

Presentation to the University of Washington Business School
For delivery November 15, 2001 at approximately 8:05 AM Pacific Standard Time
(11:05 AM Eastern)
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The U.S. Economy after September 11

- I. Good morning.
 - A. This is my first public address since the devastating attacks on New York and Washington.
 - B. In terms of the nation's economy, these attacks struck while we were vulnerable,
 1. pushing us from sluggish growth to an outright contraction.
 2. Frankly, over the short-term,
 - a the outlook isn't great,
 - b and there's a lot of uncertainty.
 - C. But I think it's important to emphasize that the longer-run outlook is good.
 1. Our economy is fundamentally strong,
 2. and it still affords tremendous opportunity.
 3. And those qualities do bode well for our economic future.
- II. I'll start with a look at the economy before September 11th.
 - A. At that time, we were in the midst of a cyclical slowdown that had begun in mid-2000.
 - B. Why did activity slow?
 1. To put it briefly, much of it was a consequence of some over-reaching during the five years before,
 - a when strong fundamentals propelled growth to phenomenal rates.

b Specifically, the technology boom led to huge investments in information processing equipment and software,

c and with that came a huge run-up in equity values.

2. By mid-2000, then, there was a pullback.

a Firms had already accumulated a lot of capital equipment and inventories—

(1) —so they just weren't in the market to buy more for a while.

b And equity values began to drop as investors re-evaluated the long-run profitability of many high-tech firms.

(1) This isn't to say that the technology surge was merely a phantom.

(2) Rather—even though the surge was real and substantial— markets appear to have gotten carried away.

c As a result of these developments, we saw large declines in business investment and manufacturing output.

3. So the slowdown was essentially part of a natural process—a correction— that would eventually lead back to robust growth.

C. In fact, up through the spring quarter, growth was still in the positive range, if only barely.

1. And that was largely thanks to moderate strength in consumer spending.

a Consumers appeared to be “looking through” the downward part of the business-investment cycle,

b confident that the longer-run fundamentals were still sound.

c So the durability of the expansion depended importantly on consumer confidence.

D. And though the data for August and early September were mainly downbeat,

1. we expected to see more acceptable growth before too many more quarters passed.

E. And then came September 11.

III. I'd like to speak briefly about the Fed's immediate response to those terrible events.

A. Our aim was to assure the public and the markets that the Fed stood ready

1. to play its regular role in the payments system
2. and to play its role of providing liquidity in times of crisis.

B. In terms of the payments system, we worked to ensure the continuation of vital services like electronic funds transfers, check-clearing, and currency processing.

1. This took some extraordinary efforts—especially without air transport for three days—
2. —and, for the most part, the system worked.

C. In terms of providing liquidity, we were concerned that the disruptions to the financial markets could have dire consequences for the economy as a whole.

1. So we provided additional funds until orderly functioning could be restored.

a This included injecting massive amounts of liquidity through

(1) discount window loans

(2) and open market operations.

(3) On the three days after the attacks, the total injection amounted to over \$100 billion a day!

b In addition, we lowered short-term interest rates twice over the next three weeks—

(1) —by 100 basis points in total.

D. These and other actions helped ensure that the financial markets could function efficiently as soon as possible, therefore minimizing disruptions to economic activity.

IV. But there were other reasons for activity to stall.

- A. As I said, we were in the midst of a cyclical slowdown,
1. and it was largely consumer spending that was keeping the numbers barely positive.
 2. By undermining consumer confidence, the attacks hit directly at the economy's main pillar of support.
 - a And, of course, it's not surprising that business confidence also suffered,
 - (1) since consumer spending represents about two-thirds of overall demand for goods and services.
 3. Indeed, the latest surveys show that consumer confidence is *way* down,
 - a Most categories of consumer spending plummeted in September, but recouped a good bit in October.
 - b Of course, auto sales have been strong because of temporary sales incentives.
 4. Industrial output and business investment spending still appear to be dropping sharply, as they have for several quarters.
 5. One of the clearest monthly measures of our economic performance is payroll employment.
 - a And the recent news is grim.
 - b In October,
 - (1) private payroll employment fell by 439,000 jobs
 - (a) —the largest one-month decline in more than fifteen years—
 - (2) —and the unemployment rate jumped from 4.9 percent to 5.4 percent.
- B. In terms of overall economic activity, real GDP contracted at about a half a percent annual rate in the third quarter,
1. after being pulled down in its last three weeks by the aftermath of the attacks.

2. For the current quarter, I'd have to agree with what most forecasters are saying.
 - a We almost certainly face further rises in the unemployment rate,
 - (1) which could put even more of a damper on consumer confidence.
 - b And the falloff in activity is likely to be sharper than it was in the third quarter.

C. Of course, there are a lot of wild cards, and an important one going forward is the spread of economic weakness around the world.

1. Part of this is related to our own downturn, as U.S. demand for foreign products softens and slows production and job growth abroad
2. But part also is related to developments originating in other countries.
 - a For example, Japan is suffering from a deflationary spiral,
 - b and efforts by the European Central Bank to ease policy have been limited by inflationary pressures.
3. So, in effect, the *world* economy has been hit by several different shocks at the same time.

V. So far, I've focused on the short run, and, admittedly, what we can see looks pretty rocky.

A. But let me turn now to the longer run, where the picture is a good deal more positive.

B. Why? Because there are several important sources of stimulus that should make economic activity rebound.

1. First, the Fed has cut short-term interest rates ten times since January.
 - a The federal funds rate now stands at 2 percent, compared to 6-1/2 percent back then.
2. The second source of stimulus is fiscal policy, which is coming in three programs—
 - a —the major tax reduction in June, including the recent tax rebates,

- b the emergency spending bill enacted just after the attacks,
- c and the fiscal stimulus bill currently in the Congress.
- d All these measures add up to a major amount of stimulus—
 - (1) —perhaps around \$160 billion in fiscal year 2002.

3. Third, energy prices have declined this year.

- a the price of imported oil has fallen by nearly 40 percent since last November.
- b And the price of natural gas has fallen even more dramatically.
- c These price declines give firms and households more purchasing power,
 - (1) and they should help stimulate demand.

4. Fourth, the “overhang” of capital equipment and software, as well as inventories, that I mentioned earlier is one that will correct itself with time.

- a At some point, the stocks of these assets will get to low enough levels that firms will need to start spending on them again.

VI. When will the recovery kick in? Most likely sometime next year. But, frankly, there’s no way to know exactly when.

A. But I do know this. The economy *will* recover,

- 1. and—in the long run—its fundamentals are strong.
- 2. First, both monetary and fiscal policies were sound going into the current situation.
 - a Inflation in the U.S. has been relatively low and stable.
 - (1) This allows our market system to work efficiently
 - (2) and it has allowed the Fed the flexibility to ease policy aggressively.
 - b In terms of fiscal policy, we came into the current situation with the federal budget in surplus.

(1) That promoted private saving and investment,

(2) and it allowed fiscal policy to ease aggressively.

3. Second, our economy has a resilient structure—

a —financial markets are deregulated,

b the banking system is sound,

c and our labor markets are flexible.

d So we can adjust relatively quickly to the kinds of shocks we've recently suffered.

4. Last, but by no means least, the kinds of technological advances that propelled the economy in the latter half of the 1990s are still in train.

a These developments operate on a long time scale,

b and they're not likely to be affected much by the kinds of cyclical developments we face today.

5. The key point is that the outlook for productivity over the long haul continues to be bright,

a and this is what matters for our standards of living.

VII. Let me wrap up by bringing the discussion closer to home.

A. Like the nation, Seattle has felt the effects of the slowdown in consumer spending and business investment.

B. Moreover, the sharp downturn in travel spending has indirect effects on Boeing aircraft sales that will hit the local economy hard.

1. Up to 20,000 jobs are expected to be lost in the Seattle area alone.

C. This will feel a lot different from Boeing's last round of large job cuts, in late 1998 and 1999.

1. At that time, the local economy continued to expand at a good clip,
2. because job gains at computer services companies such as Microsoft mostly offset the losses in the aircraft sector.
 - a And the high compensation paid by these computer companies injected substantial purchasing power into the local economy.

D. But this time, investment spending on computer equipment and software has declined rapidly,

1. and any impetus for recovery has been dampened by business uncertainty in the wake of the attacks.

E. So Boeing's upcoming cuts will add to existing weakness in the area economy,

1. and the local job situation unfortunately seems likely to get worse before it gets better.

F. But, it *will* get better.

1. The positive fundamentals in the national economy are just as pertinent for this area—
2. —and with the area's focus on technology, perhaps even more so.
3. Over the longer run, technology will be a source of strength to the national economy and especially to Seattle's economy.

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