FDIC
Speeches

Black Monday and the economic outlook.

Remarks by

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Before

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It gives me great pleasure to be back in Grand Rapids to talk about the economic outlook to the Rotary Club -- a speech my father made to this club over a long period of years. The last time I spoke in this area, I told the good people of Holland that the economy looked very strong. Three days later Black Monday hit the stock market. I'm sure a good many of your friends to the west decided to ask for their money back -- do they have a refund claim? More in a moment.

Life in Washington has been hectic at the FDIC where we insure deposits at the nation's banks, and help maintain the safety and soundness of the banking system.

When I <u>first</u> went to Washington with one of Grand Rapids' own, President Ford, I considered it a great honor to be asked into the Oval Office to talk with the President.

Do you <u>know</u> how to tell if you've <u>really</u> arrived in Washington? It's when you're in the Oval Office with the President, and the famous Red Phone on his desk rings -- and he puts it <u>on hold</u> while he finishes his conversation with you!

Last month I got my biggest thrill yet. The FDIC was working on some of the biggest problems in its history -- two very troubled institutions in Texas, First City and First Republic banks. The President asked me to his office to talk about these problems.

During our conversation, the Red Phone rang again. The President answered it, gave me a startled look, and said "Bill, it's for you."

I told my wife never to call me while I'm in a meeting.

A couple of Sundays back, Jim Harger, business editor of The {Grand Rapids} Press, wrote a column called "Whatever Happened to Plain Old Facts?"

The gist of the column dealt with how often economic predictions contradict each other, and how difficult it is to sort out which way the economy is headed from so many mixed signals.

After all, last October 19 there was a 500 point drop in the Dow Jones average, followed by a number of dire predictions that the booming days for our economy were over.

I heard that the only stock that did well that day was "Dial-A-Prayer" Incorporated.

But, by the same token, in many ways our economy upswing looked surprisingly strong for an old fellow.

In fact, we are in the midst of the longest period of sustained peacetime economic growth, ever recorded in this country!

"Black-And-Blue Monday" may have been the classic situation of "its ill wind that blows no good."

There certainly was an "ill wind" last October, especially if you were a Wall Street broker. But far from bringing on another Great Depression, the Dow's Big Drop seems to have breathed new vigor into our economy in many ways.

I'm pleased that many indicators point to economic vigor for Grand Rapids.

According to the Upjohn Institute in Kalamazoo, your local economy is doing well. Your city's furniture makers are accounting for a bigger share of the national market. The number of hours worked in your area increased during the last quarter of 1987, as did the number of housing starts; while the number of new unemployment claims fell.

Last November, within two weeks of the dramatic events on Wall Street, I gave a talk at the National Press Club.

I decided that enough people were running around trying to find <u>causes</u> for the "crash", and instead I decided to focus on the <u>effects</u>.

In my speech I suggested seven <u>positive</u> reactions to Black Monday that should materialize in the economy following the "crash". I noted that any Presidential candidate that could offer so much improvement to the economy should be a sure winner. Here are the positive developments I suggested as possible from the big crash:

(1) lower interest rates ; (2) reduce inflationary expectations; (3) a <u>real</u> move by the Congress to reduce the federal deficit; (4) a stronger banking system, partially because of inflows of deposits; (5) a reduction of speculation in the markets; and (6) economic reality would be brought to the effort to stabilize foreign exchange rates -- that is, we'd deal with our own economic problem first.

(7) Finally, the October plunge would cause our young business leaders of tomorrow to change <u>the</u> focus of their majors -- to switch from investment banking, to marketing and production.

It's been six months since the Wall Street plunge. How do these thoughts look now?

(1) Did interest rates go down?

<u>Yes</u>. In fact, the prime rate stood at nine percent the week after the "crash". It now stands at 8.50 percent.

(2) Have inflationary expectations been reduced?

Yes, and the inflation rate sank.

But, six months after October 19, we are <u>just starting</u> some inflationary pressure.

(3) Do we have a healthier banking system?

Now this one is especially near and dear to my heart.

Well, there are still a lot of problems in the banking system, especially in the Southwest. But we have seen improvements in the troubled farm belt banking region, and the problems in the Southwest may be reaching their peak. In fact, our so-called "problem bank" list has dipped <u>downward</u> over the last few months -- for the first time in almost eight years!

What effect has the crash had on this? We found that in the wake of the so-called "crash", many banks actually were doing better. Almost a third of the banks noticed that deposits were coming in at a noticeably higher rate.

So, unlike 1929, we found no "run" on our banks. If anything, people were running to put money in!

Moreover, to give you a sneak preview, we expect banking's first quarter earnings to be up.

(4) Speculation in the markets has been reduced.

Indeed, the speculative "takeover fever" that so characterized the stock market in the period before October 19 seems to have abated (at least as far as domestic efforts are concerned). In fact, we have seen the average Price/Earnings ratio of the market drop by about one-third from the inflated heights it hit before the "crash".

(5) Regarding the federal budget deficit, there has been improvement.

The federal deficit for the first half of fiscal 1988 showed an improvement relative to the first half of fiscal 1987. However, we cannot say the budget is under control. The substantial upward revision of the fourth quarter results, and the increase in the deficit for March are of concern. More hard work needs to take place in this area.

The "crash" was necessary to get the "dispute resolution group" on the Hill to take steps toward solving this problem, as the deficit reduction package late last year demonstrated. It takes a perceived crisis to get that kind of action taken.

(6) Economic reality returned to the effort to stabilize foreign exchange rates The Fed and Treasury moved to lower interest rates as the first priority and let the dollar seek it own level abroad. Thus, the dollar has fallen since October. The weaker dollar has given our economy an extra boost in the export area.

(7) Finally, our young people have switched from finance courses to ones in marketing and production.

Last week, the University of Pittsburgh took a poll of 600 students at top "B" schools.

It found that <u>20 percent</u> of the business school students planned to switch the direction of their careers; <u>away</u> from investment banking -- and <u>into</u> manufacturing.

Compared to figures a year ago, <u>twice</u> as many MBA candidates at Carnegie Mellon planned to go into manufacturing after graduating.

So, it turns out that what happened in the stock exchange last October 19 was indeed what one observer had called "a salutary shock".

But it also could be called a warning "heart disturbance," which could become a real "heart attack" if our life style wasn't changed.

Let's look at today's economy for signs of strength and potential weakness.

I'll use what we call our "red and green" charts to help in analyzing where the economy seems to be headed from here.

In our chart system, Green lines indicate a commonly accepted view that the trend indicates increased economic activity. Red indicates the commonly accepted view that the trend is toward reduced economic activity. When I was in the White House as President Ford's Economic Assistant, we used these simple trend lines to check on the many fancy econometric models on hand, and found our charts quite useful.

Let me give you a look at where today's charts stand.

-- <u>INFLATION</u>. It's under control for now, and is a <u>GREEN</u>.

-- Our <u>UNEMPLOYMENT</u> trend line is sharply down to only 5.6 percent -- the lowest level of the decade. It's <u>GREEN</u>.

-- <u>UNEMPLOYMENT CLAIMS</u> are on the decline, down almost 50,000 since February. A <u>GREEN</u>.

-- <u>INDUSTRIAL OUTPUT</u>. The Federal Reserve says OUTPUT last year at the nation's factories, mines and utilities made the Best annual showing since 1984. It's <u>GREEN</u>.

-- <u>BUSINESS CONFIDENCE</u>, as measured by the National Association of Manufacturers in a survey of top CEOs, is up. It's <u>GREEN</u>.

-- PRIVATE HOUSING STARTS have moved up in the last couple of months. A GREEN.

-- U.S. MANUFACTURING CAPACITY UTILIZATION is way up. Another GREEN.

-- And CAPITAL SPENDING, spurred on by stronger exports and high capacity utilization, is expected to increase by eight percent this year. It's GREEN.

-- INTEREST RATES are stable at a relatively low rate, another GREEN.

-- Commerce's LEADING INDICATORS have improved slightly after suffering a modest post-October decline, and are now GREEN.

-- MI has moved up. Well, I guess you could call that a GREEN.

-- GNP GROWTH is up, well above many forecasts Another GREEN.

Of course, not all of the news is GREEN. There are a couple of RED trend lines.

-- The TRADE BALANCE deficit has been on the decline, but has moved up again recently. Unfortunately, it's RED again.

-- The FEDERAL BUDGET DEFICIT is trending down, especially when compared to GNP. I'll let you decide if this is a Keynesian green or a Friedman red. But as a follower of the Friedman school, I score it as a RED.

That gives us 12 GREEN, and 2 RED.

So we have a greening picture for increased economic activity in the near term. But while trend lines are helpful, like income statements, they don't tell all. They state where we're going near-term, but we still need balance sheet items to tell us where we are. Here there are definitely some RED indicators.

America's debt levels in all sectors are at or near record levels when compared to repayment ability. Americans and their government are spending by the motto, "Always live within your income, even if you have to borrow to do so."

There has been some sign of relief in this area since "Black Monday." For the last quarter of 1987, and the first quarter of this year, the savings rate has increased. But there is still a long way to go, with household debt as a percentage of disposable personal income climbing to 87.6 percent at the end of 1987, almost 12 percentage points higher than in 1983.

The NY Fed's President Gerald Corrigan, in an excellent presentation on the long-term economic imbalance in the economy said, "the harsh reality [is], that for too long we in the United States have been borrowing more than we save and consuming more than we produce in an environment in which debt, deficits and leveraging have become a way of life for government, for business and for individuals."

The balance sheet indicates that for the longer term the U.S. will have to do all those good things we learned as kids: save, work hard, and be ready for a rainy day.

According to some analysts at Drexel-Burnham, the October plunge might have extended the life of what they see as the final boom in their predicted "seven years cycle. At best we are running out of time for dealing with our problems. Our hope is that we can turn what many saw as the PROBLEM of October, into an OPPORTUNITY for a stronger future: We must produce more, export more, save more, and continue to keep the trend lines GREEN.

If we don't heed that advice we will see the lines go from green to red. As our debt levels increase when compared with the income necessary to service the debt, our risk increases.

In closing, I'd like to quote from a new book to be published soon that discusses America's competitive strengths. It is titled, "Competitiveness: An Executive Guide to Success." In the last chapter, called the "American Advantage," the author states that America's economic freedom, educational resources, technological base, vast capital markets, and entrepreneurial spirit are good reasons to believe the U. S. will be a winner in the competitive world economy of tomorrow.

By the way, the author is otherwise known as a Grand Rapid's boy now chairing the FDIC. So you now know where I'm coming from.

Thank you.