

THE ECONOMIC OUTLOOK FOR THE SOUTHEAST

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I am pleased to be here tonight to speak with you about the economic outlook for the Southeast region. Before I turn to my outlook, let me first say that these are interesting times to be a citizen of the United States. At long last, both the people and our political leaders seem to be coming around to a point of view that the Federal Reserve has been voicing for some time--that is, that something must be done about the huge federal deficits that significantly hamper our long-term capacity to grow. As anyone who has ever overused a credit card or taken on excessive debt knows, paying down such debt involves some pain. The similar circumstance of our nation means that it will be painful to cut the deficits and eventually begin to pay down the national debt. But I am heartened by what seems to be a new attitude about changing our ways and returning to sound fiscal habits as a nation.

The U.S. Economy

Now, looking ahead in 1993, let me briefly discuss U.S. economic prospects to provide a context for the Southeast outlook. I expect the overall economy to do better than it did last year when gross domestic product, or GDP, expanded by around 2 percent. This year, total output will expand, on an annual average basis, by close to 3.5 percent. The unemployment rate should average a bit less than 7 percent--compared with 7.4 percent last year. Indeed, employment clearly began to grow in 1992 after shrinking the year before. Inflation, as measured by the

consumer price index, may creep slightly higher than the 3 percent level of last year, up to perhaps 3.4 percent on average.

The main sources of strength underlying the U.S. economy as it moves forward into an expansion phase will be consumer spending (particularly on durables), residential construction, and capital investments by businesses, especially on computers and other equipment. Lower interest rates are a factor in all of these areas. First of all, they have enabled households and businesses to restructure their balance sheets. Consumer debt service as a percent of income, for example, has fallen to levels not seen since 1986. As a result, households are in a better position to purchase goods that are typically financed with credit, and the cost of doing this is much lower than before. Moreover, there is pent-up demand in that durables simply wore out during the period of slow growth. Since the decline in interest rates over the last few years has enabled many households to adjust their debt levels and with employment likely to remain on an upward trend, these purchases are now more affordable--even at moderate rates of income growth.

At the same time, however, the aging evident in most of our population, despite the recent uptick in births, will constrain any jump in demand for either housing or consumer durables. Fortunately, or unfortunately, as the case may be, the impacts of demographics are fairly predictable. The numbers of people reaching certain age groups, aside from infancy, can be readily predicted. Thus, it seems certain that demand for cars, household appliances, and the like will not rebound as sharply as it did during other post-recession expansions in the past two

decades. This population trend will also delay the turnaround in construction of multifamily housing in most cases, a sector that remains overbuilt. While there are still too many apartments and condominiums on the market, the good news is that this component of the construction industry may be approaching its lowest point.

The proposals to reduce the deficit made by the President have not caused me to make any major changes in my overall economic outlook for the nation. However, they do make some areas of the outlook less certain. For instance, spending may shift among the consumer, government, and investment categories. Generally speaking, though, while the new fiscal policy should have an impact on the economy, significant effects probably will not be felt in 1993.

Southeastern Outlook

Turning to the Southeast, I am pleased to say that the outlook for 1993 is brighter than it has been in several years, so bright that the region should also outpace the nation. In the area of employment growth, the Southeast has been ahead of the nation. During 1992 the region added nearly 300,000 new jobs. This figure represents more than a 2 percent growth rate, which is at least twice the national gain. On an average annual basis, the Southeast could add more than 400,000 jobs this year to the economy, which is certainly not bad. As good as that number sounds, it also shows, though, how moderate this rebound is. During the 1984 recovery, by contrast, the Southeast added around 700,000 jobs--and it did so from a smaller base.

Why will the Southeast do better than the nation? The main reason is that this region

produces the goods that people have been buying once the recession ended and the recovery began. Apparel, for instance, began to pick up early on. More recently, as interest rates have come down, more people have been able to purchase homes thanks to lower mortgage rates. Fortuitously, the Southeast is a major nationwide supplier of lumber used in residential construction. Additionally, because southeastern lumber producers have been treating timber as a cultivated crop for decades, they stand to benefit from environmental restrictions in the Northwest through the 1990s.

In addition to lumber, the large textile industry in the Southeast tends to fare well when the residential building industry is doing well since many textile products are turned into carpets, draperies, and other home furnishings. Several southeastern states are important producers of home appliances, like air conditioners and stoves. Not only will national demand for these products expand in 1993, but regional demand will also receive a temporary boost, namely, the rebuilding going on in south Florida and Louisiana as a result of Hurricane Andrew. A spending surge on building materials and related household goods in southern Florida and Louisiana should persist through most of the year. Although localized, this stimulus is likely to be large enough to boost regional sales to well above 1992 levels and comfortably above the expected national pace. However, the stimulus from Hurricane Andrew will peak in the second half of the year as insurance proceeds are exhausted. When hurricane-related construction slows after midyear, spending generated by rebuilding in Florida and Louisiana will begin to fade, in turn causing overall consumer spending gains in the region to decelerate.

Aside from construction-related spending, the expected nationwide increase in demand for consumer durables is good news for the numerous auto and auto-related manufacturers in the Southeast. Textiles mills should also gain from this development since many textile products are destined for automobiles. On balance, regional manufacturing should lend strength to the economy of the Southeast.

Another sector contributing strength to the expansion regionally is construction, which is likely to continue the growth begun in 1991. Most building activity will be concentrated in single-family housing, as in the nation. For example, permits for single-family homes were up more than 25 percent in the last quarter of 1992, which was double the national pace. Part of the reason for this increase is the fact that many young home-buying people live in or have moved to this region of the country. While apartment and condominium building will remain weak, the long slide in multifamily and nonresidential construction appears to be nearly over.

There are, to be sure, certain areas of weakness. Industries that specialize in nondurable goods, most prominently apparel, will contribute less than they did during the recovery period. These producers began to experience weaker demand by the end of last year. In the longer term, apparel producers face increasing competition from countries where unskilled and semi-skilled workers are willing to work for less. Moreover, there are other areas of potential weaknesses. The region is not a major capital goods producer, and so the expected strength in capital spending by businesses on equipment will be less of an advantage. It also remains to be seen whether the trend toward consolidation and layoffs in banking, communication, transportation,

and other professional and business services has hit bottom. This dynamic has been a blow to several large southeastern cities, just as it has been nationally.

The decline in defense spending nationally will have an adverse impact on the Southeast. For the most part, though, defense-related manufacturing is less important in this region than in areas like the Northeast and the Far West. While the region depends less on defense contracting than other parts of the nation, the Southeast does have a greater proportion of military personnel. Therefore, the proposed military base closures will affect this region through job losses. As matters stand now, the Southeast, which has just over 13 percent of the jobs in the United States, will take close to 30 percent of the layoffs in the nation--about 25,000 jobs. Not all the states are losers, though. Georgia will actually gain nearly 5,000 jobs.

In the government sector, several states are currently considering some form of revenue enhancement and budgets have certainly been tight. However, the problems generally have not been as significant as those found elsewhere in the nation. On the whole, the Southeast is also comparatively less hampered by state and local government budget problems.

State by State Outlook

Turning to the outlook for specific states, Georgia, Tennessee, and Florida have more growth potential in 1993 than the other states of the region. By the end of 1992, both Georgia and Tennessee were exhibiting well-entrenched and relatively balanced, moderate economic recoveries. Georgia seems to be back on a favorable track after having absorbed several

significant negative economic shocks over the past four years, but it faces some drag from the shrinkage in airline payrolls. Tennessee is experiencing employment gains in manufacturing, especially in auto-related industries. Both states should grow moderately faster than the nation. Florida, the most populous state in the region, has lagged behind the region in recovery. It began to show signs of doing better in late 1992. Despite the effects of defense cuts on manufacturers in Florida, improved tourism, exports to Latin America, and rebuilding from Hurricane Andrew will probably be enough to put its growth on par with growth in the region in 1993.

Mississippi and Alabama mostly steered clear of the national recession during 1990 and 1991. However, the prospects for Mississippi in 1993 are dimmed by defense-related layoffs. The modest growth in Alabama should not measure up to the regional average because of deceleration in apparel, textiles, and public sector employment, as well as concerns about funding for the space station. The energy-based economy in Louisiana may be running against the general upward trend in the region. Louisiana faces the prospect of a continuing economic slump even as the national expansion builds momentum. Overall, though, growth in the region during 1993 should outpace that of the nation.

Long-Term Growth Challenges

With the short-term prospects looking generally positive, I would like to raise a note of caution about the long-term prospects. As I have pointed out, much of the growth in the region in 1993 is based on temporary advantages--rebuilding after Hurricane Andrew and an upsurge in single-family construction, for example. In the longer term, sustaining and broadening this

growth will depend upon the ability of the region to attract capital and labor. Comparatively low wages and taxes in the six southeastern states will continue to draw relatively labor-intensive investment. Unfortunately, many areas of the Southeast are not set to deliver the skilled, flexible work force that is increasingly needed to use sophisticated factory and office technology.

Growth in the Southeast over the last two decades has been fed and sustained by attracting capital, both physical and human, from other parts of the country and overseas. The substantial rise in incomes in middle Tennessee has sprung in large part from decentralization of manufacturing. Growth in the city of Atlanta has come from decentralization of corporate headquarters, outsourcing of business services, and a spectacular rate of successful small business start-ups. What all these sources of jobs have in common is a long-term commitment of capital and skills to the region.

These commitments would not have been made without the expectation of a long-run payoff to the investments. For instance, the Ph.D.'s, engineers, and highly skilled workers who have relocated to the Southeast would not have come were it not for their expectation of a better standard of living as a result of their move. The physical and financial capital would not have been invested in the region if investors did not think that the long-term payoff would be higher here than elsewhere. And this movement and growth have been strikingly apparent in Atlanta.

It is important to remember, though, that Atlanta is not all of the Southeast. In fact, there are some longstanding failures that offset the success of places like Atlanta, Nashville, and much

of Florida. For many decades, the states that make up this region were some of the most impoverished in the nation. Even today, by many measures, they continue to underperform the nation. For example, the proportion of children living below the poverty line exceeds the national average in every state in the region and reaches about 30 percent in Mississippi. Florida is the only state of the six in this region that has a higher-than-national-average per capita disposable personal income. In addition, Florida, Georgia, and Louisiana represent three of the four states across the nation with the lowest high school graduation rates.

Thus you can see that there are major differences among the states in the Southeast, and these differences bring me to my point about the longer-term challenges of growth. The basic problem is expanding the robust growth that has been enjoyed by some to all areas and segments of the southeastern population. We need better schools and factories outfitted with the most advanced equipment to broaden the improvement in living standards. Achieving these goals, however, requires a lasting commitment to investment in physical and human capital. This, in turn, requires a hospitable economic environment that people expect to be maintained over time, both in the region and in the nation. That observation brings me back to my earlier remarks about the need to cut the huge federal deficits.

As I mentioned at the outset, I believe that the new leadership in this country is doing its part in this regard. In particular, I would like to give credit to the Administration for seeking to reestablish fiscal policy as a useful instrument. During the past recession, monetary policy bore virtually all the responsibility for reviving economic growth. The reason was that huge deficits

made it nearly impossible to use fiscal policy as a countercyclical tool. From my perspective as a central banker, until a sound deficit reduction plan is implemented, monetary policy will continue to be the only countercyclical policy available. Now, however, the President has put on the table a far-reaching proposal for discussion and debate. While I do not have comments on particular aspects of the proposal, the action as a whole must be commended, in my view. I am heartened that the initial reaction from the stock and bond markets has been favorable. Likewise, I believe the reaction from people across the nation has been promising, as has that of the Congress.

Conclusion

In conclusion, the national economy is embarking on an expansion, and the Southeast will do even better than the nation during 1993 in terms of growth. As a nation, we have begun to grapple with the budget deficits, which I believe have created a significant drag on economic growth. If we are able to succeed with solid deficit reductions, the implications for the Southeast are extremely encouraging. We have already shown our ability to attract capital that spurs growth. Still, the region needs a stable long-term environment that will help it to broaden this base to all residents of the region. I am more hopeful than ever that we can meet this challenge.