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Salt Lake City Community Leaders
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A Perspective on the Economic Slowdown

I. Recent news on the economic front hasn't exactly been encouraging.

A. For example,

1. output growth has slowed significantly, and unemployment took a jump last month;

2. the stock market has dropped sharply;

3. events in the Middle East are casting a shadow on oil prices, to say nothing of their political implications;

4. and inflation remains a thorny problem.

B. With all this troubling news, it's refreshing to come to one of the bright spots on the nation's economic map.

1. Indeed, Utah's strength is in marked contrast to the national picture.

C. What I'd like to do today is give you my perspective on recent developments in the national economy and our region. I'll conclude with comments on the broad implications for monetary policy.

II. Turning first to the national economy, it's useful to begin by looking back a few years to get a better perspective.

A. We've enjoyed a remarkable peacetime expansion.

1. Since the end of 1982, when this expansion began, 22 million jobs have been created.

2. And the unemployment rate has dropped from close to 10% (in 1982) to around 5½%.

3. The growth in output has been nothing short of vigorous, averaging 3½% a year for the last 7½ years.

B. Such rapid growth pushed the economy to the limits of its capacity -- and maybe beyond.

C. As a result, we've had a problem with rising inflation since 1986.

D. To get inflation under control, what was needed was a slowdown in the pace of activity so that it didn't strain our economy's capacity

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to produce goods and services.

1. Beginning in 1988 and continuing through early 1989, monetary policy aimed at producing such a gradual moderation in economic activity.

E. And starting in early 1989, that's exactly what we got.

1. Since then, the economy has grown at a 1¼% annual rate, on average.

2. This is in sharp contrast to the economy's 3½% growth rate in 1988 (Q4-Q4) and the 5% growth rate in '87.

3. The slowdown is broadly-based: It has shown up in slower growth in spending on consumer goods, housing, and business investment in plant and equipment.

4. It's also broadly-based geographically.

   a. In all but five states, employment has grown more slowly in the last fifteen months than it did in the preceding fifteen months.

F. Given numbers like these, several recent developments take on a more ominous cast.

1. I am referring to the so-called credit "crunch," the situation in the Middle East, the possibility of fiscal tightening, and the serious downturns that certain parts of the country are experiencing.

2. I'll say a few words about each of these concerns.

G. First, the credit crunch.

1. It's true that lenders have become more cautious.

2. This is a normal and healthy response to a business environment that has become more uncertain.

3. It's also a response to the need for tighter credit standards in the wake of the high-flying lending that got the thrift industry in trouble.

   a. In the long-run, more prudent lending practices will make our economy more stable.

4. The Fed recognizes, however, that the transition to more prudent standards has the potential to temporarily slow the economy.

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5. To account for this possibility, monetary policy was eased slightly last month.

H. With regard to the situation in the Middle East, it's obvious that oil prices have been and could continue to be boosted by developments there.

1. There's no telling how far the price of oil will rise.

2. But a significant increase would mean higher inflation and slower growth in the U.S. and the world economy, at least during the transition period.

I. Many also are worrying that a significant reduction in the federal deficit would heighten recessionary risks in the economy.

1. I don't want to minimize these concerns, but past experience suggests that it's hard to say when -- or whether -- an agreement to raise taxes and cut the federal deficit will come about.

2. If it does, the Fed has the flexibility to adjust monetary policy based on developments in financial markets, which would reflect the nature of the agreement and the condition of the economy at that time.

J. Finally, a number of commentators seem concerned that recessions in some states will spread to the economy as a whole.

1. As I said a while ago, most states *are* experiencing slower growth.

2. But we also know that a number of states are experiencing outright declines in employment

a. and that they're concentrated in New England.

3. However, it seems unlikely that regional problems will be the catalyst for a national downturn.

4. Regional disparities in growth are not at all unusual, even during boom times.

a. When the economy slows as it has, it's normal for differences in economic performances across regions to widen.

b. What's interesting is that these differences are actually *smaller* than usual, based on the experience of the past 20 years.

III. On the positive side, the West has fared well while the national economy

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has slowed.

A. In fact, it's fared better than most other regions throughout the 1980s.

1. Population growth has been a key factor in much of this region.

a. In California, Arizona, and Nevada, population grew much more rapidly than the national average for the entire decade of the 1980s.

b. More recently, rapid population growth in Oregon and Washington has stimulated economic growth as well.

2. Key industries in the West also have enjoyed sustained growth.

a. The western economy has seen strong manufacturing activity throughout the current expansion, with the aerospace industry providing a particularly large boost.

(1) These developments have had the greatest effect in Washington and Southern California.

b. Another important factor has been the West's location on the edge of the Pacific. This has allowed it to take advantage of the increased trade flows with Pacific Rim countries.

(1) Sales of our exports have benefitted.

(2) Increased trade also has led to growth in the transportation and finance industries that service both imports and exports.

3. Clearly the West has enjoyed some important advantages. But I don't want to paint an unrealistically rosy picture.

a. Several of the West's resource industries -- including agriculture -- fell on hard times during the mid-1980s.

b. The region's economic diversity cushioned the impact of these problems.

c. Nevertheless, problems in resource markets did cause stagnation or decline in resource-dependent parts of the West like Alaska, Oregon, Idaho, and Utah.

d. And it wasn't until fairly recently that conditions began to improve in these states.

B. Looked at individually, western states' current performance varies.

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1. On the one hand, the coastal areas in California and Washington that have enjoyed boom conditions for some time are now cooling off.

   a. Cutbacks in defense spending are one major reason for the recent weakening. Defense-related employment has actually declined in recent months.

   b. Real estate and construction activity is cooling in the region's largest metropolitan areas. This marks a return to more "normal" conditions following booms of recent years.

2. On the other hand, the regions that were weak in the mid-80s, now are enjoying robust growth.

   a. Improved conditions in the resource industries provide one reason for the turnaround. This is certainly true in Utah.

   b. In addition, recent growth patterns within the West suggest that inland areas, including central California, Arizona, Nevada, and Utah, may be attracting development that would have gone to San Francisco and Los Angeles in times past.

      (1) Compared with the coastal metropolitan areas, these inland areas may appear attractive because of cheaper land and less congestion, air pollution, and crime.

C. Overall, the western states should do well compared with other regions during the next year or so.

   1. But performance does depend on what happens to the national economy.

IV. So, let me turn to the national outlook and the implications for monetary policy.

A. Last quarter, business inventories took a big jump. Through the end of this year, we're likely to see sluggishness in inventory investment to allow businesses to get inventories back in line with sales.

B. This will translate into continued weakness in output growth through the end of the year, backed by modest growth in consumer spending and strong export growth.

   1. We estimate that output growth for the remainder of this year will slow somewhat from the sluggish pace seen in the past 15 months.

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2. So, the best odds are that the economy will continue to "chug"ahead slowly, although no one can rule out the possibility that sometime during the second half the nation's output won't grow at all or might even decline.

C. Fortunately, the conditions are already, or soon will be, in place for faster growth next year.

1. Once inventories get back in line with sales, inventory investment will pick up again. This will be a positive influence in 1991.

2. Moreover, the rather sharp drop in the dollar since last Fall should provide a substantial boost to the economy by improving our trade balance.

D. On the inflation front, the news remains less than encouraging.

1. I said at the outset that we needed slower growth to make a dent in inflation.

2. So far, inflation hasn't yielded much.

a. CPI rose at close to 6% annual rate during first half of this year.

b. And before problems arose in the Middle East, we had expected it to rise at about a 4½% rate through end of 1991.

c. The upward trend in wages, salaries, and benefits also has not been encouraging. (Civilian ECI rose 5.4% over last 12 months.)

d. Finally the lower dollar and rising price of oil do not bode well for inflation over the next year or two.

3. Thus, the economy must grow at only a moderate pace for some time before we are likely to see significant, lasting progress on the inflation front.

a. I want to emphasize, though, that controlling inflation does *not* require the economy to grow as slowly as it's likely to grow in second half of this year.

b. Fortunately, as I said before, the seeds for a more acceptable growth rate in 1991 already have been planted.

E. Nonetheless, many are suggesting that the current pace of activity calls for a major easing of monetary policy.

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1. I want to emphasize that the risk of a downturn certainly is one of the Fed's most important concerns in charting the course for monetary policy.

2. At the same time, however, we've got to be careful not to over-react to today's weak economic numbers.

3. If we lose sight of our ultimate goal, we'll end up with a kind of rudderless monetary policy that tends to generate higher and higher inflation.

4. This would be counterproductive because high inflation tends to inhibit economic growth over the long haul.

V. Thus we're faced with a rather daunting task. We must guard against recession, but not lose the fight against inflation.

A. Unfortunately there are no guarantees in this process.

B. But by keeping on course towards our ultimate destination, and taking into account the cross currents along the way, we have the best chance of promoting maximum economic growth and prosperity in the U.S. economy in the years ahead.

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