Good morning. It's a pleasure to take part in this morning's panel session.

What I'd like to do is start things off by providing a brief overview of the national economy and the outlook for 1997. Please note the emphasis on brief. Mark Twain once said that “Few sinners are saved after the first twenty minutes of a sermon.” I don't know if Twain ever attended a talk on the business outlook but I suspect he'd be as tough on central bankers as he was on preachers. So I'll do my best to be concise.

How do I see the current situation? Well, I'd put it this way: the economy did well last year and we can expect more of the same in '97. Or, to put it in Yogi Berra's well-known words, “It's deja vu all over again.”

Fortunately, more of the same is positive news...1996 was a good year for the economy. We had very respectable growth, with real GDP growth expected to come in at about 2¾ percent. A particular bright spot throughout the year was the combination of low inflation and low unemployment rates. Inflation as measured by the Consumer Price Index was up a bit in '96 as compared to '95. But it looks as though core CPI inflation—which excludes food and energy prices—decelerated in '96...to its lowest level in more than thirty years. And the unemployment rate remained low, averaging 5.4 percent in the first 11 months of '96.

Some observers have described it as the “Goldilocks economy—not too hot, not too cold but just right.” That's not a bad description, although some might say the porridge had some lumps in it as growth was a bit uneven from quarter to quarter. We started out of the gate last year at a moderate pace in the first quarter, picked up quite a bit of momentum in the second, and then settled into a more comfortable speed during the last half of the year. Despite a bit of unevenness, though, 1996 was a good year by historical standards, especially for the sixth year of expansion.
What do I see for '97? Before giving you some numbers, I'd like to briefly cover three issues that I think will have a lot to do with how things shape up during '97. These are just a few of the many issues that are worth watching.

**The first issue**—Are consumers tapped out?

**Number two**—Will developments overseas provide a boost to the economy?

**And number three**—Will the tight job market eventually increase pressure on wages?

Regarding the first question, growth in consumer spending was generally solid last year. We don't have the final numbers yet but it looks as through spending increased about 2\% percent. In general, consumer spending growth was roughly in line with the overall economy…it didn't act as a drag on the economy or pull it along too fast.

It looks as though we'll see more of the same in '97. One positive sign is income growth. Last year, growth in consumers' disposable income kept pace with spending. We expect incomes to continue increasing at a healthy pace during '97, which bodes well for spending.

There are some potential hurdles, however. We're now in the sixth year of expansion…and we're close to beginning a seventh. At this point in the expansion, consumers have already made the major purchases that they deferred during the 1990-91 recession. In other words, there probably isn't much pent-up demand. So we probably won't see a spurt in the sale of big ticket items in '97.

The performance of the stock market could also play a role. The market did quite well in '96, which put some consumers in a better position to spend. The future performance of the stock market may influence peoples' willingness to keep spending at a healthy pace.

The consumer debt situation is another factor. It's a well-publicized fact that consumers have accumulated a lot of debt. In general, people are using a relatively high percentage of their disposable income to service their debt. But things have been improving. The growth in debt has slowed in recent months. And the debt service payments of consumers relative to their income have stabilized, although they're still at a high level.

And the savings rate has increased in recent months. Overall, we don't think consumer debt will be a major constraint on spending.

So, on balance, at the Chicago Fed we don't think consumers are tapped out. Given the healthy income picture, high consumer confidence levels, and other factors, we expect that spending will continue along at a respectable pace in '97, roughly the same as in '96.

Second question—How will developments overseas affect the U.S. economy?

There was somewhat of a mixed picture for the U.S. last year. We had strong growth in imports, thanks in part to the healthy increase in our GDP. Americans had more to spend and we spent it…including a fair amount on foreign goods and services. Export growth, on the other hand, was
somewhat disappointing. In general, our major trading partners experienced fairly sluggish economic growth, which affected the demand for U.S. exports. Overall, U.S. imports exceeded exports by a wider margin than in '95. As a result, the international sector was a bit of a drag on the U.S. economy in '96.

The outlook for the international sector is a tough call at this point. Eventually our major trading partners should see their economies pick up. This should provide a boost for U.S. exports. But I don't think we can count on a strong rebound for exports in '97. Our best guess right now is the international sector will have a neutral effect on the U.S. economy.

Finally, the third question—Will tight labor markets spark inflationary pressures?

As you know, unemployment rates continued to be low across the country, ranging from 5.8 last January to 5.1 percent in August. It stood at 5.4 percent in November. Unemployment rates were even lower in the Midwest, as low as 1.3 percent in Madison, Wisconsin, the lowest of the Metropolitan areas in the country.

That's not an isolated example, by the way. The Midwest's unemployment rates have been consistently lower than the nation in recent years...an indication of the strength of our regional economy. The rust belt has become robust. As a regional institution, the Chicago Fed has a strong interest in this trend. In fact, we've nearly completed a major study of the Midwest economy, which examines the region's turnaround and what we need to do to keep it going. But that's the subject of another talk.

As I said, unemployment rates have been quite low, in the Midwest and nationwide. It's interesting that there hasn't been more pressure for higher wages. When unemployment was this low in the past, businesses had to increase wages more aggressively to attract workers. That didn't happen last year. For example, it looks as though overall wages and benefits—as measured by the employment cost index—increased about three percent last year.

Don't get me wrong. Higher wages are all to the good...as long as productivity is increasing and we don't get a corresponding hike in inflation. Workers obviously can't improve their living standards if their raises are eaten up by higher prices.

Frankly, many economists have been somewhat surprised that workers haven't been more aggressive in seeking higher wages. Why haven't they? There's probably a number of factors at play. It seems safe to say that one reason is a lingering sense of insecurity in the workforce.

Workers seem to be more concerned about job security than wage increases. For instance, we've seen labor unions focusing on job security issues during negotiations. More and more, longer-term labor contracts have been negotiated as part of this trend, some extending as long as five or six years. At some point, though, workers may begin feeling more secure and become more aggressive in seeking wage increases.

Given past trends, the Federal Reserve will certainly continue to pay close attention to the labor markets. We're watching carefully for any signs that wage pressures are mounting. We haven't seen that yet. But it's a key issue to keep in mind during '97.
What's the overall outlook for the nation? We anticipate that real GDP will grow between 2 and 2½ percent this year. The Consumer Price Index should come in at about three percent. And the unemployment rate should fluctuate around 5½ percent.

So, as I said, it looks as though we'll see more of the same in '97. The deja vu economy, if you will. We should have another year of respectable growth, with low inflation and low unemployment rates. In other words, a year that would be consistent with the Fed's goal of a healthy, growing economy with price stability. Hopefully, I'll have an opportunity a year from now to appear at this breakfast and discuss a solid '97 performance and another promising outlook for '98.

Thank you.