

## **THE ECONOMIC OUTLOOK FOR THE SOUTHEAST**

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As a former Naval person, it is a pleasure to be here in Pensacola near the Naval Air Station to address this prestigious club. Speaking of the military, defense spending has been much in the news of late, but not exactly for the kinds of reasons that warm the hearts of military people. The decline in defense spending can be difficult for those individuals and communities that depend on the military for jobs, particularly in the short run. However, we have to keep our sights on the long term as well and remember that, with the freeing of military talent and highly technical productive capacity in the defense industry, a number of new enterprises will develop over time that should more than offset these losses. The problem is that the losses are concentrated here and now whereas the gains will be diffuse and gradual.

These changes in defense spending notwithstanding, on balance, I believe the outlook for the national economy is positive. In my remarks today I will be sharing some views on the United States as a context for where the Southeast is headed. As you will see, I believe the U.S. economy has a number of underlying strengths that augur well for the year ahead. That strength is illustrated by the experience of some military-related businesses here in the Florida panhandle that formed a network for joint marketing, production, and training. This group has apparently succeeded in creating new jobs despite the recent sluggish economic performance. Their success also has implications regarding the long-run economic development prospects for the Southeast--a topic I will touch on at the close of my comments.

## **The U.S. Economy**

Let me begin by briefly outlining U.S. economic prospects to provide a context for discussing the outlook in Florida and the Southeast. For the near term, that is the remainder of 1993, I expect the overall economy to do better than it did last year when gross domestic product, or GDP, expanded by only around 2 percent. Still, economic growth is likely to be moderate, but also not anemic. The recent GDP figure for the first quarter of less than 1 percent was, in my opinion, a retreat from an unsustainable pace late last year. Even without the effects of the March blizzards, growth would have slackened. The weak first quarter numbers are as unlikely to be repeated as were the extraordinarily strong third and fourth quarter numbers from 1992. Growth in this second half of the year should be stronger than in the first half, and GDP for 1993 should end up, on an annual average basis, at around 3 percent.

Inflation still remains under control, although it has begun to creep up and may go higher than the 3 percent level of last year to land somewhere between 3 percent and 3-1/2 percent. The unemployment rate has moved down from 7.1 percent in January to 6.9 percent. Nonetheless, I expect this number will average out at 7 percent.

The main sources of strength underlying the U.S. economy 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. As a result, households are in a better position to purchase goods that are typically

financed with credit, and the cost of doing so is much lower than before. Moreover, there is pent-up demand in that durables simply wore out during the period of slow growth. These developments, along with employment being likely to remain on an upward trend, mean that consumer spending should remain fairly healthy--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. 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--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.

On the business side, capital spending will continue to be enhanced by the reduction in borrowing costs. Also, businesses are focusing on purchasing efficiency-promoting equipment like computers. Demand for industrial equipment has been hurt somewhat by a sluggish manufacturing sector but is beginning to pick up. In the commercial construction area, office construction is not likely to turn around this year because it still suffers from a glut of office space on the market. Retail store construction, however, is beginning to show a healthy increase based on construction contracts, which should carry into next year.

Areas of weakness in the economy include not only office construction but also government spending and, for the first time in many years, international trade. With the new Administration still working to get its deficit reduction package passed, it is somewhat risky to forecast government spending, even knowing what spending cuts and increases the President has proposed. Clearly, though, defense expenditures will decline. Therefore, on balance, I believe that in 1993, as in 1992, government spending will not add to growth. I find more worrisome the shift in international trade from the positive to the negative side of the growth ledger. The main reason for this change is the worsening economic outlook for most of our major trading partners. This worldwide weakness is not likely to be reversed in 1993. Fortunately, our largest trading partner, Canada, is recovering at a moderately healthy pace. Also, the outlook for Mexico, our third largest trading partner, continues to show strong demand for capital goods--an area where the United States has a strong advantage. Still, imports will continue to outpace exports as U.S. growth remains stronger than many of our trading partners until next year.

To recap, the outlook for the nation for the rest of 1993 is one of moderate growth with some promise for increased consumer spending and business investment thanks in the main to lower interest rates. The proposals to reduce the deficit made by the Administration 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 this year.

### **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. In the area of employment growth, the Southeast has been ahead of the nation and should remain so. 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 recovery in the early 1980s, 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. For instance, with lower interest rates, more people have been able to purchase homes. 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.

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. Demand for these products is also receiving

a temporary boost from 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. However, the stimulus from Hurricane Andrew will abate in the second half of the year as the rebuilding effort peaks.

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 regional expansion 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. New home sales remain strong. In fact, payroll employment figures show that the southeastern construction industry created more jobs in the first quarter than were recorded nationwide on a net basis. A good part of this activity is due to the many young home-buying people who live in or who 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 over.



The good news even extends to banking and financial services employment, which is slowly edging higher. This turnaround may be attributed to the increased refinancing activity from both households and business. The level of business loans also is improving slowly and should gain momentum through the year. However, the increase in demand for banking services is not expected to cause a wave of new hiring. To cut costs, financial services institutions will probably continue to focus on gains in worker productivity, restraining new employment growth through 1993.

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 initial recovery period, and this will have an effect on the economy, most notably in Alabama. 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. Thus, 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 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 certainly 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. I will have a bit more to say on this subject in relation to Florida in just a moment.

### **Florida Outlook**

Focusing on Florida, I can say that overall the state is expected to be outperforming economic growth in the region and in the nation by the end of the year. This outlook should be welcome news for Floridians who have lived through a vexatious past two years when just about everything that could go wrong with the local economy did. The problems included everything from cutbacks in defense spending to natural disaster. Perversely yet fortunately, good economic news often follows disasters. Such has been the case with Hurricane Andrew. Even though Florida was already recovering from its relatively deep recession before the hurricane, the rebuilding after the storm has given retail and construction industries in the state a boost. At the same time, tourism, a major source of economic strength for the state, is rebounding from a long slide. The decline started back in 1991 with the Persian Gulf War and continued through the recession as consumers reined in their discretionary spending.

On the down side, the recovery in Florida will be constrained by the continuing loss of jobs in its manufacturing sector. Although the state is not known for its factories, its manufacturing sector actually makes up a large part of the industrial base in the Southeast.



Unfortunately, defense-related production is the main source of manufacturing in Florida, and, as we know, this is a time of cutbacks in defense spending. Communications and aircraft production are the leading income-generators in Florida. It also looks as if the state will take a strong hit in lost jobs through military base closings. Thus, the defense mix makes Florida more vulnerable than other states in the region to declines in military spending.

### **Long-Term Growth Challenges**

With the outlook for 1993 looking relatively good for the Southeast as a whole, let me address a common concern about growth best expressed by the phrase, "What goes up must come down." Specifically, many people have been predicting a convergence in growth rates among different regions of the United States, which would mean that growth in the Southeast region would have to slow down once it catches up with other regions. I would like to explain briefly why this supposition is not necessarily true.

Capital plays an important role in economic growth, and the Southeast has an excellent track record of being able to attract capital. Some research being done at the Federal Reserve Bank of Atlanta points to a continued advantage for this region basically because the return to capital here is highly competitive with other parts of the nation. At the same time, we cannot rest on our laurels. Other research being done at the Atlanta Fed shows that we should not rely on old strategies that tout manufacturing and commodities as the only basis for growth. Certainly, goods that are "exported" to other countries or even to other regions can help a poor area to bootstrap itself. However, other factors like capital inflows are equally important in

catalyzing economic development on a local basis. As we pursue new strategies to attract investment, I believe we must pay more attention to our physical and human capital. That is, we must improve the physical and educational infrastructure in this region. This way, people can take on the more challenging jobs that can be created in or attracted to this region.

## **Conclusion**

In conclusion, the national economy is embarking on an expansion, and the Southeast will do better than the United States 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 in the past few years. 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 broader vision to maintain economic development and growth. I am more hopeful than ever that we can meet this challenge and that the business leaders in this room will be among those who help to solve the problems.