

SILAS KEEHN REMARKS
ASSOCIATED EMPLOYERS OF
THE QUAD CITIES
HOLIDAY INN
DAVENPORT, IOWA
APRIL 3, 1986

Paul O-man.

"ALL'S WELL THAT STARTS WELL - OR IS IT?"

I. INTRODUCTION

Quad Cities

A. FIRST VISITED AREA LATE 1950S

1. PLEASUED TO BE BACK

B. DON'T WANT TO BE CAUGHT UP IN EUPHORIA OF THE MOMENT

- BUT PARTICULARLY EXCITING TIME

1. ELABORATE IN A FEW MINUTES

comes together just right

If everything goes

2. UNIQUE OPPORTUNITY -

develop rewarding economic experience.

II. BEFORE LOOKING AHEAD - LOOK BACK

A. SET STAGE FOR COMMENTS REGARDING THE OUTLOOK

Final Quarter of

B. LAST YEAR ENDED ON WEAKER NOTE THAN WOULD HAVE HOPED

1. EACH REVISION OF 4TH QUARTER GNP DOWNWARD

A. LAST REVISION .7%

*With some modification
will use for [unclear]
11/1/86*

2. ANNUAL BASIS 1985 +2.2% AFTER MUCH STRONGER

(+6.5%) 1984

3. 4TH QUARTER WEAKNESS HAS LED SOME TO CONCLUDE

THAT WE'RE HEADED BACK INTO A RECESSION

C. INDEED, SOME OF THE EARLY 1986 NUMBERS, PARTICULARLY

FEBRUARY, LITTLE ON THE SOFT SIDE

1. UNEMPLOYMENT RATE

A. JANUARY/FEBRUARY

2. RETAIL SALES - WEAK - *essentially flat Jan/Feb.*

3. INDUSTRIAL PRODUCTION - *fell in Feb after modest Jan gain*

4. NON-DEFENSE DURABLE GOODS - *fell in Feb strong increase in Dec.*

III. BUT IMPORTANT TO KEEP THESE IN A BROADER PERSPECTIVE - ON

A NATIONAL BASIS WE ARE OPERATING IN A VERY STRONG

ECONOMIC ENVIRONMENT

A. DESPITE WHAT SEEMS LIKE MODEST GROWTH IN 1985, THE

NATIONAL ECONOMY HAS PERFORMED WELL

1. AT THE END OF LAST YEAR, MAJOR MEASURES OF
PERFORMANCE WERE AT RECORD LEVELS

A. GNP IN 1982 DOLLARS - 10% ABOVE 1981 PEAK

B. INDUSTRIAL PRODUCTION - 11% ABOVE 1981 PEAK

C. PAYROLL EMPLOYMENT - *Very STRONG*
OVER 8 MILLION HIGHER

THAN PREVIOUS PEAK - VERY SIGNIFICANT GAINS

Total
(1) EMPLOYMENT ~~100~~ *60%* WILL GO THROUGH 100

MILLION EARLY THIS YEAR - *Q Current Quarter*

(2) ~~UNEMPLOYMENT~~ - VERY REAL AND HUMAN

REASONS - *Focus on reemployment*

(3) EMPLOYMENT PERSPECTIVE - EXPANSION NOT

GIVEN FULL CREDIT

D. WHILE INCREASE IN INFLATION SMALLEST SINCE
1967

2. NOW INTO THE 4TH YEAR OF ECONOMIC EXPANSION

A. ONLY 2 OTHERS SINCE WORLD WAR II HAVE LASTED
THIS LONG

3. FURTHER, IN MANY RESPECTS THIS EXPANSION COMPARES
VERY FAVORABLY WITH OTHER POST WORLD WAR II CYCLES

A. IF YOU ANALYZE VARIOUS COMPONENTS OF ECONOMY

B. FOR EXAMPLE, CAPITAL SPENDING

(1) LARGEST INCREASE IN CAPITAL SPENDING
FROM BOTTOM OF CYCLE

(A) HAVE RANGED FROM 15 TO 25% IN PAST
CYCLES

(B) THIS TIME ALMOST A 40% INCREASE

(C) PRODUCTIVITY NOT CAPACITY
EXPANSION - BODES WELL FOR OUR
FUTURE COMPETITIVENESS

B. GOOD NATIONAL PERFORMANCE

1. MASKS THE ~~DIVERSITY OF PERFORMANCE~~ *unevenness,*

A. AMONG GEOGRAPHIC AREAS/AMONG INDUSTRIES

B. HAS BEEN A VERY UNEVEN EXPERIENCE

2. PROBABLY GREATEST UNEVENNESS THAT WE'VE SEEN IN
~~POST WORLD WAR II PERIOD~~ *past 4 decades*
3. CLEARLY THIS IS NOT SIMPLY A BUSINESS CYCLE
PHENOMENON
 - A. REFLECTS STRUCTURAL DIFFERENCES CREATED IN
PART BY CHANGING WORLD-WIDE DEMANDS FOR GOODS
AND SERVICES
 - B. AS WELL AS CHANGES CREATED BY
 - (1) EARLIER INFLATION
 - (2) FEDERAL SPENDING AND TAXING DECISIONS
 - (3) INTERNATIONALIZATION OF MARKETS - WE
and integral part of A
HAVE BECOME A GLOBAL ECONOMY
 - (4) EXCHANGE VALUE OF DOLLAR
 - (A) ALMOST 90% 1980-1985
 - C. CONSEQUENTLY, RISING TIDE OF ECONOMIC
EXPANSION HAS NOT RAISED ALL BOATS

Slow

QUAD CITIES
4/3/86
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C. ONE BOAT STRUGGLING TO GET OFF THE BOTTOM HERE IN THE
MIDWEST - MANY SECTORS HAVE NOT RETURNED TO LEVELS OF
ACTIVITY EXPERIENCED IN 1981

1. AGRICULTURE - DIFFICULT ADJUSTMENT

2. AGRICULTURE SECTOR PROBLEMS SPREAD TO A WHOLE
HOST OF OTHER RELATED AREAS

A. MANUFACTURING, RETAIL SERVICE, FINANCIAL
ACTIVITY

B. FOR MANY RURAL COMMUNITIES THIS HAS A
PERVASIVE, NEGATIVE INFLUENCE

D. FAIR COMMENT THAT QUAD CITIES AREA ~~BORE THE BRUNT OF~~
Has felt the full
of effect of the slowness
~~THE NEGATIVE ASPECTS~~

1. ~~NOT ONLY DEPENDENCE ON NONELECTRIC MACHINERY~~ *has been*
important to your local economy

A. BUT HEAVY ORIENTATION OF THAT SECTOR TO
AGRICULTURE

~~2. I AM WELL AWARE OF THE DIFFICULT PROBLEMS HERE~~

S A. MANUFACTURING EMPLOYMENT HAS DECLINED *from 1980*

B WITH YOUR UNEMPLOYMENT RATE REACHING ALMOST
15% IN 1983

3. WHILE UNEMPLOYMENT HAS BEEN DECLINING SINCE THEN
As we look at the numbers, you

A. ~~THE~~ RECOVERY SLOW AND LAGGING THE NATION

~~4. EMPLOYMENT GROWTH IN SERVICES HAS ALSO LAGGED~~

~~A. HAS KEPT UNEMPLOYMENT RATES WELL ABOVE~~

~~AVERAGE IN COMPARISON WITH OTHER METROPOLITAN~~

~~AREAS~~

5. ON PLUS SIDE

A. THERE HAS BEEN SOME RECOVERY IN THE
NONDURABLE GOODS INDUSTRY

B. RETAIL TRADE EMPLOYMENT HAS SURPASSED 1980
LEVEL

C. THERE ALSO HAS BEEN STRONG *employment* GROWTH IN *the*
TRANSPORTATION AND UTILITIES *industries*

IV. SHIFTING BACK TO THE NATIONAL SCENE, LET ME LOOK AHEAD -
DESPITE SOME UNCERTAINTY REGARDING THE JANUARY/FEBRUARY
NUMBERS (AND STATISTICAL/SEASONAL ABERRATIONS MAY BE AT
FAULT) - THE YEAR HAS STARTED OFF WELL

the A. CONDITIONS FOR CONTINUED EXPANSION IN PLACE AND SOME *are*

RECENT DEVELOPMENTS ONLY ENHANCE THE POSSIBILITIES -

I'LL EXPAND ON SOME OF THESE DEVELOPMENTS IN A MOMENT

Enumerate a few

1. LOWER INTEREST RATES
2. LARGE DECLINE IN EXCHANGE VALUE OF DOLLAR
3. INFLATION CONTINUING LOW
4. EMPLOYMENT GROWTH MAINTAINED
 - A. THOUGH UNEMPLOYMENT INCREASED IN FEBRUARY,
PAYROLL EMPLOYMENT INCREASED AGAIN
 - B. MORE MODEST THAN JANUARY, BUT STILL POSITIVE
 - C. INCREASES IN MANUFACTURING AREA - 4 MONTHS
THROUGH JANUARY

5. STOCK MARKET PERFORMANCE

A. POSITIVE FROM STANDPOINT OF EQUITY-FINANCING

From point of view of
B. ALSO ~~IMPORTANT FROM STANDPOINT THAT CONSUMERS~~

~~NOW~~ "WEALTH ~~PER~~"

(1) SHOULD MEAN INCREASED POTENTIAL FOR
CONSUMPTION

6. CAPITAL SPENDING PLANS BEING REVISED UPWARDS -

SAY 3/4% THIS YEAR

A. PRETTY MUCH ACROSS THE BOARD, *except oil industry*

B. TAX LEGISLATION WILL BE KEY

(1) ACCELERATED DEPRECIATION

(2) I.T.C.

(3) INCENTIVES FOR PRODUCTIVITY

V. GIVEN THE GOOD START AND THESE VERY RECENT DEVELOPMENTS -

THE OUTLOOK FOR 1986 IS CERTAINLY POSITIVE

A. THE EXPANSION WILL CONTINUE

- of at least*
1. REAL GNP AT ~~ABOUT~~ 3%
 - A. ABOVE 2-1/4% FOR 1985
 - B. COULD BE SOMEWHAT HIGHER
 2. HOUSING STARTS - WELL OVER 1.7MM - 4TH YEAR
 3. AUTOS - LESS THAN 1985 - OVER 10MM - *3rd Year*
 4. INFLATION EXPECTED TO RUN ~~ABOUT~~ *less than* 3-1/2% *of last year*
 - A. RECENT DEVELOPMENTS IN ENERGY SECTOR COULD
MEAN INFLATION LESS THAN THAT
 5. UNEMPLOYMENT RATE SHOULD BE A LITTLE LESS THAN 7%
NATIONALLY

Pause ==

VI. LEST YOU GET TOO COMFORTABLE - THERE ARE SOME SIGNIFICANT

RISKS - IMBALANCES - *the Realities*
of the Year

A. WHETHER REALITY [^] MATCHES EXPECTATIONS DEPENDS ON HOW

WE DEAL WITH THESE IMBALANCES

B. COMMON DENOMINATOR - INCREASE IN DEBT

1. ACROSS ALL SECTORS - PUBLIC AND PRIVATE

2. INCREASE IN DOMESTIC NONFINANCIAL DEBT HIGHEST IN
OVER 30 YEARS
- C. LET ME START WITH THE KEY ELEMENT IN DEBT PICTURE -
THE ONE THAT PERVADES VIRTUALLY EVERYTHING THAT I AM
TALKING ABOUT - NAMELY, THE FEDERAL BUDGET DEFICIT
1. OBVIOUSLY A CURRENT AND TOPICAL ISSUE - LITTLE I
CAN ADD
 2. DEFICITS OF CURRENT MAGNITUDES AT THIS STAGE OF
THE ECONOMIC EXPANSION ARE UNPRECEDENTED
 - A. NOT AT ALL UNUSUAL TO RUN SIGNIFICANT
DEFICITS AT THE TIME OF RECESSION OR OTHER
ADVERSE EVENTS
 - B. BUT WE ARE NOW WELL INTO THE 4TH YEAR OF AN
ECONOMIC RECOVERY AND WE HAVE BEEN RUNNING
DEFICITS AROUND 4-1/2 - 5% OF THE GNP FOR 4
YEARS NOW

3. IN THE LONG HISTORY OF OUR COUNTRY WE HAVE ALWAYS
MANAGED TO BRING OUR BUDGETS IN BALANCE
 - A. AFTER AN ADVERSE EVENT HAS PASSED THAT CAUSED
THE DEFICIT - CONGRESS HAS TAKEN CORRECTIVE
ACTION TO BRING THE BUDGET IN BALANCE -
RECORD IS CLEAR
 - B. INDEED, IN THE EARLY 1830's CONGRESS NOT ONLY
FULLY REPAID THE THEN OUTSTANDING TREASURY
DEBT - BUT RAN SURPLUSES WHICH WERE
DISTRIBUTED BACK TO THE STATES

4. IN THE LATE 1960S WE UNDERWENT AN IMPORTANT
CHANGE - FROM THIS POINT FORWARD WE APPARENTLY
DECIDED TO ACCEPT DEFICITS AS PART OF THE NORMAL
OPERATION OF OUR SOCIETY - NOT AS A WAY OF
DEALING WITH AN ADVERSE EVENT
 - A. ENORMOUS POLITICAL/SOCIAL CHANGE

(1) NOT SURE WE FULLY APPRECIATED THE
MAGNITUDE

5. FEDERAL DEFICITS RESULT IN TREASURY DEBT

A. RISING AT AN ALARMING RATE

B. DEBT LEVEL IN 1975 \$500 BILLION - APPROACHED
\$2 TRILLION LAST YEAR - RISING INEXORABLY

C. OVER \$750 MILLION EVERY WORKING DAY - SOME
\$3.9 BILLION PER WEEK

OF course

6. INTEREST ON THE DEBT HAS TO BE PAID

A. GROWINGLY WORRIED ABOUT COMPOUND INTEREST
SYNDROME

(1) IS THIS AN ISSUE THAT HAS GOTTEN BEYOND
OUR CONTROL?

(2) INTEREST ON THE DEBT IS ASSUMING A MUCH
LARGER POSITION IN THE ANNUAL BUDGET -
10% IN FISCAL 1975, ALMOST 20% IN FISCAL
1985

(3) EVEN ON THIS BASIS ALONE, THE NEED FOR
ACTION ON THE DEFICIT IS VERY COMPELLING

B. BUT, IMPLICATIONS OF CONTINUED HIGH FEDERAL
BUDGET DEFICITS GO FURTHER

(1) AT STAKE - WHOLE ISSUE OF ALLOCATION OF
SAVINGS AND INVESTMENT DOLLARS BETWEEN

GOVERNMENT AND PRIVATE SECTORS

Financing the deficit

(2) ~~OF PARTICULAR CONCERN IS THAT INTEREST~~

has put pressure on the market s -

Interest

RATES ARE HIGHER AS A RESULT OF BUDGET

DEFICIT

D. TO SOME VERY LARGE EXTENT, THESE FISCAL DEFICITS ARE
BEING SUPPORTED BY THE INTERNATIONAL MARKETS

1. OUR TRADE DEFICIT LAST YEAR - A RECORD OF ABOUT
\$150 BILLION

2. WE HAVE NOW BECOME A NET EXTERNAL DEBTOR

3. POSITION NOT INHERENTLY WRONG IF THE FUNDS ARE
BEING USED FOR PRODUCTIVE PURPOSES

- A. WHICH GENERATE THE REPAYMENT CAPACITY TO
SERVICE THE DEBT
- B. WRONG TO USE FUNDS FOR CONSUMPTION PURPOSES -
BASICALLY WHAT IS GOING ON

4. AS A RESULT OF LARGE PURCHASES OF U.S. DEBT BY
INTERNATIONAL MARKETS (JAPAN) PRESSURE ON U.S.
INTEREST RATES HAS TO SOME EXTENT BEEN RELIEVED

- A. IF THERE IS A CHANGE IN SENTIMENT, WILL HAVE
TO FINANCE DEFICIT FROM DOMESTIC SOURCES
- B. HIGHER RATES THAN OTHERWISE

(1) ECONOMIC EXPERIENCE MAY WELL BE DIFFERENT

Shifting From Government

E. CONSUMER INSTALLMENT DEBT HAS ALSO RISEN TO RECORD
LEVELS RELATIVE TO DISPOSABLE INCOME

1. SOME MITIGATING CIRCUMSTANCES WHICH MODERATE THE
SHEER MAGNITUDE OF NUMBERS

- A. BUT PERSONAL DEBT LOADS HAVE BECOME VERY,
VERY HEAVY

B. RAISES THE QUESTION AS TO THE SUSTAINABILITY
OF CONSUMPTION AND THEREFORE THE ECONOMIC
EXPANSION

C. WILL CONSUMERS BE ABLE TO HANDLE THIS DEBT IF
PERSONAL INCOMES BEGIN TO FALL?

F. CORPORATE DEBT HAS ALSO INCREASED VERY RAPIDLY OVER
THE PAST FEW YEARS

1. IN 1984 CONSOLIDATED CORPORATE DEBT ISSUED BY
NONFINANCIAL CORPORATIONS INCREASED BY OVER ~~\$180~~ \$190
BILLION - A RECORD
2. THE 1985 NUMBER WAS SOMEWHAT LESS BUT SECOND ONLY
TO 1984 (\$157.5)
3. EXACERBATED BY LEVERAGE BUYOUTS, MERGERS,
TAKEOVERS, AND ACQUISITIONS
4. EVEN MORE DISTRESSING IS THE RAPID RETIREMENT OF
EQUITY THAT HAS BEEN TAKING PLACE OVER THE PAST
FEW YEARS

on an absolute Basis

5. CORPORATE AMERICA HAS BEEN DECAPITALIZING ITSELF

~~ON AN ABSOLUTE BASIS~~

6. AS A CONSEQUENCE, CORPORATE DEBT RELATED TO NET
WORTH HAS INCREASED VERY SHARPLY

G. CAN'T LEAVE THE DEBT ISSUE WITHOUT COMMENTING ON THE
VERY LARGE EXTERNAL DEBT POSITIONS OF SOME OF THE
LESSER DEVELOPED COUNTRIES

1. VERY DIFFICULT, PARTICULARLY SO FOR COUNTRIES
THAT ARE DEPENDENT ON THE EXPORT OF PETROLEUM
PRODUCTS TO GENERATE DOLLAR RESERVES TO SERVICE
THEIR DEBT

2. WORKING THROUGH THIS PROBLEM WILL BE VERY
CHALLENGING

H. AGAIN, THIS BUILDUP OF DEBT ACROSS ALL SECTORS OF OUR
ECONOMY, NATIONALLY AS WELL AS INTERNATIONALLY, IS OF
GREAT CONCERN

Introduced a

1. A DESTABILIZING ELEMENT - VULNERABILITY OF THE DEBTORS TO SERVICE THE DEBT - MAINTAINING AN ENVIRONMENT OF GOOD ECONOMIC GROWTH IS CRITICALLY IMPORTANT

2. MARGIN FOR ERROR VERY NARROW

Clearly - all this has

VII. IMPLICATIONS FOR MONETARY POLICY

- A. THESE IMBALANCES HAVE CREATED A DIFFICULT ENVIRONMENT FOR MONETARY POLICY

Dealing with

1. A COMBINATION OF IMBALANCES THAT WE HAVEN'T EXPERIENCED BEFORE

2. *either in number or* UNIQUE AS WELL IN MAGNITUDE

3. NET RESULT IS A VERY NARROW PASSAGE THROUGH WHICH TO NAVIGATE

- B. OBJECTIVE OF MONETARY POLICY REMAINS THE SAME

1. CONTINUE PROGRESS TOWARD PRICE STABILITY IN CONTEXT OF GROWING ECONOMY

A. THOUGH RECENT INFLATIONARY RESULTS HAVE BEEN

WELCOME - HARDLY PRICE STABILITY

at the Fed

2. OVERRIDING ASSIGNMENT - KEEP THE EXPANSION GOING

A. BUT IT CANNOT BE AN EXPANSION FUELED BY

ESCALATING INFLATION - EXCESSIVELY

ACCOMMODATIVE MONETARY POLICY

(1) HISTORY CLEAR THAT SUSTAINABILITY IS

of a growing economy

IMPAIRED BY INFLATION - WE'VE BEEN THERE

if we were to experience

B. BUT A RENEWED RECESSION - THE IMBALANCES I

CITED WOULD BECOME VERY DIFFICULT

C. CONSEQUENTLY, PRESSURES MAY WELL MOUNT

in our case

1. TO MAINTAIN AN EVEN MORE RAPIDLY EXPANDING ECONOMY

due

2. WITHOUT CONCERN ABOUT LONGER TERM INFLATION

POTENTIAL

3. FED WILL COME UNDER VERY HEAVY PRESSURE TO

MONETIZE OUR WAY OUT OF SOME OF THESE PROBLEMS

4. OUR INDEPENDENCE COULD BE THREATENED

Pause =

VIII. CONCLUSION

A. SAID AT OUTSET - YEAR HAS STARTED WELL - UNIQUE SET
OF CIRCUMSTANCES ~~at least~~ ^{we are dealing with} ~~OPPORTUNITY~~ ^{and} + ~~we~~ ^{all} have a great opportunity

B. LET ME JUST REPEAT AND EMPHASIZE 3 ~~FACTORS~~ ^{items}

First

1. MASSIVE REDUCTION IN ENERGY PRICES - FELL OUT OF
SKY

A. GLASS 7/8'S FULL

B. VERY POSITIVE AND PERVASIVE - NOT ONLY OUR
ECONOMY, BUT WORLD ECONOMIES AS WELL

C. VERY FAVORABLE IMPACT ON INFLATION

D. GIVES FED MORE MANEUVERING ROOM - DECREASED
INFLATIONARY CONCERNS

Second

2. SIGNIFICANT REDUCTION IN INTEREST RATES - MEDIUM
AND LONG TERM

A. YIELDS ON 30 YEAR DOWN ^{Some} ~~ALMOST~~ 400 BASIS
POINTS IN LAST YEAR - ^{over} ~~ALMOST~~ 150 BASIS POINTS
SINCE TURN OF THE YEAR

B. 30 YEAR BOND YIELDING UNDER 8% - FIRST TIME
IN OVER 7 YEARS

C. AGAIN, VERY PERVASIVE THROUGHOUT OUR ECONOMY
- AND WORLD ECONOMIES

(1) REDUCED RATES PUT EXTERNAL DEBTS OF LDCS

IN MUCH DIFFERENT PERSPECTIVE

Domestically
(2) MORTGAGE REFINANCINGS - POWERFUL EFFECT

ON CONSUMER SPENDING

Third
3. CHANGE IN VALUE OF DOLLAR AGAINST DM AND YEN -
ALMOST 30% SINCE THIS TIME LAST YEAR

A. SIGNIFICANT AMOUNT HAS OCCURRED THIS YEAR

B. ENORMOUS OPPORTUNITIES FOR OUR EXPORT SECTOR

- WILL TAKE A WHILE TO SHOW UP IN NUMBERS -

VERY, VERY HELPFUL FOR THE BELEAGUERED EXPORT
ACTIVITIES

C. BETTER OPPORTUNITIES FOR SUPPLIERS TO

DOMESTIC MARKETS - IMPACTED BY IMPORTS

C. THUS WHAT HAS STARTED WELL SHOULD END WELL

1. MOREOVER - IF WE CAN DEAL WITH THESE IMBALANCES

I'VE ENUMERATED - AND THE ^{Strength}~~POSITIVE~~ ECONOMIC
ENVIRONMENT GREATLY FACILITATES MANAGING OUR WAY
THROUGH THESE TERRIBLY DIFFICULT ISSUES

2. THE FUNDAMENTALS ARE AT HAND FOR A CONTINUATION
OF THIS FAVORABLE ECONOMIC EXPERIENCE FOR QUITE

~~←~~ SOME WHILE - AND THIS YEAR MAY WELL
~~TURN INTO~~ ^{focus}
~~DEVELOP INTO THE TURNING POINT~~ IN WHAT
MIGHT JUST BE ONE OF THE MOST REWARDING
ECONOMIC PERIODS OF THE PAST FEW DECADES

D. ON THAT POSITIVE NOTE - CONCLUDE

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