THE ECONOMIC OUTLOOK FOR THE UNITED STATES AND THE SOUTHEAST
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It is a pleasure to be here today to speak with you about the near-term outlook for the U.S. economy as well as for the region and the state of Florida. Before I turn to my outlook, though, 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 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. Earlier in the expansion, the rate of growth of productivity was excellent. More rapid job growth recently has tempered the rate of growth. Nonetheless, businesses have succeeded in keeping the level of productivity quite high. We have reached this level of high productivity not without a good deal of pain, but I am convinced that the investments that 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. As a believer in the necessity of free and open trade to promote long-term growth, 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.

The U.S. Economy

Now I would like to focus on some specifics in the economic outlook for the United States, which continues to look quite promising. My discussion 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 a little under 3 percent this year. Job growth has been strong this year, averaging about 270,000 a month. The unemployment rate of 6.1 percent is at or near most estimates of a non-inflationary rate of full employment. I expect it 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. Another factor will be a likely rise in energy prices as a result of increased demand in the United States, Europe, and other industrialized countries, as well as a significant long-term rise in demand on the part of China and other developing areas.

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 export 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 on corporate balance sheets have been worked down substantially, 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. In the near term, imports will continue to grow faster than exports as the increase in U.S. spending still outstrips that of many of our trading partners who are just beginning to recover from their weak economic conditions. 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. But two factors will slow the deterioration in real net exports and gradually lead to an improvement: As economic recoveries continue to strengthen in our trading partners, such as Germany, exports should begin to grow more strongly. In addition, the decline of the dollar vis-a-vis many other currencies that occurred over the past several months also contributes to this improving net export situation by making imports more expensive and less attractive.

Fighting Inflation

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 early this year 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 Florida

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 now slowed from a 3-1/2 percent rate to what seems to be a plateau of 3 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, Florida and Alabama 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.

Turning briefly to the outlook for Florida: Although the state has retreated from its more-than-four-percent job growth rate of late last year, along with Georgia, it still leads the Southeast in growth. In fact, the most telling economic news in this state is that the rate of growth in payroll employment, about 3-1/3 percent, is greater than the 2-1/2 percent equivalent growth in the nation. In practically any terms, this rate of growth is healthy. The problem is that many Floridians simply are not happy with 3-percent-plus growth because it is less than the more-than-4-percent growth achieved following Hurricane Andrew.

Four percent-plus growth was indeed deliriously good, but not sustainable for the long term. Even though the growth rate has diminished, I would like to point out that the sheer number of new jobs created in Florida is impressive: for example, Florida added about 190,000 jobs in the year from August 1993 to August 1994. To help you to appreciate that number, let me compare it with numbers in faster-growing Georgia, where payrolls grew at a rate of more than 4 percent. During that same period, Georgia added about 130,000 jobs to its payrolls--60,000 fewer jobs than Florida. Making a more local comparison, Miami added almost as many jobs in one year as did the whole state of Mississippi. In short, Florida is the giant of the Southeast that sometimes does not appreciate its own strength.

Overall, the Florida economy has been doing well and will continue to do so. Let me cite one example in the construction area to prove this point: Although housing construction that followed the hurricane has declined, commercial and multi-family building is on the increase. There simply has not been the kind of retrenchment that usually follows increases in construction activity that occur in the wake of a natural disaster. Over the longer term, although base closings will continue to hit the state in 1995, Florida may actually see a slight acceleration in growth, thanks to increasing incomes for retirees and expanding international trade activities.

Conclusion

In conclusion, the economic expansion in the nation remains quite strong in 1994; the southeastern region is outperforming the nation; and Florida is contributing a tremendous amount of job growth. 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 and international trade, I also believe we are putting in place the components for stable, long-term growth.