Robert T. Parry, President
Federal Reserve Bank of San Francisco

Community Leaders
Tri-Cities, Richland, WA
For Delivery November 4, 1992 at 12:30 p.m. PST

A POLICYMAKER'S PERSPECTIVE ON THE U.S. ECONOMY

I. Thank you. I'm delighted to be here today.

II. Today I'll be going over

A. economic prospects for the region and the nation,

B. and then I'll focus on monetary policy.

III. Let me begin by taking a look at the regional economy. At the San Francisco Fed, our focus is on the nine western states of the Twelfth District. Here we have a "good news-bad news" scenario.

A. Most of the District states are doing relatively well, considering the national weakness.

1. For example, during the past year, Idaho and Utah have ranked second and third nationally in employment growth.

B. But there are trouble spots.

1. And California, as I'm sure you know, is a big one.

a. The state has lost about 650,000 jobs since employment peaked in May of 1990.

2. California has been hard hit by a number of problems beyond the national weakness.

a. These include defense cutbacks and an overbuilt commercial real estate market.

C. Just as there are weak spots and strong spots in the District, there are weak and strong spots here in Washington.

1. For example, the Seattle area has felt the effects of the national economic sluggishness.

    a. Over the past year, employment has fallen 1.7 percent, largely in manufacturing and in retail and wholesale trade.

2. But Washington east of the Cascades actually has been doing pretty well.

    a. In the Spokane area, job growth was close to 3 percent, with special strength in services and trade;

    b. and in Yakima, job growth was very healthy—a bit over 7½ percent.

3. Here in the Tri-Cities area, economic performance is strong, too. In large part, this is due to the cleanup effort in Hanford.

    a. Jobs have grown 3½ percent during the last year,

    b. and the average sale price of local homes is up 23 percent!

IV. I wish I could say the same about the national picture. As you know, the national economy's performance hasn't been anything to cheer about.

A. The last three and a half years have been one of the longest periods of slow growth in this country's postwar history.

B. And though we're out of the recession, the recovery has been disappointing.

1. As a result, national unemployment remains at a high 7½ percent.

2. We may be able to take some small comfort in the preliminary data for the fall quarter.

    a. It showed real GDP growth at a 2¾ percent rate.

    b. This brings the growth rate for the first three quarters of the year to an average of 2½ percent,

(1) a definite improvement over last year's virtual standstill.

3. But it still leaves the economy running far below the robust pace of expansion we've typically seen in prior recoveries.

C. In order to revitalize the economy, the Fed has eased monetary policy substantially.

1. The federal funds rate and other short-term rates are now about a third of what they were in early 1989.

2. The discount rate now stands at 3 percent, its lowest level in nearly three decades.

D. This easing works to stimulate spending on goods and services, and therefore, economic activity.

1. First of all, lower interest rates boost spending on business equipment and consumer durables, like autos, furniture, and appliances.

2. We've also seen the effects of dramatically lower rates on the housing market.

a. Residential investment has grown at an average rate of close to 11 percent for over a year and half, with most of the increases in single-family units.

b. Although housing activity slowed in the late spring and summer, it has picked up in the last few months, and I expect to see fairly strong figures in the year ahead.

E. Still, there are a number of reasons why this low-interest-rate environment in the U.S. will probably produce only a modest expansion.

1. First, even though lower interest rates tend to lower the value of the dollar, and therefore make prices for U.S. goods cheaper abroad, we're not seeing much action in exports.

a. The problem is that a number of our most important trading partners are going through slowdowns themselves, so they're not buying as many U.S. products, even though exchange rates make our products relatively less expensive.

2. Second, we've been importing foreign goods, especially computers, at a rapid pace in recent years, and we expect this trend to continue.

    a. This cuts into demand for domestically produced goods and services.

3. Then there's fiscal policy.

    a. In view of large federal budget deficits and the end of the cold war, the government has cut back spending, especially for defense.

4. Finally, I don't need to tell you that there's trouble in the commercial real estate market in many places, not just California.

    a. The national vacancy rate is high, at about 20%.

    b. And in some areas

        (1) like Dallas, Phoenix, and Miami, the vacancy rates are even four to five percentage points higher.

    c. Normally, lower interest rates tend to stimulate spending on commercial real estate.

        (1) In fact, this is one of the channels monetary policymakers traditionally rely on to pull the economy out of a recession.

    d. But, with this much "overhang" in the commercial real estate market, it's unlikely that this channel will work the way it has in the past.

V. Now, let me give you my outlook for inflation.

A. During the past three years of recession and slow growth, labor and product markets slackened, and this restrained growth in labor compensation and product prices.

B. Moreover, since the pick-up in the economy will probably be gradual over the next year or so, we're likely to see continued downward pressure on inflation.

1. So far this year, core consumer inflation -- which excludes the volatile food and energy component from the consumer price index -- has risen at around a 3¼ percent rate, and I expect to see it decline to about 3 percent for this year as a whole and 2½ percent in 1993.

2. Compared to the 4½ percent core rate of consumer inflation in 1991, 2½ percent next year definitely would represent progress.

VI. This downward trend in inflation is in keeping with the Federal Reserve's main long-term goal of moving gradually toward price stability—a crucial element to achieving maximum economic growth in the long run.

A. Our progress on this front in recent years is important because it gives us greater latitude to respond to weakness in the economy if it's necessary.

B. Given our expectations of only a modest expansion, we can't rule out the possibility that further action will be needed.

C. But I want to emphasize that while we're doing what we can to help sustain economic recovery,

1. we're also being careful to preserve and advance hard-won gains against inflation.

D. I think our efforts in both areas ultimately will pay off.

wc 1069