

THE INTERNATIONAL, NATIONAL, AND REGIONAL ECONOMIC OUTLOOK
Remarks by Robert P. Forrester
President and Chief Executive Officer
Federal Reserve Bank of Atlanta
King & Spalding Executive Breakfast
Atlanta, Georgia
February 17, 1995

I am pleased to address this august group of lawyers about the international, national, and regional economic outlook. Perhaps, though, I should not stop there. Since I understand that King & Spalding plans to open an office in Houston, you may wish to hear my outlook for Texas, too. Sorry, but you will have to get in touch with the Dallas Fed for that information.

The International Outlook for Industrialized Countries

Let me then begin my remarks from the global perspective. Starting with the Group of Seven industrialized nations, growth for the G-7 as a whole should continue to increase moderately to about 3 percent as an annual average in 1995. That would be up from the 2-1/2 percent pace of last year. [Let me say here that the economic numbers for countries other than the United States that I am using this morning are based on forecasts done by the Organisation for Economic Cooperation and Development (OECD).] Those countries leading the G-7 with the strongest growth will be Canada and Great Britain, followed by the United States. Notwithstanding this stronger growth in general, the average inflation in all of the G-7 countries should continue to stay within a reasonable range of between 2-1/2 percent and 3 percent in 1995, which is up a bit from just over 2-1/2 percent in 1994.

Now let me discuss the outlooks for a few of the individual G-7 countries and also some emerging economies, before moving on to the United States. The European recession has ended,

and recoveries are under way in most countries. The strength of the economic recovery in Germany was welcome news, given the difficult forces of unemployment and the pressures of reunification that Germany has had to confront. For the nation as a whole, growth could reach nearly 3 percent this year, up from roughly 2-3/4 percent in 1994. Strong investment spending in North America and East Asia is boosting exports from the traditionally strong capital goods industry in Germany. This activity has helped to promote the German economic expansion in the face of sluggish consumer demand at home.

With the economy continuing to recover in Great Britain, growth should remain near the 3-1/2 percent level of 1994, which is quite a healthy rate for this nation. Exports have benefited from a depreciation of the currency. The British economy has been so strong that the Bank of England has raised interest rates to try to ensure that inflation remains under control.

Turning to Canada, recently, a number of people have asked whether it is on the same course as Mexico because of the depreciation of the Canadian dollar. I want to emphasize that these situations are vastly different. First, Canada is a highly industrialized economy. Second, it is true that the Canadian dollar has depreciated--but only by roughly 6 percent against the U.S. dollar last year, and recent interest rate increases in Canada should provide some support for the currency. I think the bigger problems are political uncertainty in the nation and the large budget deficits in some provincial governments and the national government. Still, exports should continue to grow strongly, and Canada should continue to expand this year at around 4 percent.

For two years now, Japan has been dealing with a weak economy and rising unemployment and has only recently begun to stage a recovery. The fairly substantial increase in value of the yen has also been a factor in keeping growth sluggish. More recently, the effects of the tragic earthquake in Kobe will not be clear for a while. An ironic fact, though, is that when so much destruction occurs, the rebuilding afterwards often temporarily spurs economic growth. We saw this kind of spurt after Hurricane Andrew devastated south Florida in 1992. Before the Japanese earthquake, the average annual growth for Japan in 1995 was expected to be more than 2 percent after two years of growth at a rate of less than 1 percent. What the effect will be is anybody's guess, but recovery after the earthquake should pick up growth.

The Outlook for Emerging Market Economies

Let me now move on to the emerging market economies. The current situation in Mexico has clouded the short-term economic outlook for that country and for some others in Latin America. Nevertheless, the longer-term outlook remains positive for the region as a whole. I am hopeful that the reform plan formulated by the government and the international initiative to provide financial assistance will quell the crisis of confidence and enable Mexico to resume its transition to a market-oriented--and more prosperous--economy.

Again, conditions in Argentina and Brazil are fundamentally sound, with Brazil having made a remarkable policy turnaround over the past year or so that has helped to bring inflation down. Chile, Colombia, and Peru are likely to outpace the other countries in terms of growth, with gains of between 5 percent and 7 percent. Inflation for Latin American countries should

decline in 1995 to between 20 and 30 percent. Now that range may seem high to us, but it is quite an accomplishment considering that, in 1993, the inflation rate for the region was more than 1,000 percent.

Crossing the Pacific Ocean, I now come to the booming economies of China and the Pacific Rim. Despite a slight deceleration in growth from 8 percent in 1994, economic growth in these developing economies of the Asia-Pacific region should continue to be the fastest in the world. Growth in 1995 should be between 7 percent and 7-1/2 percent for the region as a whole. As the Chinese government makes efforts to stem high inflation of nearly 20 percent, the economy should slow from its 1994 growth rate of 11 percent. Trade should remain the fastest-expanding element of the economy. Investment in infrastructure, such as ports, airports, and telecommunications, should be another dynamic factor in the ongoing rapid growth of the region generally.

To sum up my outlook then, the strongest rate of output growth in the world continues to come from newly industrializing Asian economies. The advanced economies have, generally, left recessions behind them and are experiencing moderate growth during their recoveries. Latin American fundamentals remain strong, and growth should progress despite some uncertainty at present.

The U.S. Economy

Now let me focus my attention on the economic outlook for the United States. Growth

in output, or gross domestic product (GDP) of 4 percent last year was stronger than I had anticipated. This year also 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.

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 partly 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. Still, I am very pleased that this sector of the economy will continue to grow at a healthy pace since this kind of spending works to increase the productive capacity of the economy over time.

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. 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.

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. 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.

Conclusion

So let me conclude by saying that the international economic outlook is, overall, the most positive it has been in several years. Output in the industrialized countries and most developing regions is growing. Furthermore, 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.