

ECONOMIC OUTLOOK FOR THE UNITED STATES AND THE SOUTHEAST
Remarks by Robert P. Forrestal, President
Federal Reserve Bank of Atlanta
To the Birmingham Rotary Club
Birmingham, Alabama
November 27, 1991

I am pleased by your invitation to address the Birmingham Rotary Club. I have been asked to give my thoughts on the direction of the U.S. economy. In doing so, I will focus on the national and regional economic outlooks. At the end of my remarks, I would like to talk briefly about the importance of taking a longer-term view of economic performance as we move toward a new year.

U.S. Economic Forecast

As we look at current economic conditions, I have to acknowledge that these conditions are unsettled, and the signals remain mixed. In this environment of economic difficulties, it is understandable that consumer confidence has been shaken. Notwithstanding some of the current bad news like the recent fluctuations in the stock market, I believe recovery has begun and will build momentum gradually. No one can guarantee this result, of course, but it seems likelier than other scenarios. Although business activity has been slow to pick up pace, I must point out that this recession was certainly milder than earlier ones: The unemployment rate rose to 10.8 percent in the last two months of 1982, and it remained high, by historical standards, during the expansion of the mid-1980s. In contrast, I believe the jobless rate has peaked at 6.8 percent in October this year. Thus, we must keep some perspective on the relative depth of the downturn from which we are rebuilding, even though the recovery seems slow in coming.

What does this recovery translate into in terms of numbers? In 1992, I look for positive growth--albeit modest for a recovery--of 2 to 2 1/2 percent on average. One reason for this turnaround is the easing moves the Federal Reserve has taken over the past year or so. We have already seen some reactions to this easing, in the rise of bond issuance and the lowering of the prime rate, for example, and the effects of this monetary stimulus will continue for some time.

Since employment lags behind GNP, I think the unemployment rate will take a little longer to fall, holding at 6.8 percent through the end of this year, but declining slightly to 6.3 percent by the end of 1992. The consumer price index (CPI) has abated from last year's nearly 5 1/2 percent rate, and price pressures look more moderate than they have in some time. The CPI could drop back to near 4 percent as an annual average in 1991 and turn out between 3 1/2 and 4 percent in 1992.

Strengths and Weaknesses

To elaborate briefly on the sources of strength and weakness underlying my outlook, let me discuss some of the major sectors of the economy. The forces supporting growth should be inventory rebuilding in the near term and exports and personal consumption of services over the longer term. Although businesses held smaller inventories in this recession compared to the last one, they are now beginning to move from cutting inventories to rebuilding them. This behavior has boosted industrial production as businesses place orders with manufacturers. That means the economy has received a bump up in the current quarter. However, looking farther ahead, this stock replenishment will be modest compared to what it has been in previous recoveries. As

businesses rebuild their inventories and become comfortable with those levels, their rebuilding will enter a slower phase.

Net exports should also remain a source of support as our external position as a nation--with the exception of our dependence on foreign energy resources--continues to improve. The deficit in our net exports that was more than \$160 billion in the mid-1980s will improve very slowly in the near future. The particular good news is that we are exporting more manufactured goods as we are decreasing our oil imports, although our dependence on oil imports will continue to be the largest factor in our trade deficit.

Personal consumption of services, such as health care, continues to be steady--low but steady. Since personal income figures are holding up, it seems unlikely that consumption expenditures will fall off precipitously. It is true that consumers continue to be cautious with their purchases, but under these circumstances, the economy can still grow slowly. The other aspect to be considered, though, is that the service sector itself appears weak compared with its performance in the past decade. The rapid employment growth in the last several decades has left a number of service industries with fat to be trimmed. Many have been going through a period of consolidation, resulting in furloughs and other cost-cutting measures. Nowhere is this trend more apparent than in banking, though airlines, retailing, communication, and other services have also felt the effects.

I am sure that you are all familiar with the weaknesses in our economy. The construction

industry suffers from lingering excess supplies due to past overbuilding as well as hesitancy among many lenders to finance new projects. Demographics are also contributing to the sluggish housing market. The aging of the population means that there are not as many first-time home buyers as there were when we came out of the last recession in 1982. Residential construction, especially of single-family dwellings, is undergoing a modest rebound, but existing home sales have been relatively weak. Also, apartments and condominiums are overbuilt, and so recovery in multifamily construction is not on the horizon. All in all, there is no reason to expect that a housing rebound will help to pull the economy out of the recession, as typically has occurred in the past. Besides the adverse demographics, we had eight years of expansion in which housing demand was well met. That means very little pent-up demand developed during the recession. In addition, office building and other commercial construction will probably continue to decline for another year or more, though the rate of decline should diminish markedly next year. Overall, construction will be less of a drag on growth for the remainder of this year, but it will not lend momentum to the economy until sometime in 1992.

In addition to lingering weaknesses in construction, consumer demand for durable goods remains soft. There are several reasons for this. Personal income growth has been slow. Demographics are a factor as well. Fewer new households than a decade ago translate into fewer purchases of new household appliances, for example. Weakness in construction is exacerbating this pattern, since expenditures for furniture and other consumer durables tend to rise with growth in family formation and home sales. In addition, the driving-age population is growing less rapidly, and this trend has caused auto demand to level off well below that of the 1980s.

In sum, I look for consumption and exports to lead economic growth over the coming year and a half. Commercial real estate construction will remain weak for the rest of this year and on into 1992, as will capital spending by businesses and personal consumption of durable goods. Housing should show growth in coming quarters, but it will be below average for recent recoveries. Starts will rise only modestly, due mainly to the effect of much slower population growth.

Outlook for the Southeast

In the Southeast, the story of the recession and recovery I have to tell is similar to the one I have outlined for the nation. And that in itself is a new story, because during downturns and recoveries over the past two decades, this region has tended to do better than the United States as a whole. During this recession, though, the Southeast seems to have done a little worse. Unemployment rates in the region are generally higher than in the rest of the nation, and noticeably so in Florida and Mississippi. Since last September, employment has declined in the region at a slightly faster rate than in the nation. In addition, the two biggest states in terms of population, Georgia and Florida, are the worst performers in this 1991 recession, after having barely noticed the 1982 recession.

There are at least four reasons why the Southeast did not outpace the nation during this recession. First, as I mentioned earlier, exports have been an area of strength for the national economy, but this region exports proportionately less than the nation as a whole. Furthermore, most exports from the Southeast are commodities, such as chemicals and forest products, which

tend to have narrower profit margins than high value-added products like machine tools.

Second, the structure of the southeastern economy made it quite sensitive to the current business cycle. For example, the lumber and textile industries account for a larger-than-average share of southeastern manufacturing. Both industries are extremely dependent on construction--builders need lumber to build, and new homeowners need textiles in the form of carpets, upholstery, and drapes to outfit their houses. However, as I have pointed out, construction activity is down sharply in both the region and the nation. Similarly, changing demographics and shaky consumer confidence have reduced the demand for apparel--still the leading southeastern industry in terms of jobs. These dynamics are having an even bigger effect on purchases of consumer durables like cars and appliances--industries whose relative importance is growing in the Southeast. Additionally, defense cuts certainly have not helped the electrical equipment industry, which is also one of the largest employers in the region.

The third reason for the region's comparatively poor performance is related to the fact that, for much of its growth, the Southeast--especially Florida and Georgia--has depended on immigration. Traditionally, retirees and adults in their 20s and 30s have made up the two streams of people moving into the region. In the past, retirees have moved mainly to Florida, but the poor national economy has slowed this flow. In particular, weakened economic conditions in the Northeast have made it quite difficult for everyone to sell their homes and doing so is a prerequisite for most retirees wishing to relocate. The other stream consisted of working-age people in their 20s and 30s who were more likely to move to find a job. More people moving

into the area boosted the need for many service-sector jobs--in hospitals, restaurants, shopping centers, and wholesale distribution, for example. However, now that members of the large baby-boom generation are aging, they are getting beyond their peak moving years. At the same time, there are fewer 20- and 30-year-olds entering the work force. With a smaller segment of the population in the age bracket that has the highest propensity to move, Florida and Georgia are being hit out of proportion to the rest of the Southeast.

Finally, rapid growth in the 1980s, especially in Florida, Georgia, and other areas like Nashville, generated excessive real estate development and growth in the labor pool. Now, there is too much office and retail space that cannot be absorbed and too many people in the job market. These excesses continue to affect those areas that expanded rapidly in the 1980s. Slow growth in the 1990s will make it difficult to work out of the situation.

What this all means is that as we move out of the recession, the Southeast should see a slower growth rate--but one that mirrors that of the nation. As the U.S. economy recovers and expands, the Southeast will certainly continue to grow but at a more moderate rate than the region experienced in the 1970s and 1980s. This disparity will be most noticeable in Florida and Georgia. Traditionally slower-growing states like Alabama and Mississippi will reap a benefit from not having had excessive growth in recent years. Louisiana, which had been suffering from its own oil-related recession, did not have far to fall. The recoveries in these states will, therefore, start earlier and perhaps be a bit stronger--at least in the early stages--because they have fewer imbalances to address.

Several indicators suggest that recovery is under way in the Southeast. Initial unemployment claims have been declining for two or three quarters in each state except Florida. The number of single-family housing permits has been increasing. Although these are encouraging indicators, I foresee modest expansion on the horizon. Easy growth is a thing of the past.

Taking a Longer-Term View of the Economy

As you can see from my remarks, I believe the economy--at both the national and regional levels--is heading in the right direction. It simply is not progressing as quickly as we have all been accustomed to in the recent past. As a policymaker, it is my duty to look well into the future. Policymakers take a long-term view to ensure that policy does not change rapidly, thereby introducing uncertainty into economic decision-making. From this long-term perspective, it behooves me to tell you that slow growth will be with us for some time. If business people and consumers continue to look for a sharp rebound from the recession, they are sure to remain disappointed.

The modest recovery I foresee could make business conditions "feel" rather anemic. In essence, a slow turnaround does not seem different from a slow decline to those of you who have been waiting impatiently for a rebound. Builders, retailers, and some manufacturers are unhappy with the prospects for economic growth. This 2 percent rate of growth does not compare with the boom that typically occurs after a recession. However, this pace of business activity is congruent with our low productivity growth and our low savings rate, compared with those of

our major competitors in the global marketplace. In addition, changing demographics are working against a more rapid growth rate, as are the huge federal budget deficits that have effectively prevented the use of fiscal policy to stimulate the economy.

But no matter how anemic the recovery may feel to many business people, there are limits to what macro-policy can do about these underlying long-term factors. Unduly accommodative monetary policy could merely reverse the important gains the Fed has made in restraining inflation over the last few years. Likewise, tax cuts, if not offset by expenditure cuts, would undermine the legislative framework we have so carefully constructed to rein in federal budget deficits. All of us must support sustained deficit reduction, if we are truly committed to higher savings and productivity over time.

Conclusion

In conclusion, I believe that the U.S. economy has begun its recovery from the recession. I do not, however, expect improvement to be dramatic, in part as a result of long-term demographic trends that are moderating the nation's consumption patterns. Instead, we should return to modest growth that, while not as robust as that to which we had become accustomed in the 1980s, should nonetheless prove sustainable. This expansion ought to give us the much-needed breathing space to make the kind of adjustments that will help to make our economy work better in the long run.