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ECONOMIC PROSPECTS IN 1993: A POLICYMAKER'S PERSPECTIVE

- I. It's a pleasure to be here to discuss the outlook for the economy.
 - A. I know you're most concerned with what's happening to the economy right here in the islands.
 - 1. And in the last couple of years, you've certainly had to deal with your share of problems.
 - a. Early in 1991, the Gulf War put a damper on tourist travel to Hawaii, particularly from Japan.
 - b. More recently, air fare wars last summer excluded Hawaiian routes, and Hurricane Iniki devastated Kauai last fall.
 - 2. But above and beyond these problems, Hawaii has been affected by weak economic conditions on the U.S. mainland,
 - a. especially in California, which accounts for some 30 percent of Hawaii's visitors.
 - B. So I'd like to spend some time today discussing the prospects for both the California economy and the national economy.
- II. If you look back at history, you see that California is used to weathering recessions somewhat better than the nation.
 - A. When the national economy slumps, California's economy typically just "hesitates."
 - 1. Only once before, in 1970, did California do worse than the U.S.
 - B. But now the state faces an unemployment rate of nearly 10 percent, close to three percentage points higher than 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. California, though, has been losing jobs steadily since 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. The resulting declines in property values have created problems for developers and for lenders.

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

- a. Real defense spending in California has fallen by around 17 percent since its 1988 peak.
- b. And defense contractors continue to lay off workers.

3. But these aren't the only industries facing hard times.

- a. Manufacturing activity is weak across a broad range of non-defense industries as well.
- b. And retail trade has suffered as well.

E. It's also tempting to put the focus on southern California, where, clearly, the problems have been most severe.

1. That's partly because defense is more important to the southern California economy,

2. and the commercial real estate problems are worse in that part of the state.

3. But northern California is hardly immune.

- a. During the past year, the Bay Area has lost 1 percent of its jobs.
- b. That doesn't look bad compared with Southern California's 1.7 percent decline;
- c. but it does look bad when you compare it with national employment, which grew by about half a percentage point during the year.

F. When will California's economy turn around?

- 1. In the past couple of months, there've been a few pieces of good news.
 - a. Fourth-quarter tax revenues came in somewhat stronger than expected;
 - b. the number of single-family home sales rose last year,
 - (1) as did the number of housing permits;
 - c. and commercial real estate markets began showing a little bit of activity again.
- 2. Still, it's too soon to tell whether these changes mean that the state's economy is near the bottom of this cycle.
 - a. Downward adjustments in defense and problems in commercial real estate are likely to last at least a couple of years.
 - b. And the state government is going to face some tough choices, which seem certain to intensify California's short-term troubles.
- 3. The only real hope for any improvement during the next couple of years 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 economy is.

III. So now let me turn to the national economy, where a sustained expansion seems to have been established.

- 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 available so far in 1993 suggests that the expansion now is firmly in place.

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 eased monetary policy substantially.

a. These actions have brought down the federal funds rate and other short-term rates to about a third of what they were in early 1989,

b. and have helped to bring down long-term interest rates as well.

IV. As I look ahead to the remainder of 1993,

A. I expect interest-sensitive sectors of the economy to lead the continuing expansion.

1. These sectors -- including housing, business investment in equipment and consumer spending on durable goods -- expanded rapidly last year, and are likely to do so again in 1993.

B. But there are a number of reasons to believe that developments in other parts of the economy will hold the expansion to only a moderate pace,

1. probably in the neighborhood of 3 percent, rather than the 4 to 5 percent that would be normal early in a business cycle expansion.

C. First, a number of our most important industrialized 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.
- D. Second, we've been importing foreign goods, especially computers, at a rapid pace in recent years, and I expect this trend to continue.
1. This cuts into demand for domestic products.
- E. Then, there's trouble in the commercial real estate market in many 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.
- F. 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.
- V. 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 2¾ 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.

VI. 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.

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