

Regional Update: Uncertainty Dominates the Regional Outlook

As of this writing, it is difficult to assess how recent market developments will affect the regional economy. Difficulties with European sovereign debt, the downgrade of U.S. sovereign debt, weaker-than-expected national economic data, and the mid-August decline in international equity markets will surely be felt in months to come, but just how recent events will play out in the Southeast will take time to ascertain. That said, downside risk to the southeastern economy has clearly risen.

Regional results mixed

Leading up to the August setbacks, regional business contacts described economic activity as little changed in June and July. National economic data from the first half of the year showed that consumer spending has been soft. Most regional merchants reported that retail sales growth was modest in the early summer months, although some luxury goods retailers noted steady-to-improving sales. The majority of retail contacts stated that they were keeping inventory levels lean and had no plans to increase supply in the near term. Among big-ticket items, auto sales from Japanese manufacturers slowed, but dealers noted that the effects of supply disruptions from Japan are ending.

Leisure activity continued to accelerate in most areas. Contacts reported increases in hotel room occupancy and rates in many areas. Strong attendance at theme parks, festivals, and coastal destinations was noted. Cruise bookings have risen as well, and airport contacts observed increases in passenger traffic. The overall outlook for tourism remained positive. (See this issue's "On the Ground" to read in more detail how our regional executives describe the Southeast's tourism activity.)

Real estate's slow pace continues

Residential real estate was also little changed. According to reports from brokers, home sales were only slightly ahead of last year's weak levels. Gains continued to be driven largely by reports from Florida brokers. Outside Florida, the majority of contacts reported that sales declined. Brokers continued to report declining home inventory levels as fewer homes enter the market, adding that home prices were flat to slightly down compared with a year earlier.

Homebuilders reported that new home sales and construction weakened somewhat compared with year-ago levels. Builders continued to report downward pressure on new home prices. Residential contractors reported that home improvement construction increased from earlier in the year.

The pace of commercial development was flat to slightly up compared with weak levels from a year earlier, but backlogs reportedly continued to shrink. Contractors commented that construction in health care and apartments was up and that renovations in commercial and apartment space had increased. With regard to existing commercial structures, contacts reported that credit availability and absorption improved, especially in light industrial, warehousing, health care, and energy-related space.

Manufacturing: An uneven summer

Manufacturing activity in the region was rather strong in the first half of the year, but reports from July showed that production and new orders increased at a much slower pace than reported earlier in the year. Producers of health care equipment and electrical components in particular noted stronger orders, and supply chain disruptions due to the disaster in Japan were beginning to moderate.

Many manufacturers reported increased investment in technology equipment in efforts to increase efficiency. Reflecting slower manufacturing and retail activity, freight forwarding and parcel shipping contacts reported a gradual slowing of domestic volume momentum in June and July. On the energy front, energy contacts have noticed a considerable uptick in early-stage fabrication of oil and gas extraction capital goods. Shipbuilding for shallow-water supply boats has also increased. Shale exploration has increased as firms employed directional drilling techniques for oil and gas liquids.

Hiring outlook remains uncertain

Job growth in the region was positive, but modest, in the second quarter of 2011. Florida led the Southeast with a net increase of just over 50,000, nearly two-thirds of the region's total increase of almost 77,000. Louisiana added a net 17,300 jobs, while Georgia and Alabama added a net 6,000 and 4,000 jobs, respectively. Tennessee shed a net 1,500 jobs in the second quarter, while Mississippi lost only 600 jobs.

Most business contacts indicated that their hiring plans remained modest. Uncertainty regarding future demand and the regulatory environment were the most commonly cited reasons for the muted hiring outlook. Of those that reported plans to increase employment, many pointed to having reached maximum productivity with existing staff. Staffing agency contacts continued to experience high demand for temporary or contract workers. According to reports, demand for qualified, higher-skilled candidates is robust, especially in the technology sector.



Looking at indicators of inflation, most contacts said that they did not experience significant upward wage pressure and characterized annual increases and bonuses as modest. Firms' expectations for unit cost increases are more tempered than noted earlier in the year. Nonlabor input costs have moderated but remained elevated. However, downward price pressures from productivity gains were reportedly tapering off. While regional contacts have continued to report that margins remained squeezed, there have been more frequent reports that some contacts are attempting to pass through input costs. The cost of fuel

and other inputs continued to challenge shippers' operating margins. However, maritime contacts cited some success in passing along fuel surcharges. Input costs for trucking contacts—such as costs related to tires, replacement parts, and new vehicles—remained high.

Overall, the outlook for the regional economy has clearly suffered from negative August developments. To what extent is difficult to measure because events remain fluid. The Atlanta Fed will continue to watch the data closely as it looks to its business contacts to help develop a clearer view. ■

University Studies

On a national scale, the Conference Board's Consumer Confidence Index and Reuters/University of Michigan Index of Consumer Sentiment give us insight into how consumers are feeling about the economy. From a regional perspective, we gain the same insight by looking at publications released by members of the Local Economic Analysis and Research Network (LEARN) that examine both consumer and business confidence.

Gauging recent events' local impact

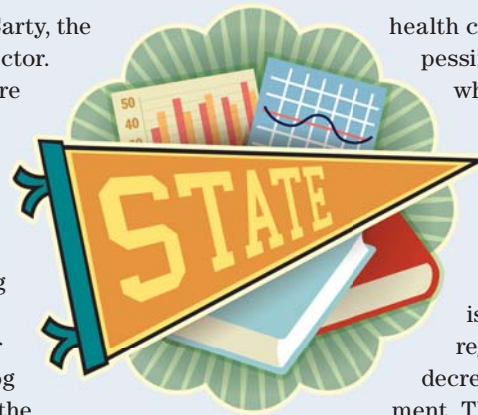
The most recent data released by the Conference Board showed that consumer confidence increased by only 1.9 points to 59.5 in July, after declining a total of 8.4 points over May and June, while the University of Michigan Consumer Sentiment Index fell 8.8 points to 54.9 in August. These reports indicate that the decrease was most likely related to concerns stemming from deficit-ceiling negotiations and weaker-than-expected economic data. Did these issues affect confidence in our region?

According to the University of Florida's Bureau of Economic and Business Research, consumer confidence in Florida rose 2 points in July to 68 points. The increase in the overall index "does not represent a big change. Most of the increase can be attributed to an increase in optimism about whether it is a good time to buy [big ticket items]. This component is now back to the level it was last

fall," said Chris McCarty, the bureau's survey director. "Looking ahead, there are two factors most likely to affect consumer confidence. One is the potential downside to housing prices. Florida is different from other states in the backlog of foreclosures and the relatively high price tag for homes along the coast which will be affected by the change in the FHA [Federal Housing Administration] rate [for mortgage insurance]. The other is the aftermath from the change to the debt ceiling and deficit reduction."

Business outlook dims

As for businesses, according to the University of Alabama's Center for Business and Economic Research, sentiment fell in the third quarter of 2011 as expectations for Alabama's economic performance decreased by 4.8 points from the second quarter to 52.5. However, a reading above 50 is still considered expansionary. Panelists in sectors related to finance, insurance, and real estate; transportation, information, and utilities; and retail trade were the most optimistic. Manufacturers were expecting a weaker quarter, with sales and profits expected to decline. The



health care industry held a pessimistic outlook as well, which is notable because health care has been the only sector that has added jobs consistently over the last several years.

The Gulf Coast is another area in the region that experienced a decrease in business sentiment. The Gulf Coast Business Council's CEO and Business Owner Confidence Index fell 9 points, to 53, in the second quarter of 2011. Although the reading was slightly above neutral and above the level from a year ago, business confidence in the local economy has fallen substantially since the end of 2010. The report cites a decline in sales tax collections and diminishing job growth as reasons. ■



On the Ground: An Interview with the Atlanta Fed's Regional Executives

Tourism-related spending has been fairly healthy in the region. Based on what your contacts have shared with you, how do you square your area's positive tourism reports with the slow-growth environment experienced in the region as a whole?

Tom Cunningham, regional executive at the Atlanta Fed:

Atlanta is a little tough to pin down in terms of "tourism." The travel and hospitality sector in the city is doing better, but my sense from conversations with those in the sector is that the increase is driven mostly by business-related travel. This is not very surprising—Atlanta has long been a center of conventions and meetings. Unlike some other cities in our region, notably Miami, Orlando, New Orleans, and Nashville, Atlanta is more of a business travel destination than a pure tourist destination. Certainly, all those other cities have very active convention businesses, but in terms of the overall mix of motivations for travelers, Atlanta is more heavily weighted toward business. Hotel occupancy rates declined sharply during the recession and have been recovering since. I think part of the apparent strength here is partly just the arithmetic of the recovery. Another issue with the hospitality industry in the Atlanta area is a notable increase in supply that was constructed in the prerecession '00s. Some of these properties have struggled, and the extra capacity has held down overall lodging prices. This isn't a lot of fun if you are a competitor in that market, but at the margin this makes the city comparatively attractive as a destination.

Lesley McClure, regional executive at the Birmingham Branch:

Reports from my contacts along Alabama's Gulf Coast have been very positive for this summer season. I think it's important to recognize that in many cases we're comparing this season to last year's season, which was

hurt by the oil spill. Nevertheless, tourism activity has been healthy to date. I attribute the disconnect between soft overall consumer spending nationally and strong tourism-related activity regionally to the disproportionate impact of the downturn and recovery. Our contacts have noted this frequently—those with financial resources are doing quite well, while others who had no financial cushion are struggling. Families and individuals with resources have loosened their purse strings and are spending some of their savings on vacations that were in many cases postponed by the recession. **Chris Oakley, regional executive at the Jacksonville Branch:** Contacts in the central Florida area are generally bullish on tourism both in terms of the current volume and future bookings. There is a positive combination of both leisure and business travelers to the area. Attendance at Orlando's convention center is very strong, with February activity setting a record. Luxury brands are also performing very well. The amount of discounting to maintain volumes that most hospitality and attraction contacts implemented has been reduced, though pricing is not back to prerecession levels.

So what are the sources of strength for this sector of Florida's economy, especially when domestic economic growth is slow and spotty? Two things stand out. First, the volume of international visitors is up and there has been a bit of a shift with where they are coming from—the area is experiencing increasing numbers of tourists from Latin America. Second, domestically, area contacts have noted some improvement in confidence and described a typical American's perspective on vacations as "nonnegotiable." Some of these visitors express a willingness to offset spending elsewhere in order to afford an annual trip for their families.

Juan del Busto, regional executive at the Miami Branch:

Our travel and tourism contacts have been reporting positive business growth the past few months, and their outlook is strong for the industry. This improved outlook includes the hotel benchmarks (occupancy, room rate, revPAR [revenue per available room], etc.) and cruise booking activity. During the recession, the cruise operators had to lower prices significantly to fill rooms, and they noted that the discretionary spending onboard was down. This has turned around over the past several months, and onboard spending has increased and bookings are strong enough to allow for raising some prices. Convention bookings have had some moderate gains.

The increased activity in spite of the slow-growth economy has probably occurred for a variety of reasons. Businesses had cut back and postponed many meetings and conventions during the recession, and there was pent-up demand for bookings once things got even a little better. On the leisure side, this has also probably had some impact with folks who still had jobs but decided to cut back on vacations and hunker down during the worst of times. These folks have felt a little better recently, but they still spend money on vacations cautiously. Additionally, a big contributor to our tourism activity has come from abroad, where folks with money are traveling from. The area has seen more international tourists, who fly over to take a cruise and typically stay at least one night before and after in a local hotel, as well as spend money at local restaurants and retail establishments.

Lee Jones, regional executive at the Nashville Branch:

East Tennessee generally, and the Smoky Mountain-Gatlinburg-Pigeon Forge tourist areas specifically, experienced a mini-boom

On the Ground continues on page 29

Data Corner: Macroprudential Supervision

When traveling on a cloudless day in an airplane at 30,000 feet, the view from on high looks dramatically different from the view on the ground. The same effect applies to the role of financial institutions in the nation's financial system. Prior to the Dodd-Frank Act, financial system regulators were statutorily required to regulate financial institutions. However, there was no explicit mandate for federal regulators to regulate and consider the aggregate effect of all financial institutions on the broader economy. Specifically, regulators were not required to study how the largest financial institutions affected both the national and global financial systems.

To address weaknesses that led to the financial markets crisis, the Dodd-Frank Act—the regulatory overhaul of the U.S. financial system passed in 2010—established a *macroprudential* approach to supervision, which includes the analysis and regulation of the collec-

tive impact of financial institutions on the broader economy, with a particular emphasis on identifying risks posed by those institutions. This broad supervision is intended to be conducted concurrently with *microprudential* supervision, the analysis and regulation of individual financial institutions. The Federal Reserve, under the Dodd-Frank Act, will add macroprudential responsibilities to the bank supervision and regulation responsibilities it had before Dodd-Frank.

Under the authority granted to federal regulators by the Dodd-Frank Act, nonbank financial firms that are deemed systemically important are subject to enhanced prudential standards. If a particular firm or a firm's activities are deemed to pose a systemic threat to the domestic financial system, regulators have the authority to force a firm to divest itself of or spin off certain activities or subsidiaries.

The Financial Services Oversight Council (FSOC) was established by the

Dodd-Frank Act to coordinate macroprudential supervision activities by the federal financial regulators, such as the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Bureau of Consumer Financial Protection, the Securities and Exchange Commission, and the National Credit Union Administration.

Macroprudential supervision seeks to identify and mitigate systemic risk. The systemic part of the threat refers to the likelihood that the entire financial system could be affected by a single (and presumably large) financial company. The FSOC is charged with designating systemically important financial companies and is also responsible for suggesting improvements in the supervision and regulation of such companies. Congress receives reports of these suggestions. ■

Econ 101: Inflation Targeting

A low and stable rate of inflation is generally considered by economists to be an important underlying factor for healthy economic performance over time. Central banks, including the Federal Reserve, are charged with monitoring inflation pressures and adjusting monetary policy to maintain long-term price stability. Inflation targeting, whereby policymakers set an explicit numerical objective for inflation, is a practice employed by many of the world's central banks—though not currently by the U.S. Federal Reserve. By publicly communicating its objective for inflation, a central bank can help anchor the public's inflation expectations.

A quantitative inflation target (sometimes expressed as a range of inflation) is not intended to be a binding policy constraint—policymakers are still free to weigh other factors, like the unemployment rate and the stability of financial markets during their deliberations—but rather a mechanism for explicitly communicating a framework for monetary policy.

Although the Federal Reserve does not currently employ an explicit inflation target, it does publish members' projections for longer-run inflation, conditional on what Federal Open Market Committee (FOMC) members view as the appropriate path for monetary policy. The economic projections are released four times a year at the Fed chairman's press conference, following the meeting of the FOMC. These projections can be found at federalreserve.gov/monetarypolicy/fomccalendars.htm. Longer-run projections for personal consumption expenditure inflation currently range from 1.5 percent to 2 percent, with the central tendency between 1.7 percent and 2 percent. ■



On the Ground continued from page 16

in tourism last year. This increase was attributed to a variety of factors but most predominantly was a combination of consumers wanting to travel shorter distances and economize on their vacation spending and wanting to avoid the issues related to the impact of the oil spill on the Gulf Coast beaches.

Turning to 2011, east Tennessee tourism was reported as being solid during the first four to five months of the year, with most businesses up slightly from the same period in 2010. However, based on recent anecdotal information gathered from our contacts in the area,

summer tourism through July is down about 10 percent compared with last year and has returned to more of a trend growth rate. This information seems to confirm reports we've been hearing from my regional executive colleagues in Florida, that tourists have returned there this summer. The Gulf Coast beaches are back to their pristine condition, and apparently consumers have adjusted to the current level of gas prices.

Robert Musso, regional executive at the New Orleans Branch: I think several factors are contributing to the recent uptick and success we have seen

in the tourism arena. First, New Orleans is considered one of the three "brand" cities in the United States, and with the value of the dollar down this has been attracting many foreign visitors. Second, many U.S. citizens who cannot go abroad have chosen New Orleans as a destination because it is seen as exotic, with a European flavor. Finally, the renaissance the city has undergone since Hurricane Katrina has made it a very attractive destination. There's more shopping, better museums, more restaurants, better accommodations, etc. ■

On Point continued from page 1

Thinking globally, acting locally

The global economy is more interconnected than ever, as unfolding events in Europe have vividly illustrated. For his story on capital controls, research analyst Andrew Flowers looked at how some nations have attempted, with varying success, to control the effects of outside investment on their economies. "The issue that interested me the most during the course of my research for this article was the ebb and flow of the power of the International Monetary Fund," he said. "Following the Asian financial crisis of the 1990s and continuing through the relatively stable era of global growth in the 2000s, the IMF seemed to have lost a good deal of its influence as a policy-making institution. With regard to loans and policy monitoring, economists and emerging-market policymakers began to

see either other institutions or the international financial markets themselves as having more influence on policy.

"Then—during and following the financial crisis—things changed. The IMF suddenly had much more of a prominent role, whether it was facilitating policy responses on the international level, providing loans to emerging market countries in distress, or being a key player in the ongoing attempt to resolve the European sovereign debt crisis. And on the subject of my article—capital controls—the IMF has in this area, too, gained great visibility in restarting this conversation about the efficacy of such policies, whether it's reasonable for countries to implement them and under what conditions."

In our next issue, we will feature our outlook for the regional, national, and

international economies in 2012. The Atlanta Fed's research department always delivers an insightful look ahead at the coming year. ■

**Lynne Anservitz
Editorial Director**