THE ECONOMIC OUTLOOK FOR THE NATION AND THE SOUTHEAST
Remarks by Robert P. Forrestal, President
Federal Reserve Bank of Atlanta
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Good afternoon! I am pleased and honored to have this opportunity to meet with fellow Rotarians and discuss the economic outlook for the nation and the Southeast. Even though you are some distance from downtown Atlanta here in Monroe, Walton County is now considered part of the Atlanta Metropolitan Statistical Area or MSA. For that reason, I know leaders of the business community such as yourselves have a first-hand understanding of how local economies are tying into larger units at a rapid rate. This tendency toward integration of economies is true not only in our state and in our nation, but also on the international stage. In fact, one of the fundamental dynamics unfolding before us today is the increasing globalization of markets. The linking of networks for transferring large amounts of money around the world 24 hours a day forces us to begin thinking of ourselves as internationalists even as we are coming to grips with far-reaching changes inside our own borders. Thus in the background of all my remarks today will be the impact that international economic developments have upon us, and after reviewing the national and regional outlooks, I'll turn to a brief discussion of some current international issues.

The National Economic Outlook

As you know, there are three basic measures of performance commonly used to gauge how the nation is doing, economically speaking—gross national product, unemployment, and inflation. I look for real GNP to expand once again this year at a rate of about 3 percent, and to come in a bit under that in 1988. Unemployment has fallen from the 7 percent level, where it remained lodged most of last year, to 5.9 percent in September. I am hopeful that it will remain in that range, which is a 7 year

low and close to what I consider the "natural rate" of joblessness. Inflation should accelerate from last year's average pace of close to 1 percent as measured by the consumer price index to as much as 5 percent in 1987 before probably dropping back a percentage point or so in 1988. Last month the Fed acted to head off inflationary pressures by raising the discount rate from 5 1/2 to 6 percent.

The importance of international developments to our domestic economy is driven home in my outlook. The higher prices in this forecast are in large part due to international factors. These include not only the lifting of oil prices from very low levels but also the rise in other import prices, which as of mid-year were up 9 percent. However, I now expect inflation to moderate in late 1987 from earlier in the year because oil prices seem to have plateaued and import prices are not affecting domestic prices by very much at this point.

The international sector is also critical to the outlook for GNP growth. I look for improvement in the foreign trade situation to be the engine behind our moderate rate of expansion, with some support from consumption. The other major components of GNP--investment and government demand--are not likely to add to overall growth. I look for very modest growth in consumption over the remainder of this year and some strengthening during the next. We have seen an improvement in the manufacturing sector, and industrial production is now 4.5% higher than it was last year at this time. The related growth in salaries in this higher wage sector should help bolster consumer spending. But consumer spending is not likely to be nearly as strong as in recent years--nor should we expect it to be. The low savings rate and high debt to income ratios that resulted from very high consumer spending growth will dampen these expenditures as we go forward.

Investment in equipment, factories, and warehouses should also pick up in response to the improved market for our exports. The positive effects of this capital spending will probably be mostly offset, however, by declining investment in offices, apartments, condominiums, and retail space. Changes in the tax code have exacerbated the short-run effects of overbuilding that occurred in recent years by treating some aspects of investment less favorably. In time this should lead to a more efficient allocation of capital as the revised tax code encourages investment dollars to be distributed more in accordance with the dynamics of supply and demand. In the near term, though, we may see some uncomfortable adjustments develop until excess space is absorbed. The market for single-family housing is also likely to be weak. Mortgage rates, though considerably lower than a few years ago are up a bit, and both housing starts and permits are down from earlier levels. For these reasons, investment seems to be at a stalemate, neither pushing nor retarding GNP growth. As for government purchases, budget deficits are, thankfully, on a downward slope, but this, of course, means much less fiscal stimulus than in the past.

This leaves us with net exports as an engine for the expansion. An improvement in the U.S. international sector is expected primarily because of the decline in the value of the dollar in foreign exchange markets. While this factor works with a lag, the dollar has been declining for two years now and we have already seen an impact. In fact, exports began picking up in real terms in the last three months of 1986 while imports flattened. Real net exports--the exports less imports--have now improved for three consecutive quarters for the first time since 1980. I am confident that increased exports and substitution of domestic for some imported goods along with the factors I mentioned earlier will sustain the expansion for at least another year.

The inflation picture will be dominated by oil prices and shifts in international

trade. Prices of petroleum and other commodities are still well below their levels of a year ago. Without the kind of help from declining energy and commodity prices we enjoyed last year, however, the rate of price increase is likely to return to its pre-1986 pattern, though not to the unacceptably high levels we saw earlier in the decade. Meanwhile, higher import prices seem likely to send us to a higher rate than in 1985, when the Consumer Price Index rose 3.8 percent. As I mentioned earlier, though, the Fed's recent discount rate hike demonstrates our resolve to keep prices under control.

Outlook for the Southeast

What does this outlook imply for the Southeast, which includes not only prosperous and fast-growing cities like Atlanta, Nashville, and most of Florida but also weak or even depressed places such as Louisiana? The main factors that will determine U.S. economic performance this year will also have a primary bearing on how this part of the country does. Stabilization of the energy sector is especially important to Louisiana and the parts of Mississippi that have been adversely affected by the sharp fall in oil prices last year. There are signs of improvement evidenced by lower unemployment rates in both states, however, and I feel confident that they have reached bottom and are in position to begin to turn around. Along with the energy sector, agriculture will be a lingering area of weakness in the Southeast.

On a more positive note, improvements in the trade balance should ultimately 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. One particular problem that affected many industries here is the failure of the dollar to depreciate against major foreign competitors such as Canada and the newly industrializing countries of the Pacific rim. Consequently, the Southeast's important forestry industry continued to be hurt by the influx of Canadian softwood. The

same has been true of apparel makers who compete with clothing manufacturers in Taiwan, Korea, and Hong Kong. Fortunately, this situation has finally begun to show some progress. The new dollar index, developed by economists at the Atlanta Fed, in part to measure the differential impacts of currency changes on particular regions and industries, indicates that in the first 9 months of 1987 the dollar fell more sharply vis-a-vis against the newly industrializing Pacific rim nations than the currencies of our other major trading partners. I expect these realignments to help. Still, foreign competition has led certain traditional southeastern industries to restructure through increased automation. This means that whatever turnaround the textile and chemical industry and others in similar situations undergo is not likely to have a dramatic impact on employment. Any 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 perform as strongly as last year if consumer spending for durables tapers off at the national level. Defense contracts are the bread and butter of many of the region's electronics producers as well as makers of transportation equipment like aircraft. With spending by the federal government expected to slow, activities in these industries may be hampered.

Aside from the effect of macroeconomic factors like deficit spending trends, the trade balance, and consumer spending deceleration, the Southeast's growth is heavily influenced by some unique regional factors. Probably the most important of these is population growth, or more specifically, in-migration. Continued growth in the national economy will make it easier for people who wish to relocate to the Southeast. Confident of their ability to sell houses in their present hometowns, these migrants can join the

inflow of people to the region and spur corresponding gains in industries like trade and services. Population-driven growth in the demand for services ranging from schools and hospitals to recreation and the whole gamut of retail establishments is one of the major reasons for the relatively rapid employment and income gains of Florida and Georgia.

The in-migration of new residents typically stimulates demand for new houses, apartments, offices, and retail space, in turn making for a bustling construction industry. In the near-term, we may see continued expansion in single-family housing for some parts of the Southeast. Other segments of the construction industry will not do as well as one might expect. Multi-family building, along with construction of offices and retail space, is likely to be weak. The reasons for this apparent anomaly are the tax law changes and the fact that in recent years many local markets in the Southeast were substantially overbuilt and need time for all the new space to be absorbed. Summing up, though growth in the Southeast on the whole may decelerate from last year, on average it is still likely to be fast enough to stay ahead of the nation, and in many areas the prospects are for pretty robust expansion.

International Issues and Problems

Having said that the nation and our region together should enjoy a continuation of our recent positive economic performance, I hasten to point out that there are several weighty issues looming on the international horizon. If unattended, they could arrest or even reverse the anticipated modest rate of expansion. These issues include imbalances in global trade patterns, inappropriate fiscal policies, protectionism, and the debt of the less developed countries, or LDCs. First, world trade patterns need to undergo a major correction, beginning with a continued increase in U.S. exports. I believe that in the short run, net exports are being pushed in this direction by the exchange rate realignment. In the long run, however, the American business community's heightened

awareness of international conditions must be translated into greater sensitivity to foreign markets. We must find ways to sell as aggressively in outside markets as we do at home, and this means becoming more familiar with other cultures, learning to speak the languages of foreign purchasers, and interpreting their unspoken signals. In the past, Americans have tended to make standard, mass-produced goods for our large home market—and for foreign markets too. We let others make specialized, high-quality products for a variety of markets. This strategy has become untenable with the rise of producers in the newly industrializing countries, where costs are lower. Today U.S. companies must become more willing to tailor products to specific customers' needs. A closer and more flexible relationship with consumers will ultimately enable businesses to develop the kinds of high-quality goods we need to compete more effectively in the global market.

In addition to the measures America might take to bring balance to trade flows, other advanced industrial economies need to rely less on exports and more on domestic demand. Japan has taken steps to stimulate domestic demand through tax cuts and increased government spending. If West Germany would follow suit, it could assume more of a leadership role in Europe. Then countries like Italy, France, Great Britian, and Spain would feel more comfortable about raising their portion of worldwide demand. Greater purchases of imports on the part of these countries would speed the reduction of America's trade deficit while helping to move the LDCs back on the track of faster economic growth by broadening markets for their exports.

Economic growth in the LDCs is essential for raising the living standards of their citizens, a concern that should be on the minds of the world's bankers as they weigh their loan policies for these countries. Many LDCs are at the point where the only returns likely from further austerity would be the negative ones of social and political

upheaval. It's therefore in the best interest of banks in advanced economies to work out creative solutions to the debt problem, because improved living standards in LDCs make the option of revolution—which would probably mean repudiation of debt and a total loss of principal—less likely. A renewed ability on the part of the LDCs to import would also help the United States, since they could buy many of our manufactured goods if they weren't so strapped.

I am concerned that if the world's industrialized economies don't act soon to bring about this shift in trade patterns, our economy, along with the rest of the world's, cound be undermined by protectionist trade policies. While I sympathize with the agony of industries, some of them here in Georgia, which have lost ground to foreign competition, I look with dismay upon the many calls for protection. Tariffs, subsidies, and other trade barriers cannot guarantee that protected industries will become more viable--a fact illustrated all too well by the experiences of agriculture, one of the most heavily insulated industries. Rather, these barriers weaken industries further by shielding them from competition. It almost certainly guarantees retaliation from our trading partners, and erosion of our purchasing power and free choice as consumers.

Rather than overreacting to short-term imbalances, it is critical for us to continue expanding our vision to include all the possibilities held out by the evolving international order. Our recent positive experience with Canada convinces me that through negotiation, rather than confrontation, we can convince our trading partners to assume more responsibility for keeping the exchange of goods and services, as well as labor and capital, as unrestricted as possible. We should continue to call on Taiwan and Japan in particular, two nations with extraordinarily high trade surpluses and substantial import barriers, to lower the protective walls which make it impossible for many of our goods and services to penetrate their markets. Raising protectionist barriers is an attempt to

"beggar thy neighbor" and get a larger share of the output pie. History teaches us, however, that in reality it only reduces the size of the pie and ends up hurting everybody. Our experience in the 1930s amply demonstrated this.

If Congress truly wants to alleviate the trade deficit, there are methods at its disposal that would prove far more effective than protectionism. If I have been somewhat critical of others for dragging their feet on easing their fiscal policies, I must emphasize that we have too been far too slow in correcting the intemperate fiscal policy that has contributed in no small measure to our current problems. If we do not make steady progress in reducing the federal budget deficit, the debt service burden will continue to mount. Since so much of our government debt is being financed by foreigners, debt service represents an outflow and so will continue to hinder improvement in our current account, offsetting much, if not all, of the gains we're making toward a balance of exported and imported goods.

Solutions to the final problem--LDC debt--are less clear cut. We must ensure that the LDCs are brought back into partnership with the United States and other advanced countries for the reasons I outlined earlier. We too would benefit, as higher domestic living standards would provide growth markets for these advanced economies. We all agree on the long-term goal of boosting living standards, since the alternative seems to be impoverishment of these countries and the possibility of political turmoil and debt repudiation. The problem is how to achieve this. Several concepts, ranging from additional loans, to securitization of debts, to partial forgiving of debt, have been advanced, but all of these plans have weaknesses. It seems clear to me that international banking agencies like the IMF will eventually have to be sources of new loans necessary to keep the LDCs on a growth path, but it is also clear that the complexity of the situation will require considerable flexibility and compromise on the part of all

concerned.

Conclusion

In sum, I am worried about the LDC debt situation. I think we will find the mechanisms to deal with it, but the solution is likely to take a very long time. Meanwhile, I am concerned that protectionist sentiment might spill over into actual policy measures. In the long run, this would adversely affect Georgians and, indeed, all Americans—not only by raising prices we as consumers must pay and through retaliatory measures hurting some of our industries, but also by foreclosing future export growth opportunities for business not yet born.

Fortunately, the current economic situation in the United States and other advanced economies, as well as the improvement in U.S. exports which I expect to continue, should allow us a breathing space in which we can work to resolve the debt situation and defuse protectionist sentiment. In these ways we can keep on course to greater internationalization of American business, a process that holds great potential for us and our fellow citizens of the world.