As always, I am very pleased to welcome each of you to the Federal Reserve Bank of Atlanta. Each year must bring new challenges your way, but, as the 1996 Summer Olympics draw nearer, I imagine each of you will be finding out what the true meaning of the word "consul" is: someone who can get tickets to the Opening Ceremonies. Let us hope that you are able to serve your country well in this difficult endeavor.

Thankfully, I have been able to focus on international efforts outside the realm of the Olympics this year. For instance, my speaking schedule has recently taken me to Copenhagen where I delivered a talk about the role of the regional Reserve Banks to policymakers at the central bank of Denmark. It seems they are anticipating the day when the European Community will have one central bank, with former central banks in each country serving more as regional Reserve Banks. The discussions with the Danish central bankers and others that I have had during previous foreign trips have given me very helpful insights into the larger context in which U.S. monetary policy decisions are being made.

With that in mind, I thought I might focus today on the U.S. economy in relationship to the international economic outlook. I would also like to talk with you a bit about how the Federal Reserve may be close to engineering a "soft landing" for the U.S. economy.
The U.S. Economy

Let me turn first to the U.S. economy: Growth in output last year was 4 percent. This rate of growth was very strong relative to our potential, and the current slowing is not entirely unwelcome. Of course, that will be true only to the extent that we do not slow too much. This middle course between economic boom and recession is the oft-mentioned soft landing. Considering that the expansion has been going on for four years, a slower rate of growth this year—perhaps 2-1/2 percent or somewhat higher—is absolutely appropriate and necessary. In fact, we welcome this development since we would like to ensure that current pressures on prices will prove to be a temporary and cyclical phenomenon. With growth decelerating, it is unlikely that the unemployment rate will decline much further. My best guess is that it will be close to 5-1/2 percent, but it could run above this level at times. Inflation may rise to somewhat above 3 percent.

As has been true the past few years, the main areas of strengths and weaknesses in the U.S. economy will not change much in 1995. Certain components of gross domestic product that have been growing strongly through 1994, especially personal consumption but also capital spending and construction to a lesser degree 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 distinctly slower than last year. That deceleration is the result of increases in interest rates and the fact that 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, it is a moderate retreat from a very rapid 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 very near our capacity—whether measured in terms of the unemployment rate or factory use. This rapid addition to productive capacity helps to temper price pressures from strong demand.

Another type of investment spending, construction of single-family homes, has contributed strongly to economic growth in the United States over the past few years. This boom in building activity peaked last year. 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. 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 U.S. 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, any progress toward reducing the deficit will be good for the long-term prospects for economic growth.

In the area of foreign trade, a number of issues should affect U.S. exports and imports. With U.S. economic growth decelerating, demand from domestic sectors for all goods--imported goods as well as those produced in the United States--should slow. Many European economies are on a moderate growth path now, while the dollar is lower than it was last year at this time. These circumstances should help our net export position. On the negative side, the Mexican peso depreciated considerably in the early part of 1995. The currencies of some other Latin American countries have also been under pressure at times. This development, along with more restrictive economic policies in that country and possibly others in Latin America, will probably restrain demand for U.S. exports from those areas. However, I should point out that, although this situation will have a negative effect on trade, it should be temporary, and U.S. trade will benefit from the structural reforms being implemented in a number of our Latin American trading partners.

Overall, the real story in exports is that there has been a long-term expansion in the volume of international trade going on for more than 20 years now. This trend has completely dominated the trade picture and any cyclical pattern. What that development means is that it is not so much the business cycle that we must worry about but rather U.S. trade policies. And, over time, we have progressively moved to more open trade, which has been far better for our economy. Consequently, even though the trade balance will improve only slowly over the next
two years, the volume of exports—and imports as well—will continue to grow. In broad terms, I can also say that the gap between exports and imports should not get much bigger during this year and may actually begin to narrow toward the end of the year.

Summing up the outlook for the United States this year: GDP should grow by 2-1/2 percent or somewhat more, with inflation rising to somewhat above 3 percent, and unemployment averaging about 5-1/2 percent. Overall, then, the national economy should be healthy, although it is true that some areas will not be growing as quickly as before.

**International Economic Outlook**

Now although I said I would focus primarily on the U.S. economy, most of you know that international affairs are so important to me that I cannot pass up the opportunity to speak at least briefly about developments in this area. In addition, all of us in this room know how important the international economy is to each of our domestic economies. Let me then talk about the international economic outlook in terms of three major trading areas for the United States: the Americas, Western Europe, and the Asia/Pacific region.

U.S. trade with the developing countries of our own hemisphere has skyrocketed over the last five years. From 1990 to 1994, total trade with Mexico has doubled to more than $100 billion. Trade with the other developing countries in Latin America grew from $60 billion in 1990 to $80 billion in 1994—an increase of 33 percent. Five of our fastest-growing export markets this decade are located in Latin America, and the region accounts for 15 percent of all
U.S. trade.

However, this has been a trying year for many economies in our hemisphere, particularly that of Mexico, and, as I mentioned earlier, growth in trade with Latin America will decelerate this year. Nonetheless, I would like to point out that, faced with a difficult financial situation, Mexican leaders did not retreat into protectionism or nationalization as they did in the early 1980s. The fact that Mexico has enacted long-term policies designed to fix the current problem, and to prevent futures ones like it, encourages me to be optimistic about the future of Mexico.

Also within the Americas region is Canada. As our single largest trading partner, it takes 22 percent of U.S. exports and ships 19 percent of U.S. imported goods. The economic outlook for Canada is very positive. Although economic growth is decelerating from the 4-1/2 percent rate of last year, Canadian real gross domestic product (GDP) should still average just under 4 percent in 1995 and 3 percent next year. The slowdown should allow Canadian inflation to remain below 3 percent annually through 1996.

Looking across the Atlantic Ocean, I am pleased to see that Western Europe has cast off the last remnants of its early 1990s recession. These economies should see growth near 3 percent this year as well as in 1996. U.S. trade with the European nations--which accounts for 20 percent of all U.S. trade--should pick up in the coming years. It does not seem likely that the move to incorporate more European nations into the European Union and further steps toward monetary union will have an adverse impact on U.S. trade with Europe.
Let me turn now to the third key area I would like to discuss, the Asia/Pacific region. The economy of our second-largest trading partner, Japan—which accounts for 15 percent of all U.S. trade—may remain weak through 1995, but could do better next year if domestic demand picks up as expected. However, the benefits of financial deregulation, lower taxes, low interest rates, and increased government spending may be offset by the appreciation of the yen. After growing 1/2 percent last year, the economy in Japan is expected to grow just over 1 percent this year and a bit above 2 percent in 1996. Slow growth combined with mounting trade tensions between Japan and the United States do not bode well for an increase in U.S. trade with Japan in the near future. I am hopeful, however, that trade talks this week between Japan and the United States will strike a compromise, since I do not believe that trade sanctions ever solve trade problems.

I mentioned earlier that five of the top 10 fastest-growing U.S. export markets are in Latin America. The other five are found in Asia. Excluding Japan, trade with the Asian nations accounts for 20 percent of total U.S. trade. These economies are expected to grow more than 7 percent in 1995 and 1996, down a bit from the 8 percent pace of last year. The potential for increased U.S. trade with this region is bright because of this growth forecast and continued efforts toward freer trade taken by Asian nations.

**Reasons Why the Fed Can Manage a Soft Landing This Time**

Now, let me finish my remarks with a few comments about the slowing of the U.S. economy. A soft landing of the economy—meaning steady, sustainable growth coupled with
subdued inflation—is definitely the goal of the Federal Reserve. Although the soft landing has been somewhat elusive in the past, I think that there are good reasons to believe that we can weather a slowdown without a recession this time around, compared with the near-miss soft landing of 1990-91. (We will never know if we could have had a soft landing at that time since the Persian Gulf War and the oil shock intervened.)

At any rate, these two times are similar in terms of policy restraints although the current conditions of the economy are different from those in 1990-91. In both cases, we had rapid growth, and so the Federal Reserve imposed restraints. But the distinctions between then and now are sustainability and balance. I think that now, because of the balance within the U.S. economy, we are more capable of reaching sustainable growth. I would like to outline a few reasons to explain how our economy is better poised to reach the soft landing in 1995 or 1996:

First, much progress has been made in eliminating the imbalances in both corporate and consumer balance sheets since the late 1980s when both corporations and homeowners were carrying a great deal of debt. Not only have they paid down the debt levels, but interest rates have been lower, which has allowed many corporations and homeowners to refinance their debt. Second, there had been considerable overbuilding by the construction industry and excesses in retailing. Although it was painful, these excesses in the construction and retailing industries have been reduced. Third, the current data on orders and income have been good. These areas may have weakened slightly, but they have rebounded and returned to their upward trend. Fourth, the banking system is very healthy with no threat of a credit crunch.
Without being too immodest, I would like to point out that the Federal Reserve and its policies deserve much of the credit for bringing about these results in the economy. One final point that is distinctly different from the situation in 1990-91 is that the value of the dollar is more favorable for stimulating exports.

All of these circumstances argue that the most likely outcome from the policies of the Fed this time around is a soft landing. As a policymaker, my concerns are always the risks to an economic outlook. Therefore, I do tend to focus on the risks, but I will say that I am not at all surprised at the kind of economic information we have been getting lately. One quarter of weak economic data is not a major concern at the Fed, because we are always looking at the long term. In my view, when we take a cold, hard look at the long term, we can see a softer economy, yes, but one that achieves sustainable growth.

Conclusion

In conclusion, the U.S. economy is slowing but also reaching the goal of a sustainable rate of growth. Although some of the short-term economic news may be negative, I believe that in the long run, the data will prove that the Federal Reserve has taken the correct steps to put the national economy on the path toward moderate and yet sustainable growth.