

AMERICAN IRON AND STEEL INSTITUTE

August 4, 1998

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I. Great pleasure.

A. Spoke to this group in 1995. Glad to have another opportunity.

II. Chicago Fed

A. This type of meeting helpful for me.

B. As you know, Fed's mission is to foster a healthy growing economy/stable financial system.

C. Fed's regional structure means System gets constant flow of economic intelligence from the regions.

1. Directors important source—including Bob Darnall

2. Perspective isn't limited to Washington, D.C., "beltway."

D. Regional structure reflected in FOMC, which is made up of seven members of the Federal Reserve Board and the 12 Reserve Bank Presidents—five of whom vote on a rotating basis.

1. I'm not voting this year—but will be in 1999.

2. Regardless of voting status, all presidents take part in discussions.

3. When I give an update on developments in our region, typically discuss steel industry.
4. Always find these types of sessions useful—one of the advantages of our regional structure.
  - a. Obtain up-to-date information on economic developments.
5. Speaking with this group especially useful because steel is such a major factor in the Chicago Fed's region.
  - a. About one-third of U.S. steel production takes place in Seventh Federal Reserve District.
6. Very interested in hearing your thoughts/ideas on economy.

### III. Economy

- A. First, like to take a few minutes to provide overview of U.S. economy.
- B. A couple of unknowns will have a lot to do with how things shape up.
  - One—Will we see a continued improvement in productivity?
  - Two—How will the situation in Asia affect the economy?
- C. First—will the current productivity trend continue?
- D. As you know, productivity is important because it's a key element that determines how fast economy can grow without triggering inflation.
- E. We had strong growth in U.S. last year—real GDP growth was 3.8 percent—largest increase since 1987 (on 4th quarter to 4th quarter basis).
  1. Real GDP growth increased in the first quarter to 5.5 percent annual rate.
  2. Growth of U.S. output slowed sharply in the second quarter to a 1.4 percent annual rate.
  3. However, final sales to domestic buyers continued to be strong—up 6.3 percent in the second quarter versus 6.6 percent in the first.
  4. The largely temporary impact of the GM strike, a marked slowing in inventory accumulation, and a further increase in the net export deficit were major contributors to the drag on the economy.
- F. Labor markets tightened further in first half of 1998.
  1. Unemployment rate dropped below 4½ percent in second quarter—lowest level in nearly three decades.

2. Labor markets especially tight here in the Midwest.
- G. At same time, measured inflation has been low.
1. Last year, core CPI came in at 2¼ percent—lowest since 1965.
  2. Overall CPI up only 1.9 percent last year—lowest since 1986—and rose at an annual rate of only one-half of one percent in the first quarter of '98.
  3. More recent data suggest overall consumer price inflation moved back up to 2 percent in the second quarter.
  4. So, overall, measured inflation has remained low so far.
- H. Historically, inflation usually accelerated when labor markets so tight.
1. Why is it different now? Number of factors.
  2. Temporary Factors:
    - Strong dollar, which contributed to fall in import prices and helped to keep inflation down. But can't expect this to last forever.
    - Slower growth in benefit costs, particularly health care costs. But seeing signs of increasing costs in health area.
  3. Wage and benefit cost increases overall have been relatively subdued.
  4. But have seen an upward trend in wages.
  5. With upward pressure on benefit costs now emerging, productivity will be important.
- I. Another factor may not be temporary—trend productivity growth may have risen to a higher level as a result of strong investment in computers and high-tech equipment.
1. Double-digit investment for past six years (Inflation-adjusted investment in information processing and related equipment on Q4 to Q4 basis).
  2. Maybe finally getting the return on that investment.
- J. Has trend productivity increased? Maybe, but not sure.
1. Strong business profits consistent with higher productivity, though latest information points to slower growth in profits.
  2. Official statistics show some increase recently in productivity growth from 1.1 percent annual average increase over the past 25 years.
    - In 1996—1.9 percent
    - In 1997—1.7 percent

3. Most recently, does appear that productivity for second quarter of '98 weakened.
    - Due in part to slower growth in output.
    - In manufacturing, appears there was still a solid increase in productivity.
- K. Certainly I've seen and heard about examples of increased productivity in manufacturing sector.
1. Very true in the steel industry.
  2. But manufacturing about a quarter of U.S. economy.
  3. Services very important—of course, it's hard to increase productivity in some services.
  4. Education, for example.
    - Relative prices will rise—2% versus 5%.
    - Hard to measure—quality of work in a classroom.
- L. Don't know if productivity improvement is temporary—a cyclical phenomenon—or a permanent change.
1. Won't know for some time—interested to hear your opinion.
  2. Fed will be watching a variety of indicators to judge how productivity is performing in the months ahead.

#### IV. Asian Situation

- A. Second question—How will the Asian situation affect the U.S. economy?
- B. As expected, U.S. export growth has slowed due to lower demand in Asian countries and a strong dollar against Asian currencies.
1. Important since Asia a major market for U.S.
  2. 28 percent of U.S. exports shipped to Asia during 1997.
  3. 23 percent during January through May of this year.
- C. On the import side, we've seen an increase in imports from Asia, as expected.
1. Asia accounted for 38 percent of the dollar value of goods shipped to U.S. during 1997.
  2. Imports from Asian markets up from year-ago levels—about 6 percent in dollar terms.
  3. Factor for industries such as steel that face foreign competition.

- D. Asian crisis should help dampen inflationary pressures.
  - 1. Prices of imports from Asia well below year-ago levels.
  - 2. Import prices on goods from Asian newly industrialized countries down 8.8 percent in June, relative to a year ago.
- E. Certainly troubles in Asian countries restraining demand for U.S. goods and services.
  - 1. A sharp deterioration in U.S. trade balance in the first and second quarters.
- F. Still to see full effects of the crisis on U.S. employment and income.
  - 1. Domestic spending remains strong.
- G. Chicago Fed estimate at the beginning of the year was that the Asian crisis would reduce real GDP growth in '98 by roughly one-half of a percentage point.
  - 1. Still believe that's a reasonable estimate.
- H. What does Chicago Fed see for the U.S. economy overall for 1998?
  - 1. Expect real GDP growth to average about 3¼ percent over four quarters of 1998.
  - 2. Consumer Price Index at around 2 percent, on average, over four quarters of 1998.
  - 3. Unemployment rate will average around 4½ percent in the fourth quarter, or a bit lower.
- V. **To finish up, like to take a few minutes to talk about the longer-term prospects for the economy.**
  - A. One of the Chicago Fed's major research projects in recent years was in-depth study of the structural changes that have taken place in the Midwest economy.
  - B. The study focused on the Midwest, but I think many of its findings are applicable to other regions.
  - C. The goal of the study was to better understand the region's future by studying its past - specifically the Midwest's dramatic comeback since the early 1980s.
    - 1. One of five Midwest manufacturing jobs had disappeared from mid-1979 through 1982—many in the steel industry.
    - 1. Unemployment in the region was almost three percentage points above the nation.
    - 2. Today, the Midwest unemployment rate is a full percentage point below the nation's.
  - D. The key question is how did we turn it around? Was it because of external factors that the

region couldn't control, like a stronger dollar? Or was it due to internal factors, such as productivity improvements?

1. In other words, were we lucky or were we good?
- E. Our study found that we were both lucky and good. But the important point for the future is that we were good.
1. There's no doubt that the Midwest was helped by developments outside the region, such as lower energy costs and growth in exports.
  2. But a critical factor in the Midwest's success was its willingness to reinvent itself.
  3. Midwest businesses reduced costs, created new product lines and made remarkable productivity improvements—the steel industry is a good example.

**VI. But the Midwest faces a major challenge, as do other regions.**

- A. The Midwest's job growth has faltered since 1993.
1. Beginning in 1987, employment growth in the Midwest outpaced the nation for six years, largely due to our rejuvenated manufacturing sector.
  2. In 1994, national job growth caught up to the Midwest's. In 1996 and 1997, annual job growth in the Midwest was below the nation.
  3. Annual job growth for the nation was 2.3 percent, compared to 1.7 percent in the Midwest.
- B. Why has the Midwest's job growth lagged the nation? Is it because of deteriorating economic conditions or a limited supply of workers?
1. Chicago Fed economists looked at this question and found that demand for workers remains strong, but that available supplies are becoming limited.
  2. In other words, our region may be running out of workers. And it appears that the shortage of workers has affected our job growth.
  3. Situation facing other regions to varying degrees.

**VII. That's one of the reasons our study highlighted the importance of education and training as a key to future economic success.**

- A. One strategy is to expand available labor by concentrating on expanding education and training.
- B. High-quality education is essential, of course.

1. We need to learn more about the usefulness of competition and choice, especially in the central cities where choice of location may be more limited.
- C. Workforce training is another key issue, although the experience in this area has not been too encouraging.
1. Workforce training has often proved to be very expensive and often ineffective.
  2. One approach is providing workers with certifiable skills that can be transferred from one employer to another.
  3. The Council of Great Lakes Governors has had some success in establishing a partnership to certify skills and credentials for workers in the metalworking industries.
- D. Clearly, no easy answers. But a key issue we all face if we're to maintain our economic momentum.
- E. Thank you. Interested to hear any comments/questions you might have.