

## The Economic Outlook Under the New Administration

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Thank you for that kind introduction and your very warm welcome. It is a real treat for me to be here today to discuss recent developments in the economy and the potential effects of the changes unfolding in Washington. I was given what I consider to be conflicting objectives: be informative, comprehensible, entertaining, relevant and short. I decided to focus on informative, and hope for the best.

But let me start with a story. Bob Woodward, the famous journalist, gave a talk in Columbus about a year ago, during which he told a delightful tale about monks in a far away monastery. They spent their lives recopying copies of copies of ancient manuscripts. One day, it dawned on one of the scribes to check the accuracy of the text he was recopying by comparing it to the original. He set out from his desk and didn't return. Another monk grew concerned and went in search of his friend. He finally found him deep beneath the monastery in the room where the ancient scrolls were kept, sobbing uncontrollably. When asked what was wrong, the unhappy monk replied through his tears: "The word was *cele-brate!*"

Accurate and timely communication is not only essential to a fulfilling life. It is also a prerequisite for achieving the highest possible level of economic activity. A few years ago, people talked about the Goldilocks Economy: not too hot, not too cold, just right. A name I liked better was the Miller Lite Economy: great growth, less inflation.

Whatever you call it, the recent performance of the economy has been historic. The U.S. economy is once again the undisputed leader in the world. Growth is up. Unemployment is down. The deficit has given way to surpluses, and the stock market posted five of the best back-to-back years ever from 1995 to 1999. The record-long economic expansion underway since 1991 will celebrate its tenth anniversary in March. But even more impressive is the fact that the economy has been larger at the end than at the beginning of each of the last 18 years.

We have come to call these pleasant circumstances the New Economy. At its core, this New Economy rests on communication. 140 forty years ago, information could travel no faster than about 25 miles per hour over relatively short distances via the pony express. Communication was so valuable that it warranted great risks and attracted substantial resources. One advertisement for riders from the time read: "Wanted. Young, skinny, wiry fellows. Not over 18. Must be expert riders. Willing to risk death daily. Orphans preferred." It was dangerous duty, but the riders were paid well, earning \$170,000 annually in today's terms.

The pony express was soon superceded by the telegraph, which gave way to the telephone, the fax machine, email, and various forms of instant communication over the internet, which are still evolving.

The advances in communication technology, made possible by the 280-fold increase in investment in computers and related equipment during the last 20 years, have permanently changed the way our economy operates. These advances have shortened recessions, lengthened expansions, and smoothed out the business cycle.

One example of modern, high-speed communications is Wal-Mart. The company monitors sales of specific items, at individual stores, around the world, in real time, from its headquarters in Bentonville, Arkansas. Businesses of any size can and do run computerized management systems that keep inventories in line with ever-changing demand. The result is lower prices, higher profits, and smaller ups and downs in the economy along the way.

The fundamental point is that the New Economy and its blessings are not the result of good luck. Our good fortune is the temporary consequence of sound economic policies and the permanent result of our enhanced ability to capture, store, and communicate information rapidly and accurately. Even as the economic clouds gather on the horizon, many of the gains of the New Economy are permanent and will not disappear in the next recession.

With that in mind, where is the economy headed, and what does the outlook hold for the convention and tourism business?

Quite plainly, the wolf is at the door. The long-predicted economic slowdown has finally and undeniably become reality. Stock prices are down and layoffs are up. Consumer confidence and auto sales are slipping. The Dot Coms are out of money, and can't get more. Business investment in equipment is faltering. Banks have tightened up, and investors have backed away from high-yield bonds and initial public stock offerings. CEOs are talking recession. And a few more economists shimmy out on that limb each week.

I disagree. The wolf is at the door, but he won't get in. Keeping in mind the Cardinal Rule of Forecasting -- which is: if you give a number, don't give a date, and if you give a date, don't give a number -- my forecast is that we are in for the biggest economic slowdown in a decade. It will be pronounced, pervasive, and prolonged, but the economy will manage to grow throughout.

For at least five reasons, we are likely to avoid recession -- a broad-based contraction in the level of activity for a half-year or more.

First, the slowdown now underway is largely due to the fading of factors that temporarily boosted growth in 1999 and early 2000.

- The recovery of manufacturing from the 1998 financial crisis.
- The build-up of precautionary inventories by both businesses and households heading into Y2K.

- The massive creation of financial liquidity by the Federal Reserve to immunize markets to Millennium Fever.

All have dissipated.

Other causes of the slowdown are simply not of recessionary proportions. Higher energy prices, the sudden scarcity of financial capital, and the reversal of fortune in the stock market will rock the boat without capsizing it.

Second, the bear market in stocks that has crushed balance sheets and egos is partly offset by some positive considerations:

- One is the bull market in bonds. The total return last year on the 30-year Treasury bond, for example, exceeded 20%.
- Another is the realization that not all of the rise in stock market wealth was permanent and the still-lofty level of equity prices. The total value of stocks increased more than fourfold from 1990, and remains more than twice its level of 5 years ago. These gains will continue to support consumer confidence and spending.
- And still another positive factor is the greater importance and better performance of residential real estate as an investment. Home values account for twice as much of total consumer assets as do stocks. And during the year ended last summer, resale home prices increased by more than 7% on average across the country, compared with declines in all of the major stock market indices.

The third reason for not expecting a recession is that the usual dogs are not barking. Rising inflation and interest rates have contributed to the onset of every recession since World-War II. Inflation undermines the health and stability of the economy, and brings forth bitter interest rate medicine from the Federal Reserve. The rise in inflation and the response by the Fed were especially modest in the latest cycle, amounting to only about one percentage point.

The level of inventories and avoidance of rampant speculation in commercial real estate markets are two additional quiet canines. Business inventories remain low relative to sales, despite recent increases. Vacancy rates are generally low, and most real estate markets have avoided the type of boom that is a prerequisite for a bust.

But I caution you. Like politics, all real estate is local. And while average conditions across the nation are not particularly alarming, some markets are strained. The propensity in recent years for average daily rates at hotels in the Orlando area to soften, while building intensifies and occupancy falls, creates a vulnerability to even a slowdown that stops short of recession.

Fourth, economies elsewhere in the world are still expanding nicely, supporting export-oriented businesses in the U.S. International lending agencies expect economic growth in Asia, outside Japan, to top 6%. Growth rates in Europe and Latin America are projected to fall, but still exceed 3% and 4%, respectively, again this year.

A bright spot for travel and tourism will be a downward adjustment in the dollar relative to other currencies, particularly the euro, as growth prospects in the United States fade relative to opportunities overseas. The weaker dollar will help keep Americans at

home and remove what has been a barrier to visits to the states by foreign travelers, especially those from Europe.

A final reason the economy will avoid recession is that the cavalry is on its way. The first troops from the Federal Reserve are already on the ground, and reinforcements will begin arriving in coming weeks.

Fed Chairman Greenspan once justified his usual practice of changing interest rates in small steps by comparing monetary policy-making to walking across a dark room in bare feet. By taking small steps, he said, you reduce the chances of stubbing a toe.

Apparently, the alarming deterioration in economic indicators in recent weeks shed ample light on matters. The Fed raced to cut interest rates by more than the usual quarter-point, did so between policy meetings, and clearly signaled that more reductions would follow.

I have long believed that the Fed lowered interest rates too far during the financial crisis in 1998, raised them too much during the ensuing recovery, and would begin to move them back toward neutral early this year. I expect the Fed to lower short-term interest rates by a full percentage-point by mid-year.

The role of monetary policy in guiding the economy is overblown. But a reduction in short-term interest rates toward a more neutral level will help to stabilize economic activity.

Fiscal policy is also riding to the economy's rescue. Arthur Godfrey once said, "I am proud to be a tax paying American, but I could be just as proud for half the taxes!" I don't expect our pride to be tested quite so severely. But the incoming administration does bring with it the best chance in years for a growth-invigorating supply-side tax cut that will provide extra protection to the economy.

The plan on the table would provide effective, and apparently needed, economic stimulus. It would raise the after-tax reward to risk-taking by lowering marginal rates and providing capital gains tax relief. And it would be front-loaded.

Narrow, targeted tax cuts merely substitute private consumption for government consumption. Back-loaded reforms would actually deepen the downturn, as taxpayers shifted income-generating activity into future periods to qualify for lower rates. Fortunately, the incoming administration has resisted advice to dilute and delay its tax plan. Officials are reportedly talking about making reductions retroactive to January 1.

Early signs also indicate that the Bush Administration might loosen regulatory policy -- particularly in the area of the environment -- that impedes development. We might well look forward to, and benefit from, a policy-making process that more accurately weighs the costs and benefits of regulatory action.

On that hopeful note, let me close with a story. When golf season ended in Columbus a few months ago, I went back to church with my family. The Minister told the following tale. A preacher, he said, once delivered a blistering sermon that rose to a fevered pitch. At the end, he commanded: "Everyone who wants to go to Heaven, stand up!" Everyone leaped to his feet, except for one gentleman in the front pew. A hush fell over the congregation as the preacher peered down from the pulpit and said to the man:

"Don't you want to go to Heaven when you die?" Startled, the man looked up and replied: "Oh, I thought you meant right now!"

Accurate communication is essential, but timing is everything. And as the economy turns down in the months ahead, we will do well to remember how blessed we are to be living and working and investing in an economy in a country and at a time of such prosperity and long-term promise.

The wolf is indeed banging on the door, and there is plenty of reason to be concerned. But the U.S. economy is no Little Red Riding Hood. It is a dynamic, \$10 trillion behemoth that has bulled its way unscathed through numerous perils in just the past decade: financial crises, interest rate increases, business failures, tax increases, wars and so on. Chances are this episode will have a happy ending, too.