Speeches

The 1997 Economic Outlook for the United States

Remarks by Jack Guynn
President and Chief Executive Officer
Federal Reserve Bank of Atlanta
Atlanta Rotary Club
Atlanta, Georgia
January 6, 1997

It's great to be here today. That's something speakers often say . . . but it's particularly applicable for me today. Some of you may remember that our meeting got snowed out last January 8, the day I was to have given you my very first big public speech in my new job. You may recall I didn't get a chance to address our club and share my 1996 economic outlook until March. Having learned what it takes to keep me from talking, I understand that, this year, one of my banker friends has got a snow-making machine hooked up in the back of the room, and he tells me he's going to let it rip if I talk too long.

What I'd like to do in the next few minutes is to reflect very briefly on how the national economy has performed over this past year, and then share my sense of the outlook for 1997 -- and what could go wrong. And, finally, I want to wind up by talking about why I think we've got to fight a trend I see toward a certain amount of complacency about this nation's economic performance. Hopefully, I can convince you that it's people like us in this room, who understand good public policy and have long memories, that must help to keep a spotlight on the need for retaining the gains we've made against inflation and for making further progress on deficit reduction. Naturally, at the end of my remarks, I look forward to responding to your questions.

The National Outlook

I have the sense that most of us are going into the new year with great expectations -- and I think for good reason. We're coming off a year in which the economy performed very well. All of the official figures for 1996 aren't in yet, but it looks like the economy grew at an annual average of around 2-1/4 percent, with unemployment at about 5-1/2 percent on an annual average basis (as low as it's been since 1989), and with inflation holding at around 3 percent. And we're now into the seventh year of this economic expansion -- only the third time in the last 50 years that we've had such a long period of sustained growth. I think most of us would agree that this kind of economic performance is terrific -- it's sort of like having your favorite college team win its bowl game not just one year, but six years running.

By the way, for those of you who are keeping score, these figures indicate that I did pretty well last year with my predictions. I came in on target with both my inflation and unemployment forecasts. I was a little low on GDP, calling for growth of about 2 percent on an annual average basis. But, in this case, I don't mind erring on the low side.

But more importantly, how do I see things shaping up for this year? Well, based on all the information we have available to us and the analysis that our Atlanta Fed staff does on an ongoing basis -- as well as insights and anecdotes from our directors and other business contacts in the region -- I believe we're going to see more of the same in 1997. It looks like another year of moderate growth somewhere between 2 percent and 2-1/2 percent (perhaps a tad slower than last year), unemployment continuing near the low level of 5-1/2 percent we've seen over the last two years, and inflation, as measured by the CPI, continuing at about its current 3-percent level.

Of course, people who make predictions about anything -- from who's going to win the Super Bowl to what the price of oil is going to be next year -- always hedge their bets. For instance, I grew up in farm country, and I can remember some of those Virginia farmers saying things like, "It looks like we're going to have a bumper corn crop -- if the rains keep coming." And how many of us have heard a college coach predict that his team is going to do well next year, assuming, of course, that there aren't any serious injuries. The point is, no one can predict what kinds of momentous and unexpected things might happen, either for the better or for the worse, to change an economic outlook.

Barring any such events, or external shocks, as economists call them, once again, I expect that consumers will be leading the way -- though not quite as vigorously as last year -- particularly in the area of autos and other durable goods. Part of the reason for this ongoing strength is that prospects for job and income growth remain positive.

Housing will probably slow somewhat, mainly because most of the pent-up demand has been met but also because of demographic constraints. Now that we're feeling the effects of the baby-bust generation, there simply aren't as many new families out there looking for apartments and houses as there were in the 1970s and early 1980s.

Overall, I think business spending will be a source of strength in the economy again this year, albeit one that has been slowing down from its high point in this decade of nearly 10 percent year-over-year growth in 1994. Everything I see and hear suggests that businesses will continue to spend on equipment, as it is now clear that re-engineering and investment in productivity-enhancing equipment was not just a short-term phenomenon.

Government spending should remain flat overall, as moderate declines at the federal level -- prompted by additional and much-needed efforts to rein in our large budget deficits -- should be offset by moderate growth at the state and local levels.

Demand from abroad is not likely to change dramatically, given that the prospects for economic growth of our major trading partners remain only moderate.

What Could Go Wrong?

So there you have it, an outlook that's not much changed from last year's, and last year was a good year. In fact, you'd have to go back to the 1950s and 60s to find a similar period when the unemployment rate and inflation were so steady and relatively low. And back then, the United States was about the only economic game in town, so to speak. Now, many countries throughout the world contribute to global economic performance that far outstrips what we had in the 1950s and 60s. I will not talk specifically today about the economic outlook for Georgia or for the southeastern region, but let me just say parenthetically that I think we will continue to do slightly better than the nation, even as our region's rate of growth slows to something closer to the national trend.

Now, you might ask, What could go wrong? There's always a list of things that could happen to change the outlook. Since we have such a well-balanced economy now, the good news is that there's simply less to worry about than usual. Here are some of the things I'm keeping my eye on as I scan the horizon for the nation and the Southeast:

First, I think it's pretty clear that continued tightness in labor markets is a real concern for business people like you and for policymakers like me. With job growth running well ahead of labor force growth, it comes down to this: Where are we going to continue to find workers? -- and -- Are they going to answer our "help wanted" ads? It's getting tougher to find -- and retain -- skilled, qualified workers. At our Bank, for instance, we've been finding for a while now that there's a premium on people with automation skills. Other pockets of tightness in the Southeast have included construction and retailing as well as certain skills like welding. Net net, labor markets are at least a question mark in my mind as I look ahead.

A **second** area I'm watching is consumer spending. It's always a critical factor to watch since it makes up two-thirds of our economy. Although job growth, income growth, and confidence are at levels that should continue to support a healthy level of spending, growing levels of consumer indebtedness may begin to dampen expenditures. Real estate is a **third** area I'm sensitive to, because overbuilding has often led to problems in the past. But I should say that we're not yet seeing such worrisome developments.

Federal Open Market Committee

These are some of the uncertainties that I think will provide useful perspectives on how things are going as 1997 unfolds, and are among the issues that will help shape my views at our regular meetings of the Fed's Federal Open Market Committee, or FOMC as it is called. These meetings, which are held every six to eight weeks during the year, are where we debate the monetary side of economic policy, as opposed to the fiscal side, which Congress is responsible for as it makes decisions on taxes and government spending. As the central bank, we use our influence over interest rates to try to keep the economy growing at the fastest pace that is consistent with stable prices.

Now, my views on monetary policy will probably become more public in this new year as I'll be rotating into a voting position on the FOMC. Because of the fact that I have a vote, some people (and I won't point my finger at my friends in the press) are going to be trying to label me and asking, Am I going to vote to raise or to lower rates? -- and -- Am I a hawk or a dove on inflation? Well, as a roundabout way of answering these questions, I would like to deal with some misconceptions about what actually goes on at an FOMC meeting. By doing so, I think you'll understand why I personally see labels like these as substantially irrelevant.

Point No. 1 -- FOMC meetings are not a rubber stamping session for Alan Greenspan. The meetings are truly deliberative discussions. They are a time when we can freely debate the various issues we each think are important to the smooth running of the economy -- and we can change our minds based on the discussion.

Point No. 2 -- There are lots of people sitting at the table debating and making the decisions. Actually, there are 19 of us who sit around the FOMC table and debate the state of the economy and monetary policy. Twelve of those 19, like me, are presidents of the regional Federal Reserve Banks; the other seven are Chairman Greenspan and the other six Fed Governors in Washington. While all seven of the governors have a vote at each meeting, only five presidents at any one time vote, and we vote in a yearly rotation.

Point No. 3 -- We all participate fully in the discussion, whether we're voting members or not. In addition to bringing 12 independent views and voices to the debate, the presidents are expected to share grassroots economic information from their directors and other business contacts throughout their respective regions. The directors of our Atlanta Fed include people like Dave Jones of Atlanta Gas Light -- and, starting this month, Juanita Baranco and John Wieland. (We've also had as directors people like Dan Sweat, Jimmy Williams, Leo Benatar, Larry Prince, and others who are part of the leadership of our region.) The information I get from our directors about what business and community leaders are seeing, are thinking, and are planning to do in their own business is a very important part of our monetary policymaking process.

Now, back to my personal views and preferences on interest rates and monetary policy. If you have to ask me whether I'm a hawk or a dove on inflation, my short answer is, I'm a pragmatist. My long answer is that throughout my career, I've always fallen back on my training as an engineer, and that's not changed in this job. That means I try to get all the facts I can before I make a decision. I've spent a lot of my career trying to bring about strategic changes that result in better, long-term outcomes, and I approach monetary policy decisions on that same basis. So hopefully I'm a pragmatist with a strategic focus. Maybe you'll get a better feel for this now as I talk about a couple of the major public policy issues that I see affecting the nation in this new year and for many years into the future.

Public Policy Issues

A few minutes ago, I gave you a short worry list of some aspects of the economy that I'm keeping an especially close eye on. But beyond those specific items, I'm worried about something even more fundamental. I've begun to think that the long string of good economic years -- with no end to this current expansion yet in sight -- has brought on a certain amount of complacency in our nation toward all things economic, and particularly toward inflation and deficit reduction. Perhaps you've seen articles in the *Wall Street Journal* and the *Washington Post* that suggested that maybe -- just maybe -- we've got things so together that there won't be any more recessions. Well, that's a tantalizing idea, but one, unfortunately, that in my opinion is premature. If you haven't already guessed it, I don't believe the business cycle is dead.

This complacency could divert our focus away from what I consider to be our No. 1 concern: holding onto the gains we've made in regard to price stability. Whereas not too many years ago inflation was at the top of many business people's worry list, I've seen surveys in the last year that showed that inflation is no longer even in the top five of people's concerns. And that honestly worries ***me***. Whether we've allowed ourselves to get complacent or simply have short memories, I think we could lose the progress we've made against inflation if we don't maintain, and even expand, the public mandate to hold the line.

What the Federal Reserve is best at doing is providing an economic environment of stable prices in which people can make their own choices about what's best for their economic well-being. And so the Fed's paramount concern in recent years has been to keep inflation low and steady -- so that individuals, businesses, and governments can make their decisions free from concerns about whether the price level is going to change significantly. Now that we've achieved a steady inflation rate of around 3 percent or less for five years, the next question becomes, Would an even lower rate of inflation optimize economic performance?

Here's how I frame that debate: If we want to ***maintain the current rate of inflation***, then the Fed's current stance is probably appropriate under current conditions. If we want to ***make further progress on inflation***, then we need to be looking for opportunities over time to nudge the rate still lower. You may also have heard the views of some that suggest we should work toward a goal of ***zero inflation***. Although there's certainly less agreement in general about the costs and benefits of going to zero inflation, I believe we should continue to study and debate that as well.

Now, I'm not a zealot who wants to take a sort of "damn the torpedoes" approach to achieve a goal of zero inflation no matter what. However, I ***do*** feel strongly about holding the gains we've made against inflation, and my preference is asymmetrical -- in other words, I would prefer to see inflation somewhat lower rather than somewhat higher. At the same time, I can also see that there will sometimes be economic situations when a more accommodative monetary policy might be the best course of action, given the conditions in the overall economy at that time -- so long as, over time, we hold to our long-term inflation objective. But, most of all, I want 1997 to be a year in which the Federal Reserve helps to shape the continuing debate about inflation. I would not like us to ever rest on our laurels, and I think this time in our economic history is an ideal one for contemplating, discussing, and debating how we, as a nation, feel about inflation.

There's another economic public policy issue that's high on my agenda, and, I hope, also on yours. Monetary policy does not get made in a vacuum. It's intimately connected with fiscal policy. And without strong leadership to bring down the overall federal deficit even further and to work on chipping away at the national debt, no matter how good monetary policy is, it can't do the entire job. I'm extremely happy to see that deficit reduction is back on top of the Administration's list of what it wants to accomplish in the next four years. I also believe that many of us, and many in Congress, now have a firm grasp of how serious the problems are that we face down the road. We now seem to understand that significant further deficit reduction cannot come from such simplistic solutions as reduced waste in government.

The deficit problem in some ways is worse than current numbers indicate. We've all read how the Social Security Trust Fund is projected to go from a surplus that is being used to offset the federal deficit to insolvency over the next generation. The Medicare program will be in big trouble much sooner. We've got to fix these problems -- either on the benefits side or the tax side. If we don't follow through on a balanced budget plan, government reports show that entitlement and discretionary programs could add nearly $700 billion to the national debt by the year 2002. That's some freight train getting ready to run over us.

As I said last year when I spoke to our club, we must hold Congress's feet to the fire and insist that our elected representatives work hard to reach agreement on a long-term deficit reduction plan. But let me add to that this year. Do we not also have to look at ourselves and decide to hold our own feet to the fire? Given the pressures that will worsen our deficit problems in future years, do we really think that we won't need to make some sacrifices to bring them back into line?

As a nation, we've been notoriously slow to come to terms with difficult issues. There's a lot of good thinking about solutions going on, both inside and outside of government, and I believe we should be willing to at least consider some bold and controversial options and to encourage our elected representatives to do so as well. These options might include income-indexed Social Security and Medicare benefits. Sure, we've earned our full benefits in a legal sense, but can we really afford them, in a social sense? Our thinking should include full exploration of broader investment options for Social Security monies, as outlined in today's report from the Advisory Council on Social Security. I hope that we can conceive of these and other kinds of far-reaching changes. I also hope that we'll be willing to embrace those that would be best for the long-term economic health of our nation.

Conclusion

That's my 1997 take on the economy and some very personal thoughts on a couple of the broad public policy issues we must face. As I wrap up, let me say again that last year was a very good year for our economy, and that 1997 holds the prospect for nearly the same. Let me also say that when I go up to Washington, D.C., and sit down with my colleagues, I would like to be able to take into account some of your views. I mean it when I say I'd really like to hear from some of you once in a while.

Thank you for inviting me back again this year.

CONTACTS

Jean Tate
404-498-8035