

**THE ECONOMIC OUTLOOK FOR 1991**  
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**To the Camara de Comercio Latina de los Estados Unidos**  
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Good evening! I am pleased and honored to appear before the Camara de Comercio Latina de los Estados Unidos. As requested, I will present my outlook for the economy in this country and say a few words on the prospects for banking here as well. I would also like to speak a little about developments in Latin America. Two years ago I was privileged to talk to you about the international economy, and at that time I had to paint a rather gloomy picture of economic conditions among our neighbors to the South. Recently, however, the situation there has brightened considerably. While there is still much to be done in the region, I think the United States can begin thinking in terms of a return to healthy trade relations with Latin America somewhat sooner than we had earlier anticipated. I will share my thoughts on this topic in a moment; first, however, let me set the stage by explaining my outlook for the U.S. economy.

**The U.S. Outlook**

We all understand, of course, that any forecast today is subject to great uncertainty. Therefore, in considering prospects for growth in 1991, I must emphasize that my forecast depends on the price of oil. Regardless of how long the conflict in the Middle East lasts, the invasion of Kuwait has already brought us a significant adverse supply shock which has affected both prices and production. This fact has been evident in the weaker economic performance of recent months and has led to forecasts for slower growth in the year ahead. Lately we have seen

a drop in oil prices for several reasons. The fundamentals, especially greatly increased output from oil producers other than Iraq and Kuwait, suggest that current supply shortages are being met for the most part. Moreover, the market appears not to expect hostilities to interrupt supply. In the long run, however, there is a limit to the decline in prices because non-OPEC production is falling off, and growth in demand has been only temporarily slowed by the price shock. Thus, the situation in the Middle East continues to increase the uncertainty in the economic outlook for the year ahead.

With that caution in mind, let me give you just a few numbers. I look for growth in real gross national product (GNP) to average about 1/2 percent for the year. However, I think that we will see improvement in the second half of the year, and I believe that the recession will be over by the end of 1991. Since employment lags behind GNP, I think the unemployment rate will be slightly above 6 1/2 percent at year's end. I look for inflation to abate, however, and drop back to about 4 percent as an annual average.

Let me elaborate briefly on the sources of strengths and weaknesses that should bring about this sort of economic performance in the coming year. In the context of continuing pressures from the energy sector, I feel that the strongest sectors of the economy will be the personal consumption of services along with exports. Weaker sectors include construction, business investment, and other consumers' purchases, especially of durable goods. Government will likely be a positive factor on balance, although the scale of its contribution remains to be determined.

Among the strong points for the U.S. economy in the year ahead, the service sector, which represents half of all personal consumption expenditures, will certainly be respectable. Net exports should also remain a source of strength as Japan and several of our West European trading partners experience relatively strong expansion. So, the international trade sector should contribute to growth in spite of recessions in Canada and the United Kingdom. Underlying this anticipated growth are the Federal Reserve's earlier and recent easing moves which should make themselves felt over time and provide impetus to growth.

I am sure that you are all familiar with the weaknesses in the economy. The construction industry suffers from lingering excess supplies due to past overbuilding as well as hesitancy among many lenders to finance new projects. Again in 1991, as in 1990, the aging of the population should dampen the demand for first-time home purchases. Thus, the construction industry is not likely to provide support to growth in the year ahead. I believe, however, that the downturn in construction is probably near the bottom and that the industry is not as likely to exert as much of a drag this year. Consumption of durable and nondurable goods should likewise remain weak this year. In addition to this slump in consumer demand, many in the business sector are encountering tighter lending standards at many banks. Thus, it does not look as if capital spending by businesses on new plant, offices, or equipment will lend support to the economy.

The Gulf war's impact will probably make fiscal policy a positive factor in this year's economy. However, the degree of stimulus provided by government spending will depend upon

the length and intensity of fighting in the Persian Gulf--neither of which can be predicted at this point. In sum, I look for services and exports to lead economic growth in 1991 while construction, consumption of durable goods, and investment to remain weak.

### **Implications for the Banking Industry**

I would like to make just a few remarks about the implications of this outlook for the banking industry. The performance of commercial banks tends to reflect that of the general economy with something of a lag. My outlook for a fairly short recession and a return to moderate growth later in the year suggests that the banking industry is likely to follow a similar, though perhaps more gradual, course. One reason to expect a slower rebound in banking is that construction is one of the weaker points in my outlook, and many of the difficulties that banks have experienced have been related to that industry. Nonetheless, southeastern banks are, for the most part, adequately equipped to weather the current situation. They were relatively well capitalized when they entered this downturn, and they have also made strong efforts to address those problems that have occurred in their portfolios.

Looking farther ahead, I am hopeful that the Treasury Department's recently released proposal for restructuring U.S. banking will put us on the road to improving the industry's competitiveness during the coming year. In my view, we must strengthen our banking system in four fundamental ways. First, deposit insurance protection must be well defined and strictly limited in scope. Deposit insurance has allowed us to take the safety of our personal transaction balances for granted, and this has served well to prevent bank runs on solvent institutions.

However, the present system has frequently protected far more than just individual accounts and thus has inadvertently created incentives for excessive risk-taking. These incentives must be eliminated.

Second, capital levels need to be raised to increase incentives for prudent management. Third, we need a structural change in regulatory oversight capable of forcing institutions to take immediate steps, including liquidation when necessary, if their capital ratios fall below established thresholds. Policies must be designed so that prompt corrective action and sufficient capital cushions minimize the costs of the collapse and liquidation of the largest banks. This expectation should be enforced in ways that prevent the possibility of a contagious loss of confidence in the financial system. Fourth, after bolstering banks' capital and reducing the deposit insurance subsidy, we should allow a general expansion of bank powers. If policymakers can address this range of concerns, I believe U.S. banks will be better suited to handle future cyclical swings in our own economy as well as the competition posed by foreign institutions in the expanding global market.

### **Prospects for Trade with Latin America**

Just as international considerations are helping push us toward serious efforts at banking reform, the globalization of markets for goods and services is also likely to spur us to further consolidation of trade arrangements in this hemisphere during the year ahead. I would like to conclude my remarks this evening with a few thoughts on the importance of Latin America in that process. Although they have been overshadowed by the Gulf War, several major initiatives

have begun over the past eight months that point toward the emergence of a new economic order in this part of the world. The broadest of these proposals was the "Enterprise for the Americas" concept advanced by the Bush administration last June. This plan would provide opportunities to reduce some of the official debt owed to the United States, suggest steps for liberalizing Latin American-U.S. trade flows, and encourage domestic and foreign investment in the region. A few months later, Mexico and the United States announced they would begin negotiations toward a bilateral free trade agreement. And two weeks ago, Canada agreed to join in three-way conversations on free trade with its North American neighbors.

Why have we seen so many of these developments in so brief a period of time? Clearly the globalization of world markets for goods and services is a powerful stimulus for liberalizing trade flows wherever that is possible. It becomes increasingly obvious with each day that capital markets are continually steering resources toward their most efficient uses without regard for geography. "Country of origin" is becoming an increasingly irrelevant concept in a market where, for example, automobiles bearing U.S. brand-names can be assembled in Canada with parts from Japan, Germany, and several other countries. Under such circumstances, the labor resources of Latin America and the capital resources of the United States and Canada represent a "natural" fit that could substantially enhance trade among our countries. This is particularly urgent in light of the capital and labor matches that are already being developed by Japanese firms in less industrialized countries of Asia as well as between Western and Eastern Europe.

It must remain our ultimate objective to work out multilateral trade agreements in the



broadest possible manner. However, closer trade relations among neighboring countries can serve as "pilots" to work out solutions to the complex issues like agricultural and intellectual properties which prove so difficult to resolve among a larger group of nations. Indeed, I feel these efforts, when they aim toward the same ultimate objectives as the GATT, can contribute toward greater openness in worldwide trade as well. The Free Trade Agreement signed by the United States and Canada two years ago, for example, eliminates trade restrictions over time and also sets up mechanisms for resolving any future disputes through bilateral commissions. In this way, the agreement focuses on opening channels for the exchange of goods and ideas. To me, the U.S.-Canadian accord--and, for that matter, the continuing negotiations among the nations of the European Community--have been model programs that help demonstrate the value of free trade. Their initial successes point the way toward new agreements like the one Mexico and the United States are considering. Beyond that, I believe they also strengthen the arguments for dropping barriers among a broader range of countries such as the 95 GATT signatories.

Another reason for greater enthusiasm about hemispheric trade at this point is the steps Latin American countries have taken to make their economies more compatible with those of potential trading partners. Mexico stands out for its efforts to bring down inflation, restore fiscal discipline, privatize its industries, and dismantle protectionist barriers. In addition, throughout the region, military regimes have been replaced by elected governments and dramatic economic reforms have begun. Such economic and political changes are of no less importance than the developments taking place in Eastern Europe, even though they have attracted less of the world's attention.

Of course, there are still great obstacles to be overcome. In particular, we cannot underestimate the difficulty of resolving the debt issue. Reduction of official debt is a feature of the "Enterprise for the Americas" package, but, as you know, this addresses only a small portion of this huge liability. Unfortunately, the U.S. government--with its own large budget deficit--does not have much flexibility. Debt-for-equity swaps are also valuable tools, but they cannot be expected to solve the entire problem. We still need to apply a good deal of creativity and resourcefulness to working out this complex problem.

## Conclusion

In conclusion, although this year has begun with war and economic difficulties, I am optimistic that by the end of the year the nation's economy can return to moderate growth. Likewise, I think the banking industry is moving toward better performance, though its path may lag behind that of the overall economy somewhat. In addition, I look forward to this year as a period that will bring lively discussion of the banking reforms we have needed for so long and, perhaps, the beginning of a new era of competitive strength in U.S. banking. I hope we are also on the threshold of a new era in Western Hemisphere trade relations. We must seize the momentum for change that is gathering force in Latin America and aim for greater integration of our economic resources through free trade. By working together, the members of the American community--North, Central, and South--can enhance their positions in the global market and raise the living standards of all their people. Finally, I congratulate the Camara de Comercio Latina de los Estados Unidos for your important contributions to this historic effort.