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THE NATIONAL AND REGIONAL ECONOMIC OUTLOOK FOR 1989
By Robert P. Forrestal, President
Federal Reserve Bank of Atlanta
To the North Carolina Textile Manufacturers Association
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Good morning! I am pleased and honored by your invitation to address this annual meeting of one of the South's most important trade industries. Last year I had the privilege of speaking to your colleagues in the Georgia Textile Manufacturers Association, and I profited greatly from exchanging ideas with them as I already have with many of you. It goes without saying that the textile industry is of great importance to the economy of the six states of our Federal Reserve District and certainly to North Carolina. Textiles account for about twice as much employment in our region as in the rest of the nation, and along with the closely related apparel industry, provide some 40 percent of the manufacturing jobs in your state. By its decisive and forward-looking actions, moreover, the textile industry has also made itself more important to the entire nation in the past few years. It has done so through its exemplary performance in meeting the challenge of international competition. By heavily investing in capital improvements, particularly in new and more efficient machinery, you have demonstrated the correct strategy for adapting to today's changing environment.

I have been asked to give you my outlook for the national economy as well as for the region. Although it is a bit premature to give a detailed outlook for 1990 at this point, I will suggest in general terms how I think the economy will shape up in the year ahead while looking more closely at the results I expect for the current year. Let me begin with the outlook for the nation and then turn to the Southeast.

The National Outlook

For 1989 and on into 1990, 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 2.5 percent in the second and third quarters. I think that, on average, GNP growth will probably be just under 3 percent in 1989, slowing to just under 2 1/2 percent in 1990. As a result of this moderating pace of expansion, unemployment is likely to decline less dramatically than in the last two years. The jobless rate should hover around 5.2 percent for the remainder of 1989, as it did during the first six months, and perhaps fall nearer to 5 percent next year. Inflation, however, will average in the vicinity of 4 3/4 percent for 1989 and 4 1/2 percent in 1990. The burst of price pressures earlier this year almost assures us of inflation in the 4 3/4 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 because of its positive impact on price pressures, I want to emphasize that I am not at all comfortable with this level of inflation. 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, 4 1/2 percent inflation that at this rate, prices would double in about 16 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 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.

Turning to the factors underlying the outlook for economic activities, the continuing expansion in 1989 has been fueled by exports, investment, and consumption. Exports have brought the trade deficit lower again this year, and manufacturers will turn out more goods to meet foreign demand even though this process has now moderated somewhat. Although in recent weeks the dollar has risen above its levels of late 1988, it is still about 29 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. 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. These should do better than offices and retail facilities, which are overbuilt. 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 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 declined, 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.

In sum, the U.S. economy will no doubt chalk up a good grade for its performance in 1989, and next year's pace, while decelerating somewhat, should be quite respectable. 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 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

Turning to the Southeast, growth here 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 the past year.

Farmers in this part of the country did not fare as badly as their midwestern counterparts during last year's drought, and agricultural producers started the year in a good position. 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. The winding down of defense contracts and sluggish car sales have been negative factors for aircraft and some electronics and automobile plants in the region. 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 last year, 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. Your own 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 for weak residential construction. Underlying conditions suggest that this situation will persist 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 some older workers in other states, finding themselves in greater demand, elected 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 on the part of 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.

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, Louisiana 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. It is difficult to pin strong hopes on the success of this one, and, of course, I would not want to see much increase in energy because of the possible impact on prices in general. Along with good foreign and domestic demand for steel and paper, better apparel sales are boosting industries that are important to Mississippi and Alabama and helping to offset weaknesses in construction-related industries.

Conclusion

In conclusion, I expect the final numbers for this year to indicate solid, but not dramatic, growth in both the nation and the Southeast. A similar pattern seems to be in store for us in the year ahead as well. I think we should feel satisfied with this somewhat slower pace of business activity because it seems to be sustainable and should help ease the inflationary pressures that I consider to be a dark cloud on an otherwise bright horizon. As regards the textile industry, I feel the prospects remain good, and, assuming you maintain your leadership role in adapting to a changing marketplace, you should continue to do well for years to come.