Chattanooga Kiwanis Club
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s-chat

THE NATIONAL AND REGIONAL ECONOMIC OUTLOOK FOR 1989

The National Outlook

For 1989, I see a continuation of expansion in the U.S. economy, but at a somewhat slower pace. In the first quarter of this year, real GNP grew 3.7 percent, decelerating to 2.7 percent in the April-June period. I think that on average, GNP growth will probably be just over 3 percent in 1989 and will probably slow to just under 2 1/2 percent in 1990. As a result of this moderating pace of expansion, unemployment will probably decline less dramatically than in the last two years. The jobless rate should hover around 5.2 percent this year, as it did during the first half of the year, and perhaps fall nearer to 5 percent next year. Inflation, however, may accelerate to over 5 percent on average for 1989 and closer to 5 1/2 percent in 1990. The consumer price index rose 5.4 between January and March and then spurted to 6.4 percent in the second quarter. That early burst of price pressures almost assures us of inflation in the 5 percent range even though recent energy and food price declines have partially offset some of the large jumps we saw earlier this year.

While I welcome this deceleration in overall business activities, I want to emphasize that I am not at all comfortable with this level of inflation, and I am becoming increasingly concerned that some people are becoming complacent with the present inflation rate. I would remind those who feel we can live with, say, 5 percent inflation that at this rate, prices would double in 14 years. What's more, it is a mistake to believe that inflation can somehow be stabilized in this range. We have never in the past been successful in capping inflation at 5 percent; instead, it has always accelerated beyond that level. In the past few years, measures of inflation have appeared moderate, but this can be explained to a large extent by weakness in energy prices. Meanwhile, underlying inflationary tendencies have actually been somewhat higher. Moreover, we

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are running up against problems of capacity constraints that I will discuss in a moment. Therefore, we must treat current inflationary pressures as a serious threat to our nation's economic well-being.

The continuing expansion in 1989 will again be fueled by exports, investment, and consumption. Exports are likely to bring the trade deficit lower again this year, and manufacturers will turn out more goods to meet foreign demand. Although in recent weeks the dollar has risen above its levels of mid-1988, it is still about 28 percent below the peak of early 1985 vis-a-vis the currencies of our major trading partners. U.S. goods should remain attractive to foreigners in terms of their prices, especially since currency realignments affect trade flows with a considerable lag. At the same time, past dollar declines will no doubt translate into higher prices for imports. Thus, consumers here can be expected to continue shifting their purchases to domestically produced items. The outlook for investment is for continued moderate growth in response to increased demand for business equipment, especially computers and aircraft.

The weak sectors in the economy will probably be construction and government. I expect modest growth in commercial building led by warehouses and other industrial structures should do better than offices and retail facilities. However, residential building shows few signs of permanent strengthening. The housing cycle remains in a downturn and is not necessarily at its lowest point. Demographic trends, especially the passage of the baby-boom generation from its period of peak household formation, also contribute to a soft housing market. Government spending, too, will have to remain on a downward slope if we are to meet Gramm-Rudman-Hollings requirements without raising taxes.

As I mentioned, inflationary pressures are the most worrisome aspect of the

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outlook. The U.S. economy's capacity to grow is realistically about 2 1/2 percent per year. Except for the farm sector, growth has been above that level for well over a year. Meanwhile, now that the baby-boom generation has been absorbed into the work force and the number of new workers is diminishing, labor markets have begun to show signs of tightening. If growth were to continue at last year's pace while the number of new workers declines, labor costs would tend to rise in the absence of stronger advances in productivity. Capacity utilization is down from its peak, but it is still quite high, above 90 percent in certain industries. This combination of developments suggests that bottlenecks and shortages of materials may occur that could lead to general price increases. Although energy and commodity prices have weakened, "core" inflation, especially in services, is over 5 percent. I do not believe the economy has slowed enough to provide relief from this sort of pressure.

In sum, the U.S. economy appears headed for a good performance in 1989, although this year's growth should decelerate somewhat from last year's. I think it is important to remember that there is a considerable difference between a slowing economy and a slow economy. We need to become comfortable with a pace of 2 1/2 percent as a goal and not regard it as weak. Instead, it is a rate of growth more in line with an economy that is at or very near full capacity. Thus, the anticipated slowdown should be viewed as a necessary and welcome adjustment. On the other hand, inflation presents very real risks to the continued health of the economy.

Regional Outlook

Growth in the Southeast slowed appreciably last year, and I do not foresee a quick return to the robust pace we enjoyed earlier in the expansion, when the margin of growth between the region and nation was quite pronounced. On balance, I expect that the southeastern economy will maintain the growth rate attained during 1988. Farmers in

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this part of the country did not fare as badly as their midwestern counterparts during last year's drought. Thus, agricultural producers here would stand to benefit from the good year in farm markets I anticipate.

As in the rest of the nation, the Southeast should also enjoy growth in manufacturing as a result of improving exports and diminished import competition. Interestingly, though, the rebound here so far has not been as strong as in the industrial heartland. In 1988 the winding down of defense contracts was a negative factor for aircraft and electronics plants in the region, and this year should offer no reversal. Still, many primary and intermediate producers--paper and chemicals, for example--are running at full tilt and will likely remain at high levels. With apparel sales maintaining their momentum from the end of 1988, factory output in this important regional industry is reversing the losses incurred last year and apparel jobs are helping to boost overall manufacturing employment rather than retarding growth as in 1988. Another major southeastern industry, textile manufacturing, is also performing well largely because of the degree of automation that has been added. However, automation also means that textiles are unlikely to be a major contributor to employment growth. Moreover, carpet demand could taper off as construction continues to ebb, though orders are reported to be holding up well thus far this year. Weakness in construction nationally has inhibited growth in the region's important softwood lumber industry, but rising export demand is keeping the industry on a growth path.

Construction will probably continue to be weak here, as it will in other parts of the country. Except for industrial plants, commercial properties tend to be overbuilt just about everywhere. Moreover, the Southeast experienced a break in the pattern of steady population growth that had been an engine of expansion for many years--especially in Florida, Georgia, and parts of Tennessee. This slowdown in new arrivals made 1988 a

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weak year for residential construction as well. Underlying conditions, including the increase in mortgage interest rates early in the year, suggest that this situation will persist in during the remainder of 1989. It is still possible, though, that some improvement in building activities may occur now that the repercussions of several major layoffs are largely behind us.

One reason for the diminished numbers of new residents has been the resurgence of manufacturing in areas of the country that had lost jobs earlier in the current expansion. Even Florida has felt the pinch as more older workers in other states, finding themselves in greater demand, elect to defer retirement. Fortunately, however, although the dollar has risen against foreign currencies in recent months, it is still low enough to encourage foreigners to visit Florida and other vacation spots in the region. The dollar's value has also prompted more domestic travel by U.S. residents by making trips abroad costlier. Thus tourism promises further boosts to economic growth.

Still, with fewer people coming to the Southeast than earlier in the decade, expansion in the service and trade sectors will probably remain slower than in recent years. Like construction, these businesses are quite population-sensitive. Nonetheless, these two sectors, by virtue of their size, will again be the major sources of new jobs. Government, too, will probably employ more people. Past population growth has created a need to improve education and expand infrastructure, and these activities are falling largely on the shoulders of the state and local governments.

Here in Tennessee, I expect to see mixed economic performance in the final analysis for 1989. Total employment growth for the first six months of the year was about 1 percent over last year. This rate was slower than the 1.8 percent growth logged by the Southeast in general and 2 1/4 percent for the nation in the same period.

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Construction remains weak here, and employment in the government sector has actually declined, largely as a result of cuts in TVA activities. Trade and services are relatively strong, and manufacturing is doing well also. The transportation equipment industry has increased employment since last year. Even though the economic impact of GM's Saturn plant has not been up to original expectations, the demand at Nissan is great enough that the company is adding a new assembly line. Textiles and apparel producers are leading nondurables manufacturing to relatively strong growth as well. Finally, with abundant rainfall and increased plantings of grain and soybeans, agriculture should again be a positive force in Tennessee's economy. All told, the state should have a year of respectable growth, although I do not expect a return to the heady growth rate of a few years ago.

In summary, the region's growth rate, which had been better than the national average for much of this decade, will probably remain closer to that average in the year ahead. Florida will again lead the region in economic growth. Georgia and Tennessee will have respectable years but not up to the pace established through 1987. What would help Louisiana most in the short term would be a substantial increase in oil prices. (In the long run, of course, the state must diversify.) While OPEC's latest accord offered some promise of higher oil prices, these agreements seem to be far shakier in the 1980s than in the 1970s, and it is difficult to pin strong hopes on the success of this one. Nevertheless, a substantial upturn in energy prices would help Mississippi, too, and would benefit Alabama's producers of steel pipeline. Along with good foreign and domestic demand for steel and paper, better apparel sales are boosting industries that are important to these two states, and helping to offset weaknesses in construction-related industries.

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