

WBBM NEWSRADIO BREAKFAST OUTLOOK

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I. Intro

- A. Pleasure to be here. I appreciate each of you taking the time to be here this morning.
- B. Central bankers sometimes get typecast as purveyors of gloom and doom
 - 1. We get paid to worry
 - 2. We're practitioners of the dismal science
 - 3. We get accused of taking away the punch bowl just when the party's getting started.
- C. So I'm pleased to have an opportunity today to bring you some good news about the economy.
 - 1. We've just finished off quite a year. It's hard to avoid superlatives when you look back at 1997.
 - 2. It was a remarkable year for the economy — a year that caught almost all forecasters by surprise.
- D. The economy's performance reminds me of Yogi Berra's comment after Tiger Woods won the Masters Tournament last summer.
 - 1. Yogi was asked if Tiger had exceeded his expectations.
 - 2. Yogi replied, "He's done more than that!"
 - 3. Like Tiger Woods, I think the economy has exceeded our expectations — and then some.
- E. Let me give you a few numbers to back up my superlatives.

1. It looks as though real GDP growth will be about $3\frac{3}{4}$ percent over the four quarters of 1997— the largest increase since 1987.
 2. The unemployment rate fell to 4.6 percent in November — the lowest in 24 years.
 3. Finally, the core Consumer Price Index, which excludes food and energy prices, should increase only about 2 percent.
 4. That's the lowest inflation rate in over three decades.
- F. From the central banker's point of view, we hit the trifecta — we had strong growth, high employment, and low inflation.
1. What makes this even more impressive is that we're approaching the seven-year anniversary of this economic expansion.
 2. In fact, we're now in our 82nd month of continuous growth.
 3. That makes this expansion the third longest in our nation's history, behind only the 92-month expansion during the 1980s and the 106-month expansion during the 1960s.
- G. So what do I see for '98? I'd like to briefly cover three issues that I think will have a lot to do with how things shape up this year.
1. First — Will consumers keep on spending at a rapid rate?
 2. Second — Will the tight job market trigger inflationary pressures?
 3. And third — How will developments overseas affect the economy?

II. Consumer Spending

- A. Let's look at consumer spending first.
1. Consumers continued to purchase goods and services at a healthy clip last year.
 2. Spending growth was a bit uneven from quarter to quarter, but it looks as though it will average about 32 percent for the four quarters of 1997.
 3. We don't expect growth in this area to be quite that strong this year, although it should continue at a very respectable pace.
- B. Why do we think we'll see continued growth in consumer spending?
1. Two of the key factors are a strong employment picture and a positive outlook for disposable income.
 2. In other words, consumers should have more money to spend.
 3. And with consumer confidence at a high level, we expect that they'll be inclined to spend it.

4. The overall strong performance of the stock market last year may also increase people's comfort level in making purchases.
- C. There are some factors that will tend to dampen spending growth. Let me briefly mention three.
1. First, some consumers have accumulated quite a bit of debt and there are concerns about the level of delinquencies and bankruptcies.
 - a. Consumer debt levels are high relative to income. So are monthly payments to service that debt.
 - b. But consumer debt and monthly payment levels are no longer increasing more rapidly than income— that's an encouraging sign.
 2. Second, banks have indicated that they've adopted somewhat tighter standards for extending credit to consumers.
 - a. In general, I think this is an appropriate trend, given the relatively high level of delinquencies and bankruptcies.
 - b. But it could have a dampening effect on consumer spending.
 3. Third, most people have already made their major purchases at this point in the expansion, so we probably won't see a spurt in the sale of big-ticket items.
 - a. It does look like we'll continue to see fairly strong demand for cars and light trucks, though.
 - b. The auto industry sold roughly 15 million units last year and most analysts are predicting similar numbers for '98.
 - c. In addition, with home sales at high levels, we expect relatively strong demand for appliances and other household items.
 - d. So we're likely to see some continued strength in these sectors, but not large increases from 1997.
- D. Overall, I don't think consumers are tapped out. Given the high level of consumer confidence, the healthy outlook for income growth, and the strong employment picture, we expect that spending growth will continue at a respectable pace, although a bit slower than last year.

III. Consumer Spending

- A. The second issue I'd like to discuss is whether tight labor markets will trigger inflationary pressures.
- B. In the past, of course, inflation usually started to accelerate when growth was so strong and the unemployment rate fell to such a low level. Instead, we've seen inflation move lower.
- C. Tight labor markets have been especially evident here in the Midwest.
 1. We've had unemployment rates lower than the nation since 1992. That's a dramatic change from our 'Rustbelt' days back in the early '80s.

2. The unemployment rate for the Midwest averaged 4 percent during 1997 — a full percentage point below the nation.
 3. In fact, the Midwest not only enjoys low unemployment rates, but our worker participation rates are hitting very high levels. In other words, the region may be running out of potential workers.
 4. The Midwest employs 66.2 percent of its working age population – significantly higher than the nation.
 5. Wisconsin has the highest worker participation rate in the country — 72.1 percent.
 6. So the strong demand for workers continues, but the available supply is becoming limited.
 7. That seems to be a factor in the region's slower job growth compared to the nation during the past two years.
- D. As I said, such a tight labor market in the Midwest and throughout the nation usually resulted in inflationary pressures in the past.
- E. Why haven't we seen history repeating itself? There are a number of factors that seem to have played a role. A few are temporary; some may be more permanent.
1. One of the temporary factors is the strong dollar, which has contributed to a fall in import prices.
 - a. That's helped to keep inflation down.
 - b. But of course, we can't count on import prices reducing our inflation rate forever.
 2. Another temporary factor is slower growth in benefits costs for many businesses, particularly health care costs.
 - a. Again, this trend could continue for a while. But we've had reports that employer costs for health benefits may rise more rapidly this year.
 - b. For example, one report indicated that firms will face HMO rate increases that are twice what they were in '97.
 3. There's another factor that may not be temporary.
 - a. It's possible that trend productivity growth may have risen to a higher level as a result of strong investment in computers and other high-tech equipment.
 - b. Such investments have increased at double-digit rates for the past five years.
 - c. The U.S. may finally be getting the return on that investment in the form of higher productivity growth.
- F. Productivity growth, of course, is essential because it's one of the key elements that determines how fast our economy can grow without triggering inflation.
- G. Has trend productivity growth increased? The evidence is mixed.
1. The strong business profits in recent years are certainly consistent with higher productivity.

2. But until recently, the official statistics didn't show any change from the 1.1 percent average annual increase we've seen over the past 25 years.
 3. However, the latest data indicate that productivity is picking up — it increased at twice the trend rate in the second quarter of 1997 and four times the trend rate in the third quarter.
- H. Is this recent pickup a temporary, cyclical phenomenon? Or does it reflect a more permanent increase — an increase that could reduce the potential inflationary pressures generated by tightness in the labor markets?
1. Unfortunately, it will be some time before we'll know the extent of any lasting improvement in productivity and its effect on the economy.
 2. In the meantime, the Fed will certainly continue to pay close attention to the labor markets and watch for signs of increasing wage pressures.

IV. Overseas Developments

- A. That brings me to the third issue — How will events overseas affect our economy?
- B. Of course, recent events in Asian markets have complicated the answer to this question.
- C. It's still too early to draw any definite conclusions, but we are starting to get a better idea of the overall impact of the Asian situation.
1. For example, the International Monetary Fund recently lowered its 1998 growth forecast for the world economy from 4.3 percent to 3.5 percent.
 2. That dramatic revision took place in just two months, which highlights how quickly the turbulence in Asia changed the outlook for the world economy.
- D. The Asian situation will affect the U.S. economy on both the export side and the import side.
- E. On the export side, there will be less demand for U.S. products in Asian countries because of the slowdown in their economies.
1. At the same time, the sharp appreciation of the dollar against Asian currencies will make it more difficult for U.S. exporters to compete in those markets.
 2. That will certainly have an impact on our overall level of exports. The U.S. shipped nearly 29 percent of its exported goods to Asian markets during 1996.
 3. For the Midwest, Asia is a comparatively small market, at least when it comes to manufactured goods.
 4. However, the situation is much different for the region's agricultural exports.
 5. For example, we estimate that 55 to 60 percent of the Midwest's exports of so-called coarse grain such as corn was shipped to Asia last year.

- F. On the import side, there are some positive effects. With Asian currencies weaker relative to the dollar, imports from Asia will be less expensive.
1. This will benefit U.S. consumers and U.S. producers who use foreign components because it will help dampen inflationary pressures.
 2. Asia already accounts for 39 percent of goods imported to the U.S. and we expect that Asian imports to the U.S. will increase during '98.
 3. This will put pressure on U.S. industries competing with certain imports, such as autos and steel.
 4. That's a trend that will be felt in the Midwest because the auto and steel industries are so heavily represented here.

V. Conclusion

- A. So how will all this affect the U.S. economy during 1998?
1. The situation is still evolving, but our current estimate is that the recent problems in Asia will reduce our real GDP growth this year by roughly half a percentage point.
 2. As a result, we anticipate that the overall effect of the international sector will be to reduce our real GDP growth by about three-quarters of a percentage point.
 3. That's essentially the same effect we estimate that the international sector had on real GDP growth during 1997.
- B. Despite the effect of the international sector, however, we expect solid growth for the U.S. during 1998.
1. We anticipate that real GDP will grow between 2 and 22 percent.
 2. The Consumer Price Index should increase between 2 and 22 percent.
 3. And the unemployment rate should come in at about the current level.
 4. As I said, our economy will grow more slowly than last year, but it will grow at a pace that's more sustainable over the long run — a pace that won't trigger inflationary pressures.
- C. An economy that grows at a solid, sustainable pace may not be exciting. But a roller-coaster economy is a losing proposition in the long run.
1. As the great tennis instructor Vic Braden once said, "Losers hit a wide variety of shots, but champions keep hitting the same old boring winners." That's what I want to see — the same old boring winners.
 2. Hopefully, a year from today we will be discussing another winning year for the economy.
- D. Thank you.