

LATIN AMERICAN CEOS
NORTHWESTERN UNIVERSITY

Evanston, Illinois
August 5, 1998



I. Welcome. Great pleasure.

- A. Personal interest in international arena—served as deputy U.S. trade representative in early ‘90s.
- B. Always a pleasure to continue interaction with Northwestern—professor of strategy and international management, prior to coming to the Chicago Fed in late 1994.

II. Chicago Fed

- A. First, as background, quickly describe Chicago Fed
- B. Fed’s mission—foster healthy growing economy/stable financial system.
- C. Founded in 1913 by Act of Congress.
- D. 12 Regional Reserve Banks.
- E. Federal Reserve Board in Washington oversees Reserve Banks
- F. Monetary policy/Supervision & regulation/Financial services
 - 1. As will see in tour—check and cash
- G. Chicago Fed territory—Illinois, Indiana, Iowa, Wisconsin, Michigan

1. Head office in Chicago, branch in Detroit, check processing centers in Des Moines, Milwaukee, Indianapolis and Peoria.
- H. Federal Open Market Committee—FOMC—responsible for monetary policy
1. Made up of seven members of the Federal Reserve Board and the 12 Reserve Bank Presidents—five of whom vote on a rotating basis.
 2. I'm not voting this year—but will be in 1999.
- I. Fed's regional structure means System gets constant flow of economic intelligence from the regions.
1. Perspective isn't limited to Washington, D.C., "beltway."
 2. Always find these types of sessions useful—interested in hearing your thoughts/ideas on economy.
- J. Fed also insulated from day-to-day political pressures.
1. 14-year terms for Federal Reserve Board.
 2. System not funded by Congressional appropriations.
 3. Fed income derived primarily from interest on U.S. government securities it has acquired through open market operations.
 - a. About 95 percent of that income turned over to the U.S. Treasury.
- K. Structure helps Fed focus on policy, not politics.

III. Economy

- A. 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.
1. One- Will we see a continued improvement in productivity?
 2. Two-How will the situation in Asia affect the U.S. 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. But manufacturing about a quarter of U.S. economy.
 2. Services very important—of course, it's hard to increase productivity in some services.
 3. 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.
 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.
- D. Asian crisis should help dampen inflationary pressures in U.S.
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 the 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. Like to make one last point.
- A. Believe it's essential that the U.S. continue to play an active role in the global community.
 - B. U.S. participation in providing IMF funding is appropriate.
 - C. U.S. reluctance regarding issues such as lowering trade barriers is ironic in this environment, given the strength of the economy.
 1. For example, the failure of fast track authority for President Clinton last fall.

- D. U.S and Latin America provide a good example of benefits from continuing to reduce trade barriers.
 - 1. Latin America an important growth area.
 - 2. Latin America (including Mexico and the Caribbean Basin) has estimated population of more than 470 million.
 - 3. U.S. Commerce Department estimated that total GDP of Latin America and the Caribbean Basin will grow at an average of 5 percent through the year 2000.
 - 4. Last year, the U.S. exported more to Brazil than to China despite the fact that Brazil's population is less than one-seventh of China's.
 - 5. During the first five months of '98, 19.7 percent of U.S. goods exports went to the 20 major Latin American republics (including Mexico)—up from a 17.2 percent share during the same period in 1997.
 - 6. During first five months of '98, 15.7 percent of U.S. goods imports came from Latin America—the same share as first five months of '97.
 - 7. U.S. exports to Latin America are up 15.8 percent from a year ago. Imports are up 6.1 percent.
- E. Important advantages to both the U.S. and Latin America to build on progress of the Uruguay Round and encourage free trade in the Americas.
- F. Thank you. Interested to hear any comments/questions you might have.