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ECONOMIC PROSPECTS FOR CALIFORNIA AND THE NATION IN 1993

I. This afternoon I'm going to discuss the outlook for both the nation and California,

   A. and their stories are different enough that we could almost call this "The Tale of Two Economies."

      1. In the nation, we're seeing continuing signs of moderate expansion—

         a. —not a boom, by any means, but a sustainable pace of economic growth.

      2. Here in California, though, the economy presents a much different picture.

II. So let me start with a look at developments in our region.

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

   B. And this is unusual for us.

      1. If you look back at our history, you see that we're used to weathering recessions somewhat better than the nation.

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

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

      3. But this time around, our unemployment rate has been higher than the nation's since around the beginning of the recession.

         a. In fact, even though we did see a dramatic decline in California's unemployment rate last month, it's still more than a point and a half higher than the national rate.

   C. In most business cycles, as the nation heads into recovery, California picks up steam at the same time.

      1. 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 200,000 fewer jobs than we did just one year ago.

D. Now, I'm sure I don't need to tell you that the state's most severe problems have been here in Southern California.

E. Certainly a lot of the attention has focused on the L.A. area and the job losses related to the sagging commercial real estate market and defense cuts.

F. But San Diego has had its share of trouble, too.

1. Right here, the office vacancy rate was close to 25 percent at the end of last year—

a. —much higher than the national average of around 19 percent.

2. And defense cutbacks have led to losses in employment in San Diego that are just as dramatic as the losses in the L.A. area.

a. This isn't surprising since San Diego has a heavy concentration of both defense contractors and military bases.

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

1. Manufacturing activity is weak across a broad range of non-defense industries as well.

2. And retail trade also has suffered.

3. So, altogether, over the last year, the number of jobs in this area fell by about 1 3/4 percent.

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

1. The number of jobs has been volatile in recent months, but the low point to date was last December.

2. These figures suggest that we're probably at the bottom of this cycle.

3. My guess is that we'll be bumping along the bottom a while longer.

    a. Downward adjustments in defense will continue.

    b. And problems in commercial real estate are likely to last at least a couple more years.

4. That means the state government is going to face some hard choices in the budget process, which seem certain to intensify California's short-term troubles.

5. So it's likely that, even if we <u>are</u> near the bottom of the cycle, we'll see little in the way of growth during the next couple of years.

    a. To a large extent, whether we see any growth at all over the short term will depend on the pace of improvement in the national economy.

III. So now let me turn to the national economy.

A. After nearly three years of recession and sluggish growth, a moderate expansion finally took hold in the first half of last year.

1. Unfortunately, we've seen the economy slow so far <u>this</u> year, but I don't think this means the expansion is off the tracks.

    a. Some of the slowdown may have been due to bad weather in the east,

    b. and some may be due to uncertainty about tax increases that Congress is considering.

    c. In any case, expansions typically show a good deal of quarter-to-quarter volatility.

2. So I think it's safe to say that a moderate expansion is still well in hand.

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

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 they've 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 several developments in other parts of the economy probably will hold the expansion to a moderate pace.

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 much of Europe and of monetary and fiscal policies in Japan will help, but I still expect to see weak growth abroad this year.

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. Third, commercial real estate markets are overbuilt in a number of places, not just here in southern California.

a. And it will probably take years to work off the overhang.

4. Finally, of course, there are government cutbacks at all levels– federal, state, and local.

a. Now, the fiscal outlook may change once we know how negotiations on Clinton's budget proposal and health care reform work out.

(1) The Administration's failure on the temporary spending program will have only a very small negative effect on economic growth this year and next.

C. So, all in all,

1. I look for growth to be in the neighborhood of around 2½ percent for the remainder of this year, rather than the 4 to 5 percent that would be normal at this stage of a business cycle expansion.

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

V. Now, let me give you my outlook for inflation, where the picture is somewhat mixed, and definitely disappointing so far this year.

A. Since the expansion to date has been only moderate, unemployment has declined only gradually, leaving considerable slack in labor markets.

B. However, newly revised data suggest that there's <u>less</u> slack than we thought in capacity utilization.

1. It appears that firms have been quick to trim their capacity in response to the weaker-than-normal recovery.

C. At the same time, we've gotten some surprising and worrisome inflation numbers this year.

1. Core consumer inflation—which excludes the volatile food and energy component from the consumer price index—rose at a 4½ percent annual rate over the first four months of 1993.

2. Furthermore, employment costs also rose at a somewhat faster pace in the first quarter than they did last year.

D. How worried should we be about these figures?

1. The capacity utilization numbers are a concern, but I still believe that the inflation fundamentals are favorable.

2. The revised capital utilization rates still aren't high,which should restrain price increases to some extent,

a. and labor markets continue to show signs of slack.

3. Therefore, I expect to see core inflation decline somewhat for the remainder of this year and next from the 3½ percent rate registered in 1992.

E. But there are no guarantees when it comes to inflation forecasts.

1. So 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. Where does this outlook leave monetary policy?

A. The main way 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 in recent years is gratifying and consistent with that long-term goal.

2. However, we can't rule out the possibility that recent inflation figures are a danger signal,

a. and the situation must 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.

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