

ECONOMIC OUTLOOK FOR THE UNITED STATES AND THE SOUTHEAST
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I am delighted to be here this morning to discuss the economic outlook for the United States and the Southeast. Since I see from the program that Eleanor Clift of *Newsweek* and Fred Barnes of the *New Republic* will be debating issues tomorrow, I might ask whether I have been unknowingly paired with some other notable figure: Rush, are you here? No? In that case, I will move ahead with my remarks on the economy. By way of background, I believe it is worthwhile to start with a long-term economic outlook for the nation, particularly since, as a central banker, a good deal of my time is devoted to preaching the virtues of looking at the long run.

Longer-Term Outlook Update

With that in mind, I would like to 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 than it was at the beginning of this decade when it stood at 5-1/2 percent. 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. However, the need to resist inflation is as strong as ever. I will have more to say on this topic later on in my remarks.

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 past several years, many consumers and businesses worked hard to successfully reduce their leverage, and this also bodes well for the future. In addition, businesses slimmed down cost structures and made significant commitments to realizing gains from automation. We are just beginning to see this process yield fruit, and we will continue to do so over many years.

Not only the private sector but the public sector as well has become more mindful of debt levels. Last year, 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. Finally, in the area of international trade, the North American Free Trade Agreement (NAFTA) made it through Congress, and 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.

The U.S. Economy

Having explained, in my view, some of the promising steps taken toward long-term growth, I would like to turn now to the economic outlook for the United States. My discussion begins with three key measures of economic performance--output, inflation, and employment. For the nation as a whole, I believe the economy could grow at a pace of around 3-1/2 percent

for the year as measured by gross domestic product (GDP). Inflation, as measured by the consumer price index (CPI), should increase by around 3 percent this year. Earlier declines in oil prices, productivity gains, and ongoing import competition are keeping prices well behaved in the near term. Unemployment should move down from 6.7 percent in January to a little more than 6 percent toward the end of the year. This improvement is better than it sounds because the U.S. Labor Department changed its methodology at the start of this year, with the result that measured unemployment is about half a percentage point higher, on average, than the one obtained by using the old method.

The main strength supporting this outlook lies in consumer spending, especially on durable goods like autos and household appliances, but there are other strengths. Residential construction will also make a solid contribution to growth, leading to continuing strength in related areas, such as home furnishings. The purchases of consumer goods should support continued growth in manufacturing. Finally, capital spending by businesses, especially on computers and industrial equipment, should remain vigorous. The lagged impacts of the relatively low interest rates of the last few years--even though rates have moved up recently--are a factor in all of these areas. Recent employment gains should also provide support for further increases in personal income and consumer spending. On another promising note, imbalances have been worked down substantially on corporate balance sheets, due largely to the earlier declines in interest rates, the lengthening of debt maturities, and equity issuance. Banks and real estate firms are also stronger.

To be sure, there are also specific areas of weakness in the economy: commercial construction, government spending, and international trade. Office construction still suffers from overbuilding in previous years, but I believe that we are beginning to see a modest upturn. While state and local purchases will grow, government spending overall will be weak because expenditures at 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.

The third 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, however, has begun to show signs of reversing. (Indeed, the International Monetary Fund [IMF] has revised its forecast higher for world economic growth.) I expect the western European economies to round the corner this year. Whatever growth in exports the United States does have will come from Latin American countries, Canada--our largest trading partner--and Asia, excluding Japan. Computers, telecommunications, and other capital equipment, as well as services, should remain the leading exports. In fact, our leadership in technology bodes well for the future. At the same time, imports will continue to grow faster than exports as the increase in U.S. spending still outstrips that of many of our trading partners.

Current Direction of U.S. Monetary Policy

These weaknesses notwithstanding, it does not seem appropriate to be concerned about whether the U.S. economy can expand. If anything, it would be wiser to worry about the possibility that too rapid and thus unsustainable growth will ultimately contribute to rising

inflation--an outcome the Federal Reserve most assuredly wants to avoid. Therefore, the Fed began in February to shift away from the accommodative monetary policy stance we had had for some time.

Certainly, we recognize that the globalization of the U.S. economy helps to dampen domestic price pressures. However, the economy has been growing at a rate in excess of its long-run potential, thereby running the risk of constraints on capacity. This situation often leads to inflation. In general, as the gap between actual and potential output narrows, central banks begin to become concerned that the momentum will push an economy through its capacity constraints. Although there have not yet been any signs of accelerating inflation at the retail or output level in the United States, the pressures that can lead to it are there. With the current course of monetary policy, the Fed wants to make sure that inflation will no longer be a problem in the United States. In that light, it is critical for us to fend off inflation before it starts recurring.

Before moving on to my outlook for the Southeast, I would like to say a few more words about inflation. It may seem to many people that the Fed spends too much time worrying about inflation, particularly since the economy is healthy now, and inflation seems to be quiescent. However, an important point to remember is that the costs of inflation are significant. One reason for having an independent central bank is that it allows us to take a longer view of the economy. This long-term vision is especially important when dealing with inflation because price increases accelerate with a long lag. For example, inflation peaked in 1982, long after monetary policy saw it coming and moved strongly to counter it and long after the early 1980s recession began. We

all recognize the importance of avoiding this situation again.

At the same time, to achieve this goal, the Fed does not pursue a single-minded effort to reduce inflation without regard to transition costs and social preferences. While inflation undermines and distorts economic growth, I am not so single-minded as to believe that we must achieve zero inflation immediately or that we necessarily have to reduce inflation at every stage of the business cycle. As I see it, there are always trade-offs to be made when trying to bring inflation down. Businesses, labor, and consumers must be given time to adjust their financial behavior in light of changing economic policy. Too quick an adjustment can cause too much pain, and I personally believe policymakers must be attuned to these social costs.

Outlook for the Southeast

Now, let me turn to the economic outlook for the southeastern region, which is quite bright. Since the recession, the southeastern region has been outperforming the nation in terms of job growth by about 1-1/2 percentage points. In 1994, that advantage may diminish--not because the Southeast is decelerating, but rather because the U.S. rate is accelerating. However, the gap has not narrowed yet. The good news is that on both the regional and national level, economic activity is quite healthy. Individual states will vary in performance, but even the weakest states in the region are seeing at least modest growth.

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. New-home construction across the nation brings special benefits to the Southeast because of its traditional manufacturing concentration--a combination of lumber, furniture, textiles, appliances, and other construction-related products. This help from the rest of the nation should allow the manufacturing sector to grow modestly or at least to hold its own as the region loses jobs in the apparel industry to international competition. Finally, construction in the Southeast itself is likely to outperform the nation this year thanks to the strength of the regional economy, although housing construction may begin to taper off as the year progresses.

A few other areas are contributing to the strength of the regional economy. Although sales of durable goods may have begun to peak, expanding sales of apparel and other nondurable goods should begin to pick up some of this spending slack. Tourism and convention business should improve at most vacation spots in the Southeast, particularly given the relative health of both the regional and national economies. The one obvious negative in the outlook stems from cutbacks in defense spending that are affecting the defense and aerospace industries, particularly in Alabama. Taking all these factors into account, the Southeast is likely to enjoy strong but balanced growth throughout 1994.

Since most of you are from either Georgia or Florida, let me brief you on their prospects. Comparing the economic outlooks for each state in the Southeast, the clear winner in terms of 1994 growth is Georgia. Since the end of the 1990-91 recession, Georgia has reestablished itself

as a growth leader in the Southeast. A resurgence in single-family construction across the nation after catastrophes like the earthquake in California and the floods in the Midwest sparked increased demand for building-related products. Because of its relatively heavy concentration in textiles and wood products manufacturing, Georgia benefits economically from disasters in other states. Corporate relocations of both domestic and international companies should also continue to increase demand directly and in the construction and service sector. As in other parts of the Southeast, business services will contribute to growth. About the only negatives to be noted in the outlook for Georgia are the recent announced cutbacks by Lockheed and Delta.

Turning briefly to the impact of the upcoming 1996 Olympics: The Olympic games will mainly affect the Atlanta metropolitan area. Retailers and tourist-oriented businesses that are thinking ahead are expanding into the Atlanta market to take advantage of the Games. However, you may 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 for purely technical reasons as the temporary employment burns out after the Olympic flame has been doused. The question is, how serious will this letdown be and how long will it last?

Florida is likely to post moderate growth this year, and employment should continue to grow thanks mainly to tourism and construction. Although European tourism business remains down in South Florida, an overall increase of about 4 percent is expected for the state in 1994. Much of that increase in business will come from Latin America and the Caribbean, whose improving economies have encouraged travel to the United States. Retail sales in Florida should

continue to grow moderately this year, although year-over-year sales figures may look weak because of the abnormally high post-Hurricane Andrew levels in the first half of 1993. 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 the lower interest income retirees have earned in recent years and the loss of defense-related jobs.

Conclusion

In conclusion, the economic expansion in the nation promises to be quite strong in 1994, yet at a rate of growth that does not create its own problems; the southeastern region is outperforming the nation; and Georgia is doing the best of all the states in the region. From a long-term perspective, as a nation, we have taken significant strides to correct difficult problems. We still have many problems to face, such as the continuing trade imbalances with other nations that are experiencing their own recessions now and competition from international companies for jobs in the region's apparel industry. On the whole, however, the state, the region, and the nation should remain on solid ground in 1994.