

Community Leaders Luncheon
Portland, Oregon
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ECONOMIC PROSPECTS IN 1993: A POLICYMAKER'S PERSPECTIVE

- I. It's a pleasure to be here to discuss the economic outlook for the region and the nation.
 - A. I'd like to begin with a look at economic conditions here in Oregon,
 - 1. where you're actually getting some signs of strong performance.
 - B. Then I'll turn to the national economy,
 - 1. where the outlook is for continued moderate expansion and gradual declines in the unemployment rate.
 - C. And finally, I'll look at the inflation picture and implications for monetary policy.

- II. Here in Oregon, economic conditions are reasonably good,
 - A. especially when compared to the national picture.
 - 1. Even though the U.S. economy has been expanding over the past couple of years,
 - a. the nation now has 0.8 percent fewer jobs than it did when the recession began in July 1990.
 - 2. Over the same period in Oregon, though, the number of jobs has grown 3.2 percent!
 - B. Not all sectors have managed to register growth, however.
 - 1. For example, there's the construction sector.
 - a. While construction employment began to decline nationally in 1990, it more or less held steady here in Oregon.
 - b. But in 1991, the number of construction jobs in the state started to slide, too, and employment in this sector fell nearly 12

percent before rebounding in February.

2. Second, the lumber and wood products industries began to decline well before the nation entered its recession, and these industries have lost more than a fifth of their jobs during the past four years.
 - a. Naturally, the towns and areas dependent on timber-related industries have suffered a good deal,
 - b. and they're likely to continue to face hardship in the future.

C. What are the areas of strength?

1. The service sectors have posted strong growth through most of the current cycle.
 - a. Since July of 1990, Oregon's service industries have added 18,000 jobs, a gain of more than 6 percent..
 - b. Health services account for 5,000 of the new jobs. The rest are spread across a wide variety of service sectors, including engineering and management services, business services, amusement and recreation, and education.
2. And employment has grown 3 1/2 percent in the wholesale and retail trade sector during the same two and a half year period..
3. Financial industries also have performed well.
 - a. For example, employment in the financial services industries grew nearly 9½ percent during the last two and a half years in Oregon, while it registered a small decline nationally.
 - b. In keeping with the state's relatively strong economy, Oregon banks' financial results have been better than the national average as well.
 - (1) The problem loan ratio is lower in Oregon than in the nation, and it was lower in almost all asset types.
 - (2) And fourth-quarter return on assets was even higher in

Oregon than the strong results seen nationally.

D. One reflection of the economic health of the region is in the behavior of housing prices, especially in the cities, where the strong-performing sectors are located.

1. For example, in 1992, housing prices appreciated an average of 11.9 percent here in Portland.

E. Overall, then, the outlook for Oregon's economy is favorable.

1. Unlike its neighbors, Washington and California, Oregon is less dependent on aerospace and defense-related industries,

2. and the quality of life remains high, while living costs remain relatively low.

III. Now let me turn to the national economy.

A. The good news for the nation is that a sustained expansion seems to have been established.

B. 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, economic growth accelerated further.

a. In fact, the economy expanded in the fourth quarter alone at a strong 4.7 percent rate!

b. Although data available so far in 1993 suggest that the economy has slowed somewhat from its brisk pace late last year, there are reasons to believe that the expansion is firmly in place.

C. In my view, monetary policy can take some of the credit for this.

1. Since economic growth turned sluggish 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 -- business investment in equipment and consumer spending on housing and other 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. I look for growth to be in the neighborhood of 3 percent, rather than the 4 to 5 percent that would be normal early in a business cycle expansion.

2. As a result, the unemployment rate will decline only gradually.

C. What are some of the factors?

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

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

b. 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.

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

a. This cuts into demand for domestic products.

3. Then, there's trouble in the commercial real estate market in a number of places.

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

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

4. Finally, the large budget deficit and the end of the cold war have led the federal government to cut back, especially for defense.
 - a. And state and local governments, too, have been constrained in the face of their own deficits.
 - b. 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.
 1. Since the economy probably will grow only moderately this year, these pressures for disinflation are likely to continue.
 2. 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.
- B. But despite these favorable fundamentals, recent data on inflation have been worrisome.
 1. Core consumer inflation—which excludes the volatile food and energy component from the consumer price index—rose at a 6 percent annual rate in both January and February.
 2. Even without food and energy, the monthly CPI figures tend to be volatile, so it is too soon to tell if recent data represent a trend or an aberration.
- C. For now, I expect to see core inflation decline somewhat this year and next from the 3½ percent rate registered in 1992.
 1. However, future inflation figures will warrant careful attention to see if they reverse the strong increases early this year, or if inflation is turning out to be more of a problem than now seems likely.

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 downward trend in inflation that seems to be in place would be in keeping with that long-term goal.
 - 2. However, we cannot rule out the possibility that the most recent inflation figures are a danger signal,
 - a. especially now that the expansion seems to have been established.
 - 3. Therefore, the situation should be watched carefully.
- B. 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.
- C. I think our efforts in both areas will pay off.

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