

THE OUTLOOK FOR THE SOUTHEAST
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Good morning! I am delighted to have this opportunity to discuss the outlook for the southeastern states of the Sixth Federal Reserve District. Though the region on average has tended to outstrip the nation in its rate of expansion in recent years, what happens nationally and internationally will have a fundamental bearing on how the Southeast performs in 1987. I expect the U.S. economy to grow at about the same 2 1/2 percent rate that it did last year, but with improved balance among the sectors of the economy and the regions of the country arising from at least a stabilization of the downturn in the energy sector and a gradual improvement in the trade balance and hence in the manufacturing sector.

This more balanced growth would be especially welcome news to certain parts of the Southeast, which includes not only prosperous and fast-growing localities like Atlanta, Nashville, and most of Florida but also weak or even depressed places such as Mississippi and Louisiana, which are heavily dependent on energy and farming. The economies of Alabama and Tennessee as well as much of rural Georgia are more oriented to manufacturing and as such have been facing many of the same foreign-trade-related difficulties as the nation. In contrast, the service-based economies of Florida and certain metropolitan areas in other states have been doing quite well and seem likely to continue on that path.

Stabilization of the energy sector will be especially important to Louisiana and parts of Mississippi, both of which have been adversely affected by the sharp fall in oil prices last year. As workers have lost oil-related jobs in Louisiana, many have returned to Mississippi, their home state. This movement has raised Mississippi's unemployment rate

appreciably and now the two states vie each month for the dubious record of the nation's highest jobless rate. It's hard to overstate how bad circumstances are in Louisiana. Because that state's economy is not well diversified but is quite dependent on petroleum products and farming, virtually every sector is weak. State and local governments, for instance, have had to cut back sharply on hours and even the number of employees as well as services, just at a time when many services are needed even more. There is reason to hope that things will not get any worse even if they don't get much better any time soon. The rig count has been inching up. If oil prices remain near or a little below recent levels, at least the losses should be stemmed, but very little growth is on the horizon in any event. This forecast clearly has implications for financial conditions in the state. Not surprisingly, there have been some bank failures associated with the economic downturn. These have been handled with a minimum of disruption, and I expect that regulators will continue to effect smooth transitions in the future should other institutions fail. In addition, a bottoming out of problems in the energy sector suggests that the number of troubled institutions may well have peaked.

Along with the energy sector, agriculture will be a lingering area of weakness, not only during 1987 but perhaps for several years to come. Heavy indebtedness incurred during periods of prosperity will continue to go unserved, resulting in additional bankruptcies and foreclosures among borrowers and loan losses for lenders. Fortunately, farm credit has been a less serious problem in the Southeast than in other sections like the Midwest. That is because farm loans make up a smaller share of institutions' portfolios here and because many southeastern farmers have additional sources of income from other jobs. Thus, as serious as financial conditions of some southeastern farm operators are, I see no cause for special concern about the future. Moreover, agricultural conditions themselves could improve. The effects of the drought that devastated much of the Southeast last summer should largely be behind us. In addition,

farming in the Southeast as a whole is less dependent than the Midwest on grain crops and hence on export markets, which are glutted. Although southeastern farmers have less to gain from expected international developments than, say, their Midwestern counterparts, the basic picture is also less bleak to begin with.

Improvements in the trade balance would spell good news for many southeastern manufacturers who were subject to either intensified import competition or greater difficulty in marketing abroad after the dollar appreciated in the early 1980s. However, special circumstances will limit the positive effect of the dollar's general decline in the last two years on several of the largest and most widespread southeastern industries, particularly textiles, apparel, chemicals, and lumber. The reason is that the currencies of the chief foreign competitors in these industries have not undergone much appreciation relative to the dollar. While I think that prospects are better at least for textile producers, whose profits seem to be improving, whatever turnaround these industries undergo is not likely to have a dramatic impact on employment because foreign competition will remain keen, forcing employers to continue seeking ways to maximize productivity and minimize costs. This will mean substituting capital for labor as much as possible. Employment in industries like textiles has been declining for 20 years. A rise in output will generate some new jobs, but employment gains will not be proportionate to advances in output.

Other locally important industries are likely to face mixed prospects this year. Auto and related manufacturing, for instance, which is a significant and growing economic activity in Georgia, Tennessee, and Alabama, may not have as strong a year as last if consumer spending for durables tapers off at the national level. The Southeast does have a number of so-called high tech centers, particularly in Florida. For some producers of technologically advanced equipment, the dollar's decline should boost sales abroad.

However, many will probably grow more slowly because of the downward slope of federal budget deficits and the attendant pressure on defense spending. Defense contracts are the bread and butter of many electronics producers as well as makers of transportation equipment like airplanes and space shuttle components. Still, the currency realignment we have had should exert a broadly positive effect on southeastern factory owners and employees.

Aside from the effect of macroeconomic factors like deficit spending trends, the trade balance, and consumer spending deceleration, the southeastern economy is heavily influenced by some unique regional factors. Probably the most important of these is population growth, or more specifically in-migration. Continuing inflows of people and corresponding gains in employment and personal income are major reasons for the more rapid expansion of Florida and Georgia. Florida's population has risen at a rate three times as fast as the national average in the 1980s. This influx of people stimulates demand for new houses, apartments, offices, and retail space, in turn making for a bustling construction industry. Recent arrivals also generate greater demand for a variety of services ranging from schools and hospitals to recreation and the whole gamut of retail establishments.

Expectations of continued growth nationally suggest that movement to the Southeast will persist, since most people who want to relocate will be able to sell their homes elsewhere. In addition, the dollar's decline should have a positive impact on another kind of in-migrant—a temporary one, namely, the tourist. Florida attracts more foreign visitors than any other state. A lower dollar translates into more visitors from abroad as well as more domestic travel by Americans. Tourism tends to stimulate demand for services and trade in much the same way as permanent population growth. Therefore, workers will continue to find jobs in the expanding service and trade areas so that the

region's total employment should increase by about half a million new jobs in 1987.

Construction--the other population-driven economic sector--will not, however, do as well as one might expect, given the anticipated amount of population expansion. Single-family housing may continue to expand, but multifamily building along with construction of offices and retail space is likely to be weak. The reasons for this apparent anomaly are the tax law change and the fact that many local markets were substantially overbuilt in recent years and need time for all the new space to be absorbed.

Despite probable weaknesses in construction and energy, together with mixed performance in manufacturing, the Southeast overall seems likely to benefit from the chief forces that will shape U.S. economic performance in 1987--more stable energy prices and an improvement in the trade balance. In addition, the region should retain and even increase its attractiveness to new residents and businesses, both from elsewhere in the nation and from abroad. The states that are likely to do best are, once again, Florida and Georgia due to their disproportionate population growth and the diversity of their economies. Mississippi, whose economy is based primarily on farming, forest products, and energy, and oil-dependent Louisiana will probably end up at the other end of the spectrum. Alabama and Tennessee will probably turn out to be somewhere in the middle. Whatever happens to manufacturing nationally should be reflected closely in these two states. Though growth in this region may decelerate somewhat from last year, it is still likely be fast enough on average to stay ahead of the nation.

This picture suggests that financial conditions in the region should remain healthy. The Southeast was an early leader in the move toward regional interstate banking, both in terms of legislative authorization and actual cross-state mergers and acquisitions. I see merger activity slowing down somewhat but still continuing. On the whole, I think

this move has been a positive development for the region, bringing the fruits of greater competition—more services and better prices—to local corporate and individual customers. At the same time, it has not brought about many of the bad consequences that some had feared. In particular, interstate banking has not resulted in the demise of community banks. Rather, most of these have been able to retain their unique niche as providers of special personalized services. Thus, the financial as well as the economic outlook for the Southeast suggests that this region of the country will retain its special appeal to businesses considering relocating or expanding, to individuals seeking better job opportunities or a more desirable place to live or retire, and to investors seeking profitable outlets for their capital.