THE OUTLOOK FOR THE UNITED STATES AND THE SOUTHEAST IN 1992

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It is both a pleasure and a challenge to stand before this group at the beginning of each year to give my view of where the economy is heading--particularly since some of you diligently keep score of my forecast and like to remind me of my hits and misses. Let me first acknowledge what all of us know: that 1991 was a tough year for the U.S. economy. Even though the recession was mild by historical standards and some economic signs suggest that recovery has been under way, many businesses, consumers, and lawmakers seem unwilling to believe this. Confidence is quite low, and there is a widespread sense of disappointment. Many people, especially after the Gulf War, had high expectations for a strong recovery based on memories of rebounds in the early 1980s and the 1970s. Unfortunately, the U.S. economy will not be able to return to the more rapid growth to which we have become accustomed, at least for the foreseeable future.

In my remarks today, I would like to focus attention on the change in growth prospects. I am not going to dwell on the reasons we are undergoing a transition from rapid growth to slower growth. Rather, I want to concentrate on the need for Americans to change their attitudes about growth in a fundamental way. I am not just talking about adjusting to less rapid growth, but more basically, about learning to stop supporting schemes that spur growth only in the short term. Instead, as a society, we must learn to evaluate alternative patterns of growth in terms of their ability to sustain expansion over the long term. Before I discuss this vital issue, let me first

review the forecast I gave for 1991, followed by the economic outlook for 1992 both for the nation and the Southeast.

Last Year's Performance Scorecard and the National Outlook

The recession, which probably began in July 1990 before the Persian Gulf crisis, lasted longer than I--and many others--had expected. Therefore, even though I forecast only marginal growth in real gross national product (GNP) of 1/2 percent on average for 1991, the final figures will probably show that GNP instead contracted by around 1/2 percent, on an annual average basis. This would be the first year since 1982 that the U.S. economy has not expanded. The duration of the recession also affected the unemployment rate, which should end the year around 6.8 percent, somewhat above the 6 1/2 percent rate that I projected. With this low growth rate, quite logically, inflation has proven milder than expected. The Consumer Price Index (CPI) averaged a little under 4 1/2 percent, about 1/2 a percentage point lower than I said it would.

Turning to the outlook for this year, I look for the economy to grow at a moderate pace of around 2 percent. Since employment lags behind GNP and many businesses are consolidating, I think the jobless rate will remain pretty much unchanged. Price pressures look more moderate than they have in some time, and the consumer price index (CPI) should turn out to be 3 percent or a bit higher as an annual average in 1992.

Strengths and Weaknesses

Generally, the pace of business activity will accelerate gradually as current problems are worked through and more household and corporate income becomes available for spending. Of

course, progress will not be even across the economy. To elaborate briefly on the sources of strength and weakness underlying this outlook, let me discuss some of the major sectors of the economy. The forces supporting growth should be exports and consumer spending, particularly on services. Net exports should continue to be a source of some support as our external position continues to improve, but the pace of expansion will be slower than in the last few years. Many of our major trading partners have begun to grow more slowly. Also, we remain heavily dependent on foreign oil.

Personal income growth has been slow but steady, lending support to growth in consumer spending, especially for services. The service sector is a major part of business activity, making up over half of total household spending. While it is true that consumers continue to be cautious with their purchases, even under these circumstances the economy can still grow slowly.

It is easy to lose sight of this somewhat optimistic outlook for growth in demand for services because, on the supply side, the service sector appears weak compared with its performance in the past decade. The rapid growth in the last several decades was accompanied by even more rapid employment growth, and this disparity 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. This trend is very apparent in banking, although airlines, retailing, communication, and other services have also felt the effects. Nonetheless, consumer spending, especially for services, should lend modest support to the recovery.

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 appropriate 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. Besides the adverse demographics, we had eight years of expansion in which housing demand was very well met. That means very little pent-up demand developed during the recession. However, residential construction did pick up last spring and may show further improvement in the months ahead. Apartments and condominiums are quite overbuilt, but the rate of decline should narrow markedly. All in all, there is no reason to expect that a housing rebound will contribute much to the recovery, as typically has occurred in the past. Overall, though, construction will be less of a drag on growth in 1992.

Office building and other commercial construction will probably continue to decline for another year or more, though the rate of decline should diminish next year. Other capital spending by businesses--on new equipment, for example, likewise is unlikely to improve much until the slack in currently unused capacity is taken up.

In addition to lingering weaknesses in construction, consumer demand for durable goods remains poor. Aside from the slow pace of income growth, demographics are again a major factor. Fewer new households 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. This trend, along with the fact that cars are better built and last longer, has caused auto demand to level off well below that of the 1980s.

In sum, I look for exports and consumption of services to lead economic growth over the coming year. Housing should show growth in coming quarters, but it will be below average for recent recoveries. Commercial real estate construction will remain weak, as will capital spending by businesses and personal consumption of durable goods.

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. That in itself is a new story because during downturns and recoveries over the past 15 years this region has tended to do better than the United States as a whole. The two biggest states in terms of population, Georgia and Florida, were the worst performers in the 1990-91 recession after having barely noticed the 1981-82 downturn. Florida's unemployment rate has remained well above the national average for some time. Generally, employment has declined in the Southeast by about the same margin as in the nation, with a slight lag.

One factor that stalled the region's performance in this recession is its industrial composition. Except for paper and chemicals, exports represent a relatively small share of the

region's manufacturing base. Exports have been critical in dampening the recession nationally and they will be a major source of support in 1992. Instead of exports, many of the region's major industries, which are based on low labor costs, are fighting a battle against developing countries that can offer even lower wages and other costs. In addition to the region's industry mix, the Southeast's faster-than-average growth in recent years actually is working against prospects for robust recovery. This rapid growth attracted a good deal of real estate speculation. Consequently, there are daunting construction-related imbalances yet to be resolved. The region's service sector, likewise fueled by very brisk growth in the '80s, is undergoing the same kind of consolidation that is occurring nationwide. Thus, the region has many of the same weaknesses as the U.S. economy but fewer strengths.

Longer-term, the region will remain a more attractive place to do business than other areas like California that have become very expensive. We continue to see consolidating firms relocating to the Southeast. In 1992, however, the imbalances may dominate. As the U.S. economy recovers and expands, the Southeast should see slow improvement--paralleling the nation but at a more moderate rate than the region experienced in the 1970s and 1980s. Tennessee will probably track the nation quite closely. Florida and Georgia may lag behind in 1992 because the imbalances there are much greater. 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 in the mid- to late-1980s, did not have far to fall. The recoveries in these three states will, therefore, start earlier and perhaps be a bit stronger--at least in the early stages--because there are fewer imbalances to

overcome.

Looking Ahead to Our Long-Term Future

Having reviewed the outlook for the nation and the region, at this point it has been my custom to discuss two or three major issues facing the nation in the year ahead. This year, though, I would like to concentrate on the single issue I mentioned at the beginning of my remarks, namely, the importance of changing our attitudes about growth. As I noted, there is widespread disappointment with the slow pace of recovery and a growing sense of urgency that something be done to quicken this pace or to "jump start" the economy. The danger is, of course, that policymakers will be pressured into a "quick fix"--one that will spur growth for a year or two only to create new imbalances that will have to be corrected through yet another transition similar to the one banking, real estate, and many service industries have been experiencing.

Why is it that Americans have such impatience in this recovery when the last recession was so much more severe in terms of the contraction in GNP and the toll on employment? (You may recall that the jobless rate was 10.8 percent in November 1982 compared with 6.8 percent in this recession. Moreover, the unemployment rate remained high well into the expansion. As late as 1986, 7 percent of the work force was still unemployed, on an annual average basis.) As I see it, the main reason for the current disappointment is that many people have confused cyclical economic problems with imbalances that stem from longer-term, secular adjustments that need to play out in order to be resolved. These include consolidation in the service sector and

excessive borrowing--by consumers, businesses, and the government. They also ignore fundamental demographic changes that alter aggregate demand for many products in a profound way. Having confused the problem, they seek the wrong solution.

Much of the current slow pace in the recovery arises from the complex transition businesses and households are having to make from the effects of fiscal policies during the 1980s. Fiscal policy produced unsustainably fast growth in several ways: a large defense build-up, tax reforms that encouraged excessive real estate development, and, more generally, the ongoing stimulus of large federal budget deficits. In enacting the 1986 Tax Reform Act, Congress recognized that real estate development was creating too much space and that federal budget deficits were growing out of control. Of course, removing the tax advantages from real estate generated considerable dislocations. Nonetheless, the artificial stimulus had to be removed. Otherwise, the ultimate imbalance between supply and demand would have been much larger and the resulting adjustment even more painful and attenuated.

More generally, the U.S. economy is going through a period of adjustment, working through the consequences of past decisions that engendered short-term, unsustainable growth through borrowing. In the 1980s we tried to create fast growth through fiscal stimulus. Although there was much talk about investment-led growth and there was a lot of capital spending in real estate, the nation neglected other important kinds of investment, more public in nature, that are equally important. There were many initiatives in education, for example, but we lacked the staying power as a society to see these through. We are now seeing alarming

cuts in educational expenditures, affecting the very basics of the curriculum, in some states. Likewise, we failed to come to terms with health care, the other primary form of human capital investment, instead transferring this issue largely to the private sector, as I mentioned.

Throughout the '80s, rather than investing, we consumed more than we produced. Now we are beginning to service that debt, much of which is owed to foreigners since, as a nation, we lacked the savings domestically to meet all our demand for financing. To support that debt service, we are exporting a large share of our output; that is, what we are sending abroad for others to use is growing faster than the growth in what we are consuming domestically. We are producing more, so to speak, but enjoying less.

This important insight, I believe, goes to the heart of the current malaise regarding the economy. Economic statistics like GNP reflect only what we produce, not what economists call "welfare," that is, our sense of well-being. In the past, growth in output was generally translated into growth in domestic consumption, but that is not happening now because of the debt service burden. This burden is also limiting our capacity to grow, as does slower population growth since labor is perhaps the most important factor of production.

Clearly, long-term dynamics are constraining U.S. prospects for expansion relative to the fiscally induced growth of the 1980s and to the 1970s when the baby-boom generation was entering the work force in huge numbers. What, if anything, should be done to address popular dissatisfaction? First, I think we must cultivate some patience with cyclical policy measures.

Countercyclical fiscal policy was not implemented in the recent recession, and rightly so, because of the huge federal budget deficits that must be contained and reduced. However, monetary policy has been at work. Credit growth at banks is weak, but interest rates have come down substantially and corporate bond issuance is up, largely as a result of the Federal Reserve's easing moves over the past year or so. This accommodative monetary policy will continue to yield effects for many months in the future. The Fed will certainly be attentive to the economic situation. However, we must be careful not to squander the hard-won gains against inflation by pushing the economy onto a growth path that is too rapid to be sustained.

Second, as Americans look for policy measures that promote growth, we must be careful to select those that do not just yield a payoff in the next year or two but rather measures that foster sustainable growth. The corollary to this shift in thinking from short-term to long-term growth is that we must become more willing as a nation to grapple head-on with difficult challenges. We must start making hard choices about devoting resources to solve problems that in the past we tried to solve largely through growth itself. For example, we must begin to deal directly with difficult socio-economic issues such as affordable housing, health care, and education. We have simply not addressed these issues on the societal level, but rather have relied on growth itself to make the problems go away. However, many problems--poverty, for one--persisted despite the rapid growth of the 1980s. Moreover, in recent years, as fiscal policy has lost all latitude, government began to privatize social issues such as medical care. These costs are increasingly being passed on to employers. Unless we begin to debate these problems as a society, this strategy of avoidance will simply make U.S. businesses less competitive in the

global marketplace.

Other countries are showing considerable discipline in hewing to a longer-term growth strategy. West Germany has decided to accept slower growth in the short term in order to integrate the economy of East Germany. European countries are looking to raise their performance in a sustained way by integrating economically through the EC 1992 agenda, even though economic integration on such a large scale involves a good deal of sacrifice on the parts of the governments and the people of the various EC countries. For one thing, by integrating their economies and eventually using one currency, the different national governments are giving up a certain degree of autonomy in their monetary policies.

We need not look only at industrial countries to find examples of such future-oriented leadership. Developing countries in Latin America and Africa are making basic changes in their economies. More recently, leaders in Poland and other eastern bloc countries have also been won over to the precepts of a market economy. They are now working through the uncomfortable consequences of stabilizing their currencies, privatizing their industries, and revamping their infrastructure of intermediaries--finance, transportation, distribution, and so on--before they can begin to reap the benefits of a market system.

In view of what is going on elsewhere in the world, the United States may be falling behind in global competition. Unless we, too, make some tough decisions soon, we will be unprepared to compete in the global marketplace. To get tough with ourselves, we must be

willing to reorder our priorities, realizing that whatever we target for investment--be it education, health, or infrastructure--will not yield as quick a payoff as building another high-rise office building did in the '80s, for example. Yet, we can be secure in the knowledge that we will have improved the prospects of our nation for the future.

Conclusion

The kind of transition in thinking that Americans--including business executives, consumers, taxpayers, voters, and lawmakers--must undertake is certainly not easy. Nor is it easy for those who are unemployed or facing difficult business problems to be patient and work through the present transition, allowing the policy medicine that has already been administered to work its way into the bloodstream. Nonetheless, my fervent hope is that we can transmute this time of questioning and change into a serious discussion of our long-term goals and how we should achieve them.

It is becoming more critical every day that Americans change our expectations to bring them more in line with a mature economy that may grow more slowly yet steadily over time. I believe we have the sense to know that something must change in the way we view our situation. I only hope that we will also have the will to encourage our elected leaders and policymakers to translate our desires into economic policies truly in line with the needs of the future.