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By Robert T. Parry, President, Federal Reserve Bank of San Francisco

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Keeping the Economy on Track

I. Good afternoon.

A. Today I want to give you my views on the national economy, and I'll close with some observations on economic conditions here in Oregon.

II. The U.S. economy has performed magnificently well--for quite some time.

1. This expansion has been the longest in our history.

2. It has been remarkably strong, especially in the last few years.

3. It has produced the lowest unemployment rate in thirty years.

4. And, if we take out the temporary effects of higher oil prices, inflation has remained pretty tame.

III. At this point, most economists believe that one important source of this performance is a so-called "technology shock."

A. In other words, technological advances have been pumping up productivity.

1. And productivity has indeed been phenomenal.

a Over the past four quarters, the growth rate of productivity hit an amazing rate of just under 5 percent!

b This is about two and a half times the rate that prevailed during the 70s, 80s, and early 90s!

B. Faster productivity growth expands the overall *supply* of goods and services.

1. And that means the economy's sustainable growth rate can be higher without generating ever-increasing rates of inflation.

2. Furthermore, an acceleration of productivity from two percent to three percent and beyond tends to hold inflation down.

C. Attributing the productivity surge to a "technology shock" makes sense for a couple of reasons.

1. First, since the mid-1990s, firms have been investing heavily in information processing equipment and software.

a And they wouldn't do that unless these items were enhancing productivity and therefore profits.

2. Second, we can all think of examples where technological developments have improved and even revolutionized the way firms do business.

IV. But a rapid expansion of the supply side of the economy probably is *not* the only important force we're dealing with--

--it's also possible that the booming economy has been driven by strong *demand*.

1. In other words, people and businesses have been willing and able to get out there and buy a lot of goods and services.

2. A good part of this rapid growth in demand may stem from the technology shock itself.

a For example, enhancements to productivity have made a substantial contribution to the incredible gains in the stock market since the mid-1990s that have added so much to overall financial wealth.

b In turn, the surge in wealth has stimulated consumer spending.

B. Normally, this kind of buying surge runs the risk of igniting inflation.

1. But for a while, at least, some important developments in addition to accelerating productivity held prices in check.

a For example, the prices of imported goods were kept down by a strong dollar, as the strong U.S. economy attracted foreign investment.

b And from late 1997 through early 1999, oil prices were falling.

C. Since then,

1. oil prices have been on the rise.

2. Furthermore, years of rapid economic expansion have led to a tight labor market.

a In fact, many businesses are reporting great difficulty in finding qualified workers.

D. To sum up, then, the Fed has faced a combination of good news about the present and reasons for concern about the future.

1. The good news has been about the technology shock and faster productivity growth, which ultimately translate into faster sustainable growth for the economy.

2. The concern has been about rising inflation risks, even though actual inflation has remained moderate.

E. Deciding how to set policy to keep the expansion on track while guarding against inflation involved dealing with a lot of uncertainty.

1. For example, we couldn't know how long the technology shock would last, nor even exactly how big it was.

2. In addition, though we knew we were dealing with a higher sustainable growth rate--

a --we didn't know exactly what that rate was.

F. As a result, we took a cautious approach and raised short-term interest rates gradually.

1. From September of 1999 to May of this year the federal funds rate--our main policy tool--moved from 5-1/4 percent to 6-1/2 percent.

V. Since May, the Fed has basically been sitting tight. There are several reasons for this.

A. First, we know that monetary policy actions affect the economy with a lag.

1. So the last round of rate increases are probably still affecting the economy.

B. Second, we know that many things *besides* increases in the funds rate could tend to slow the economy. And we've wanted to watch how those factors play out.

1. For example, the overall stock market has been essentially flat for about a year after four straight years of very large increases--

    a --so that could put a dent in consumers' spending plans, which would contribute to some slowing.

2. Another factor is the dollar, which has been quite strong.

    a That, too, could contribute to slowing, since it makes U.S. exports more costly for consumers and businesses abroad, and makes imports less costly for U.S. buyers.

3. Finally, conditions in financial markets have tightened.

    a Borrowing costs for all but highly rated companies have risen sharply in recent months.

    b And business borrowers also have been facing more stringent conditions on bank loans.

VI. With these slowing factors and the Fed's short-term interest rate increases, it appears that the economy has moved into a more sustainable growth range.

A. First, we saw a significant slowing in real GDP in the third quarter--to 2-3/4 percent, following a 6 percent increase over the prior four quarters.

1. A good deal of this slowdown occurred in interest-sensitive sectors of the economy like housing and business investment.

B. Second, employment growth has been more moderate for several months now.

C. Third, the inflation numbers also look reasonably good, in general.

1. Core inflation--that is, excluding food and energy--rose about 1-3/4 to 2-1/2 percent over the past twelve months, depending on the measure used.

    a And though real wages have gone up about two percent over the past year,

        (1) That's still well below the increase in productivity,

        (2) so labor costs have remained moderate.

D. All in all, then, it looks as if the economy is on track for

1. continued, but moderated, growth,

2. with reasonably favorable inflation performance.

E. But, of course, nothing's ever perfectly certain.

1. And even though this evidence is pretty encouraging,

2. It's too soon to know for sure if we've really got the inflation risks under control.

3. While the tighter financial conditions I mentioned give us reason to think the slowdown is likely to continue,

a We'll have to wait and see.

F. But you can be sure that the Fed will continue to work toward keeping the economy on the right track toward sustainable growth and low inflation.

VII. I'd like to conclude with a few remarks about the local economy.

A. Although the Oregon economy has slowed in recent years, conditions in the state remain strong.

1. In fact, Oregon is a good example of a state that seems to have settled in at a more sustainable rate of long-term growth.

2. Over the past twelve months employment in the state has expanded by 1.2 percent.

a As a result,

(1) labor markets are tight--especially in urban areas,

(2) personal income growth is strong,

(3) and residential and commercial real estate markets are healthy.

B. A primary driver in the state's ongoing expansion has been the high-tech sector.

1. Over the past several years, Oregon has become one of the nation's leading

makers of high-tech electronics products.

a In fact, recently released data on gross state product show that between 1992 and 1998, the value added in electronic equipment and instruments in Oregon increased more than six-fold,

(1) growing from $2.3 billion in 1992 to $15.1 billion in 1998.

2. And I'm not talking just about Intel and chips.

a Many other of America's best known players in the high-tech market--such as HP, Epson, and NEC--have major facilities in Oregon.

b And recently, a host of smaller hardware and software companies have decided to set up operations in your state.

C. The jobs and investment returns created by high-tech companies have generated gains in income and wealth that have,

1. powered robust consumer spending,

2. and helped maintain strong conditions in your area--

3. --despite ongoing weakness in some of Oregon's other key industries, such as lumber and wood products and agriculture.

D. Looking forward, Oregon's

1. highly educated population

2. and solid base of electronics manufacturers and information-technology firms

3. should keep the state very competitive in our rapidly changing national economy.

E. And given Portland's recent award from Money Magazine's as the "Best Big City" in the U.S. there should no shortage of businesses and individuals interested in keeping Oregon growing.

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