

THE ECONOMIC OUTLOOK FOR THE UNITED STATES AND THE SOUTHEAST

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Once again, it is a pleasure to be invited to speak with the members of the Kiwanis Club of Atlanta about my economic outlook for the United States and the Southeast. Many developments from last year make me optimistic about the future because, at long last, the nation is taking major steps toward solving long-term problems, such as inflation, the budget deficit, and health care, where the debate has just begun.

I am very encouraged that our nation is beginning to grapple with these issues, which it had put off during the 1980s because, if continued, these investments in our future will benefit us long beyond my time and yours. The result should be moderate and steady growth--not as heady as in much of the '80s, but certainly more sustainable.

However, as promising as the overall economy may be, I would not be doing my job as a central banker if I did not have an area of concern to point out. In the midst of the positive steps we have taken as a society, I sense a deepening distrust of public policy institutions. In my talk today, I would like to discuss how this distrust, if left to fester, can hamper the progress this nation is making on long-term issues. Before I turn to this topic, let me review current economic conditions and the outlook for 1994.

The U.S. Economy

I believe we will have another good year of moderate growth with GDP expanding by about 3 percent--slightly faster than in 1993. In fact, the momentum of business activity in the last three months could even push this figure higher. I expect inflation, as measured by the CPI, to increase at an annual average rate of between 2-1/2 percent and 3 percent. Earlier declines in oil prices and ongoing import competition are keeping prices well behaved. Of course, if growth does prove stronger than expected, we could see rising pressures on resources by the end of the year. Unemployment should continue to improve, perhaps dropping by as much as half a percentage point even though certain methodological changes by the U.S. Department of Labor will raise the stated rate somewhat.

Areas of strength will change little from last year. Consumer spending will still be strong, especially on durable goods like autos and household appliances. Home furnishings should also remain healthy, owing to the fact that residential construction will again be a solid contributor to growth. The continuation of pent-up demand for consumer goods should support continued growth in manufacturing. Finally, capital spending by businesses, especially on computers and industrial equipment, should remain vigorous. The relatively low interest rates we have had in recent years is a factor in all of these areas. Recent employment gains should also provide support for further increases in personal income and consumer spending.

To be sure, there are also specific areas of weakness in the economy, which are essentially the same as last year: commercial construction, government spending, and international trade.

Office construction still suffers from overbuilding in previous years, but I believe that we are slowly beginning to see a modest upturn. While state and local purchases will grow, government spending overall will be weak because purchases on the federal level are being affected by defense cutbacks and deficit reduction. Of course, I do not view this "weakness" negatively because deficit reduction is long overdue. Another negative factor is the outlook for net exports, which remains poor due mainly to the weak economic conditions of many of our largest trading partners. This situation abroad is troublesome and likely to be reversed only slowly. However, the western European economies should begin to round the corner this year. Whatever growth in exports the United States does have will come from Mexico and other Latin American countries, as well as Canada--our largest trading partner--and Asia, excluding Japan. Computers, telecommunications, and other capital equipment should continue to be the leading exports. At the same time, imports will continue to outpace exports as growth in U.S. spending continues to outstrip that of many of our trading partners.

These negatives notwithstanding, I am optimistic because the economy expanded last year and because, at long last, the nation has begun to take major steps toward solving long-term problems. First, looking at inflation, we have had clear success in bringing it down to a much more acceptable level than at the beginning of this decade when the CPI rose 5-1/2 percent. Second, in the area of the budget deficit, where we have needed to change our ways, Congress passed a plan last year that begins to deal with it. Third, health care reform has finally moved to the top of the list of socioeconomic issues we must grapple with, and at least we are beginning to debate this difficult issue as a society.

Southeastern Economic Outlook

Now, let me turn to the economic outlook for the southeastern region. As you may know, since the recession, the Southeast has been outperforming the nation in terms of job growth by about 1 percentage point. In 1994, that advantage will likely diminish--not because the Southeast will decelerate, but rather because the U.S. rate should accelerate. The good news is that both on the regional and national level, the pace of job growth will step up somewhat.

Three sectors in the Southeast will continue to outshine national growth: service industries, manufacturing, and construction. For several years, the service sector has been the main source of job growth for both the region and the nation. Specifically, the Southeast should get most of its gain from business services employment. Nonetheless, the unique manufacturing structure in the Southeast--a combination of furniture, textiles, appliances, and construction products--should benefit from the strength in new-home construction across the nation even as the region loses jobs in the apparel industry. This help from the rest of the nation should allow the manufacturing sector at least to hold its own. Finally, construction in our own region is likely to outperform the nation this year thanks to the strength of the southeastern economy and to the fact that more people are again moving into the region.

Looking at each state, the clear winner in terms of 1994 growth is Georgia. The state should lead the region with strength coming from many sources, including services, home-building, and the manufacture of building-related products. I will come back to the outlook for Atlanta in just a moment.

Mississippi can thank casino gambling for providing a short-term economic stimulus that is sparking activity in several sectors. Above-average growth is expected to continue through 1994, though it might diminish as Mississippi gets competition from next-door neighbor Louisiana for gaming dollars. Strong national housing activity will benefit the lumber and furniture industries in the state, and the relatively large food-processing sector should continue to do well.

Florida is likely to post moderate growth this year, and employment should continue to grow thanks mainly to tourism and construction of single-family homes and luxury condominiums. The factors tending to retard growth, which were masked in 1993 by the stimulus from rebuilding after Hurricane Andrew, will temper the overall expansion. I refer in this case to lower interest income for retirees and the loss of defense-related jobs.

Tennessee will continue to perform relatively well in 1994. The service sector should account for the majority of job gains, and automobile production in the Nashville area is likely to lead a growing manufacturing sector. For the state as a whole, the true shining star for Tennessee is residential construction. The state is coming off two consecutive record-breaking years of growth in single-family construction. Although this expansion will slow a bit in 1994, it will remain strong, especially in Nashville.

Alabama and Louisiana are the two states that are likely to grow more slowly than the region in 1994. Alabama suffered through a languid 1993, with some basic industries experiencing trouble and overall employment growing only weakly at the end of the year. Winning the Mercedes

auto plant was a bright spot that should contribute some high-wage jobs this year as the plant is built and lead to a pick-up by year-end though at considerable cost in terms of state revenues forgone. Alabama may also introduce casino gambling, which could provide a boost to the economy. However, the main problem is the continuing weakness in apparel manufacturing, which is the largest manufacturing employer in the state.

Louisiana should experience some modest growth after a sluggish 1993. It too grew more slowly than the national economy last year and lagged behind the region. Reasons for the improved outlook include an energy sector that will not be dragging down the entire economy of the state this year and economic stimulus from riverboat and casino gambling that will be introduced this year.

Now let me return to our immediate environs. As we are all quite aware, Atlanta is beginning to build toward the 1996 Olympics. Retailers and tourist-oriented businesses that are thinking ahead will probably expand into the Atlanta market prior to 1996 to take advantage of the Games. However, you may probably be able to divine what I am going to point out next--that, following the Olympics, there is likely to be an economic letdown in the Atlanta area during 1997 and 1998 for purely technical reasons as the temporary employment burns out after the Olympic flame has been doused.

Longer-Term Outlook Update

Since I often preach the virtues of looking at the long term, I would like to briefly review a few of the strides we have made as a nation in laying the groundwork for steady, long-term

growth in the United States. First, inflation is noticeably lower. Through a judicious use of monetary policy, the Federal Reserve has managed to engineer the lowest inflation in many, many years. I do not have to explain to this audience how important low inflation is to the world of commerce and trade. Another promising factor for continued economic growth is a more highly productive work force. We have reached this level of high productivity not without a good deal of pain, but I am convinced that the investments businesses are making today will create greater opportunities for growth in the future. During the recession and recovery, many consumers and businesses have worked hard to successfully reduce their leverage, and this bodes well for the future. Businesses also slimmed down cost structures and made significant commitments to realizing gains from automation.

Not only the private sector but the public sector as well has become more mindful of debt levels. In 1993, we finally saw some movement toward containing the size of the federal budget deficit, thanks to the fact that the Administration and Congress agreed on a deficit-reduction plan. I would now like to encourage continuing vigilance in this area, because the job is not yet done.

Finally, on the subject of international trade, you will recall that this will be a source of weakness for the U.S. economy in the year ahead. For the long term, however, we have had the good news that the North American Free Trade Agreement (NAFTA) made it through Congress and that the compromise on the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) was finally struck. Looking even further into the future, I fervently hope that these two achievements will not be seen as final steps, but rather as steps in the right direction toward global

free trade as it is being promulgated in GATT.

To sum up so far, then, the economic expansion is continuing, with growth that is moderate yet sustainable in a lower inflationary environment, and we have begun to address a number of long-term problems.

Growing Distrust of Public Policy Institutions

Ironically, in the midst of so much optimism about gains the nation has made lie the seeds of cynicism and mistrust. I have heard them most clearly in the voices of those who ask me, "If the economy is doing as well as you say, then why don't I feel better?" One thing to bear in mind is that economic measures of output, such as GDP, do not do a good job of measuring well-being. Although I do not have a ready answer for each individual circumstance, I do understand that the transitions our economy has been going through have been traumatic for many people and businesses.

But going beyond individual traumas, I see an even more troublesome effect on a societal level. The election year of 1992 and the rancorous debates in Congress in 1993 about the deficit and NAFTA have pointed up that many Americans seem to greatly distrust their public policy institutions. This distrust goes beyond the "anti-incumbent" attitude that permeated recent elections. People seem to feel disenfranchised from the government overall. The irony is that the American people may actually be better represented than ever before in terms of having more women and minorities serving in Congress as well as at the state and local levels. However, whether or not

government has begun to "look more like America," many Americans still do not seem to trust the way it and other public policy institutions operate.

I am concerned about this issue, because public distrust could have a number of adverse effects. First and foremost, it could hamstring the process already begun of taking a longer-term perspective to problems in America. Rather than trying to wade through the debate on difficult issues such as health care, for example, some people could decide that so long as they have health care coverage, why should they care about somebody else's problem? Needless to say, this kind of attitude cannot serve us well when it comes to solving problems on a societal level.

Distrust among the public could also prevent the United States from keeping its leadership role in the global economy, because inward-turning Americans might not be interested in helping other nations less well off than ours, such as the former Soviet Union.

Finally, distrust on the societal level can infect the atmosphere and cause one public policy institution to turn on another. Perhaps I am more personally aware of this effect because the Fed seems to be taking a number of hits in this regard. In fact, I find it quite ironic that in a period of great changes in the world, when more and more countries are making their central banks *more* independent, here in the United States, we seem to be trying to make ours *less* independent. Although Congress has occasionally questioned the need for various aspects of the Fed's independence, lately it seems to me that it has been more-than-usually interested in reining in the independence of the Fed. For instance, the chairman of the House Banking Committee is

sponsoring legislation to videotape monetary policy deliberations along with a variety of other measures that would politicize the Fed. On this point, I would like to say that the deliberative and thoughtful approach we take to monetary policy would be seriously undermined by politicizing the central bank.

In addition to Congress, the executive branch has recently added its voice to the chorus by putting forth a proposal to remove the Fed from its bank regulatory and supervisory function in order to create a simplified regulatory system. Since my time this afternoon is limited, I will refrain from entering into a spirited defense of the Fed. I will add, however, without going into any detail, that since the central bank is the organization charged with maintaining the health and stability of our complex banking system, a wholesale change of the regulatory system such as the Administration has proposed could needlessly imperil the financial system. In my view, removing the Fed from hands-on responsibilities for supervising at least a part of the banking industry reduces our ability to deal with systemic risk.

Perhaps the Fed has not been articulate enough or persuasive enough in explaining its vital role in the smooth functioning of the U.S. economy. The plain truth is that the healthiest economies in the world are served by the most independent central banks. Those countries that have the strongest separation between the fiscal and monetary authorities are also most likely to have low rates of inflation and growth that is sustainable. I do not like to think of what might have happened in the United States had the Fed not taken anti-inflationary actions over a long period of time to create the current sustainable growth that benefits the entire nation. To achieve this goal, we have

not pursued a single-minded effort to reduce inflation without regard to transition costs and social preferences. In fact, the accommodative policy stance we pursued in recent years helped to soften the recession and foster the ensuing recovery and expansion.

Despite this success, the importance of central bank independence is a lesson that some foreign countries seemed to have better learned than we Americans. I am hopeful that those countries now moving toward greater independence for their central banks will offer up an object lesson that might, by virtue of its distance, provide some perspective to those in the United States who question the need for an independent central bank. While the Fed will always have its critics--and, in a democratic society, that is as it should be--their criticisms should not make us lose sight of the value of the checks and balances that strengthen this nation.

Conclusion

In conclusion, I believe it is important for policymakers to face up to the public sentiment against their institutions and begin to counteract the distrust I have described. Otherwise, we will not be able to carry forward on the even more difficult changes yet to be made. As I see it, the best way for the federal government and other public policy institutions like the Fed to win back the confidence of the American people is through policies that will hold inflation down, create more jobs in a dynamic economy, and continue to control the federal budget deficit. I liken this course of action to taking an antibiotic: we must finish the whole course of treatment, or else the illness can come back much worse.

I would also like to reiterate how important it is for policymakers and Americans to take advantage of this changing time to carry out policies that may not, at first blush, be popular, but will indeed redound to the benefit of all in the long run. The 1990s have become a time of readjustment for Americans, both consumers and business owners. However, we have a sterling chance to come through this period of unease with the strongest economic grounding this nation has had in a long time. I hope you believe with me that the American spirit will prove to be large enough to understand what it takes to achieve such great gains.