THE ECONOMIC OUTLOOK FOR THE UNITED STATES AND THE SOUTHEAST

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I am pleased to be here in Nashville with you this evening to discuss the economic outlook for the nation and the Southeast. As an added attraction for those of you who operate locally, I will also touch on the outlook for Nashville and the state of Tennessee. Before I begin, I would like to say that business people have one of the toughest tasks in our economy today--that of trying to anticipate how macropolicy changes will affect the microeconomy of their businesses and then adapting to those changes while still finding ways to make a profit.

Change is simply a fact of life in our economy. Indeed, it is what makes the U.S. economy so dynamic, resilient, and innovative. It does seem, however, that the pace of change in the business environment today is vastly greater than it was even 20 years ago. In addition, all of us are dealing with a good deal of uncertainty in the economy. The give and take between Congress and the President on the deficit reduction plan may have contributed to this uncertainty. I believe, however, that it is worth going through a period of uncertainty now to reap the benefits later. By reducing the deficit, I am convinced we will increase the capacity of the economy to grow in the long run.

The U.S. Economy

For the near term, that is the remainder of 1993, let me briefly outline U.S. economic prospects to provide a context for the outlook in Tennessee and the Southeast. 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 for the year is likely to end up, on an annual average basis, at around 3 percent or a bit less.

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 in the June report. Nonetheless, I expect this number will average out at a little under 7 percent for the year.

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 many durable goods 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 and Congress still working to agree on a deficit reduction package, it is somewhat risky to forecast government spending. 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. 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. Demand for home appliances that are produced in several southeastern states is also receiving a temporary boost from the rebuilding going on in south Florida and Louisiana as a result of Hurricane Andrew. However, the stimulus from Hurricane Andrew will diminish 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 and particularly here in Tennessee. 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 extends even 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. As I mentioned at the outset, the level of business loans also is improving slowly and should gain momentum through the year.

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 regional economy. 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 also 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.

Tennessee and Nashville Outlook

Now to complete my mission of covering the local economic outlook: Economic expansion in Tennessee continues to gain momentum at a moderate, balanced pace. The state has the least to lose from defense spending cutbacks because, among the southeastern states, it is the least dependent on defense-related industry. Its unemployment rate rivals that of Mississippi as the lowest in the region. Cars are what continue to drive the Tennessee economy, as it were, not just in terms of the increase in production at the Saturn and Nissan factories but also auto-related production more generally. This expanded production should boost personal income and consumer spending, in turn helping the retail sector to continue expanding. In addition, the housing market is strong, leading to increased purchases of durable goods. With all of these positive features, the Tennessee economy should continue to outperform the nation through 1993.

For a manufacturing-intensive state that ranks seventh nationally in motor vehicle production, the recent performance of Tennessee is extraordinary. States whose strength lies in producing durable goods typically get hit hard by recessions. In fact, during the 1982 national recession, automobile manufacturers and other transportation equipment companies here reduced their work force nearly as sharply as the average across the nation. Since 1989, however, while more than 250,000 transportation equipment workers have been laid off nationwide, Tennessee has added 15 percent more workers to this industry. Basically, this surge in new auto jobs muted the impact of the national recession on Tennessee. Nondurable industries have not done nearly as well, though, with employment dropping in the apparel and food processing industries, for example. Generally, though this nondurables weakness reflects the evolution of the state toward more capital-intensive, higher-wage production and away from less-skilled, low-wage jobs.

Turning to prospects for Nashville, the recent rebound in auto loans and purchases should continue to benefit the local economy. The nearby Saturn and Nissan auto plants have played a vital role in the growth of the city by adding thousands of jobs, both directly and indirectly, to the economy. Residential construction has been growing rapidly as well. Interestingly, as Nashville has expanded its role as a popular vacation and convention city, revenues from tourism have recently surpassed those of its traditionally key industries--insurance and publishing. Overall, prospects for Nashville look positive.

Independence of the Fed

Now, before I conclude my remarks this evening, I would like to make some brief comments on another topic that is very much related to the economic outlook, especially in the long term: the independence of the Federal Reserve System. The issue of the independence of the Fed has surfaced lately in the form of several legislative proposals. One proposal in Congress now would prevent Federal Reserve Bank presidents from voting on monetary policy at Federal Open Market Committee meetings because they are not appointed by the President of the United States. The reasoning behind this suggestion seems to be that those appointed by the President and approved by the Senate would more fairly represent the wishes of the majority. Other proposals would increase Fed "accountability" (quote, unquote).

There are two basic reasons why I believe central bank independence is vital. The first is economic and is based largely on views about what kind of monetary policy can best serve the nation. To put it simply, those countries that have the most independent central banks, such as Germany, Japan, and the United States, tend to have the lowest rates of inflation. Being removed from day-to-day political pressures enables most independent central banks like the Fed to look to the long term and follow a course that keeps inflation in check. However, when debt levels are high, as they are today, popular sentiment can become somewhat biased in favor of inflation since it is easier to pay off debt with inflated dollars. History and recent events should remind us, though, that chickens always come home to roost. The rather severe readjustment businesses and consumers have had to make during this last recession could be seen as a consequence of the inflation bias and unsustainably fast growth of the 1970s and '80s.

Aside from the economic arguments for independence, I think there are fundamental reasons that go to the heart of our political traditions. The public-private structure of the Fed, whereby a policymaking government body, the Federal Reserve Board, oversees and coordinates the activities of the quasi-privately managed 12 district Banks, works very well as it is set up. The 12 Bank presidents provide checks and balances to the Board of Governors. As you may know, I meet regularly with business leaders, farmers, labor leaders, civic and community leaders, and others to learn how they see economic conditions and what they think should be done. I am then able to share this information in confidence with my Washington-based colleagues on the Board. By bringing together a broad range of information and opinion from the 12 Reserve districts in the nation, I believe the process of reaching a responsible consensus on monetary policy is enhanced. In this way, checks and balances within the Federal Reserve System work toward price stability and sustainable growth while ensuring that policy does not ignore the seriousness of economic problems faced by certain sectors and regions.

Unlike the European style of more centralized governments, the United States has a long tradition of using checks and balances in its government. Such a system may not operate as smoothly as a centralized one, but it suits our nation. That is because, as a people, we are uncomfortable with concentrations of power, whether they be economic or political. In a sense, then, the Reserve Bank presidents exemplify a federal system of governance in which regional interests and needs are institutionally guaranteed a voice at the table where policy decisions are made.

All this is not to say the Fed is unaccountable for its actions. Twice a year, the chairman of the Federal Reserve gives a report on the economy and monetary policy objectives to Congress as mandated in the Full Employment and Balanced Growth Act of 1978, more commonly known as the Humphrey-Hawkins Act. Also, the seven governors are chosen by the President with the consent of the Senate. In turn, the 12 Fed presidents must be approved by the Board of Governors. Knowing how critical is the role the Fed plays in policymaking for the nation, I too am convinced of the need for accountability. However, unlike some of our legislators, I believe the Fed has been structured wisely to maintain a fine balance between accountability and independence.

Conclusion

In conclusion, the national economy is likely to grow moderately in 1993, and the Southeast will do better than the United States. 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 long-term growth in the U.S. economy are encouraging. With stronger growth nationally, the already solid prospects for Tennessee should be even brighter.