

## Speeches

### The 1996 Economic Outlook for the United States

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What a pleasure it is to be actually addressing the Atlanta Rotary Club today! Nearly a quarter of the year has gone by since I was originally scheduled to speak. The good news is that I've been able to cut my speech down by a quarter also. In all seriousness, I am pleased to continue the tradition of having the president of the Atlanta Fed give the economic outlook for the year. For many years, I've sat in the audience with you as Bob Forrester--and before him Bill Ford and Monroe Kimbrell--shared their forecasts on the strengths and weaknesses of the U.S. economy. This year, I'm the one on the spot, and, believe me, I have a new appreciation for the way my predecessors boldly went out on the limb.

Today, I'd like to talk about the outlook for the U.S. economy and then move on to a short list of public policy issues that are close to my heart. But first let me recall Bob Forrester's predictions for 1995. Most of you know that he has launched still another career as a "reborn lawyer." Before he left for his new law office perched high above Peachtree Street, he gave me his OK to report on how he did with his forecasts for you a year ago.

Now, Bob has been an excellent prognosticator over the years. He did well for himself again last year, getting two out of his three predictions correct. Actual GDP growth in 1995 turned out to be 2.1 percent on an annual average basis, so Bob's forecast of about 3 percent sounds like a substantial miss. However, Bob's projection was based on the old way of measuring output, not the new chain-weighted statistic now being used. So with that adjustment, Bob was right on the mark. He also came very close with his prediction that the unemployment rate would average between 5-1/4 and 5-1/2 percent, as it came in at 5.6 percent. His one miss came in regard to inflation, as measured by the CPI (consumer price index). He thought it might rise to a little above 3 percent. Instead, it averaged 2.8 percent for 1995.

Now, let me give you my own thoughts in these same areas for 1996: First, I believe the U.S. economy should expand by about 2 percent on an annual average basis in 1996. This expansion in GDP, while roughly the same as last year's 2.1 percent, signifies that the economy remains on a moderate growth path. Second, I believe that unemployment in 1996, on an annual average basis, should be about the same as last year's 5.6 percent rate. And, third, inflation, as measured by the consumer price index, should continue to average between 2-1/2 percent and 3 percent. That would not be much different from last year's 2.8 percent. One way to look at the overall picture is to say that the economy is moving forward without major impediments but also with somewhat less momentum than we experienced earlier in the recovery.

The good news here is that inflation remains low while real growth and the unemployment rate stay in the healthy range. Several factors are contributing to this favorable inflation picture. These factors include greater international competition for most traded goods, productivity gains through technology, and very competitive labor markets. Of course, I expect that monetary policy will continue to create an environment conducive to moderate growth and low inflation, and this belief conditions my outlook.

All in all, this outlook portrays an economy with few imbalances and without worsening inflationary pressures. Now, as a central banker, I'm satisfied with this kind of an outlook, but I'm aware that, because the economy is weaker now than we anticipated at the end of last year, some people are not. It's undeniable that some of the numbers from the fourth quarter were worse than we have seen in a while. After all, consumption rose less than 1 percent, inventory accumulation declined substantially, and federal government purchases were down by a big drop of almost 13 percent. But it's highly unlikely that any of these situations represent long-term trends. Consumers seem sure to spend more; inventories should bounce back; and the rate of decline of government purchases won't be so steep from here on out. All of this leads me to believe that much of the recent slowing is temporary. In fact, the strong employment report last Friday reinforces my more optimistic view of the economy although I would caution against extrapolating from a single month's data.

#### EVALUATION OF THE ECONOMY'S STRENGTHS AND WEAKNESSES

As might be expected in a well-balanced economic environment, there are few glaring weaknesses or overpowering strengths. The component that should contribute the most strength to the economy as we move through 1996 is capital spending. Consumer spending may not be as strong as it's been in the past few years of this business expansion. Net exports should continue to improve, although more slowly than previously projected. But neither of these should be a drag on the economy. Government purchases, on the other hand, look like they will be a net drag.

#### CAPITAL SPENDING

Let's look a little more in depth at each of these components, starting with capital spending. It's expected to grow at a particularly robust rate, although even it will be less spectacular than has been the case over the last couple of years. After several years of extremely rapid expansion at double-digit rates, capital spending by businesses on factories and equipment should slow to a still quite healthy 6 to 8 percent in 1996.

Conditions to support this rate of growth are still good. Corporate profits remain healthy, and equity gains have enhanced corporations' ability to raise cash. Also, although long-term interest rates have been rising recently, they are still low compared with past years. For instance, corporate A-utility bond

rates have recently been just under 7.5 percent. This figure compares with a recent high of about 9 percent in November 1994. Last year, capacity utilization for virtually all types of businesses--not just manufacturing--edged down, although it should remain steady at moderate levels this year. These levels should be high enough to elicit more investment. Overall, then, what we have is investment slowing, and this should help to maintain a balance between growth in capacity and anticipated demand growth.

As usual, investment in equipment--particularly computers--is outpacing growth in office buildings, factories, and other structures. It's important to note that we don't see the alarming level of speculative building that had emerged in some regions at this stage of other economic expansions.

Although inventory growth was down over the past two quarters, and domestic demand does remain moderate, I believe that the adjustment to overbuilt inventories during the last year is about complete.

## CONSUMER SPENDING

Moving from the business side to the consumer side, spending by consumers has been down recently, but prospects for the long term are reasonably healthy. This year, it looks as though consumers will slow their pace of spending to just slightly more than 2 percent compared with 3 percent last year. This rate should be easily managed because it will be in line with personal income growth. Despite all the headlines and personal anecdotes about re-engineering, downsizing, and permanent layoffs, payroll employment rose an average of more than 140,000 jobs per month from January to December of last year. At the same time, personal income, unadjusted for inflation, rose at an annualized rate of about 6 percent. This moderate growth on both fronts should continue into 1996.

Meanwhile, unemployment should remain in the 5-1/2 percent range. The civilian labor force is expected to grow slowly over the next two years. Therefore, only modest increases in employment should be needed to keep the unemployment rate near its current level. Also, the recent bull stock market has increased personal wealth and argues for optimism with regard to consumer spending.

Housing will probably provide considerable impetus to the moderate economic expansion. Lower mortgage rates should give housing a small boost. Housing starts should also rise in 1996 after falling in 1995, but the level won't match the pace of earlier years. With increased housing activity, spending on household durable goods, such as carpets and major appliances, should grow moderately. Demographics, along with saturation of pent-up demand, will also hold automobile sales to a modest growth rate.

Overall, then, based on what we know about job growth, personal income, and household wealth, it looks like personal consumption is bound to improve from the fourth quarter's pace over the course of the year.

## EXPORTS

In the area of international trade, our trade balance is likely to improve as the year goes on. The underlying factors behind this expected improvement include projections of moderately stronger growth on average for our trading partners--although not quite at the pace that was projected last year. Two of our largest trading partners, Japan and Mexico, will still likely be facing sluggish growth this year. Also, Canada, our largest trading partner, will probably post only moderate gains, as will Western Europe. Growth rates should be strongest in the developing economies of Asia and most of Latin America. Another factor that should help to improve the trade deficit is the somewhat restrained pace of domestic spending, which will keep import growth slow over the next several years.

But forecasts for this sector are tricky because they depend on what happens to the economies of our major trading partners, and their growth has averaged less than ours over much of this expansion. Currently, they are improving, but not as fast as expected. Also, recently, trade data have been much better.

## GOVERNMENT SPENDING

Finally, the area of government purchases will be affected by what kind of agreement Congress and the President reach on balanced-budget legislation--and I will have more to say on this topic in a few moments. Still, in the current atmosphere of restraint, government purchases should remain flat in 1996, with federal purchases declining and state and local government purchases increasing. This situation will probably dampen economic growth.

## SUMMARY OF ECONOMIC OUTLOOK

That's my outlook for the national economy, and it shows that I believe the fundamentals are still in place for moderate growth. While fourth quarter data from 1995 showed a slowdown--and that may carry over into the first months of 1996--I believe we are looking at a temporary situation. Inventory growth should resume, consumers should spend more, investment should stay reasonably strong, and government spending should not shrink as fast as was the case last year.

Tracking the economy over the last couple of months has been a little like tracking the return of a spacecraft from orbit in the early days of the space program. If you remember, there was a period of time during a spacecraft's return to earth when NASA's control center would lose communication with it. During this black-out period, it was also impossible to get current data on the trajectory, so it wasn't completely clear where the craft would splash

down. In a sense, you held your breath looking for the parachute.

That's how it's been with the economy of late. We know the trajectory of the economy at the time of the government shutdown, which interrupted the gathering and reporting of much of our economic data. The shutdown was followed by a series of blizzards that disrupted some economic activity. So we are less sure than we customarily would be about the trajectory of the economy as we entered 1996. Now, with much of the data that have come out so far--data that are still incomplete--it seems the economy has weakened somewhat. In the long term, the economy still appears to be on the kind of trajectory that will give us moderate and sustainable growth.

## ECONOMIC OUTLOOK FOR THE SOUTHEAST

Having discussed the nation's outlook at some length, I would now like to take a look at the southeastern region. This information is particularly important to me since one of my responsibilities at FOMC (Federal Open Market Committee) meetings is to share my view of regional economic developments and prospects. Like the U.S. economy, the Southeast's economy is now entering a period of moderate and balanced growth that's likely to continue through 1996. In fact, although the region's growth may decelerate, we should continue to grow at a faster rate than the nation in terms of payroll employment, which has been true throughout the recovery from the 1990-91 recession.

Consumer spending and services, especially boosted by tourists, and construction should be the areas of strongest growth. Retailing has been growing in the 5 percent range, especially in high-end goods such as jewelry and household furnishings, and should continue to do so. Automobile sales, however, may remain weak compared with previous years. Residential construction looks reasonably good, while multifamily and commercial real estate markets should remain strong throughout the region, with most areas recording both high occupancy rates and new project announcements.

In contrast, manufacturing--which has been an engine of growth in the region for the past two to three years with the production of autos, housing-related products, and paper--may have reached its cyclical peak. Apparel manufacturing has been hard hit by international competition and lower labor costs abroad, and this situation is unlikely to change. Although manufacturing has backed down to lower levels of output, there is still some potential for spots of strength. For instance, thanks to the rebound in home sales and construction in the last quarter of 1995, there could be a short-run increase in demand for housing-related materials, which are such a large component of the southeastern manufacturing sector.

Even if this expected rebound in real estate markets does not generate a significant number of new manufacturing jobs, other sectors of the regional economy have sufficient potential to maintain a moderate pace of growth for the balance of this year. For instance, tourism and business-related travel will continue to contribute substantially to the strength of the regional economy. These activities also fuel employment growth in the trade and service jobs that cater to tourists and business travelers, allowing them to continue to account for the majority of the new jobs created during 1996. With the Olympics coming this year to Atlanta, it's easy to say that tourism has a better shot than manufacturing does at increasing regional growth this year.

A rundown of the prospects for each of the southeastern states shows that Georgia and Florida should continue to have the strongest economies in the region, which has been true for a number of years now. These two states now account for about two-thirds of the work force in the Southeast.

**Georgia** will obviously see an upsurge in short-term employment as the Olympic Games approach, as well as an extraordinary flurry of spending during the two weeks of the game. But no matter that the Olympics will dominate the state news in every way this year; even without the Olympics, the Georgia economy would be strong. Services provide about a quarter of Georgia's jobs and should continue to post strong growth. Some of the strongest areas of payroll growth will continue to be in business services, such as temporary-help services. Temp agencies and hospitality services will see a surge in demand with the Olympic Games but they also will feel the letdown afterward as all that was temporarily associated with the event will come to an end. However, given the fundamental strength of the Georgia economy, we should expect neither a long-term slowdown nor a particularly deep one. It's probable also that our neighboring states of Tennessee and Florida will absorb some workers who will be laid off after the Games are over.

**Florida** has enjoyed annual payroll growth of about 4 percent since 1993, and it should continue at more than 3 percent growth into 1996. Tourism and health care are the two traditional big businesses in the state. While one is rebounding thanks in part to increased tourism from the Summer Olympics, the other is facing problems from reforms of medical programs at the federal level, particularly because of the large number of retirees in the state. What should contribute to a good year for the Florida economy is its diversification into services and manufacturing and the major boost from its traditional power base in tourism.

**Tennessee** has had more than its share of labor shortages this year, particularly in entry-level jobs in services and the burgeoning automobile industry. But this is the sort of problem every state might like to have. Tennessee has become the center of the new southern auto industry, and, as such, its future is bright despite a near-term slowdown with the current slack in auto sales. Parts and components manufacturers will be migrating south for many years to come to be closer to the auto manufacturing plants. That means that pressure on labor markets will continue in 1996 as manufacturing and services, along with ancillary construction, continue to expand. Tourism will also do well thanks to an Olympic venue in the state, although it will not be as significant as in Florida or Georgia.

**Alabama** should see accelerated economic expansion this year, but it will be gradual and uneven. The reason is that the state has three distinct economies, two of which should do well and one that is declining. The economy in the northern part of the state should continue to expand thanks to the auto industry, but it may also be hampered temporarily by NASA downsizing. The economy of the Gulf Coast should do well with tourism and manufacturing. It is the economy of the central part of the state that is suffering the decline because of substantial job losses in the apparel industry, and there is nothing on the immediate horizon to replace those jobs.

**Louisiana** is likely to continue to benefit from new gambling ventures, although not in New Orleans, where two river boats and the land-based casino closed last year. But it is manufacturing, energy, and services, particularly outside of New Orleans, that should push the state forward through 1996, albeit at a somewhat slower pace.

**Mississippi** has also been affected by the mixed blessings of a boom in gambling activities. Last year, as the boom diminished, so did economic

development associated with new gambling ventures. The state has largely worked off its initial problems in the slowdown, though, and should see some mild acceleration of growth during 1996.

### THREE PUBLIC POLICY ISSUES

Now, let me take the few remaining minutes to set forth three important public policy issues that I see on the horizon. As I begin to devote more serious time and conversation to public policy issues, these three keep coming up.

An issue that's of special interest to me--and that I think has major economic consequences--is continuing the restructuring of the banking industry. I've spent a lot of my career dealing with banks and bankers. This experience has led me to conclude that the present framework in which banks operate is far from optimal. Restrictions on geographic expansion and product offerings are like the remnants of an old cobweb that has outlived its usefulness but has not been swept away. We must find a way to let banks do what they do best. Freeing banks to compete fairly with other financial institutions is good not just for banks but also for businesses and consumers--in fact, for the economy as a whole.

To me and to many others, it seems clear that now is the time to dismantle Glass-Steagall restrictions on what banks can do. The Federal Reserve and other regulatory agencies have done their part to allow certain well-managed and well-capitalized banks to add new powers on a limited basis. While I believe these measures are appropriate and helpful, I advocate moving beyond incremental measures and acting comprehensively. This kind of action must be taken by Congress.

The second issue on my list is price stability or the control of inflation. In the United States, we central bankers feel strongly about protecting the purchasing power of our citizens' income--it's in essence our sacred trust. So, every chance we get, we point out that an environment of stable, low inflation encourages the most efficient allocation of resources. This enhances our standard of living and, ultimately, improves the economic well-being of everyone. This result does not appear instantaneously, but it does emerge over a longer period of time. That is why a true commitment requires a long-term perspective. We've come a long way in dealing with inflation from the days in the late '70s and in 1980 when it hit a high of 13.5 percent. Those were indeed the "bad old days."

One of the very happy developments in economic policy over the last 15 years has been the reduction of inflation to a modest and relatively stable rate of about 3 percent. The reason that I'm even more excited about the good work we've done in this nation on the inflation front is that it appears that other countries have also increased their commitment to policies that hold down the rate of price increase. We can see this turn of events in Europe, where admission to the European Monetary Union is contingent upon each country bringing inflation down to certain threshold levels. We can also see this shift in various countries of Latin America, where, until recently, national policies had given rise to chronic high inflation.

Despite this trend, there may be times in the future when certain forces will argue for relaxing the commitment to long-term price stability in favor of other interests and outcomes. And if those times come, and surely they will, it will be extremely important to the Fed and other policymakers for business executives, as well as workers and consumers, savers and investors, to stand up for holding the line on the major gains we've made with respect to price stability. I would ask each of you to examine your views on keeping inflation under control and to let me know your opinions on the complex problem of achieving true price stability for the United States.

The third crucial issue--deficit reduction--is one that I thought might be settled by now. But because it has not been settled, it has become even more important than before. Earlier this year, I had great hopes that Congress would hash out the difficulties in balancing the budget and reducing the deficit. But both Congress and we as a nation seem to have lost momentum. I'd like to say as strongly as I can that we must not lose our nerve. We must make the necessary progress in this area in order to gain the long-term benefits. It's time now to make the toughest decisions, decisions that will profoundly change the way government has been operating in the economy.

Ironically, we've imposed some of the fiscal restraint that was being discussed, thanks to some federal agencies and programs not being fully funded in 1996. But we've done so without gaining the credibility that a long-term commitment would bring. In other words, we've incurred a lot of the costs without ensuring the benefits. I understand that, politically, this debate over what to cut when and where is extremely difficult. But I would ask all of us in this room, is it not worth holding Congress's feet to the fire--and sticking to our own resolve--to create a stronger nation?

### CONCLUSION

In conclusion, I'm pleased to make my debut before your group with an economic outlook that speaks of moderate and balanced growth and low inflation. It may seem too optimistic for some, but I'm convinced that the weakness we've seen is most likely only temporary. Barring any unexpected events--a phrase that makes me sound like a true-blue economist--the economy should be able to remain on such a moderate path to the ultimate benefit of all. No doubt, we'll be faced with many unexpected challenges in the years ahead, and I've alluded to a few of them. But I believe that we're more capable than we've ever been before of dealing with the toughest problems and creating a better economy both for this region and the nation.

### CONTACTS

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