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THE ECONOMIC OUTLOOK FOR THE UNITED STATES AND GEORGIA

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It is a pleasure ~~I am always pleased~~ to address the Commerce Club on the topic of the economic outlook for the nation. Perhaps, though, you are not so pleased to see me since the Federal Reserve raised interest rates two weeks ago, for the seventh time in 12 months. Knowing that you might not be overjoyed by that move, let me emphasize at the outset that my outlook for the economy is very positive. One important reason it is so positive is that the Fed has been fighting inflation, and such efforts actually work to promote lasting economic growth.

The U.S. Economy

Let me now turn to the specifics of the outlook for this year beginning with a quick look back to 1994. Last year, gross domestic product (GDP) expanded by 4 percent. The unemployment rate averaged 6.2 percent, and inflation, as measured by the Consumer Price Index (CPI), was an annual 2.6 percent.

Looking ahead, this year has all the earmarks of another good year, but with somewhat more moderate and, at this point, more appropriate growth. I think that GDP will increase on an annual average basis of 3 percent or possibly a bit higher in 1995. With growth decelerating, it is unlikely that unemployment will decline much further, and it has already edged up a bit in January. My best guess is that it will average between 5-1/4 percent and 5-1/2 percent. Inflation may rise to somewhat above 3 percent, since price pressures tend to increase as the economy operates at or near capacity. Moreover, energy prices are likely to rise. Demand is increasing in Europe and other industrialized countries whose recoveries are gaining momentum, as well as in China and other rapidly developing countries.

As has been true the past few years, the main areas of strengths and weaknesses in the economy will not change much in 1995. Certain components of gross domestic product that have been growing strongly through 1994, such as personal consumption, capital spending, and construction, will still be growing--but at a slower rate. Healthy demand for automobiles and other durable consumer goods accounted for much of the acceleration in personal consumption last year. Sales of automobiles and other durables will be good again in 1995, but they will not provide an added boost to the economy as they did in 1994. That deceleration is the result of increases in interest rates that have occurred. Also, pent-up demand has largely been met. Consumption of nondurable goods like clothing will continue to grow, but not enough to offset the expected slowing in demand for consumer durables to a pace that is more sustainable.

The same theme holds true in the area of investment by businesses in productive capital, such as plant and equipment. Capital spending has been growing in the double-digit range for two years now. Although this investment will be decelerating, this retreat is from a very high and unsustainable pace. I would like to add that this aspect of growth is quite significant. That is because it expands the capacity of the economy, a matter which is quite vital at this time when we seem to be near or at our capacity--whether measured in terms of the unemployment rate, factory use, or some other measure.

Another type of investment spending, construction of single-family homes, has contributed strongly to economic growth in the nation over the past few years. This boom in building activity has now peaked. Although multifamily and commercial construction should be increasing in 1995, these anticipated increases will not offset the decline in single-family construction.

Government spending is likely to be flat after shrinking somewhat last year. The ongoing pressure to reduce the federal budget deficit should help to keep government spending down. Of course, it is hard enough to make economic forecasts. I am certainly not going to attempt a political forecast, especially this year. Still, any changes that the new Congress might enact are not likely to affect economic activity directly in 1995, although they could indirectly affect expectations as reflected in financial markets. Let me emphasize also that, although government spending will not add to GDP, I do consider deficit reduction to be very positive, not negative.

Looking at that part of our economic growth that is affected by foreign trade, I can say that the gap between exports and imports should begin to shrink this year after several years of growing larger. However, this is not to say the deficit will go away. The U.S. trade balance will continue to be in considerable deficit. The United States has been growing relatively faster than its traditional trading partners. In turn, the demand here for imports has increased faster than the demand abroad for U.S. exports. Fortunately, the signs point to a narrowing of this trade gap this year, as the U.S. expansion slows and the pace of economic growth picks up in Europe and Japan. Additionally, the ratification of the General Agreement on Tariffs and Trade (GATT) will set a more positive climate for U.S. trade, although I do not expect a substantial impact in 1995.

At the same time, the Mexican peso has depreciated dramatically in recent weeks. This development, along with the institution of more restrictive economic policies in that country and possibly others in Latin America, will probably restrain demand for U.S. exports from those areas. I would be glad to try to answer any questions you may have on this subject following my remarks.

In summation, I normally speak of strengths and weaknesses, and it is true that some areas may be weaker than in the past year or two. This year, however, it might be better for me to say that the economy will be very healthy overall.

Southeastern Economic Outlook

Briefly, I would now like to review the outlook for the Southeast. After three years of leading the nation in job growth, the region will see a leveling off of employment creation in 1995. This development is nothing to be alarmed about because the Southeast should still enjoy healthy job growth this year. Gains in southeastern employment have slowed from a peak of 3-1/2 percent in 1993 to around 3 percent annually last year. Payroll expansion may continue to decelerate modestly to a rate of about 2-1/2 percent during this year. Although the nation had been lagging behind the Southeast, it has now almost caught up as both the nation and the region are enjoying comparatively strong employment expansion.

Since the recession the Southeast has derived much of its strength from a concentration of industries that grow quickly when the national economy emerges from a recession. One of these areas is consumer durables. Building-related industries, such as wood products, carpets, textiles, furniture, and appliances have benefited from the growth in residential construction, both in the Southeast and across the nation. These industries typically give the Southeast a large boost at the onset of a recovery--a boost that, at least in relative terms, fades as the expansion continues. Another manufacturing area that is growing in importance is the emerging southern auto industry, from which Tennessee and Alabama are benefiting.

Although construction and manufacturing of consumer durables helped the Southeast to outpace the country early in the recovery, a major source of job growth has been and will continue to be in the service sector. Health care, business services (such as temporary agencies), and tourism account for the bulk of these new service jobs. Employment in these services stopped accelerating in 1994 but has maintained a strong growth rate of about 6 percent. These service jobs should continue to grow at a faster rate than manufacturing in 1995.

Georgia, along with Florida, continues to have prospects for the strongest growth in the region in 1995. As all of us can plainly see, construction related to the upcoming Olympic Games is occurring nearly everywhere downtown, ranging from housing for the athletes around the Georgia Tech campus to the Olympic stadium. Although this construction is an obvious sign of economic growth, it will account directly for only a small portion of the overall growth in the state. Meanwhile, job growth will remain quite strong, rivaling that of larger states, such as Florida, in absolute numbers.

Combatting Inflation

Having said all this about what lies ahead for the nation and the region in 1995, clearly I have given a positive outlook. And yet, a lot of people say to me, "Why then has the Fed made all of these interest-rate moves when growth seems balanced and there are no signs of inflation?" My answer to them is that the question is really irrelevant because the Fed does not look at inflation just at this moment in time. Rather, we look at what the possibilities for inflation are much farther into the future--six months, one year, even 18 months out, and that is our main concern. We essentially want to avoid the situation of the 1970s and '80s when inflation was quite high. As I mentioned, in our view, the economy has been approaching the limits of capacity, and in the past that situation has presaged inflationary pressures. Bearing that in mind, the Fed has acted to combat these pressures in advance.

There is, however, another view of the world that argues that the economy is less prone to inflation than it has been. There are many reasons for this new perspective, including changes in the labor force, business investment, and general expectations about inflation. I will not go into them here. Suffice it to say that, according to this point of view, the Federal Reserve should not have to act as aggressively to contain inflation as it has in the past.

If this view is right, and the Fed continues to deal with inflation according to the standard operating procedure, then we might get less growth. But the fact is, this view is just a theory now, and the burden of proof lies with those who believe that things have changed. Because of this, I believe that the Fed must continue to operate as we have in the past until we receive enough evidence to be convinced that a shift is appropriate.

Conclusion

In conclusion, two weeks after the Federal Reserve raised interest rates, today I have given you a positive economic outlook for both the nation and the Southeast. But, as you might surmise, I believe these two matters actually go hand in hand. By being anti-inflationary, the Fed is actually being pro-growth.

The United States is now approaching its fifth year of growth since this recovery and expansion began in 1991. In the 1980s, the nation experienced the longest peacetime expansion in recorded American history after the Fed found a way to control runaway inflation that had reached 13-1/2 percent at the start of that decade. That expansion, which began in 1982, went on for 8-1/2 years. Needless to say, Alan Greenspan and company, myself included, would like to see this expansion beat that record. With the Federal Reserve continuing to keep a watchful eye for signs of inflationary pressures, I would hope that we can add to our string of expansion years.