Speeches

Nurturing Sustainable Growth in a Global Context

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It's a pleasure to be here this evening for the opening of "Old Money, New Money: The Rise of Southern Capitalism." First, let me say that I'm delighted that the Atlanta Fed is working with the Atlanta History Center to tell the story of money from a Southern perspective.

We've all heard references to "old money" and "new money," but in my experience people have a profound emotional connection to any kind of money that's best summed up in the overused movie line, "Show me the money." In fact, I can tell you that folks get pretty excited touring the Money Museum at our Fed office in Midtown, where you can see things like an uncut sheet of $100,000 bills (never in circulation), a solid gold bar, and millions of dollars in cold, hard cash. Unless I miss my guess, Atlanta History Center visitors will appreciate the hard work and energy that have gone into the fascinating new exhibit we're celebrating here tonight.

Reflecting on your theme of money and Southern capitalism, our region has undergone a dramatic evolution from a mostly agrarian economy to a low-wage manufacturing economy and then into today's multidimensional mix of businesses that generally mirrors the broader U.S. economy. This evening, I thought I would try to add some context to this exhibit by offering my own view on the current national economic outlook and the implications for monetary policy. I expect many of you may share my sense that—despite a lot of positives that I want to talk about—our economy is going through a very turbulent time. I'm going to suggest that some of that turbulence is related to the forces of globalization—powerful but not fully understood developments that are reshaping our economy in ways that are both exciting and sometimes unsettling.

First, I'd like to begin with an overview of the current economy. Right now, the United States is in the fourth year of a solid and sustained economic expansion. Until the fourth quarter of 2005, we had 10 straight quarters of gross domestic product (GDP) growth of 3 percent or more. Since the beginning of 2004, the U.S. economy has created nearly 4.5 million jobs, averaging about 173,000 new jobs a month. Core inflation, putting aside the volatile food and energy components, has remained relatively low and stable, and, importantly, expectations for future inflation remain "well anchored," as monetary policymakers say. So, by those basic measures, the U.S. economy is doing quite well, and I believe it's also noteworthy that our economy has adjusted to the current period of rapid economic change in some new and surprising ways.

But before I proceed with my outlook, I need to reconcile the latest reading of GDP, our broadest measure of economic output. As you may recall, GDP grew at only about 1.6 percent in the fourth quarter last year—about half the pace of the previous 2 ½ years. The analysis done by my staff and others suggests this relatively weak reading was an aberration that does not imply a loss of momentum going forward. And I agree with this assessment. Part of the slowdown at the end of last year was because of auto and truck sales, which were soft in October and quite weak in November following a round of earlier incentive-led sales. But vehicle sales picked up in December, January, and February. Other consumer spending has been well maintained, and retail sales this quarter seem to be on a solid pace. Also in the fourth quarter, government spending declined sharply, but I don't know anyone who's ready to declare the start of a new era of fiscal discipline. In fact, the large and worrisome fiscal deficit seems certain to worsen not far down the road as the baby boomers begin to retire.

As we evaluate today's economy, business spending remains strong. A prevailing theme for the past few years has been the quest for efficiency, and I see the trend of productivity enhancements continuing with intense global competitive pressures, which I'll discuss more in a few moments. Today's computer equipment, for instance, depreciates more quickly than ever. So, technological advancements lead to more spending on information technology equipment and software, and that pattern seems to be continuing.

Taking into account these positive observations, private forecasts predict first quarter GDP growth of more than 4 percent. Looking beyond the current quarter, the fundamentals for continued growth appear to be in place. While we may not have seen the full adjustment in spending by businesses and households in the face of persistently higher energy costs, so far spending has not been significantly curtailed. In addition, the much-anticipated slowdown in housing activity appears to be playing out in an orderly way.

Another important contribution to economic growth has been employment. Last year, more than 2 million jobs were added, making 2005 the best year for hiring since 2000. Those new jobs, and the new income they provide, are vital to future growth in household spending. The unemployment rate is a very low 4.8 percent. In fact, there is growing concern about a shortage of skilled workers, especially in fields such as health care, finance, accounting and construction. But, even in tighter labor markets, I'm inclined to believe that with management ingenuity and the flexibility afforded by immigrant labor, businesses will continue to add new jobs over the months ahead at a pace similar to last year.

In judging the outlook for the economy, no central banker would focus on GDP and employment growth without taking into account inflation and inflation expectations. Our recent economic history clearly tells us that low and stable inflation—and expectations of ongoing price stability—are necessary preconditions for sustained economic growth and employment. We learned some tough lessons in the high-inflation period of the late 1960s and the 1970s, when some policymakers believed that by allowing inflation to creep higher we would get more growth and employment. But now we know from both experience and from a vast body of academic research that the costs of rising and unstable inflation far outweigh the benefits.

As I said earlier, we've been enjoying an extended period of generally low and stable core inflation. Of course, there have been some spikes in overall headline inflation measures that are primarily related to wide month-to-month swings in energy prices. Having characterized the recent inflation experience as generally favorable, I think it's important to note that core measures of inflation in 2004 and early 2005 started drifting upward to around 2 percent—still moderate, but at the upper bound of what I would like to see over the long run.

In many ways, our recent inflation experiences have defied precedent. Higher energy prices have put significant pressure on businesses to raise prices. And we've seen many examples of pass-through of some costs in the form of energy surcharges. In addition, for more than a year, many of my business contacts have told me of plans to increase prices, and, in some cases, they've already made price increases stick. Yet, overall measures of inflation tell us that somewhere in the production chain many businesses have chosen to absorb significant input cost increases. Despite the factors that have helped to contain large inflation increases during the recent period, I share the notion conveyed in our last postmeeting Federal Open Market Committee (FOMC) statement that "possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures."

Understanding globalization

A major factor permeating most every aspect of the economic outlook is globalization, which I mentioned earlier. The term has been in our vocabulary for a while now, but its usage seems to have accelerated lately. If you search on Google for "globalization," you'll find more than 100 million references. Not everyone welcomes globalization, but it's a fact of life in this day and age. In fact, the market dynamics underlying globalization have been with us for some time and have played a key role in the economic development of the South featured in the History Center's new exhibit.

Think about some recent global developments and their possible implications. Clearly, strong growth in India and China has contributed to higher energy usage and elevated energy costs, which have shown through in higher measured headline inflation. Also, millions of new workers who have been brought into competitive markets—from Asia, Eastern Europe, Latin America, and elsewhere—have changed the dynamics of employment and put downward pressure on labor costs, both here and abroad. And more competitive global labor markets are forcing U.S. companies to rethink some costly employee benefits, including health care and pensions. The upside is that U.S. consumers have benefited through lower prices for many goods that are now being imported. But, whether we like it or not, the effects of a more global economy are inescapable; economic events in distant places have a profound impact close to home.

Today, dramatic changes can occur at the speed of a mouse click, with financial markets bustling nonstop and vast sums of capital zipping around the world, every moment of every day.

But globalization involves both challenges and opportunities, often in tandem. Here in Georgia, for instance, an overseas business just this week committed significant investment to build a highly productive new automobile manufacturing facility. Some new jobs will be added, but at the same time older and more labor-intensive automobile factories in the area (that happened to be owned by domestic automakers) will soon begin to shut down.

Moreover, global capital flows are having an increasingly important impact on our current economic climate. For example, we have not yet fully explained the long-term interest rate "conundrum" described last year by former Fed Chairman Alan Greenspan. Longer-term interest rates have remained stubbornly low, despite the Fed raising short-term interest rates 350 basis points. And most people attribute at least part of this unusual structure of interest rates to large flows of capital from overseas into this country.

What's evident—and potentially disturbing—about this trend is that our federal deficits have been financed more and more by overseas lenders. While the availability of capital from overseas contributes to lower interest rates and stronger economic growth in this country, I'm concerned that this trend is unsustainable.

In many ways, our economy has entered uncharted waters when it comes to global imbalances, which is one reason I suspect many people feel uneasy about the economic outlook, despite the mostly positive economic data I've already described for you.

Even our best and brightest economists cannot be sure of how all the effects of globalization play out in our economy. A large body of our economic forecasting is built on models—some with many variables and others that are less elaborate. By definition, economic modeling assumes one can learn from the past—predicting future outcomes according to prior relationships and previously observed behaviors. But the rapid pace of globalization has altered many of these variables, and our economy continues to adjust in unexpected ways.

A policymaker's view

So what does this economic outlook and my analysis of globalization suggest for monetary policy? First, let me provide some background on recent Fed actions. In the early stages of the solid economic expansion that's now firmly established, the Fed began to remove the very accommodative monetary policy put in place from 2001 to 2003. The economy continued to gain momentum, and in fourteen consecutive steps going back to June 2004, we raised the fed funds target rate from an extraordinarily low 1 percent to its current rate of 4½ percent rate. This current rate, by the way, is still relatively low by some historical standards.

During the past 20 or so months that the Fed has been steadily increasing short-term interest rates from unsustainably low levels, the FOMC was able to clearly communicate to financial markets the path of policy and the likely timing of recalibration. Based on the economic conditions at that time, the Fed had the latitude to be explicit in our communication with the public.

While our various steps to enhance the transparency of policy actions have been helpful to both financial markets and to policymaking, it's important to recognize that our policy path over the coming period is somewhat less certain. And, as I've said on other occasions, as policymakers we should resist the urge to say more than we know.

I continue to think the most likely path for the economy is sustained GDP growth with inflation and inflation expectations contained within acceptable bounds. But I, like others, will be watching very carefully as events unfold.

Several areas warrant close attention. As I suggested earlier, households and businesses seem to be coping with persistently higher energy prices without a major reallocation of spending. But it's possible we haven't yet seen the full adjustment to the new reality of elevated energy costs. Also, we don't yet know the full effects of the potential transitions in residential real estate markets. Despite the removal of very accommodative Fed monetary policy, credit markets are still accommodative, in my view, and this liquidity could boost the economic expansion and contribute to stronger-than-expected inflationary pressures. The relative lack of broad pricing power that's been observed in many competitive world markets could begin to change, especially if domestic demand increases beyond present forecasts.

While we don't yet know the full impact of the significant policy adjustments of the past twenty months, I believe these actions have made a favorable economic outcome much more likely. At present, my sense is the balance of risks to both growth and inflation forecasts is now close to being equal.

Closing

In closing, I hope I've conveyed my view of today's economic expansion as being well-grounded and likely to continue in the near future. And that outlook is good news for the Southern economy, which is a microcosm of the national economy. In my remarks, I also tried to be candid in suggesting that in today's increasingly global environment there are some new uncertainties that we must continue to try to fully understand and learn how to take into account. Finally, I hope I've conveyed that a monetary policymaker's job is to nurture sustainable economic growth in a steady, low-inflation environment over the long term. In my view, the Fed has made significant adjustments to policy with the aim of enabling favorable economic conditions that allow businesses to make rational decisions without interference from high and unstable inflation.

Now, I'm no historian. But I was around for much of the 20th century, and I've had an up-close and personal view of economic change in the Southeast since I started working for the Atlanta Fed more than 40 years ago. Early in my career, I remember the Southeast economy lagged behind much of the rest of the country. But that was before the emergence of today's postindustrial economy. Where do we go from here? There will be some ups and downs along the way. But it's my hope and belief that the rise of Southern capitalism is only beginning and that our best days are still ahead as we adjust to a new set of economic circumstances for the 21st century.

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