

THE ECONOMIC OUTLOOK FOR THE UNITED STATES AND THE SOUTHEAST
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Julian has asked me to discuss the economic outlook for the nation as well as for the region and the state of Georgia. I hope to do that eloquently, inclusively, and--given the nearness of the 12:45 tee times--as briefly as is humanly possible. For the devotees, I will be glad to answer any questions when I have finished. To the task at hand then.

The U.S. Economy

My discussion today of the U.S. economy begins with three key measures of economic performance--output, inflation, and employment. For the nation as a whole, growth in real gross domestic product (GDP) is likely to average more than 3-1/2 percent in 1994, with the pace of expansion decelerating as we move toward year end. Inflation, as measured by the consumer price index (CPI), should turn out to increase between 2-1/2 and 3 percent this year. Earlier declines in oil prices, productivity gains, and ongoing import competition are keeping prices well behaved in the near term. Job growth has been strong this year, averaging about 287,000 a month. The unemployment rate of 6 percent is at or near most estimates of a non-inflationary rate of full employment. I expect it to remain near this level or perhaps to edge a bit lower over the rest of this year.

Looking ahead into 1995, the U.S. economy should grow at a slower rate than in 1994, closer to 3 percent. Unemployment should continue to fall below the 6 percent mark. That leaves

inflation, which may rise further to slightly more than 3 percent, particularly if growth does not moderate as much as I anticipate.

The main strengths supporting this outlook are the three c's: consumer spending, capital spending, and construction. Consumer spending, especially on durable goods like autos and household appliances, continues to support expansion in the economy. There is still some pent-up demand for durables, though somewhat less than a year ago. The purchases of consumer goods should support continued growth in manufacturing. Capital spending by businesses, especially on computers and industrial equipment, remains vigorous. The weak dollar and the long-awaited European recovery should boost domestic sales, which in turn should lead to more investment by businesses. Finally, construction, both residential and commercial, is a positive factor in the economy. Although home building is decelerating, it remains at a relatively strong pace. Excess supply in the commercial and office area has been absorbed, and there are reports of stronger activity in many areas of the nation. Growth in construction also contributes to strength in related areas, such as home furnishings.

Even though interest rates have moved up recently, the relatively low rates of the last few years 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. All of these signs point to an overall promising outlook.

To be sure, there are also areas of weakness in the economy, specifically, government spending and international trade. 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 other negative factor at this point is the outlook for net exports, which had been poor due mainly to the weak economic conditions of many of our largest trading partners. However, as economic recoveries begin to emerge in our trading partners, such as Germany, exports should begin to grow more strongly. The decline of the dollar vis-a-vis many other currencies that occurred over the last seven months also contributes to this improving net export situation. These factors will slow the deterioration in real net exports and gradually lead to an improvement. In the meantime, the main source of growth in exports 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, though, imports will continue to grow faster than exports as the increase in U.S. spending still outstrips that of many of our trading partners.

These weaknesses notwithstanding, the risk in this outlook is not whether the U.S. economy can expand. Rather, it is the possibility that too rapid and thus unsustainable growth will lead to a worsening outlook for inflation. Therefore, the Fed began in February to shift away from the accommodative monetary policy stance we had maintained 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 exceeding capacity. This situation often leads to inflation--an outcome the Federal Reserve most assuredly wants to avoid. Early in a recovery period, inflation is not a problem, but, 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 to date there have been only scattered price increases, the pressures that can lead to accelerating inflation are there. With the current course of monetary policy, the Fed wants to make sure that inflation will not become a problem in the United States. In that light, it is critical for us to fend off inflation before it starts recurring.

Now, 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 those who focus on monetary policy 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. At the same time, 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 and Georgia

Now, let me turn to the economic outlook for the southeastern region, which is quite bright. Since the recession, the southeastern region has been expanding in terms of job growth at a rate well in excess of the nation. As U.S. economic growth has improved, though, the two areas seem to be converging, with the Southeast beginning to plateau at a relatively healthy rate of growth and the United States catching up. Let me give you some specific numbers: While U.S. job growth has been increasing at a 2-1/2 percent rate, the southeastern region has been increasing at a 3-1/2 percent rate. Georgia has done far better, at a rate between 4-1/2 percent and 5-1/2 percent.

Three sectors in the Southeast 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 continue to 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 continue 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. Improving conditions in the commercial and multi-family sector should offset slowing residential construction.

A few other areas are contributing to the strength of the regional economy. Although sales of durable goods may have started to peak, expanding sales of nondurable goods are beginning to pick up some of this spending slack. Tourism and convention business should continue to 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, as witnessed by the recent proposed merger of Lockheed and Martin Marietta. Of the states in the region, Alabama and Florida have been the most affected by the defense cutbacks. Taking all these factors into account, the Southeast is likely to continue to enjoy strong but balanced growth through the end of the year and into 1995.

When 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, in part because of the stimulus provided by the Olympic Games and in part because of relatively strong in-migration. Corporate relocations of both domestic and international companies should continue to increase demand directly and in the construction and service sectors. A resurgence in single-family construction 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. However, repairing the flood damage in south Georgia should provide only a mild short-term stimulus to the economy of the state. Fortunately or not, the relative poverty in that part

of the state means there was less damage. Still, there is no way to measure the heavy toll that occurs when business and lives are so disrupted.

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?

Conclusion

In conclusion, the economic expansion in the nation remains quite strong in 1994; the southeastern region is outperforming the nation; and Georgia is doing the best of all the states in the region. As I mentioned earlier in my remarks, the risk in this outlook is not whether the U.S. economy can continue to expand, but whether growth that is too rapid and unsustainable might ultimately contribute to inflation. In this regard, I can promise that the Fed will remain ever-vigilant. However, with the steps we have been taking as a nation to deal with difficult long-term problems, such as the deficit, I also believe we are putting in place the components for stable, long-term growth.