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The Economy in 2002

- I. Good afternoon. I'm delighted to be here today.
 - A. This is my first speech of the new year, a time when we all think about beginnings.
 - 1. But for so many Americans—and for the U.S. economy—
 - a —a new era began not on January first, 2002,
 - b but on September eleventh, 2001.
 - B. Today—a little more than four months since those tragic events—I'd like to look at
 - 1. where the economy stands now
 - 2. and where it's likely to go in the longer run.
- II. As for where we stand now, the data on the economy appear to be mixed. And, frankly, that's an improvement over the period just after the attacks.
 - A. The good news is that consumer spending has held up pretty well after plummeting in September.
 - 1. A good deal of the strength reflects a surge in auto sales as people took advantage of extraordinary financing incentives.
 - 2. In addition, housing markets have done reasonably well, given the low mortgage rates.
 - 3. This good news is important—

- a —and not just because it helps the current performance of the economy.
- b It's also important because it says something about consumers' confidence in the future.
 - (1) Consumers appear to be “looking through” the recession—
 - (a) —confident that they'll be able to pay off the loans they took out to buy cars and houses,
 - (b) because they're pretty confident that the longer-run fundamentals in the economy are sound.

B. Of course, not every sector is performing well.

- 1. And that's the bad news.
 - a But some things do appear to be getting better—at least a little.
- 2. For example, industrial output and business investment spending—which were dropping well before September eleventh—still appear to be relatively weak.
 - a But the *rate* of decline seems to have slowed in the last few months.
- 3. The same basic message applies to labor markets.
 - a In October, we saw the largest one-month drop in private payroll employment in fifteen years.
 - b And the decline in November also was sizable.
 - c But in December—though the number was still negative—it was a good deal smaller.

C. In terms of overall economic activity,

- 1. in the third quarter, real GDP contracted at a 1-1/4 percent annual rate.
- 2. As for the fourth quarter, we don't have complete data yet.

- a So far, at least, it looks like GDP contracted again.
- b But the quarter did seem to end on a better note than the one it began on.

D. Where does this leave us in terms of the shorter-run outlook?

- 1. Well, the Blue Chip consensus forecast is actually pretty optimistic. It looks for
 - a real GDP growth to turn slightly positive this quarter
 - b and then to accelerate quickly to more acceptable rates.
- 2. It's true that the more positive recent data do make this optimistic scenario more of a possibility.
- 3. But I'd also argue that it's too soon to bet on it.
 - a When the data are mixed like this, the uncertainty about the near-term outlook is great.
 - b And there are downside risks.
 - (1) For example, we almost certainly face further hikes in the unemployment rate,
 - (a) which reached 5.8 percent at the end of last year.
 - (2) And that could put a damper on consumer confidence and spending in the near term.

III. On a more local level, Southern California also faces some uncertainty in the near term.

- A. Recent employment figures indicate that the national slowdown has taken hold here.
 - 1. And weakness in travel and tourist spending, aircraft manufacturing, and general export activity will damp growth in coming months.
- B. But it's important to remember that this area has benefitted from greater economic diversity in recent years.

1. For example, Southern California saw moderate economic growth most of last year,
 - a while the rest of the nation slipped into recession.
 2. One result was largely favorable conditions in the local real estate sector.
 - a In Los Angeles, vacancy rates on commercial property rose only somewhat during 2001,
 - (1) compared to sharp increases in most other urban areas in the West.
 3. And demand for homes has been remarkably robust throughout Southern California,
 - a with prices and the pace of construction and sales remaining at high levels.
- C. Of course, some weakening in local real estate markets is likely before the national economy turns around.
1. But with this area's economic diversity, it should be able to weather the current national recession much better than the last one.
- IV. So far I've talked about the mixed data and the uncertainty about the near-term outlook. Let me conclude by turning to the longer run national outlook, where I'm definitely optimistic—for several reasons.
- A. First, both monetary policy and fiscal policy were sound going into the downturn last year.
1. Because we've had years of low inflation, the Fed has had room to cut short-term interest rates substantially—
 - a —by four and three-quarters percentage points last year.
 2. And because we had built up a budget surplus, fiscal policy has had room to maneuver.
 - a Though one stimulus package stalled in Congress last year,

- b the two that did pass will provide substantial stimulus this year.
- B. Second, we seem to be getting a boost from last year's sharp declines in energy prices.
- C. The third reason has to do with recent data on business investment and what's sometimes called the "overhang" problem.
 - 1. After years of huge investments in information processing equipment and software in the latter half of the 1990s, firms began to pull back in mid-2000.
 - a Basically, by then they had already accumulated a lot of capital equipment and inventories—an "overhang" —
 - b —and they haven't been in the market to buy more for a while.
 - c So the pullback is a kind of "correction," which is often an important feature of business cycles.
 - 2. And now,
 - a as I said, it appears that the decline in business investment is slowing.
 - b Moreover, recent data suggest that businesses have made some progress in paring down their unwanted inventories.
 - c So the "overhang" problem may be correcting itself, which means we may be seeing the beginnings of an upswing in the cycle.
- D. The fourth reason I'm optimistic is that 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.

- E. The fifth and final reason has to do with technology and the productivity of the American work force.
1. 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.
 2. The key point is that the outlook for productivity over the long haul continues to be bright,
 - a. and this bodes well for our standard of living.

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