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ECONOMIC PROSPECTS FOR CALIFORNIA AND THE NATION IN 1993

I. It's a pleasure to be here.

A. This morning I'm going to discuss the outlook for both the nation and the region.

B. And then I'd like to talk about what this outlook means for monetary policy.

II. Let me start with a look at developments in this region.

A. Nevada has fared quite well during the difficult economic environment of the past couple of years.

1. Economic activity in the state has grown throughout the national recession and the weak recovery period.

2. That has kept Nevada in the "Top Ten" states in terms of employment growth.

B. Much of Nevada's growth has been right here in the Las Vegas area.

1. This metropolitan area accounts for a little over 60 percent of the state's jobs.

2. But during the past two and a half years, it has accounted for 86 percent of the state's job *growth*.

C. Still, the good news is tempered by the fact that the pace of growth in Nevada *has* slowed significantly during the past couple of years.

1. Since July of 1990, Nevada employment has grown at an average annual rate of around 2 percent.

2. That compares with average growth of 7 1/2 percent during the previous three years.

D. Most sectors of Nevada's economy have seen slower growth in recent years, but two important sectors help to focus on the sources of the weakness.

1. Employment growth in hotels, amusement parks, and other recreational

services has slowed dramatically,

a. from an annual rate of 10½ percent during 1989,

b. to a rate of 1½ percent during the past two and a half years.

2. And construction activity slowed during 1990 and 1991.

a. Nevada lost nearly a fifth of its construction jobs between March 1990 and October 1991.

b. Since then, renewed activity has brought back more than 55 percent of those lost jobs.

E. One reason for the slowdown in Nevada is the weak economy in California, home of many of Nevada's visitors.

III. So I'd like to take a few minutes to describe California's situation in detail.

A. To put it bluntly, California is in a long and deep recession.

B. And this is unusual for the "Golden State."

1. If you look back at California's history, you see that the state usually weathers recessions somewhat better than the nation.

2. When the national economy slumps, California's economy typically just "hesitates."

3. Only once before, in 1970, did California do worse than the U.S.

a. But now California faces an unemployment rate of 9.5 percent, more than two percentage points above the national rate.

C. The current economic scene in California is unusual for another reason, as well.

1. Usually, as the nation heads into recovery, California picks up steam at the same time.

2. But not in this cycle.

a. According to the NBER, the U.S. economy has been in recovery—a sluggish recovery, but a recovery nonetheless—since March 1991.

b. In California, though, we now have 360,000 fewer jobs than when the national recovery began.

D. Now, from a lot of the news coverage, you might think that just a few industries are accounting for a lot of the employment losses.

1. For example, commercial real estate is seriously overbuilt in many parts of the state -- especially in southern California.

a. As a result, more than a quarter of the construction jobs that existed three years ago are gone today.

2. And the defense sector has been hit hard by cutbacks.

a. Real defense spending in California has fallen more than 13 percent since its 1988 peak.

b. And aerospace employment has fallen 31 percent since the beginning of 1990 -- a loss of 78,000 jobs.

3. But these <u>aren't</u> the only industries facing hard times.

a. In fact, both non-defense manufacturing and trade have lost more jobs than either construction or aerospace.

E. When can we expect to see the state's economy turn around?

1. Well, we did get some encouraging news in January's employment report,

a. which showed a gain of nearly 50,000 jobs during the month.

b. Still, it's much too soon to tell whether this first gain in six months represents the beginning of a trend.

2. But downward adjustments in defense and problems in commercial real estate are likely to last at least a couple more years.

3. And the state government is going to face some tough choices, which seem certain to intensify California's short-term troubles.

4. The only real hope for any improvement in the near term seems to be

improved demand for the goods and services produced in California.

a. And that, in turn, depends to a large extent on how robust the national recovery is.

IV. So now let me turn to the national economy, where the signs of sustained expansion seem to be building.

A. After nearly three years of recession and sluggish growth, a pattern of moderate expansion took hold in the first half of 1992, when real GDP grew at a 2¼ percent rate.

1. Then, in the second half of the year, the economy registered a robust 4 percent growth rate.

a. In fact, growth in the fourth quarter alone was recently revised up from 3.8 percent to a strong 4.8 percent!

2. Combining this with the data so far on January's performance has raised my confidence that the expansion will be sustained.

a. For example, the improvement in the unemployment statistics, which began in mid-1992, continued in January, with a declining to 7.1 percent.

B. In my view, monetary policy can take some of the credit for the acceleration in the economy.

1. Since economic growth began to slow about four years ago, the Fed has let short-term interest rates fall substantially.

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

3. Moreover, intermediate and long-term interest rates also have fallen substantially in recent years.

V. As we look ahead to the remainder of 1993, I expect the expansion to continue.

A. But there are a number of reasons to believe that it will be held to a moderate pace, probably in the neighborhood of 3 percent, rather than the 4-5 percent that would be normal early in an economic recovery.

B. First, a number of our most important trading partners are going through slowdowns themselves,

1. and this will tend to hold back the volume of U.S. products we can sell abroad.

2. The recent easing of monetary policies in Japan and much of Europe will help, but I still don't expect to see robust growth abroad.

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

1. This cuts into demand for domestic products.

D. Then, there's trouble in the commercial real estate market in <u>many</u> places, not just California.

1. The vacancy rate nationally is high, at about 20 percent.

2. And it will probably take years to work off this much overhang.

E. Finally, the large budget deficit and the end of the cold war have led the federal government to cut back, especially for defense.

1. And state and local governments, too, have been constrained in the face of their own deficits.

2. Of course, the outlook may change once we know how negotiations on Clinton's budget proposal work out.

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

A. Over the period of recession and slow growth, labor and product markets slackened, and this restrained growth in labor compensation and product prices.

B. Since the economy is likely to grow only moderately this year, the pressures for disinflation should continue.

1. Another factor contributing to the disinflationary trend is the large increase in worker productivity in 1992—

a. the largest of any year in the last two decades.

b. If this continues, firms will have a better chance of meeting increased demand without having to increase prices.

C. During 1992, core consumer inflation—which excludes the volatile food and energy component from the consumer price index—rose at around a 3¼ percent rate,

   1. and I expect to see it decline to about 2½ percent this year and to be a little lower in 1994.

   2. These numbers represent significant progress over the 4½ percent core rate of consumer inflation in 1991.

VII. What does this mean for monetary policy?

A. The main way in which the Federal Reserve can contribute to long-run economic growth is by providing an environment of low inflation.

   1. So the continuing downward trend in inflation that I expect is very much in keeping with that long-term goal.

B. Our progress in lowering inflation has been important also because it has given us greater latitude to respond to the weakness in the economy in recent years.

C. I want to emphasize that while we'll pursue policies consistent with the continuation of the economic expansion,

   1. we also must be careful to preserve and advance hard-won gains against inflation.

D. I think our efforts in both areas are paying off.