

Speeches

Growth Through Balance

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What I'd like to talk about tonight is the U.S. economic outlook. GDP, our shorthand for gross domestic product, roared ahead at 7.2 percent in the third quarter, a rate that is faster than at any time since 1984. I'm inclined to view this past summer's surge of output as an exclamation point in a sequence of eight straight quarters of rising GDP, a period when output growth averaged over 3 percent. As my remarks over the next few minutes will suggest, I expect output growth will continue, although probably at a pace less dramatic than reported for the third quarter. While the economic trends clearly are favorable, employment growth remains stagnant, far below levels of the late 1990s. Holding this economy up for inspection, it looks as though it's gaining strength and stamina overall, but with some sectors still working off their excesses and imbalances.

For the past few months, I've been saying that growth appears to be gaining momentum. After looking at recent data and talking to business folks like you, I want to stress this evening the now broad-based character of growth that's unfolding. I believe the economy is gaining a stronger foothold as weaknesses become increasingly confined. What we're seeing is growth that is spreading across industries and sectors, becoming more balanced.

What do I mean by balanced? Well, the World Series Champion Florida Marlins come to mind as a useful illustration. After the team won the Series in 1997, the owner dismantled the roster to unload payroll and hired young talent with potential for the future. The team suffered through five straight losing seasons. But this year they pulled together and made the playoffs as a Wild Card team. In October, they beat the mighty Yankees through a combination of clutch hitting, speed, defense and pitching. In other words, they won through balance.

The Marlins' approach to building a championship team is instructive, I think, because it shows the importance of preparing for the future and performing well in a number of different areas. As growth spreads through the economy, a sequence of additional positive events becomes increasingly likely. Among those is employment. Job destruction should ease, and job creation should intensify. The unemployment rate, now 6.1 percent, should begin to fall. What's happening in our economy now? Let's grab a clipboard and consider a range of factors.

Consumers continue their heavy hitting

I'll start with consumer spending, which accounts for about 70 percent of GDP. For the past three years, consumers have done the heavy hitting for the economy. You'll recall growth in the broad economy began to falter in late 2000, just before the declared start of the recession in the first quarter of 2001. Companies retrenched and the stock market plummeted. But, in a very uncharacteristic pattern, consumer spending, on a quarterly basis, didn't contract during the recession. And in the third quarter this year, consumer spending grew at a whopping 6.6 percent. For the household side of the ledger, it has been "let the good times roll," or "*laissez les bon temps rouler*," as folks say in Cajun country.

Consumer spending at last quarter's torrid pace is unusual and unlikely to continue. Certainly, the tax cuts and cash-outs from mortgage refinancing during the extremely low mortgage rates this summer added a kick to spendable income. Some of this strong spending was leveraged, but we do not appear to be in the danger zone when it comes to debt. As a percentage of income, household debt payments for obligations such as autos, credit cards and mortgages have actually fallen a bit since they rose to peak levels in 2001. Many families have managed to keep spending with the help of very low interest rates. At the Federal Open Market Committee meeting two weeks ago, we left the overnight funds rate at 1 percent, with inflation remaining in check and consumer prices rising at an annualized rate of 1.2 percent.

It's difficult to judge how long the boost from tax cuts will last or to measure the additional stimulus that will come from the still accommodative monetary and fiscal policy. But I do have the sense that retailers will have reason to be upbeat about the coming holiday season. Businesses, for their part, have done an excellent job of luring consumers through attractive pricing and financing terms. Sales of durables have been strong, and I see few reasons why the trend should abate. For instance, truck and auto sales this year have been generally solid. Appliances, electronics and furniture also are on a lengthening list of goods that are selling well. The pace of growth in consumer spending may ease somewhat in the coming quarters but is likely to remain strong, providing critical ongoing support for the economy.

Consumer spending is supported by a strong housing market. During the past few years, housing starts and sales have climbed in much of the country, and the rate of homeownership has increased. I'm sure many of you in this room have purchased homes or refinanced to take advantage of mortgage rates that earlier this year reached 40-year lows. Mortgage rates have moved a bit higher since June but are still quite attractive by historical standards. Looking ahead, I expect the large proportion of the population born between 1946 and 1964 will continue to fuel a strong demand for primary residences and vacation homes.

Businesses begin to bulk up

Perhaps the most important story now in the economy is the rebound in business spending. Although business investment spending accounts for only about 10 percent of total GDP, a sharp drop in investment spending was a big factor leading to the 2001 recession. Business fixed investment plunged by 5 percent each year in 2001 and 2002, but this downward trend appears to have been reversed. Business spending on equipment and software grew in five of the last six quarters and surged 15 percent in the third quarter at the highest rate since early 2000.

Commercial borrowing is another good indicator of business spending. Over the last two years, bank corporate loan demand has been weak even though banks have been ready to lend and terms have been favorable. But at least some bankers are telling us that their customers are beginning to talk about new projects, with new loans in the application phase. When viewed along with recent activity in the market for initial public offerings and relatively good business in the bond market, the picture of a more vigorous corporate sector has begun to emerge.

Through hard decisions and perseverance, businesses have strengthened their balance sheets. Careful cost control has paid off in the form of improved productivity. Total revenues for publicly traded companies have increased for three straight quarters, and profits are at the highest level since the third quarter of 2000. And as businesses decide to shift from a hunkered-down defensive posture to offense, they will be more competitive than ever.

Growth spreads by industry

Many companies are now seeing improvements, but imbalances remain in some industries, such as telecom. All of the tough decisions and recalibrations are by no means behind us. The breakneck pace of change in the 1990s did not stop when the dot-com bubble burst. In this turbulent climate, successful managers are proving to be those who are not afraid to throw out old assumptions and try new ones.

Companies continue to collectively retool, and some are farther along than others. It will take time to get back to an economy that exhibits sustainable strength across all sectors, just as it took a while for the rebuilt Marlins to field a team capable of winning another World Series. But almost all recent data suggest the economy is rebuilding successfully.

Perhaps no part of the economy has undergone more turbulence than travel and hospitality. Following the double whammy of recession and the Sept. 11 terrorist attacks, several major air carriers filed for bankruptcy protection. Low-cost upstarts have added a new dimension to the air travel shakeout as they have expanded aggressively. My contacts in the airline business tell me they are moving quickly to adjust. As they do so, my sense is that airlines will be aided by growing domestic passenger traffic as both business and leisure travel pick up. As an aside, recovery in tourism is one reason why the Southeast as a region is now at the front of the national pack when it comes to growth and new job creation.

A rebound in technology spending is another sign of broad-based growth. The information industry continues to provide many valuable innovations. For instance, new advances in supply chain and inventory management and electronic communications have fueled rapid productivity gains. While the Nasdaq index remains far below peak levels, this year's recovery of technology stocks reflects the expectation of future growth in this area.

As the economy shifts, manufacturing has had an especially tough time. In a speech I made in September, I noted that many domestic manufacturers appear to be shedding jobs permanently as low-skill operations move to lower-wage countries around the world. While manufacturing remains weak relative to 1999 levels, some signs are encouraging. Rail and truck shipments have increased, along with orders for packaging materials. Manufacturing production in the United States increased in four of the last five months and is up 1.2 percent since its April low. Recent manufacturing surveys also have been more favorable.

During this time of manufacturing upheaval, Americans have been buying more and more imports. The U.S. trade imbalance is probably with us for a while, but surviving exporters have become stronger. Exports grew 9.3 percent at an annualized rate in the most recent quarter, up from 1 percent during the prior three-month period. Export growth has improved along with economic conditions among our major trading partners in Asia, Europe and the Americas.

To complete the picture of broadening economic growth, I'd like to point to a couple of other developments. In multifamily housing, I'm hearing that in some areas of the Southeast apartment owners are offering fewer concessions and nudging rental rates upward as vacancy rates improve. Increased government spending for the military also has been felt in many places, including the shipyards in this region.

Uncertainties remain

The economy in recent years has been full of surprises, and I expect there will be more. Although major combat in Iraq is over, shaky geopolitics and the prospect of terrorism remain risks. The increase in health care costs is another concern that I've mentioned in the past. And ahead of us is the growing federal deficit and its future direction. The unusual expenses associated with the military action in Iraq and the reduction in federal government revenue associated with the countercyclical tax actions should abate with time. But there are other large fiscal policy issues associated with Social Security and Medicare that have yet to be resolved.

Employment is yet another uncertainty. The economy lost approximately 2.7 million jobs since the start of the recession and half a million jobs since January. But I think it's worth reminding ourselves that job growth usually follows GDP growth. A net jobs gain of 57,000 was reported for September, and the number of new claims for unemployment insurance has come down in recent weeks.

Have labor markets begun to stabilize? Layoffs continue, but new jobs have been created in fields such as health care and education that require specific training and skills. Broader job growth to date also has been reported in residential construction and the service sector. But much of the hiring in recent months has been by firms seeking temporary workers, an important first step before adding to full-time payrolls. I expect to see additional hiring for permanent jobs as we move into 2004 and companies reach the limits of what they can accomplish by leveraging productivity gains and existing staff.

Training never ends

The key to sustainable economic growth, as with building a winning baseball team, is balance. You can't win in the big leagues with a lineup of only power hitters. Success on the field requires players with diverse and complementary skills performing at peak levels.

But there is no off-season for the economy. We need to remind ourselves to be patient — and realistic. A crash program of quick fixes is not what it takes to succeed as we recover from the excesses of the past and some bad unforeseen shocks that have come our way. In hindsight, we realize the growth of the late 1990s was not sustainable. Bulk-up technology spending led to excess capacity and other problems that we're still working off.

The dynamics of today's economy are different, with growth driven by consumer spending and businesses motivated by efficiency and cost control. We live in a free market economy. There always will be tough decisions to make, lessons to be learned and risks to be taken. But with the better balance we are seeing now in this economic expansion, my confidence is growing that the economy will be in shape for the demanding contests of the future.

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