Speeches

The Road to Recovery and an Atlanta Perspective

Remarks by Jack Guynn to the
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Thanks for that introduction. When Jim Durrett got in touch with me last spring to speak to you all today, there were a number of good reasons to say yes.

For one thing, I'd had to turn down some earlier invitations a couple of years ago, and Jim's the persistent type. Jim also let me know that if I said no this time, he'd unleash two of my directors, John Wieland and Egbert Perry.

For another thing, it was an honor to be asked to tee up a discussion for a panel as distinguished as the one that will follow my remarks.

The last reason I decided to accept Jim's invitation — to be perfectly honest — was that it was nearly a year away. The economic recovery was still looking pretty tentative when Jim got in touch with me last spring. But the Federal Open Market Committee had cut the fed funds target rate to 1¾ percent, gross domestic product had started to register some growth around the fourth quarter of 2001, and I was fairly optimistic that I'd be able to tell a promising recovery story by now.

By the numbers, I suppose you could argue I was right: GDP, our broadest measure of economic activity, has grown for six quarters in a row now, and most macroeconomic indicators are generally moving in the right direction. But I have to admit that it doesn't really feel like a recovery. That's especially true in Atlanta, where we've had relatively more job losses than the rest of the country, and particularly in the local commercial real estate market, where office vacancy rates are stuck at around 20 percent.

So what I'd like to do in the next few minutes is talk a little about this recovery: how it's different from previous recoveries, how it's playing out here in Atlanta, and what I think it will take to get things moving and the office buildings full again.

Let me begin with a quick overview of the state of the economy. GDP growth ranged widely over 2002: 5 percent annualized in the first quarter, 1.3 percent in the second quarter, 4 percent in the third quarter, and 1.4 percent in the fourth quarter. As recoveries go, that works out to a fairly respectable average of somewhere around 2.4 percent on the year. But the big quarter-to-quarter swings and the continuing problems in some sectors made the recovery seem less than convincing.

Compared to the last economic cycle, which began more than a decade ago, this recession and recovery really have been quite different. Manufacturing employment is way off in this recovery compared to the last one, while construction employment — because of the strength in homebuilding — is relatively stronger. And capital spending on equipment and software, which is one of the keys to renewed expansion, is more than 10 percent off the peak level it reached in the third quarter of 2001 and is recovering only slowly.

The big difference in this recovery, though, is that there has been no consumer-spending boom. And there's been no boom, in part, because consumer spending never declined in the first place during the 2001 recession.

In the early stages of most recoveries since World War II, growth has surged as consumers loaded up on the big-ticket, credit-sensitive goods they put off buying during the recession: things like cars, sofas and refrigerators. This consumer-spending rebound is an important signal to businesses. It tells them first to begin building inventories, then to increase spending on capital equipment and facilities, and then to recall laid-off workers or begin hiring again.

But in the downturn that began two years ago, consumer spending never declined; in fact, it actually grew — real personal consumption expenditures grew by 2.5 percent in 2001 and over 3 percent in 2002. And it grew even faster in interest-rate sensitive sectors like housing and autos. To be sure, all of this consumer spending was good for the economy: There wouldn't be any recovery to discuss if consumers had cut back on their spending. And spending probably would have been weaker if incomes had fallen as sharply as they did in the last recession.

What this means going forward is that the recovery's going to be driven by growth in business investment spending and a pickup in employment, along with continuing gains in consumer spending. Again, though, the absence of a decline in consumer spending earlier in this cycle means a sharp rebound in consumption is unlikely.

As for the probability that businesses will increase their investment spending, I actually do think they may start soon (and, anecdotally, I'm hearing that many already have). But it's possible that we won't begin to see much clear evidence of it until the second half of this year.

For one thing, as I just discussed, the absence of a consumer-spending boom means businesses don't have the unambiguous signal they usually look for to start investing again. The two-year, low-level buzz — not going away, but not getting much stronger, either — makes it difficult for businesses to pick up, or count on, a strong growth trend in the consumer sector. That makes it difficult for them to plan investment spending.

For another, industrial capacity utilization is still off: At around 75 percent, it's well below the 80 to 85 percent range we witnessed during much of the 1990s. Obviously, this decline is the legacy of the last decade's high-tech boom, when too many industries anticipated too much demand and invested too much. But then consumer-spending growth leveled off at about half the 1997–99 rate, and businesses were left with too much inventory and too much capacity. For the last couple of years, those industries have been in profit-restoration mode, cutting costs by laying off workers and idling plants. Before many of these industries begin to invest in new capacity again, they'll bring some of their underutilized capacity back on line — running two shifts instead of one and so forth.

A related concern to me — and this is not strictly economic — is that the exuberance of the late 1990s, and the downturn that followed it, has made executives gun-shy about taking risks. I can't say that I blame them, of course! But it would not be good for our economy if businesses become too risk-averse. They simply have to take them. And one kind of risk — an increasingly reasonable one, I think — is business investment.

Risk aversion and the postponement of investment spending are also surely related to the possibility of war. That's a substantial source of uncertainty in the economy right now, and many businesses are simply holding off on additional investments until they have a better picture of what's going to happen overseas.

So there are a lot of reasons to be concerned about when business spending will pick up. But there are also, I think, some good, solid reasons to be optimistic.

First, the painful rounds of cost cutting we've witnessed these last few years are making a difference. No, we surely haven't seen the last of them, because in a dynamic economy businesses restructure all the time, recession or recovery. But the restructurings are working. Slowly but surely, profit growth is returning. And profitability has to be present before businesses will consider expanding investment and recalling laid-off workers.

Another thing for business to be optimistic about is continuing productivity growth. Many things that happened in the 1990s later fell apart, but, happily, productivity wasn't one of them. We know that productivity growth declined slightly in the fourth quarter of 2002, but the level of labor productivity was still nearly 4 percent higher than a year earlier. Rising worker output pushes unit costs down, which reinforces profitability. Over time, this also allows businesses to raise workers' wages without increasing prices.

Finally, for well over a year now, monetary policy has been aggressively expansionary. This has been a boon for consumers, most apparent in the auto and home-building sectors. Even though we haven't yet seen an expansion in demand for credit from businesses, they have at least been able to refinance existing debt at lower rates. I do think, though, that business demand for capital will grow, especially when some of the current geopolitical uncertainty is resolved.

More than a few times, I've heard this economy referred to as a "stealth recovery," and I do think it's fair to say that the recovery is being obscured by some of the clouds I just mentioned. Still, though, the recovery is real — it's showing up on our radar; we know it's here — it's just not as obvious as it usually is.

Setting aside the towering exception of war — which, to a pilot, I suppose, is like saying "except for that mountain" — I think the recovery will be a lot more apparent to all of us in the second half of the year. Until then, though, some numbers may get a little worse before they start to show improvement.

Unemployment, for example, may still increase a bit before moving in the right direction later this year. Actually, that is typical of most recoveries. Usually, when the economy begins to emerge from a recession, people who hadn't been looking for work — and therefore hadn't been counted as unemployed — go back into the labor market. But since early in a recovery there are more new job seekers than jobs, unemployment actually increases.

It may also be a while before manufacturing employment makes a turn for the better. Manufacturing employment continued to fall through 2002 and still has not stabilized. Even when it does, though, it's probably more likely that temporary workers will be added first on an as-needed basis and that permanent workers will only be recalled later as market conditions firm up. What this means for the overall composition of labor market growth is that we'll probably see relatively more employment growth in services than in manufacturing. This was also the case coming out of the 1991–92 recession.

Also — and this is more of a reiteration than a prediction — I don't think consumer spending is likely to accelerate for a while. Just to be clear, I don't expect a decline in consumer spending. But considering that we've had three straight years of stock market declines, and that many businesses are still in cost-cutting and lay-off mode, consumers are being understandably cautious. I think that adds up to only modest growth in consumer spending for the near term.

So while the economy is in recovery by a GDP measure, you could be forgiven for thinking otherwise. The big things we usually associate with a recovery — a consumer-spending boom, larger business investment spending increases — haven't materialized, largely because of the nature of the recession and the boom that preceded it.

The late 1990s boom-and-bust cycle also has a lot to do with how Georgia and the metro area are faring. Last year, as many of you know, metro Atlanta lost more jobs than any metro area except New York and Chicago, which are obviously substantially larger. The numbers in metro Atlanta, of course, dominate the statewide statistics.

In 2001, Georgia added no new jobs on net, and last year employment actually declined by around 2 percent. By comparison, total employment for the United States over the same period declined by only 1 percent. And some sectors of the local economy have performed much worse than this comparison would suggest.

In the construction industry, for instance, Georgia is performing considerably worse than the nation as whole, if not as badly as it was 10 or 12 years ago. I think that's a reflection of the very mixed construction picture in Georgia and Metro Atlanta: Residential construction has been in a multiyear boom, so growth in that sector is about equal with the rest of the country and therefore much stronger here than in the early 1990s. However, the local commercial real estate market, as many of you well know, is softer here than in many other parts of the country, and that weakness is showing up in metro-area vacancy rates that are approaching and in some cases exceeding decade-ago highs. As a result, construction employment is down sharply: more than 8 percent last year versus 2 percent for the nation as a whole.

So it's clear that Georgia's economy is doing worse than the rest of the country's today. In some ways, though, the state's economy is also doing worse compared to its own position in the last recovery.

Arguably one of the most striking differences has been in the state's service sector. In 2002, payrolls in Georgia's service-producing industries fell by almost 2 percent. Again, this was a much greater decline than for the nation as a whole, which was actually flat on the year. But it was also much worse than the decline we witnessed in the previous recession of 1990 and 1991. Indeed, during the early 1990s, service employment was the only source of job growth in the state. This time in Georgia, though, state and local governments and health care service providers have been the only sectors adding to payrolls in any significant numbers. Obviously, with states and towns in budget-cutting mode, government will provide less of a lift this year.

The conventional wisdom is that service industries, especially those not connected with retail and wholesale trade, are less affected by changes in aggregate demand and supply conditions than manufacturing and construction. This is the rationale for the argument that service industries bring stability to an economy — and it has been true in the past. But the most recent recession has put the conventional wisdom to the test. And in Atlanta the stability of services has been especially hard pressed.

Employment in transportation services and telecommunications (which of course are heavily represented in Atlanta) were particularly hard hit in the state. Payrolls in Georgia's transportation sector fell by 6 percent last year, the largest percentage decline in the sector in the Southeast, and much, much larger than the reductions we witnessed in the 1990–91 downturn. Similarly, the state's telecommunications service providers cut payrolls by 7 percent last year: Again, that was the largest percentage decline in the sector in the Southeast, and much bigger than the decade-ago contraction.

The employment picture here demonstrates the concentration of telecommunications and transportation in Atlanta. The telecommunications industry, of course, continues to work its way through adjustments that actually began before the recession started in March of 2001. The transportation sector is still reeling from the shock of 9/11, but that industry was displaying weakness well before the recession began too. Needless to say, services linked to both those industries — everything from customer service to data processing to lodging and conventions — are suffering as well.

Throughout the 1990s, metro Atlanta regularly led national surveys of in-migration and job creation. I think it's fair to say that we boomed a little bigger than the rest of the country during that period. Now, though, the formula has been turned on its head, as more industries concentrated here have had more acute transitions, and experienced more economic distress, than the nation as whole. So if you think the recovery has been slow to arrive in Atlanta, I'd say you're right.

Still, though, tentative as it may be, and slow as it has been to arrive, I do think recovery is making its way to Atlanta. If it's going to take root, though, and if it's going to blossom into something better, the regional economy will need the same thing the national economy needs: a pickup in business spending and the consequent employment growth that will bring. Now, I certainly don't pretend to be an expert on the office market, but I would observe that a substantial amount of absorption seems to be in order before much new speculative construction will take place locally. In the office market, at least, that points toward employment growth in the service sector as the most immediate catalyst.

In the long term, of course, the economic interests of the office market and the metro area are pretty closely aligned. After all, the people who fill up those office buildings also pay taxes and build houses and buy cars. But whether we want to rev up the corporate recruiting machine to bring in new jobs and businesses, or keep the ones we already have, the metro area and the state simply have to remain competitive in the global market for talent, capital and ideas.

So as the recovery begins to build up some steam — as businesses struggle to close budget deficits and fill office and industrial space and restore profitability over the short term — I hope we'll stay focused on two issues that will have a much bigger impact on the vitality of the region in the long term. What I'm talking about, of course, is transportation and education.

One of my favorite economic maxims is from the late writer and economist Herb Stein. Stein's law says, "If something cannot go on forever, it will stop." When he coined that expression in the 1980s, Stein was actually writing about the U.S. balance of payments deficit. But he could have been writing about any number of other things, including Atlanta traffic.

At least once a week, I hear some frustrated driver mutter, "This can't go on forever." (I've been known to say that myself.) It's true; this can't go on forever. And I can think of two reasons why it won't. The first is that we do nothing and that people get fed up and leave the region. The second reason it won't go on forever, though, is that we don't let it, that we get our act together and assemble the transportation system the metro area so desperately needs.

That's why I was so encouraged to learn that the leadership of the Atlanta Regional Commission has begun to consider the possibility of a single, regional transportation initiative. Like most roads in Atlanta, this one will be long, occasionally bumpy and crowded with a lot of competing interests. But the 10 counties and 60-something municipalities that make up metro Atlanta are a single economic unit, and it's essential that we make this trip together.

The second thing to keep an eye on for the long-term is education. Recently, a colleague used the term "labor arbitrage" to describe the practice of relocating a business to take advantage of lower wages and salaries. That's something we know all about here in the South, where over the last 30 years or so we've seen labor-intensive manufacturing jobs move overseas, and many more higher-skilled, capital-intensive manufacturing jobs move in. Of course, it has always been a myth that labor costs were the sole consideration in job location decisions. Plenty of other factors are involved, too, like property rights and contract enforcement, energy and transportation infrastructure development, and the training and education of the local labor force.

But since we've talked a little today about keeping office buildings full, I think it's worth realizing that technology now allows service sector jobs to go overseas just as easily as any manufacturing job. Early last month, *Business Week* ran a cover story on this very issue titled, "The New Global Job Shift." As *Business Week* put it:

> It's globalization's next wave — and one of the biggest trends reshaping the global economy. The first wave started two decades ago with the exodus of jobs making shoes, cheap electronics, and toys to developing countries. After that, simple service work, like processing credit-card receipts, and mind-numbing digital toil, like writing software code, began fleeing high-cost countries.
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> Now, all kinds of knowledge work can be done almost anywhere. . . The driving forces are digitization, the Internet, and high-speed data networks that girdle the globe.

In the South, we tend to think about job creation the way we might think about an SEC football game: Georgia vs. Florida or Alabama or Tennessee. But as *Business Week* points out, in accounting and IT support and customer service and so many other office-dwelling, service sector jobs, the competition's not on the other side of the state line, but on the other side of the planet.

Again, I don't want to overstate the case. There's more to this issue than just the cost of labor. Many, many service jobs — medical, legal, sales and others — can't be shipped overseas, and many more shouldn't be as a practical matter. But that still leaves a more-than-respectable number in play.

Obviously this is an issue that has implications far beyond the commercial office market, or even the state and national economies, and I suspect we'll be wrestling with it for years to come. For now, though, the only way to guarantee that the local labor force will remain competitive is through education.

For policymakers at every level, the current business cycle has been a pretty tough education. The experience we've gained these last two years has confirmed some things we thought we knew but has also disabused us of some outdated notions. For me, one tough lesson has been that the Atlanta economy is not quite as immune as we thought — not as insulated from national economic developments as we had hoped.

For the last two years, the region's businesses have been working their way back toward profitability and renewed growth. I have absolutely no doubt that we're on track to achieving this in the short run, and that we'll stay there in the long run if we also commit ourselves to improving the region's transportation infrastructure as well as its human capital.

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