output of goods and services grew only 2.2 percent. Still the 2.4 percent rate of growth we had in the July-to-September period was a significant speed-up from the virtual standstill we experienced from April to June.

While most recent data do show an improvement in the aggregate, they mask the substantial setbacks and losses still being suffered in some sectors of the economy. A sharp drop in prices has virtually crippled producers in the oil industry. At the same time, problems in the international sector are adversely affecting many farmers and manufacturers despite the dollar's extended and substantial decline, at least against the currencies of some of our major trading partners.

While the trade situation will soon improve for reasons I'll describe in a moment, the slow response of our trade balance to this currency realignment means that industries sensitive to import competition as well as many export-oriented farms and factories continue to languish. That's been important in areas like middle Georgia, where textile and apparel manufacturing are large local employers. Some southeastern plants have been forced to close, and owners of others have had to look for ways to cut expenses in order to survive. Given the labor-intensive nature of most apparel factories, cost-cutting usually entails reducing the work force. Another special feature of textile and apparel manufacturing that has contributed to the present plight of this industry is that the chief competitors are in countries whose currencies haven't changed significantly since the dollar began its decline 18 months ago. I have reference, of course, to Korea, Singapore, Hong Kong, China, and Taiwan. At the Atlanta Fed we have developed a new dollar index to focus on currency changes in specific groups of countries like these newly industrializing Pacific rim nations, and what we have found is that the dollar has actually risen slightly against these currencies whereas it has fallen about 20 percent against those of our 18 largest trading partners overall. In view of these contrasting patterns, it shouldn't surprise us that we haven't seen more relief in industries that compete with these countries. The same is true of the locally important forest products industry. Our

main competitor in softwood lumber, for example, is Canada, and the Canadian dollar has hardly budged relative to the U.S. dollar.

On the other hand, the economy has scored some important successes, and there are large areas of strength. We've done quite well on the inflation front, and some sectors have continued to grow at a very respectable pace. Price increases have been modest this year. The most recent figures for September show somewhat of a jump from August, but much of this was due to a partial reversal of earlier oil prices declines. For 1986 overall, the consumer price index will probably rise only 2 percent compared to almost a 4 percent increase last year.

Another positive sign is consumer spending. Consumers continue to buy freely. You often hear that retail spending is almost flat if you factor out auto sales, which have been jumping around from month to month because of special dealer financing incentives. However, if you're going to start adjusting these numbers for unusual and distorting developments, you really should remove gasoline service station sales as well. That is because retail sales are not adjusted for price changes. Since gas prices have been falling significantly, total sales in this category have been slipping, offsetting rises in other areas. Clearly, that slippage is not "bad" for most of us. When you make this adjustment, retail sales have increased this year at an annual rate of more than six percent. Residential construction has also proven quite responsive to the decline in mortgage interest rates that has occurred over the last year or so. Starts are being sustained at an annual rate of over 1.6 million. That pace is slower than earlier this year but definitely quite strong. Finally, you have to consider that the expansion has lasted nearly four years, longer than any we have seen since the 1960s.

## Outlook

In view of the current mixed state of the economy, we must ask ourselves whether the weaknesses are so serious that they threaten to terminate the expansion or at least snuff out the potential for a period of faster growth that would help us reduce the level of unemployment. I think that there are several reasons for optimism. Recently released data for the third quarter shows substantial inventory cutbacks. While that news was bad for the past quarter, its future implications are positive. Factory managers and retailers have drawn inventories down to extremely low levels. Thus any increase in demand is likely to be passed through to production quickly, and I think that such demand will come.

Consumer spending, as I mentioned, has been quite strong, and the prospects seem good for it to remain so even though the pace might slacken somewhat. Personal income has been rising, though modestly at times. What's more, the drop in oil prices that has been so painful to certain regions of the country has boosted household discretionary income nationally. As people spend less on gas and oil, they can increase purchases of other goods like housing, furniture, cars, and a variety of services.

Deficit spending by the federal government is not likely to undergo the dramatic reduction that seemed likely a year ago when Gramm-Rudman was passed. Frankly, I think that development is unfortunate because of its long-term effects on our capital markets and on our foreign trade position. However, in the immediate future it means we won't feel much of a drag exerted by contraction in the government sector.

The area that is most likely to add to or at least help sustain the economy's momentum is the international sector. I know this promise is beginning to sound hollow

after being made for so long by economic forecasters. Still, I think we should continue to have faith that the trade balance will improve because of a number of reasons that account for the slow progress we've had so far. I've already mentioned that the dollar has not declined against the currencies of Canada and certain Asian nations which have become large trading partners. While this situation may not change soon, other obstacles to improvement should prove temporary.

Some delay in the economy's response to a lower dollar is to be expected since an upturn in net exports typically follows a currency depreciation or devaluation only with a lag. Because the price of imported goods rises while that of exported commodities falls, with an initially unchanged volume of trade, the trade deficit worsens, especially for trade flows covered by contracts. Later the volume of imports slows in response to price increases, and the amount of exports rises as American goods become cheaper abroad. One factor that has extended these lags is that much of the dollar's decline was not initially translated into higher import prices. Instead foreign producers chose to hold the line on prices, absorbing the difference in reduced profits in order to maintain their share of the U.S. market. This tactic obviously can't be pursued indefinitely, and I think there's evidence that narrowing profit margins are beginning to reach their limits with the ongoing dollar depreciation we've had this year.

On the export side, there have been several unfortunate situations. First, economic growth in our major export markets--Europe, Japan, and Latin America--has been quite slow. Germany has, however, picked up smartly, and some of the other European countries are doing a little better now. As they improve, we should see an increase in demand for U.S. goods. Earlier weak demand for U.S. farm products--we actually had a deficit in farm trade in May and June for the first time in two decades--appears to have

been temporary. It probably stemmed from deferred purchases by foreign buyers who were waiting until new farm programs which lowered prices took effect. There is already some evidence that agricultural exports are picking up.

All these extenuating circumstances may sound like too many excuses, but according to data just released today the merchandise trade deficit narrowed in September again after declining somewhat in August. That is evidence that we may be finally beginning the turnaround I'm expecting. As that happens, we can expect our manufacturing sector to perk up. This development, in turn, should have a positive effect on labor markets and personal income and thus help sustain consumer spending, which has been the strength of this expansion in the past year or two.

As we look at the monthly trade numbers, it's also important to bear in mind that exports don't have to surpass imports again for a rebound in GNP to occur. Even if the trade deficit merely flattened, its drag on overall GNP growth would be reduced and the pace of expansion would accelerate. For instance, if the trade deficit had not worsened from 1984 to 1985 but merely stayed the same, albeit quite large, GNP growth would have been one and a half percentage points higher last year or over 4 percent.

There are, I admit, definite areas of weakness. Except for some rebuilding of inventories, investment is not going to pull the economy along. Slipping utilization of the nation's productive capacity makes business hesitant to invest in new plants and equipment. Office space around the country is overbuilt, and a correction has seemed inevitable for some time. The long legislative debate over tax reform created an atmosphere of uncertainty which made businesses reluctant to undertake major new capital projects, and the new law is unfavorable to investment in many ways.

## **Agriculture**

Another problem area is farming, and here I'm afraid progress will be slow despite the fact that farm exports should strengthen somewhat with the implementation of lower price supports and the dollar depreciation that has already occurred. As I mentioned a few moments ago, there are worldwide surpluses of many basic farm commodities. These are a result of favorable weather in much of the world, heavy subsidies to farmers in many countries, and both technological and policy changes that have boosted production in former importing nations such as India and China. The resulting surfeit of farm products is depressing prices worldwide. Market prices of grains recently averaged 10 to 30 percent below year-ago levels, which were already depressed compared to the more favorable prices at the beginning of the 1980s.

Many American farmers are in a special bind because of financial stress. In the 1970s when shortages prevailed and inflation was rampant, they borrowed heavily to acquire new land and expand production. At that time taking on a heavy debt load seemed justifiable given the profits available and the apparent unending cycle of higher prices. Borrowing large sums was not unduly risky as long as world demand for food was high and U.S. prices were rising so rapidly. The former kept the price of farm land—a main source of loan collateral—high and rising, while the latter made repayment easier because each dollar borrowed was worth less when repaid later. However, farmers who took on such debt burdens were mistaken in their inflationary expectations. Inflation was reined in during the early 1980s, and so farmers could no longer rely on paying their loans back in cheaper dollars. At the same time agricultural supplies began to rise worldwide, driving prices down. As prices fell, so did land values because the earning prospects for this asset were much diminished. Many farmers were caught in this squeeze, and their

troubles have captured much attention in the news.

Fortunately, most farmers are not in this situation. A recent USDA survey found that 70 percent of all farmers are in sound financial condition, while only 10 percent were classified as vulnerable. And, despite falling farm prices, most farmers who are not heavily indebted have seen their net incomes fairly well maintained with the aid of government programs for major crops. Producers who have agreed to idle a portion of their acreage, for instance, qualify for income maintenance payments. They are also eligible for price support loans on crops grown on remaining acreage. In real terms, incomes of such farmers have remained above the pre-boom level of the 1970s. Problems have been concentrated among relatively few farmers, especially in the mid-West. Some Georgia producers have been affected. Those in area where row crops are important, for example, have experienced drops in land value of 50 percent or more. However, farm land owners near metropolitan areas have enjoyed rising land values. Farmers in hilly regions where broiler production is concentrated have also gained because of the profitability of that industry in recent years.

Nonetheless, Georgia farmers have had their own special problems. This summer's severe drought was worse here and in South Carolina than in the rest of the Southeast. Farmers in these states face the prospects of having less to sell in a market where prices are already low. On the brighter side, incomes of some of the state's crop farmers will be helped by government income maintenance programs. Georgia farmers have been participating heavily in acreage reduction programs, reducing the area planted by nearly a million acres in 1986. A bright spot for north Georgia farmers is broiler production. Lower average feed costs, along with shifting consumer preference toward poultry products, are having favorable effects on this industry.

The outlook for agriculture, both nationally and in the Southeast, will depend on how quickly farm supplies can be brought more closely into line with worldwide demand. Other issues, like credit burdens and farm foreclosures, will shrink in intensity as this main problem is addressed. Unfortunately, the issue is complex, and, in my opinion, complicated by a long tradition of misguided support policies. The problem with most of these policies is that they provide the major income supports to the largest farmers by operating through the pricing mechanism. Subsidies tied to output encourage the biggest and most efficient producers to increase production substantially, often resulting in lower market prices. Low-income farmers with limited production capacity have frequently been hurt by the very support programs that were enacted on their behalf. It would have been better if specific programs designed to aid only those farmers and their families most in need had been adopted.

These programs also adversely affect our international trade position because of the distortions they inadvertently produce. For example, sugar producers in the United States receive 21.78 cents per pound, while world prices average only 5.6 cents a pound. Imports are also restricted by quotas. The result is that American consumers must pay more than if we produced less and imported more. The United States is not alone in protecting its farm sector, and we clearly need to continue pushing for international agreements to scale back these programs. Still, we are a major world supplier and we can lead by example as well as exhortation through diplomatic channels. Our success in reforming policy will have as much to do with improving the farm outlook as the good weather we always hope for and the faster economic growth I do believe we'll see next year.

### **Middle Georgia Economy**

Fortunately, here in Georgia we've been enjoying pretty solid growth throughout this business cycle, notwithstanding problems in certain sectors like farming. You hear a lot about Atlanta's prosperity, but statewide the unemployment rate in August was only 5.9 percent and here in Macon the latest figures show a similarly low rate of only 5.7 percent. Manufacturing employment has been growing in the Macon metropolitan area, in contrast to the situation in the rest of the nation. Employment in food production is up 14 percent through the first three quarters compared to 1985, and even textile employment rose 7 percent—well ahead of the slight increase statewide. Apparel and paper aren't doing as well, but at least jobs haven't been lost in these locally important industries. Construction and services have also been sources of job growth here. As the dollar's decline begins to be felt, I'm sure the effects will quickly radiate out to this region and accelerate the state's already healthy growth.

### **Conclusion**

Summing up, I am concerned about the rather slow growth the economy has had this year and the lack of progress in reducing unemployment. However, when we weigh the current strengths and weaknesses of the economy, I believe there is reason to expect this expansion to continue, and it's quite possible that growth will speed up somewhat, especially as the trade deficit begins to narrow. As that happens, we could see some renewal of inflation, but I don't think we have too much to fear there. The signs just aren't out there to indicate a rekindling of inflation of the sort we had in the late 1970s. With faster growth, we should find it easier to deal with some of the problems I've addressed tonight like farm policies as well as other issues like the federal budget deficit. As these are tackled, I am confident that this nation can embark upon a long period of robust but noninflationary economic growth that will bring greater prosperity

**to citizens from every social stratum and all regions.**