It’s a pleasure to discuss the regional and national economic outlook with you today. Like many parts of our country right now, the Piedmont-Triad region faces daunting economic challenges. The recession we have just been through was severe. But the U.S. economy has been expanding since about the middle of last year, and there is evidence of improvement in the Triad region as well. This morning my task is to survey the regional economic outlook for you, in order to help you think through what lies ahead for the Piedmont-Triad. Because economic conditions in the rest of the country are such an important influence on local economic conditions, my approach will be to spend roughly equal time on the national outlook and economic conditions in this region. Before I begin, I should mention that these are my own views and are not necessarily shared by my colleagues on the Federal Open Market Committee.¹

To start with the picture for the U.S. economy as a whole, we are, as I said, in the process of recovering from a very severe recession. A wide range of indicators show that economic activity has been expanding since the middle of last year. Real GDP, for example, has grown at a 3.7 percent annual rate over the last three quarters, which is a bit above its long-run trend. Granted, some of the increase was due to one-time factors. Last year’s fiscal stimulus measures, for example, have been providing some boost to activity since the second half of last year, but the effect will largely fade away over the course of 2010. And the way GDP is calculated, it received an additional one-time boost from the completion in mid-2009 of the sharp inventory reduction that is typical of recessions. Demand since then has been met entirely from production, which is what GDP measures, rather than by drawing down inventories.

A look at the most recent GDP report, however, supports the idea that we’re on a sustainable upward trajectory. Let’s start by taking a look at consumers. Their spending accounts for more than two-thirds of total spending in the GDP, and it is now clearly on an upswing. During the recession – that is, in 2008 and the first half of 2009 – real consumer spending fell at a 1.2 percent annual rate. But in the last half of 2009, consumer spending increased at a 2.2 percent annual rate, and last quarter it increased at a 3.6 percent rate. That turnaround is likely to be durable, in my view. During a severe recession consumers tighten up on spending, in part due to job losses and the associated cut in current incomes, but also due to their weakening outlook for future income growth. Moreover, many households prudently defer major purchases when the headlines are alarming and jobs are threatened. But when the worst of the bad news begins to ebb, a growing number of households begin to sense that their jobs are in less jeopardy than they had thought. That improvement in expected income trends combines with the release of pent-up
demand for big-ticket items and leads to a pickup in consumption spending. So while unexpected adverse shocks that disturb household income prospects have the potential, as always, to set this process back, the baseline outlook for consumer spending suggests growth at reasonably healthy rates in the months ahead.

The brighter picture is not limited to consumers. Business investment in equipment and software usually displays large swings in recessions and recoveries, and the latest experience fits that pattern very well. After falling at a 14.7 percent average annual rate during the recession, this investment category bottomed out in the third quarter and has risen at an average annual rate of 16 percent over the last two quarters. Again, prudent firms often defer capital spending in recessions, which creates a pent-up demand that boosts spending early in recoveries. And while sales may have fallen in many industries, technology continues to advance. As a result, there’s an array of opportunities to deploy new capital to improve business processes and consolidate IT infrastructure. So I expect equipment and software spending to continue to rise this year and beyond.

This good news on spending has had a clear impact on the supply side of the economy. In manufacturing we have seen a sizable swing in activity. Industrial production fell almost 15 percent during the recession; since June of last year, it has risen every month, resulting in a cumulative increase of over 6 percent. That turnaround is evident in consumer goods, especially autos; business equipment; and raw materials; and even the production of construction supplies increased last quarter. Forward-looking indicators also are painting a brighter picture. An association of purchasing managers publishes information monthly on new orders for manufactured goods in the form of an index that takes on a value of 50 when the number of responding firms with rising orders equals the number of responding firms with falling orders. That index fell to a record low level of 22.9 in December, 2008, but has been above 55 every month since last July, and hit a sky-high level of 65 last month. This shows that a clear majority of manufacturers are seeing their order books expand, setting the stage for further increases in production this year.

I should put all this good news in the proper perspective, however. While the beginning of a recovery does mark the return of growth in overall economic activity, there are always economic sectors where weakness persists for some time. For example, while residential construction has stabilized over the course of the last year, it may not be a major contributor to growth in the near term. We had an incredible boom-bust cycle in housing – the number of new housing starts rose from 1.4 million in 1995 to 2.1 million in 2005 before falling to 554,000 last year. For perspective, it would take about 1.1 million starts per year to accommodate population growth with an unchanged homeownership rate. During the boom we built more houses – and bigger houses – than we ended up needing, and currently a large number of homes are vacant nationwide. While home prices may have stopped falling, most observers see only a slow, uneven advance in home building for some time.

In addition, the recession caused a sharp fall in the demand for commercial real estate, which has resulted in elevated vacancy rates in everything from retail stores and warehouses to offices and manufacturing facilities. Nonresidential construction spending has fallen 15 percent over the last seven quarters. And leading indicators for this sector, such as architectural billings and vacancy
rates, suggest that nonresidential construction will continue to be very soft for an extended period.

The most visible and painful fallout from the recession, however, can be seen in the labor market, where we lost 7.3 million jobs during the recession. Then in the last half of 2009, while GDP and manufacturing production were increasing, we lost an additional 1.1 million jobs. That has raised the prospect of another jobless recovery such as the one that followed the 2001 recession, when employment fell for a 21-month period after the official end of the recession. This time, though, we are already seeing evidence that employment is on the path to steady growth. Payrolls expanded by 573,000 jobs in the first four months this year, and the pickup in demand that is already underway is likely to keep employment on an upward trajectory.

It will take some time, however, to make substantial progress reducing the ranks of the unemployed. The loss of over 8 million jobs caused unemployment to surge from 4.4 percent of the labor force in 2007 to 10.1 percent last October. Although the most recent reading is somewhat lower, at 9.9 percent, its elevated level is an indication of just how much ground remains to be covered. Keep in mind that as the labor market strengthens, more people begin to actively look for work and thereby add to the number of people that are counted as unemployed, and that happened in April. Despite strong job growth that month, 635,000 people entered the labor force and the unemployment rate rose by two tenths of a percent. This latest experience illustrates a phenomenon that is familiar to students of previous business cycles: month-to-month movements in the unemployment rate can be misleading in the early stage of a cyclical recovery, and as a result, employment growth can provide a better read on labor market trends. And there, as I said, the recent news has been encouraging.

This recession took an even greater toll on North Carolina’s workforce. While total employment in the nation declined a little more than 6 percent since the beginning of 2008, the roughly 300,000 jobs lost in North Carolina amounted to more than 7 percent – and the loss rate in the Triad region was even larger. The state saw a commensurately sharper increase in unemployment. After matching the national rate of 4.4 percent late in the expansion, North Carolina’s unemployment rate jumped to 11.2 percent during the worst of the recession, exceeding the national rate by more than one full percentage point. In the Triad region, unemployment reached 11.4 percent at the end of last year, though it has declined slightly as of March.

Several factors account for the more pronounced downturn in this region. One of the most noteworthy was an industry structure that was particularly vulnerable to the collapse in global demand for manufactured goods. Despite recent successes in diversifying its economic base, North Carolina is still more heavily concentrated in manufacturing industries than the rest of the nation. While manufacturing accounts for a little less than 9 percent of total employment in the U.S., it accounts for more than 11 percent in the state and more than 14 percent in the Triad region.

The global downturn in late 2008 was particularly unkind to the Triad. The region has undergone a broad secular decline in manufacturing, much like the American Midwest experienced during the late 1970s and early 1980s. Just prior to the most recent downturn, it appeared that the Triad region...
had put most of that decline behind it and was beginning to recover. To be sure, the cyclical upturn in global economic activity following the 2001 downturn provided some help. Yet at the same time, some of the regional initiatives aimed at broadening the structure of the regions’ economy were beginning to bear fruit. Indeed, although employment was slow to rally after the 2001 recession, a steady gain in jobs was achieved starting in early 2004 and lasting until the onset of the recession at the end of 2007.

Economic downturns, however, can interrupt even the best laid plans, particularly a contraction as severe as the one we just experienced. The history of the Fed Ex hub at the Piedmont Triad International Airport symbolizes the region’s frustrations. Fed Ex was, if you’ll pardon the expression, a high-flying company experiencing strong growth in shipments here and abroad as a result of a robust expansion in global trade. Its decision to locate an Atlantic cargo hub at PTI was welcome news for the region’s planners, given their focus on transportation and logistics. But just as the facility was ramping up to meet projected increases in shipments, global trade collapsed and freight volume plunged.

Despite the understandable disappointment, the development of a transportation and logistics cluster should be viewed as a plan delayed, not denied. Economic growth is, as I said, turning up, and has begun to boost manufacturing output and freight shipments across the globe. For example, PTI reported that Fed Ex shipments in March 2010 were nearly 42 percent ahead compared to a year earlier.

More broadly, consumer spending and business investment are driving a recovery in U.S. economic activity that has expanded to include more industries, more regions and more workers. Despite the remaining weak patches in commercial construction and housing, labor markets are stabilizing and we’ve begun to see a measure of job growth here in the North Carolina and the Triad too. While unemployment rates are still quite elevated in the state and in this region, the worst of the deterioration is now behind us and we can look forward to a continuing expansion. The presence of FedEx and the expansion of the airport give the region a competitive advantage that is likely to pay dividends as the recovery solidifies and gains momentum.

The cyclical upturn in general economic activity will provide some relief to the Triad region as it continues to work through some of its longer term structural challenges. The decline of traditional manufacturing industries in the Triad, and in North Carolina more broadly, represents in part a continuing shift away from more labor-intensive manufacturing. Global competitors can often underprice U.S. firms on goods made using lower-skilled workers. And new capital equipment tends to be labor-saving, which enables manufacturers remaining the U.S. to produce more output with less by way of labor inputs than in the past. In addition, new “advanced manufacturing” technologies often require workers with different skills than were required in old-line manufacturing operations. As a result, many displaced workers from declining industries are a mismatch for the higher skills required in the new production environments. We often hear people say that some jobs are “gone and will never come back.” An alternative perspective is that the old jobs get traded in for new jobs with higher skill requirements. Economists call this “skill-biased technological change,” and it appears to have been an important feature of economic growth over the last several decades.
The steady shift toward higher skill requirements for our workforce suggests critical roles for education and training. And I think some of the most promising news for the Triad is on the education front. The founding of the Joint School for Nanoscience and Nanoengineering, and the establishment of a National Science Foundation Engineering Research Center here further enhance the area’s rich educational environment. In addition to the obvious benefits of a better educated workforce, these new endeavors have the potential to more rapidly translate research and development efforts into new, job-creating enterprises for the region.

I should emphasize that the steady demand for upgraded skills extends beyond the scientists and engineers that our four-year colleges and universities must supply. We also will need technically-adept production workers with the knowledge and ability to manage sophisticated equipment and the analytical problem-solving ability to continually improve the quality and efficiency of operations. Community colleges play a key role in training such workers, including through programs tailored to specific employers. A critical measure of success for any region undergoing this skill-biased transformation is the extent to which workers displaced from old-line manufacturing operations are retrained to attain the higher skill levels needed for employment in the newer production environment.

Fortunately, North Carolina has a strong education system that supports much more than traditional four-year college degrees. Educators in the Triad, for example, have leveraged high schools and community and technical colleges to augment traditional four-year programs in support of the region’s growing aerospace cluster. These types of initiatives will be vital in creating and maintaining the skilled workforce that will continue to attract growing companies like Hondajet, Cessna and Comair to the region.

One might wonder what state and local governments can do to help this skill-biased transition process. Economists who have looked at that question suggest that spending to improve the quality of human capital ultimately yields high returns in the form of greater employability and higher wages over a worker’s lifetime. The array of human capital strategies ranges from investment in early childhood education, where the benefits are long term, to customized job training programs that match employers’ needs and show more immediate results. As always, well-grounded research is essential to improving program effectiveness over time.

The severity of the most recent economic downturn, however, slashed state and local government revenues at the very time outlays were rising as well, leaving budgets severely strained at every level. Economic downturns, however, are unlikely to reduce the expected returns on human capital investments, so keeping long-term priorities in sight is critical.

To summarize, then, U.S. consumer spending and business investment in equipment and software are driving a recovery that is gradually picking up steam. Housing and commercial construction are likely to lag behind. While the Piedmont-Triad region was hit harder than other parts of the country due to a concentration in manufacturing and exports, efforts to attract transportation and logistics activity seem to be bearing fruit. I expect the region’s economic recovery to track the national recovery, but with perhaps a bit of a lag. More broadly, the longer term challenge is to keep up with the continually rising demand for higher skilled workers. Here,
the outlook is more promising due to recent higher education initiatives and a generally strong state educational state system.

And finally, an economic outlook address by a central bank official would not be complete without mention of inflation, and fortunately, I can be brief. Inflation, the best we can measure it, has been running between 1 and 2 percent since early last year. Although some recent readings have come in below that range, I believe inflation is unlikely to stay that low. In fact, the public apparently expects higher inflation in the future, which suggests that policymakers will need to be careful to avoid waiting too long to raise rates.

---

1 I am grateful to Rick Kaglic, Ann Macheras, Roy Webb and John Weinberg for assistance in preparing this speech.