

Regional Update: Economic Activity's Pace Quickening

Southeastern business contacts described economic activity as expanding at a somewhat stronger pace in January and early February compared with late last year. They also describe a notable improvement in expectations across most sectors. In particular, nearly four out of five of the Atlanta Fed's directors reported in January that they expect economic activity to improve over the next six months compared with the previous six months. These directors, from the Atlanta Fed and the five regional branches, present viewpoints from a wide geographic footprint. Other business contacts also expressed similar optimism.

Optimism gains a foothold

This amount of positive feedback bears careful attention as we may be seeing the beginnings of tangible momentum building in the economy. Though the economy still faces some serious headwinds and many uncertainties, optimism emanating from the Southeast—where the recession struck an especially hard blow to economic activity and where recovery has been slow—is notable.

Although firms' expectations were generally more positive, they nevertheless continued to express caution. In particular, concerns about negative effects from developments in Europe weighed on many people's minds, as did the potential for further increases in energy prices.

Is employment turning the corner?

The employment outlook has also improved. Firms indicated that hiring expectations going into 2012 are better than they had been going into 2011. However, many contacts noted that plans to increase profits still revolved around further efficiency gains from improvements in internal operations. Several businesses reported plans to increase payrolls because they expect an improvement in sales going forward.

Some firms still indicated a preference for contract workers for short-term projects, but several expressed increased willingness to consider them for permanent positions. Aside from optimism about future sales, some contacts also reasoned that their current employees do not always possess the necessary skills, leaving firms with no choice but to hire new workers.

Businesses' outlook brightens

The Atlanta Fed's business contacts expect overall investment levels to remain firm. Additionally, more businesses have noted increased confidence among their customer

base, and that confidence is driving increased expectations for future improvement in sales growth. This optimism appears to translate into plans for expansion in more firms than previously detected.

Concerns over increased input costs eased further, although several manufacturing firms did note an increase in commodity prices. Few contacts reported having significant pricing power.

Looking at particular sectors, regional retail contacts noted that sales and traffic in January and early February were up from a year ago. Final holiday sales reports were generally positive, as slightly more than half of our retail contacts indicated that sales were better than they were last year. Retailers also expect overall sales to improve modestly over the course of 2012. Auto dealers noted that January's warm weather likely boosted sales for the month, and they anticipate new vehicle sales to continue to improve. Hospitality contacts, with the exception of cruise lines, reported strong bookings for this year.

The majority of southeastern residential brokers reported that home sales accelerated in January and early February and stand above levels from the same period last year. The outlook among brokers for sales growth continued to improve with most anticipating modest year-over-year gains over the next several months. Most regional homebuilders indicated that new home sales and construction activity growth, measured year over year, increased slightly during January and early February. However, several contacts noted that unseasonably warm weather in the region likely pulled some activity forward. Contacts also noted that multifamily construction remained robust. Over the next several months, homebuilders anticipate new home sales and construction to be flat to slightly up compared with a year earlier. Most commercial real estate contacts indicated that conditions continued to improve slowly in the region.

Manufacturing, energy make gains

Manufacturers noted more positive results in January and early February compared with late 2011. In particular, firms reported increased levels of new orders along with improved expectations for future orders. Most contacts also signaled that inventory levels have risen in line with these improved order expectations. Transportation contacts reported that inventory-building trends appeared to be similar to the end of last year. Port officials noted that both imports and exports have leveled off since the beginning of the fourth quarter of 2011, although trade with Latin America continued to experience modest growth.

In the energy sector, contacts in the exploration field noted that recent lease auctions have helped stimulate more industry optimism, contributing to an improvement in investment conditions. Regional gasoline inventories remained above their seasonal norms for this time of year as national and global gasoline



consumption remains relatively soft, although contacts reported ongoing concern about the impact of geopolitical uncertainty in some OPEC countries on energy prices going forward.

On the farm, significant rains have eased drought conditions for agricultural parts of Alabama, Mississippi, and Louisiana, but parts of Georgia and Florida have seen drought conditions

worsen. Mild temperatures throughout the region are a matter of concern to peach and other fruit-crop growers hoping for adequate conditions for the current growing season. Contacts reported that some farmers in Alabama and Georgia were reviewing their planting plans in light of their concerns regarding labor shortages. ■

The Atlanta Fed's Regional Economic Information Network (REIN) recently introduced *Southeastern Insights*, a report that presents economic intelligence gathered via REIN's network of business contacts and other regional sources during the latest Federal Open Market Committee cycle. The report is available at frbatlanta.org/rein/rein-pubs/SE-insights/120319.cfm.

University Studies

In 2011, the U.S. economy faced several obstacles that hampered growth. From the downgrade of the government's credit rating to a weak job market to tepid consumer spending, 2011 marked a year of slow growth. Real gross domestic product (GDP) for the United States grew 1.7 percent for the year, according to the U.S. Bureau of Economic Analysis. The Blue Chip Economic Indicators forecast expects real GDP to grow 2.2 percent in 2012. Given the higher pace projected for the nation, what rate of growth might southeastern states see this year? Annual forecasts produced by members of the Atlanta Fed's Local Economic Analysis and Research Network (LEARN) provide some insight into the direction of some of the region's state economies for 2012.

Alabama's pace expected to rise modestly

Alabama's gross domestic product rose 2.2 percent in 2011. According to the University of Alabama's economic outlook released in January 2012, Alabama's economy should expand at a slightly better rate of 2.4 percent this year. The report—coauthored by Sam Addy, director of the University of Alabama's Center for Business and Economic Research—calls for nonfarm employment to rise 1.1 percent and 20,000 jobs to be added for the 12-month period ending in October 2012. (For comparison, statewide employment increased only 0.2 percent from October 2010 to October 2011.)

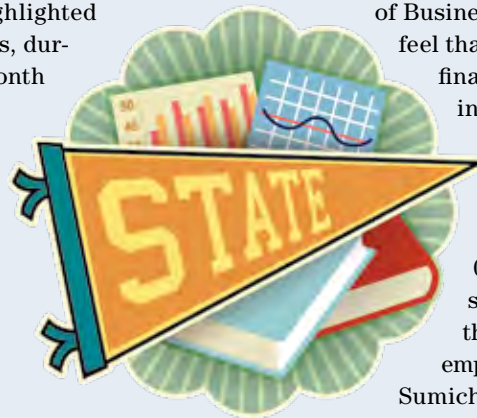
The report highlighted that manufacturers, during the same 12-month period, added 1,900 jobs, or 0.8 percent, to their labor force. In 2012, Alabama's manufacturers are expected to be major economic drivers and will increase their employment by 0.6 percent.

The report's authors are optimistic that an improvement in the labor market will encourage more Alabamians to enter or reenter the workforce.

The Peach State looks at sluggish growth

Slow growth will continue for Georgia in 2012, according to a forecast prepared by the University of Georgia's Simon S. Selig Jr. Center and released in November 2011. The state's economy will expand by only 1.5 percent, the report said, indicating that the reason for persistently slow growth is that Georgia experienced a deeper recession than the nation overall and has also substantially lagged the nation during the recovery. The report also says that while the United States has experienced job growth since 2009, Georgia's labor market generally continued to lose jobs.

Robert Sumichrast, dean of the University of Georgia's Terry College



of Business, and his colleagues feel that Georgia should finally turn the corner into job growth in 2012, projecting that net employment for the state will increase by 18,000 jobs or 0.5 percent. "That small uptick will be the first annual gain in employment since 2007,"

Sumichrast said. "But that is only 5 percent of the total jobs Georgia lost due to the recession. That won't help Georgia's unemployment rate improve much. It will average just over 10 percent in 2012."

Sunnier days ahead for the Sunshine State?

According to the University of Central Florida's Institute of Economic Competitiveness December 2011 forecast, real gross state product expanded at a tepid 0.7 percent for 2011 but should expand by 1.7 percent this year. Researchers at the institute also reported that Florida's payroll job growth finally took root in 2011, with job gains of nearly 0.8 percent. In 2012, job growth is expected to average 1.8 percent. The report stated that the unemployment rate will decline slowly through 2014. ■

Econ 101: Inflation Expectations



Inflation expectations are a critical component of the inflation outlook and, ultimately, they play a role in achieving price stability. But our understanding of inflation expectations is limited, in part as a consequence of imperfect measurement.

Simply said, inflation expectations are the rate at which individuals, businesses, and investors think the general prices of goods and services will rise. Businesses' and individuals' expectations of inflation affect every decision they make about spending and investing. The price a firm sets for its goods or services, an individual's decision to purchase a new car or home and the wage they demand from employers, how much businesses and individuals put into savings—inflation expectations affect all of them.

Central banks study inflation expectations because expectations signal where inflation may be going in the future. Though central banks have little impact on short-term variations in prices—like those resulting from an increase in the demand for beef, for example, or a decline in oil production—monetary policy can determine inflation over the long run. However, longer-term inflation expectations can be difficult to measure, and current knowledge of inflation expectations is somewhat limited.

A few years ago, Fed Chairman Ben Bernanke challenged researchers by asking, “Do we need new measures of expectations or new surveys? Information on the price expectations of businesses—who are, after all, the price setters in the first instance—as well as information on nominal wage expectations is particularly scarce.” Indeed, our measures of firms' inflation expectations are generally anecdotal. The Atlanta Fed is helping to fill that void with the Business Inflation Expectations (BIE) survey.

The BIE was created to measure the year-ahead inflationary sentiments of businesses in the Southeast. It also helps inform



the Atlanta Fed's view of the sources of cost changes and provides insight into the factors driving businesses' pricing decisions. To see the latest BIE results and to learn more about the survey, go to frbatlanta.org/research/inflationproject/bie/.

The Atlanta Fed's Inflation Dashboard acts as a platform for visualizing recent inflation measures in the context of longer-term trends. The dashboard's 30 data series capture inflation movements from various perspectives. To provide a snapshot of the current inflation picture, each of the 30 series has been



grouped into six broader categories: retail prices, inflation expectations, labor costs, producer prices, material and commodity prices, and money and credit. For more information, go to frbatlanta.org/research/inflationproject/dashboard/. ■

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

Regarding the outlook for growth in economic activity, what are some of the main themes you are detecting in your conversations with business leaders throughout the region?

Tom Cunningham, regional executive at the Atlanta Fed: My impression is that there is a growing sense of confidence in the strengthening of the economy. Cautious optimism has been a recurrent theme for a while, and early last year the economy suffered a series of shocks—

earthquake, tsunami, flood, debt-ceiling problems—that may or may not have been responsible for softness in the economy later that year, but they certainly caused a lot of angst.

The beginning of this year seems substantively different. Instead of watching and planning for action when things seem to be doing better, there is some action. This change is particularly evident in wage increases. Executives are frequently telling me that they are giving wage increases where they weren't during the

recession, and there is a serious intent to bring up the pay of their better employees because of fear of poaching by rival firms.

None of this suggests that things are booming, but it seems as though actions are being taken that are consistent with firms anticipating higher rates of growth in the near future.

Lesley McClure, regional executive at the Birmingham Branch of the Atlanta Fed: Among my contacts in the last six weeks there has been a noticeable uptick in optimism about continued improvement

in their businesses, but no one expects dramatic improvement—overall, there is a belief that incremental improvement will continue. Several contacts continue to express concern about downside risks stemming from the situation in the euro zone or another shock to oil prices.

Generally, I hear only modest plans for hiring, but one of my contacts has observed an increase in companies converting temporary staff to permanent staff.

Although residential real estate is still struggling, there were reports of some improvement. For example, high-end homes are starting to see some sales close, and as we've noted for a while now, multifamily housing sales are strong.

Also, the port in Mobile is very busy with both export and import goods.

Chris Oakley, regional executive at the Jacksonville Branch: Interviews and feedback at the end of the fourth quarter of 2011 and in the early part of January were notably more positive as contacts were looking forward into 2012. Among many, expectations for sales are up, and these

expectations are generally translating into plans for some level of increased hiring.

In addition, investment plans continue, with many indicating additional expenditures on technology and automation, often being funded by cash reserves, even in an ultra-low interest rate environment. Even so, contacts' optimism was tentative, primarily stemming from concerns about Europe and a possible [fiscal] contagion. Others noted domestic concerns, especially worries about continued high unemployment and difficulties for small businesses in obtaining credit along with the uncertainties about the upcoming presidential election and what the outcome will mean for the economy.

Some manufacturers are resuming work on plans for new facilities that had been shelved over the last few years, and we have heard hints of increased commercial real estate activity, though interest is primarily in prime locations. Large businesses indicated no issues with funding. Weakness remains in the housing sector, with most contacts not predicting a full

recovery until 2015 or beyond. With regard to consumer spending, sentiment was by and large positive.

Reports on employment were mixed, though the trend toward more new hires has definitely improved. Some are increasing sales staff, while others indicated plans to increase IT, analytic, and compliance staff. Sentiment on finding qualified workers was mixed, with some concerns about recruiting quality people with needed technical skills or who can pass preemployment screening. Others had no trouble filling positions and had vast numbers of applicants.

In general, contacts did not express concerns with rising input prices, though a few noted that while there has been some stabilization with certain inputs, prices have stabilized at levels higher than they are comfortable with. There continues to be little pricing pressure—the lack of wage pressure has also contributed to stable prices, though most contacts have reinstated merit increases, and some contacts noted challenges with benefits costs.

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Data Corner: Real versus Potential GDP

Someone once said, "Whoever controls the yardstick controls the agenda." That's a useful adage to keep in mind when thinking about how the measures of gross domestic product (GDP) are produced. The total value of goods and services can be added up in many ways. For example, we might look at how much income households and firms are earning, a measure that the U.S. Department of Commerce makes readily available. But the headline estimate of GDP is produced by tallying up all the expenditures people make.

Why measure output by adding up spending? That's the usual agenda behind the GDP numbers. When the notion of estimating GDP was conceived, the prevailing economic theories held that fluctuations in economic activity primarily reflect fluctuations in economic demand—and those theories prevail today. Further, if one presumes that fluctuations in demand account for much of the ups and downs in economic activity, it seems natural that economists would want to know as much as possible about what people are buying or—more to the point—what they are not.

In the United States and elsewhere, much of what constitutes a policy of economic stabilization largely focuses on the stabilization of spending, which economists sometimes call "aggregate demand." So stabilizing aggregate demand is the agenda, one could say, and defining GDP as the sum of all spending is the yardstick.

This approach to measuring GDP leads to another way of thinking about national output. Although GDP may represent what we are producing today, how much could the economy produce if all of its resources were fully employed and at peak efficiency? Economists refer to this measure as *potential GDP*, as distinguished from *real* or *actual GDP*.

While potential GDP might not be headline news for the average person, for economic policymakers—those who are expected to formulate policies that help maximize economic performance, potential GDP is a crucial metric. If our actual GDP is less than our potential, the policymaker's job is to understand the reason for the underperformance and to set policies to help improve performance. ■

Grassroots continued from page 5

nearly 25,000 in military and civilian jobs, a number that has held steady in recent years. While important sectors such as construction and retail and wholesale trade declined during the recession, BEA data show that the military's economic activity in Pensacola has increased in each year since 2005.

Given the Navy's vital place in the local economy, Pensacola leaders are concerned about possible Pentagon budget cuts. "We're all holding our breath here" regarding military spending decisions in Washington, Harper said.

As important as it is, NAS Pensacola used to be even more dominant in the local economy. For one thing, the rest of the economy has grown up around NAS, while its staffing level has remained constant in recent years. Second, since the mid-1990s, NAS has performed less aircraft repair and maintenance than it once did, meaning the contracts the base awards locally are less lucrative than before because they do not involve as much engineering and technical work, according to Harper.

Meanwhile, Mayor Hayward is looking to clean up the city and alert busi-

nesses near and far that Pensacola will welcome them. He said the city has some 100 waterfront acres that can be improved. "I didn't want to watch the demise of Pensacola," he said of his reasons for running for mayor. "It was time to lead."

Now he's getting his chance. ■

This article was written by Charles Davidson, a staff writer for EconSouth.

REIN

Regional Economic Information Network

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Juan del Busto, regional executive at the Miami Branch: High unemployment rates and the slow real estate recovery continue to be major headwinds against the pace of economic activity going forward.

Our contacts in travel and tourism tell us that the industry is doing well and that the outlook is bright for 2012. The recent cruise ship disaster and tragedy [off Italy's coast] will have some impact on that sector's business this year. Our automobile contacts are very optimistic and positive about their sector's business and outlook.

In summary, our contacts are cautiously optimistic about the economy but are also concerned about the ongoing economic policy uncertainty and global issues such as what is occurring in Europe.

Lee Jones, regional executive at the Nashville Branch: My Nashville directors and Tennessee contacts seemed to be a bit more cautious than most in their outlook for 2012. From the perspective of a generally improved fourth quarter of 2011, the Nashville Branch members of the Regional

Economic Information Network heard similar sentiments—business executives were concerned about another year of weakened yet positive performance for 2012, just as they saw in 2010 and 2011, when the years started strong but ended with disappointing results. In a recent meeting, the CEO of a national retailing firm headquartered in Nashville summed up 2011 by saying that it was on the whole their best year ever in terms of total sales. Yet this executive's outlook for 2012 is only moderately to cautiously optimistic.

Most contacts shared that they are slowly experiencing a slight pickup in demand, but the "new normal" of tightly managing inventory, the continued need to seek greater efficiencies, and very weak margins continues an environment that feels far from a strong recovery. As a result, many are in a wait-and-see posture with regard to increasing production and employment. Most indicated that the fourth quarter and the holidays provided some bright spots in consumer spending. However, many continue to be very cautious regarding factors such as regula-

tory compliance, continued volatility in equity markets and consumer confidence, and the election. For our contacts, these combined factors present an environment of uncertainty and potential challenges in 2012.

Robert Musso, regional executive at the New Orleans Branch: Growth is occurring, most notably in the energy sector. We've heard of staffing increases in this sector and in some others as well—it's all very promising. The news is as good as we've heard in three years. Some of it is hiring for new projects—such as boat construction—but part of it is tied to infrastructure projects because limited infrastructure work has been done in the past few years.

We've also heard discussions of salary merit increases of 2 percent to 3 percent. For the last two or three years, everyone's salary has been frozen, so it's time to catch up. ■