

THE ECONOMIC OUTLOOK FOR 1988
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To Kiwanis Club of Columbia, Tennessee
January 21, 1988

Good afternoon! It is a pleasure to have this opportunity to speak to you Kiwanians here in Columbia. My topic, the economic outlook for the nation and the region, is one that is of special significance at this time. This promises to be a year which will provide more than its share of debate on economic policy in conjunction with the presidential election. This is fortunate because several economic issues warrant thoughtful consideration at this moment in our nation's history.

Last October the stock market crash dramatically signaled investors' uneasiness with the current or anticipated future state of affairs. I do not share the view of those who see a recession on the horizon. I do, however, believe that the market's warning must be heeded. In particular, we must seriously grapple with the issue of global competitiveness. Otherwise we may sacrifice our own and our children's future standard of living. The manner in which we address this issue will have a profound effect on our long-term economic performance. Therefore, I feel it is appropriate to give competitiveness a prominent place in this afternoon's proceedings. For that reason, after presenting my outlook for the nation and the Southeast in the year ahead, I will discuss why our competitiveness is threatened and what we must do about it.

The National Outlook

In the year just ended, real GNP grew about 3 percent, a rate of expansion that helped keep the unemployment rate at or below 6 percent throughout the second half. At year's end prices, as measured by the consumer price index, were 4.4 percent higher than in December of last year. Looking to 1988, I see a continuation of expansion at a slower

pace of 2 percent or a little higher. With decelerating growth, unemployment should stay near the 6 percent mark or perhaps rise somewhat. Inflation is likely to be about the same as last year. My outlook for continued growth in GNP rests on three areas of strength: continued modest advances in consumption, further gains in capital spending on new equipment, and a fairly significant improvement in the foreign trade sector.

Consumer spending is likely to advance, albeit modestly, in 1988, in spite of the stock market crash last fall. Well before October 19th, household consumption had slowed considerably from its pace earlier in the expansion. Perhaps consumers were reading the writing on the wall even before the gurus of Wall Street were. At any rate, the main source of momentum for growth will not be consumption but rather net exports. These have been trending up in real, or inflation-adjusted terms, since late 1986. The dollar's substantial drop in value against foreign currencies makes our goods more attractive to foreigners. This development has boosted production and employment in our manufacturing sector. In addition, West Germany and Japan have recently begun to stimulate their economies. This policy shift should further bolster our sales of U.S. manufactured goods abroad.

However, given the extent of the dollar's fall, we have yet to see import prices rise as much as anticipated. This is unfortunate in the respect that it would curb imports and foster more domestic consumption of U.S.-made goods. Many foreign producers have been able to cut profits in order to hold on to U.S. market share. Others have found ways to divert sourcing to countries whose currencies have not appreciated as much against the dollar. Overall, therefore, foreign goods continue to come into the country in large volume. Nonetheless, export growth should continue to boost ongoing gains in the manufacturing sector. In turn this will likely spur investment, especially in equipment. Early surveys of capital spending plans suggest fairly good gains in this area.

Probably the weakest sector of the economy during the coming year will be

commercial and residential construction. Substantial amounts of office, condominium, and apartment space remain to be absorbed. In addition, the stock market's decline could make it harder for businesses to raise capital for major new projects. Government spending will not exactly be a weak spot. Indeed, the federal budget deficit is likely to increase moderately in 1988. Last year's reductions were achieved in part through one-time occurrences such as asset sales. Nonetheless, the attention paid the deficit following the stock market crash means that fiscal stimulus will be less than in recent years. Together these factors suggest that GNP growth will continue in 1988, but not quite as rapidly as in 1987.

Turning to inflation, oil prices are likely to stay in their present range despite some discord in OPEC at year's end. However, last year's further decline in the dollar should push non-oil import prices up even more. As this happens, the dollar-related increase in domestic manufacturing could exert upward pressure on labor costs. Capacity utilization has been rising. What's more, unemployment is close to the point at which further efforts to stimulate growth result in more wage pressures than job gains. Hence, I expect prices to advance at about the same rate this year as last, i.e., 4 1/2 - 5 percent. In all, with slower but still moderate growth in GNP and no acceleration in price increases in the offing, we can look forward to another year of decent economic performance.

Outlook for the Southeast

In its diversity the southeastern economy reflects the strengths and weaknesses of the nation as a whole. The likelihood of continued or even faster growth in manufacturing bodes well--at least for those regional factories that have been modernized. It is true that last year the dollar finally began to depreciate against the currencies of developing countries in the Pacific basin and Canada. That movement was important because these are the chief competitors of many regional industries like

apparel. Nonetheless, the amount of currency realignment is quite small compared to the dollar's fall against the yen, deutsche mark, and currencies of other advanced economies. Moreover, cost structures in many of these developing countries are far more favorable to low-wage, labor-intensive production. That type of industry became the staple in much of the South as the labor force shifted out of farming, and it is still important in many localities. Thus, for many of the region's industries the likelihood of substantial improvement is not high. Fortunately, the outlook for agriculture, while not rosy, is brighter than it has been in some time. Worldwide supply and demand are moving closer to some sort of balance. The situation for natural resources like oil is similar.

In terms of specific states, Louisiana and Mississippi will do better than last year, which appears to have been the trough. The rise in cotton prices is helping Mississippi's large farming sector. However, the upturn in manufacturing that the rest of the country has been experiencing may largely bypass Mississippi. That is because so much of its factory output is in the low-wage sector, where developing countries have a decided advantage. Louisiana's situation is in some ways worse because its economy is so lacking in balance. Even its small manufacturing sector is tied largely to energy. However, if oil prices remain fairly stable, the modest recovery in drilling activity should continue and expand in 1988.

Alabama's geographic middle-ground is paralleled economically. Manufacturing gains should help this state further the advances begun last year. Its economy remains heavily oriented toward industrial production despite growing health and educational services, especially in Birmingham. In addition, with somewhat brighter prospects for farming and energy, Alabama's still important natural resources sector should experience some improvement. Indeed, coal production had already begun increasing last fall.

Georgia, Florida, and Tennessee, on the other hand, can expect to see more of the good performance they have experienced of late. These states enjoy diversified

economies. They have more technologically advanced manufacturing and a growing service sector. These factors help offset weaknesses in import-sensitive industries like apparel or in the production of commodities like phosphates, whose prices remain depressed in world markets. Of course, rapid population growth is also a boon, especially to Florida and Georgia.

Tennessee has not experienced a population boom like Florida's, but it has enjoyed continuous, smooth population growth for some time now. This pattern has allowed sound expansions in the trade and services sectors. The best news at the beginning of 1988 is the strength of the manufacturing sector. We are seeing renewed growth in industries like aluminum, for example. This is true not only in fabrication, but in primary production as well. One reason for this turnaround in aluminum and for the generally positive outlook of manufacturing is that many plants have been outfitted with technologically advanced machinery. As a result, the laborers who are hired tend to have higher skills and hence command higher wages. Such an upgrading of facilities and the workforce should have a beneficial impact on the entire state's economy over the long run. Other types of manufacturing--transportation equipment and auto parts, for instance--are also showing signs of strengthening. These signs range from expansions of existing facilities to new plant openings. Overall, then, I expect Tennessee to repeat last year's good performance with 3 to 4 percent growth in total payroll employment. On balance, the Southeast should outperform the nation again in 1988, drawing strength from the same international forces that will boost manufacturing in the nation as a whole.

Competitiveness--The Only Answer to Our Twin Deficits

At first glance this outlook would seem to suggest it is "business as usual." After all, the United States has had more than five years of continuous growth. In addition, the economic indicators point to more expansion in the near term. Yet a number of signs indicate that all is not well--the stock market crash, our slow progress in narrowing the

trade deficit, and, perhaps most important, the growing level of debt. In the same period that we have enjoyed our longest postwar economic expansion, we have gone from being the world's largest creditor nation to becoming its greatest debtor. In 1981, the world outside owed us about \$140 billion, more than at any time in the past. At the end of 1987, we owed nearly \$400 billion to foreigners, also a record amount. More significantly, this debt was not used to finance an expansion of our productive capacity. Rather we borrowed to pay for current spending, especially by the government.

This remarkable turnaround from creditor to debtor helps explain the feeling of uneasiness that exists in the midst of our apparent prosperity. We have rightly begun to question how we are going to make the "monthly payments" on all the purchases we have put on the national "credit card." When the bull market came to an abrupt halt on Black Monday, the stock market was saying that the future was just too uncertain. Investors no longer believe we can pay up without either changing the way we do business or becoming content with reduced living standards for ourselves and our children.

As a result of massive federal budget deficits, we have been exporting IOUs in the form of Treasury securities for the past five years or so. In order to service and ultimately retire our huge external debt, we must be able to run substantial export surpluses--and soon. How can we manage to turn our trade deficit into this needed surplus in a timely manner? Some would propose that we raise artificial barriers to protect our products against foreign competition. I have been on record for some time as opposing anything less than optimally open markets. Therefore, I won't go into the details of my position again at this time. Suffice it to say that protectionism merely stifles competition and so raises prices and limits consumer choices. It surely will not help raise or even maintain our living standard.

Others might hope that further dollar depreciation will continue to make U.S.-made goods more attractive to foreign and domestic consumers. In this regard, however, I feel

we are reaching the point of diminishing returns. A currency realignment has been occurring for nearly three years now. In recent months the dollar fell quite sharply although stability seems to have been restored of late. If the dollar were to resume its precipitous fall, though, the likelihood of inflation would rise. So would the probability of economic downturns in those foreign economies to whom we hope to export more. These developments would negate whatever gains we might hope to achieve.

We must, then, look at the other basic determinants of competitiveness--productivity and quality--if our products are to sell better on world markets. To increase productivity we need to invest more in both our physical and human capital. We cannot expect to squeeze much more out of labor costs. I do not deny that we have made considerable productivity gains in manufacturing during the 1980s, largely in response to heightened foreign competition. Unfortunately, much of our recent investment has not been directed to resource-saving equipment or new factories. Rather it has been sunk into hotels, offices, and the like. Perhaps the idea was that we could spend more time meeting to discuss productivity!

The kind of investment we need goes beyond the narrow classifications made in constructing the GNP components. In addition to spending more on new equipment, research, and so on, we must invest more in our public infrastructure--roads, mass transit, and the like. We must also pay particular attention to building up human capital even though in an accounting sense such government expenditures are considered consumption. Unless U.S. workers are better educated, they will be unable to use new technologies. Moreover, they will lack the flexibility to make the necessary adjustments to technologically advanced production processes. Nor will they be able to adapt to another fundamental change we must make--toward higher quality.

In the past, Americans have tended to make standard, mass-produced goods especially for our large home market. We made the Ford family sedans and the Kodak

Instamatics. Others turned out specialized, high-quality products--Mercedes and Leicas--for a variety of markets. The arrival of much lower cost producers has meant that we can no longer hope to survive by concentrating on low-end goods. As we rethink our production objectives and move into the better quality niches, U.S. business leaders and workers alike will be called on to change old habits and ways of thinking. This shift requires a better educated work force at all levels. We need managers who can think analytically and creatively. We also desperately need managers who have the vision to see market opportunities in the far corners of the world. Yet our schools seem to have difficulty teaching students to read and write, to compute, and to master even the basics of science, history, and geography.

Policy Directions and Personal Responsibilities

Clearly, we need to invest more to raise our productivity and quality. These goals must be met if we are to be competitive in world markets and so retire our external debt. The latter is essential to maintaining our living standard. To increase investment, though, we must learn to consume less and save more. In particular, we must begin saving at a level consistent with the position we hope to maintain in the world economy. We have also been looking to the government to cut its deficit spending and thereby free up more funds for private investment. It is easy to blame the federal budget deficit as setting the tone for borrowing in order to consume--a bit too easy, perhaps. The deficit is not a new problem. Again, it is something about which I have voiced my opinion for several years. To be sure, we need to keep pressure on policy makers to continue reducing the gap between revenues and outlays. At the same time, there may be limits to how far we can go in reducing government spending. Many budgetary outlays--estimates range from 40 to 80 percent--have become locked into place. What is left to cut? Shall we make even less investment in public infrastructure than the insufficient amount we have been making? Shall we further minimize our commitment to

education? In my view, such a strategy would be extremely short-sighted. It could hinder our attempts to enhance our productivity and quality, and thereby pay off our debt to foreigners by exporting more.

Thus, despite the mounting frustration we may feel at the lack of progress on this front, we must stop blaming the government. Instead, it is time for all of us to say we have met the government, and it is us. Through our votes, the American people have the final voice in policy matters. We overwhelmingly reaffirmed the policies that led to our deficit by our votes in the past.

What can and should we do? A starting point might be further progress toward a truly neutral tax system. The one we now have still encourages consumption relative to saving. It also extends more favorable tax treatment to debt relative to equity financing by taxing corporate dividends twice. We cannot pass the buck entirely to Washington, though. Rather, we must curb our personal proclivity for consumption and rein in our huge household debt. We should also give more support to local and state policy makers who are attempting to upgrade our nation's schools. That means viewing these efforts as investments for which we should willingly pay through property, sales, and other taxes. These measures do imply that a smaller portion of income growth will be available for consumption. Yet we must remember that in the long run they are the only way we can work to preserve the living standard that has come to be the envy of the world.

Conclusion

Before I began to address the related problems of competitiveness and debt, I started out by saying that we could look forward to another reasonably good year in the national and regional economies. If I have rained on the parade a bit, it is because I wanted to impart my own sense of urgency that we address these latent problems from a position of relative strength. We still have time to correct our course and minimize the

damage. First, though, we have to muster the resolve--personally and publicly--to do so. I am hopeful that in the year ahead we will give careful thought to these issues and meet this challenge boldly.