GREATER MILWAUKEE COMMITTEE

Milwaukee, Wisconsin
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Regional Economic Development and the U.S. Economy

I appreciate the opportunity to be here. It's nice to have a chance to get to meet and talk with the members of the Greater Milwaukee Committee (GMC). You are here because you are dedicated to the prosperity of this region. Because you care about the Milwaukee area's economy and its sustainability. And that is why I'm here as well. Like you, the Fed cares about sustainable economic growth — on a national level, but also right here in Southeast Wisconsin.

You know, I almost always begin my talks with a brief overview of the functions of the Fed, no matter how knowledgeable the audience. The Fed used to be much less in the public eye than it is today, and even now a lot of people don't understand what exactly we do. I had one person tell me he thought the Federal Reserve was the national bird sanctuary. Actually, our mission is very simple — to help ensure a healthy and growing economy. We do that in several ways: by supervising and regulating banks; by providing financial services to banks and the U.S. government; and — the Fed activity that that gets by far the most attention — by setting monetary policy.

The Chicago Fed serves a five-state area consisting of most of Wisconsin, Illinois, Indiana, Michigan and all of Iowa. Our head office is in Chicago. But we also have regional offices in Milwaukee, Detroit, Des Moines, Indianapolis, and Peoria.

If you'd like to learn more about the activities of the Fed, I hope you'll come to visit us. Last Saturday, July 7, we officially opened our new Visitors Center in Chicago — complete with weekend hours. We believe our new Center will put us on the map as a place to visit in downtown Chicago. We're excited about it because we will be able to inform more people about the Fed's operations, and about the important role of their central bank.

While our primary mission is to foster sustainable economic growth on a national level, I'd like to take a few minutes to talk about a lesser-known aspect of that mission — that is, the role we play as a catalyst and facilitator in regional economic development. In this capacity, we bring together different groups with common interests, so that they can address issues that directly affect regional communities, businesses, and consumers — in areas like affordable housing, fair access to capital and credit, and predatory lending. Our goal in these areas is to promote fair and equal access to credit, and more broadly, financial empowerment — the ability of any person to participate fully in the economy and in sound and competitive markets.

Over the last two years, representatives of the Chicago Fed spoke with local government, business, and community leaders in the Milwaukee area about their vision for the region's future. What we heard was that you wanted to do something concrete about suburban sprawl and concentrations of poverty. You said that the availability of a greater range of housing opportunities is needed throughout the region; that housing and economic development are inextricably linked.

A recent report from Moody's Investors Service illustrates the impact of housing market dynamics on the future prospects for economic growth in the outlying areas of the region. In assigning Waukesha County its highest bond rating, Moody's nonetheless noted that Waukesha's stability is threatened by a significant worker shortage for which it needs more affordable housing, mass transportation and worker training.

Why is housing such an important factor in assuring the health and sustainability of the Southeast Wisconsin economy? Like many metropolitan areas, this region's job growth has occurred outside the central cities of Milwaukee, Racine and Kenosha. One problem is that many workers continue to live in the city and face limited public transportation options to these new jobs and a limited amount of housing within their financial reach. The result? Low-wage workers living in pockets of concentrated poverty, further and further removed from the jobs that would sustain them while employers consistently list workforce availability as a primary impediment to future growth.

Given the implications of the jobs/workforce mismatch, you decided that being an effective economic competitor with other metropolitan regions requires taking an inclusive, proactive approach to improving the housing and economic development of the region. One new initiative in the greater Milwaukee region to address these issues is the Housing Opportunity Partnership for Southeast Wisconsin (HOPS).

The Chicago Fed has been involved in similar partnerships that have had significant results. One partnership, for instance, addressed mortgage credit issues and fair access to housing in Chicago. A major result of the partnership's work was that 400 families avoided foreclosure through counseling services and workout arrangements. Another program tackled access to capital for small business owners. This partnership resulted in the creation of a new venture capital fund to finance entrepreneurs and small business owners for whom there was previously little traditional funding. These efforts, like yours, are being brought to life because of the local leadership's dedication and commitment to improve their communities. I want to emphasize that these are local solutions to local problems identified by local leaders.

HOPS, too, is the product of a local leadership that identified concerns and set out to address them in a meaningful way. Of course, no one has all the answers on housing and regional economic development. But by bringing together local partners with a broad variety of perspectives, you have a better chance to make a real impact. HOPS includes community, business, and municipal leaders, housing experts, non-profits, bankers and others. It's strictly a volunteer effort and there's no legal or formal requirement. But all of the partners have the will to make a difference and to promote the economic health of Southeast Wisconsin.

And they all agree that the buy-in and participation of the corporate leadership of Greater Milwaukee is essential. HOPS needs your support to make a difference.

As HOPS prepared to get underway, it looked for potential partners in the Milwaukee area. And as you may know, Jim Keyes, President and CEO of Johnson Controls and a member of your group, is also a member of our Chicago Fed Board of Directors. So I naturally turned to him for some early input. Jim is one of nine board members who represent the regions and industries of our five-state district. Members help keep us up to date on economic developments in their area, and in doing so, play an important role in the formulation of monetary policy. This is a real public service, and I very much appreciate their contribution.

Jim also made a contribution to HOPS when he recommended that we seek out the Greater Milwaukee Committee and Bob Milbourne to participate in the effort. It was excellent advice. Your enthusiastic efforts have been essential in getting this partnership off the ground. Bob was instrumental in involving David Rusk, former mayor of Albuquerque and a nationally recognized expert on urban development. David met with GMC members and municipal mayors and managers, and helped bring to them his vast understanding of the importance of housing policy for the economic sustainability of regional economies.

Thanks to Bob, the GMC, and others, when the HOPS partners first convened in January, the stage was set. The group began by selecting key areas for discussion and organized task groups to address each of four topics: wealth building and preservation; regional housing issues; fair housing; and mortgage lending. With an overarching goal of fair access to housing and other resources, each of the task groups is developing a set of recommendations designed to make a substantive impact in their more specific area.

Once the task groups issue their recommendations, HOPS will enter the final phase: implementation. And that's where you come in. As the corporate leadership of the Milwaukee area, your support of the HOPS recommendations will be critical. The partnership will need leaders to step forward and take responsibility for carrying forth individual recommendations. The recommendations will be published this fall at an event to which you will all be invited. I hope that each of you will consider how you can play a part in implementing the recommendations. Your involvement and support is vital for the ultimate success of the Housing Opportunity Partnership for Southeast Wisconsin.

Now that I've spoken about some important issues facing the regional economy, let me turn to the national economy — which is obviously at an important juncture. So far in 2001 we've continued with the slower pace of economic growth of late last year. You might recall that this slowing in economic activity reflected production cutbacks in response to slowing demand. Auto-related industries and other durable goods manufacturers adjusted production relatively quickly late last year in an effort to liquidate excess inventories. The slowing in consumer demand was triggered by several factors. Rising energy prices, the stock market correction that reversed the wealth effect, and a concomitant fall in consumer confidence all played a role. Another factor was monetary policy actions from mid-1999 to mid-2000 that increased short-term interest rates in response to an economy that was then growing above its sustainable rate.

The slowdown late last year started here in the Midwest. We were particularly hard hit given our concentration in autos and manufacturing generally. A cold winter didn't help either, and a relatively strong dollar also weighed heavily on our export growth. Since then, the slowing quickly spread to other regions of the country and especially to the high-tech segment of the manufacturing industry. After growing at breathtaking rates over most of the 1990s, output of information processing equipment has slowed dramatically in response to a decline in demand. As a result, we have a glut of high-tech goods and production capacity that will take longer to absorb than many economists had estimated earlier in the year. These dynamics have caused companies in all industries to delay, cancel, or cut back their capital spending and hiring plans amid lowered expectations for demand and profits and increased uncertainty about the economic outlook.

In the first quarter we saw economic growth of around 1¼ percent — which is well below potential. We estimate that to be around 3 to 3½ percent. The key factor determining economic growth in this year's first quarter was the inventory correction. For the most part, consumer spending growth held up, but individuals often were buying stockpiled goods. Businesses had slowed production growth rates to reduce their swollen inventories. Such an inventory adjustment is an essential step before the economy can start growing at a more rapid but sustainable pace. In this regard, there is some indication that conditions have begun to stabilize in the auto sector. On average, inventories of light vehicles recently have moved closer to desired levels. This is a significant positive for the Midwest. Provided demand continues to rise at a fairly solid rate, production of durable goods will rebound. In fact, we've already seen some month-to-month increases in motor vehicle production.

As I indicated, the overhang of high-tech capital goods has been an important contributor to the slowdown. It's been a key factor underlying the cutbacks in both actual and planned business capital spending, and adds a great deal of uncertainty to the short-term outlook.

Despite these difficulties, inventories should be coming into better balance as the year progresses, although at different rates in different industries. This should allow production to pick up again and realign itself more closely with demand. Moreover, as the year progresses, demand should be stimulated by Federal Reserve actions that have reduced the federal funds rate target by 275 basis points since January. Combined with the fiscal stimulus associated with the just enacted tax cuts and the recent downward trajectory in energy prices, these factors add up to an outlook in which economic growth gradually improves later in 2001, and continues into next year.

Clearly there are risks to the economic outlook. One potential obstacle to growth is consumer confidence. If Americans don't buy, production won't rebound. Surveys show some increases lately, although consumer confidence remains significantly below last year's record highs due, to some degree, to declines in equity prices. Currently, consumer confidence reflects greater optimism about the future of the economy more than about current economic conditions. But it's spending that really counts and consumer spending has held up fairly well. Similarly, the housing market remains strong. Both consumer spending and the pace of home sales reflect that a large portion of the population is currently employed. However, if the troubles in the manufacturing sector continue to spread to other sectors and cutbacks in business spending cause the unemployment rate to rise faster than expected, we're likely to see slower personal income growth as well. And that would weigh on consumption and housing expenditures.

Energy prices, another risk, are down somewhat from last year's high, though they remain volatile. Lower energy prices help reduce inflationary pressures and encourage growth. But energy markets respond quickly to changing events, and shocks can happen at any time. If shocks become widespread or long lasting, the outlook would change.

Still another risk is the possibility of further slowing in growth abroad. A healthy world economy increases U.S. exports and thus the growth of our economy. Recently, however, growth abroad has been less robust and this has contributed to declines in our exports. Unfortunately, there are few signs of any pickup in foreign growth.

The Federal Open Market Committee, or FOMC, the Fed's key policymaking group, summarized the situation at the time of the June 27 rate cut. Of the factors currently weighing on the economy, we explicitly listed declining profitability and business capital spending, weak expansion of consumption, and slowing growth abroad. We also noted that inflation is expected to remain contained. We concluded that the risks were still weighted mainly toward economic weakness in the foreseeable future, despite favorable long-term prospects for productivity growth.

I continue to think the most likely scenario is for economic growth to pick up later in the year from its current slow but positive pace — with improvement continuing next year. There's a story about an economist's epitaph on his tombstone, which read: "I am guardedly optimistic about the next world, but remain cognizant of the downside risks." That's sort of how we feel at the Chicago Fed — cautiously optimistic. The FOMC's prompt, forward-looking response to the subpar economic growth of recent quarters reduced the likelihood that economic weakness would continue in 2002.

Let me also add that while the risk of economic weakness is currently greater than that of increasing inflation, we can never ignore inflation. We always carefully examine trends in inflation and the outlook when we make policy. Let me assure you that this is no easy job to put into practice. Inflationary pressures tend to build up in slow but subtle ways, and once they are in place, long and painful adjustment periods may be needed to wring them out.

And so, in our quest for both maximum sustainable growth and low inflation, we at the Fed must continually be taking actions far up the road in a very uncertain environment. To do so effectively, we must begin with a sound understanding of how our complex economy behaves. In this regard, we are much like yourselves in your pursuit of a sustainable Milwaukee area economy. You are to be commended for understanding and acting on the important role access to housing plays in providing job opportunities for workers and businesses. We look forward to working with you as partners — partners in both HOPS and in our monitoring of the Midwest and national economy.

Now we come to the most interesting part of the program, where we open the floor for discussion. I'm really looking forward to your questions and comments.