THE ECONOMIC OUTLOOK FOR THE UNITED STATES AND GEORGIA

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It is a pleasure to be here this afternoon to discuss with you my national and regional economic outlook. At the beginning of every year, I give my annual outlook speech to the Atlanta Rotary Club, of which I am a member. This year, I spoke about how we had made real progress in bringing down the rate of inflation, but that, as a nation, we had still not begun to deal with the federal budget deficit. Like others in the Federal Reserve, I have been on a virtual soapbox since the early 1980s warning about the perils that the large buildup of government debt brings.

Now at the end of the year, I am pleased to be able to say that we have finally begun to deal with one of our longest-running problems, increasing federal budget deficits. Progress on these two important areas of inflation and the deficit, along with other improvements in productivity as well as in the amount of debt held by corporations and households, bode well for the long-term future of the United States. Indeed, as dissatisfied as we may be with recent economic performance, it is important to bear in mind that the U.S. economy remains the strongest major economy on the world scene. Of course, I am here today to focus on economic conditions in Georgia and the Southeast. However, as a backdrop to this discussion, let me begin with an overview of the economic conditions in the United States and prospects for 1994.

The U.S. Economy

I expect the overall U.S. economy to grow about 2 1/2 percent on an annual average basis

this year. I believe that growth in 1994 should accelerate slightly to around 3 percent.

Inflation still remains under control. Despite a brief run-up in prices earlier this year, the consumer price index should rise about 3 percent, on an annual average basis--essentially unchanged from last year. In 1994, that figure should be slightly higher but no more than 3 1/2 percent.

The unemployment rate has moved down from 7.1 percent at the beginning of the year to 6.8 percent in October. Nonetheless, with still-sluggish job growth, I expect this number to average out at around 7 percent for the year. In 1994, unemployment ought to come down to the 6 1/2 percent level, on an annual average basis. The problem we are facing is that increased productivity holds down job growth in the short term. However, this same increase in productivity is very good for long-run real income growth.

The main sources of strength underlying the U.S. economy will continue to be consumer spending (particularly on durables), residential construction (although its growth is slowing), and capital investment by businesses, especially on computers and other equipment. Lower interest rates, which have been engineered largely by the monetary policy actions of the Federal Reserve over the last several years, are a factor in all of these areas. The main reason is that 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. Thus, 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, is an underlying factor that tempers growth in the U.S. economy. As the population profile of a country ages, demand for either housing or consumer durables tends to be constrained. It is a rapidly expanding younger population that increases the demand for cars, household appliances, and the like as they form families. The baby boom generation helped propel such growth during other post-recession expansions in the past two decades. Now, however, the U.S. population is growing older, and we can see the results in the modest rebound from the 1990-91 recession.

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. Federal government spending continues to decline not only because of defense cuts but also because of the deficit reduction

measures. In fact, this is the first recovery we have had without significant help from the government. Although states and local government purchases are rising slowly, they have not replaced the cuts in spending by the federal government. On balance, then, I believe that in 1993, as in 1992, this constraint in government spending will be a slight drag on 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 worsened economic conditions most of our major trading partners are experiencing. This worldwide weakness is troublesome and not likely to be reversed in the near future. The western European economies, however, should begin to round the corner sometime next year. In turn, the United States stands to gain on the export side. In the meantime, fortunately, our largest trading partner, Canada, is recovering at a moderately healthy pace. Also, the outlook for Mexico, our third largest trading partner, and many other Latin American countries remains bright. Demand for capital goods--an area in which the United States has a substantial advantage--is especially strong. Overall, however, imports will continue to outpace exports as U.S. growth remains stronger than that of many of our trading partners until next year.

To recap, the outlook for the nation for the rest of 1993 and into 1994 is one of modest growth with some promise for increased consumer spending and business investment thanks in no small measure to lower interest rates. The proposals made by the Administration to reduce the deficit 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.

Southeastern Outlook

Turning to the Southeast, I can report that the rate of growth has begun to taper. The regional economy is now tracking closer to the national economy than it has during the past year, a year in which we were doing relatively well compared with the nation. In the area of employment growth, the Southeast had been ahead of the nation earlier in the year by a rate of almost two to one, but growth has now slowed to a pace that is about even with employment growth in the United States. Still, on an average annual basis, the Southeast could add almost 250,000 jobs this year to the economy, which is certainly not bad, coming on the heels of an increase of 300,000 last year. That number also shows, though, how moderate this rebound is. During the recovery and expansion in the early 1980s, by contrast, the Southeast added more than a million jobs--and it did so from a smaller base.

Why has the Southeast been doing better than the nation? The main reason is that this region produces the goods that people have been buying since 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 and related building products 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 draperies and other home furnishings. New home building also increases the demand for home appliances that are produced in several southeastern states. In addition, the rebuilding going on in south Florida and Louisiana as a result of Hurricane Andrew and in the Midwest due to flooding has temporarily boosted these purchases. As the rebuilding effort from Hurricane

Andrew begins to diminish, the increased demands from the midwestern flooding should take over for another nine months.

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. Textile mills should also gain from this development since some textile products are destined for automobiles. On balance, regional manufacturing should continue to lend strength to the economy of the Southeast, although the growth in manufacturing jobs has begun to taper off. This development is contributing to a narrowing of the gap between the rate of growth in the Southeast and the United States.

Another sector adding 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. 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. The level of business loans also is improving slowly and should gain momentum through the year. In addition, tourism has been doing well in the Southeast, thanks in

part to the flourishing of foreign tourism, although the effects of stories about the perils of foreign tourists in Florida are yet to be determined.

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 difference in output 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. That competition will be unrelenting as time goes on.

Moreover, there are other areas of potential weakness. 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, defense-related manufacturing is less important in this region than in areas like the Northeast and the Far West. Nonetheless, 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.

Since we live in Georgia, let me briefly discuss its outlook: Of the six southeastern states that we track at the Federal Reserve Bank of Atlanta, its economy is doing the best. The housing cycle helped immensely in 1992, and now the service sector and corporate relocations are keeping the economy lively. Although foreign investment is currently and temporarily weak, the Olympic Games are starting to have a positive effect, which will continue through 1996.

Overall, then, the Southeast is in reasonably good shape in terms of growth, with automobiles, housing, and consumers leading the parade. Although the rate of growth is slowing a bit and the gap between the United States and the region is narrowing, the Southeast should continue to do at least as well as the nation.

Conclusion

In conclusion, the U.S. economy is likely to grow slightly faster in 1994. Given the gains we have made in regard to inflation, productivity, and the reduction of debt by corporations, households, and the federal government, I believe we have laid the groundwork for creating a strong economy in the coming decade.