

Regional Update: Economy Continues Moderate Expansion

Feedback from Atlanta Fed contacts in the Southeast remained generally positive regarding economic performance over the last few months. While worries about the sustainability of the recovery remain, they have abated somewhat. However, few business contacts anticipate growth to accelerate in the near term. In addition, many businesses expressed concern regarding the impact of high energy prices on the outlook. The ongoing financial stresses emanating from Europe are another concern. Importantly, contacts did not indicate that they were altering business plans because of these potential downside risks.

Employment strengthens while catching up

Many of our business contacts supported the idea that recent employment gains were related to firms' "catching up" and restaffing to levels that were more in line with current needs. These firms cut back payrolls severely during the recession and the early stages of the recovery. While companies continue to turn to part-time, temporary, and contract workers to meet short-term needs, their outlook for hiring full-time employees is a bit more tempered. In fact, some staffing firms noted that a variety of businesses were aggressively hiring contract labor. Hiring by manufacturing firms remained largely positive, and reports from the health care and hospitality sectors were especially buoyant, although there appears to be some seasonal effect with regard to the latter.

Many firms continue to report difficulty finding qualified applicants for skilled positions. Some contacts in the agricultural sector and many in the trucking business are also experiencing difficulty finding qualified employees. One large manufacturer addressed the lack of qualified workers by bringing back retirees on a contract basis to help train new hires. Firms also indicated a growing concern about retaining top employees. Some companies have implemented programs to retain top talent, and many firms have reinstated merit pay programs for their most valuable staff.

Prices show some flexibility

Though most contacts continued to report that they have little pricing power, more firms recounted successful attempts or plans to pass on price increases since our last report. Increased transportation costs, especially those resulting from higher gasoline and other fuel prices, were reportedly passed on to customers without much difficulty.

The inflation expectations of businesses in the Southeast for the coming year fell to 1.8 percent in May, down from 2.1 percent in April, according to our most recent business inflation survey. Firms also reported that their unit costs had risen 1.6 percent compared with this time last year, which is 0.3 percentage points lower than their assessment in April.

Looking forward, firms' expectations for nonlabor costs subsided in May. Only 9 percent predicted a strong upward influence from those costs—a significant decline from the 18 percent that responded in a similar way in April. Firms anticipate labor costs will put only little or moderate upward pressure on prices in the year ahead.

General economic activity trends positively

Consumer spending in the Southeast remained positive as mild weather appeared to boost sales in some areas. Auto sales have been especially strong, and industry sources expect sales to remain solid going forward.

Tourism remains strong in the region. While our contacts in the hospitality sector do not anticipate continued gains at the rate experienced last year, overall tourism levels should remain strong this year. All contacts noted that a significant surge in gasoline prices, above current levels, would pose a threat to this outlook.

Indeed, many of our contacts cited gasoline prices as a concern, but few report significant changes in consumer behavior stemming from higher pump prices. The notable exceptions were reports from contacts in rural and lower-income areas, where higher gasoline prices are already having an impact on spending in these areas.

In early April, the Atlanta Fed's Center for Real Estate Analytics conducted a survey of 150 contacts in the real estate and construction sectors. According to the survey respondents as well as input from our boards of directors and our Real Estate Advisory Council, sales of new and existing houses were improving in the Southeast.

Besides normal seasonal trends, contacts attributed the increase in sales and buyer activity to attractive pricing and increasing levels of consumer confidence. While low mortgage rates were cited as an influential factor, rates have been low for some time and were not considered to be the sole reason behind the recent rise in activity. They also noted an overall improvement in the credit quality of mortgage applicants as contributing to the improvement in the housing sector. Interest in home buying is increasing modestly, reportedly from first-time home buyers,



as evidenced by a growing number of people participating in homebuyer-education programs.

Single-family construction was picking up slightly in prime locations, while multifamily building activity continued to be healthy. Home sales were increasing at a faster pace in more desirable locations that have better-rated school districts. Generally, home prices seemed to be stabilizing or experiencing more modest price declines than they have over the past several years.

Manufacturing activity across the region remained healthy. The Southeast Purchasing Managers Index (PMI) produced by Kennesaw State University rose 2.5 points in April from March to an index reading of 63.5. New orders and production components increased and, like the overall PMI, remained robust with index readings of 71.1 and 71.9, respectively.

Several large auto manufacturers announced plans to add to payrolls and increase production. A major industrial equipment producer and two midsized manufacturers announced plans to expand their presence in Georgia. Production and investment in the energy sector remain very strong.

Transportation contacts continued to report volume growth across most segments. Rail reports noted significant volume increases in shipments of automobiles, steel, and forestry products. Domestic coal shipments slowed because of the effects of warmer weather and lower natural gas prices.

Looking ahead

Around this time last year, reports came in similar to what contacts say now—that is, the economy was expanding at a moderate pace and the outlook, although not free from downside risks, was positive. Although we are all wary of a repeat of 2011's summer swoon, most observers do not expect the economy to derail in 2012. The fact that payroll employment gains in our six-state region decelerated in April to a gain of 14,400 jobs—from March's increase of 19,200 and February's 31,300 gain—has not altered the view that the regional economy remains on a moderate growth track. ■

Econ 101: Transmission of Monetary Policy

In its broadest terms, “monetary policy” refers to the actions undertaken by a central bank to promote macroeconomic stability. These actions influence the availability and cost of money and credit. But how does monetary policy get transmitted?

Dave Altig, the Atlanta Fed's research director, has described the transmission of monetary policy by making it analogous to the snapping of a long rope that has many tassels coming off it. These tassels represent the various credit markets in the economy. Normally, when the Fed snaps one end of the rope by raising or lowering the target for the fed funds rate—the benchmark overnight interest rate that banks charge each other to borrow funds—the motion ripples down, reaching rates on longer-term U.S. Treasury securities. Meanwhile, the various tassels on the rope reach private credit markets, where the larger economy is affected. For example, cutting the federal funds rate helps stimulate the

economy because longer-term rates tend to fall when the Fed lowers the short-term rate, and because lower longer-term rates tend to encourage purchases of long-lasting consumer goods, houses, and capital goods.

In ideal circumstances, the snapping of a rope analogy suggests that monetary policy is pretty straightforward. But circumstances are usually far from ideal. For one thing, a lot of forces other than just monetary policy are always influencing credit markets. So when the Fed snaps the rope, it needs to try to account for the fact that the wind may be blowing the rope as well. Moreover, as the recent global financial crisis vividly illustrated, there can be major impediments to the transmission of monetary policy along the rope. In his more



recent discussions of policy effects, Altig has embellished his rope-snapping analogy to include the idea of bricks sitting on the rope, impeding policy's ability to progress as effectively to the tassels at end of the rope (and Main Street) as it normally would. The Fed has undertaken some more recent policy moves, such as maintaining a very low fed funds rate target, as part of a concerted effort to crack the policy-impeding bricks, and in some cases to step over the bricks, to increase the effectiveness of monetary policy. ■

University Studies

The Atlanta Fed's Local Economic Analysis and Research Network (LEARN) consists of economists from universities or economic development centers in the Southeast who provide valuable insight into local economic conditions via information found on their websites throughout the year. Two reports in particular, published in April 2012 by members of the University Research Center of Mississippi Institutions of Higher Learning, indicated that the state is doing much better this year. One of their reports looks at the current state of the economy, and the other is more forward looking. Following are some highlights.

Growth under way in Mississippi

Mississippi's Business examines the state of Mississippi's economy. Written by state economist Darrin Webb, it assesses the state's economy using two indices it produces—the index of leading indicators and the index of coincident indicators. Overall, the report broadly notes that the state's economy has improved this year as both indices showed growth. Much of the improvement can be attributed to the annual employment benchmark revisions made by the U.S. Bureau of Labor Statistics. The revised data helped show that in the last half of 2011 and early 2012, Mississippi's economy was the strongest it had been since early 2010, but they noted

growth is mild by historical standards.

According to the report, the index of leading economic indicators rose for five consecutive months as of February. The February gain of 1.3 percent put the index at the highest level since June 2008. The gain was supported by improvements in seven out of the eight components that make up the index. As for the index of coincident indicators, it reached the highest level since January 2009 in February. The index rose 0.2 percent from a month earlier. This index experienced six consecutive months of increases. The report goes on to say that “the economy appears to be improving but remains below the prerecession peak.”

Another positive reading in Mississippi

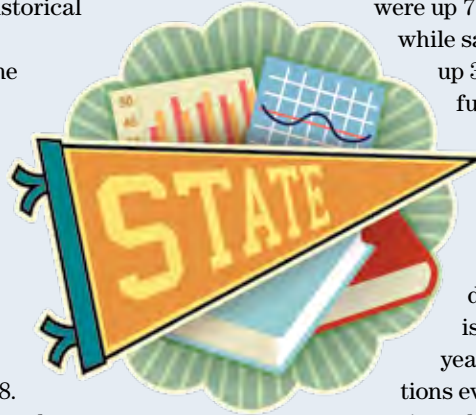
Mississippi Economic Outlook is another publication that surveys the state's economy. The headline for the April 2012 issue was “State Economy Shows Spring in Its Step.” The publication, written by economist Marianne Hill, indicated that state income tax collections through March

were up 7 percent from last year, while sales tax revenues were up 3.3 percent. State general fund revenues for fiscal year 2012 were up 5.6 percent from a year ago and 4.7 percent ahead of estimate.

The report also indicated that the economy is on track to reach fiscal year 2012 revenue projections even with tight budgets projected for the next few years.

Payroll employment grew 0.1 percent in the first two months of 2012 on a year-over-year basis. Gains were greatest in mining and lodging, health care and social assistance, and transportation and utilities. Employment growth should be positive for most industries. In particular, the report mentioned that the manufacturing sector should expand as several major facilities have already begun production. The report also said \$377 million in new investments have been announced since the beginning of the year. Additionally, reconstruction efforts following last year's tornadoes continue to boost activity. Overall, the report forecasts slow but improving growth for 2012.

Based on these reports, 2012 shows some promise of being a better year for Mississippi. ■



Data Corner: Consumer Confidence Surveys

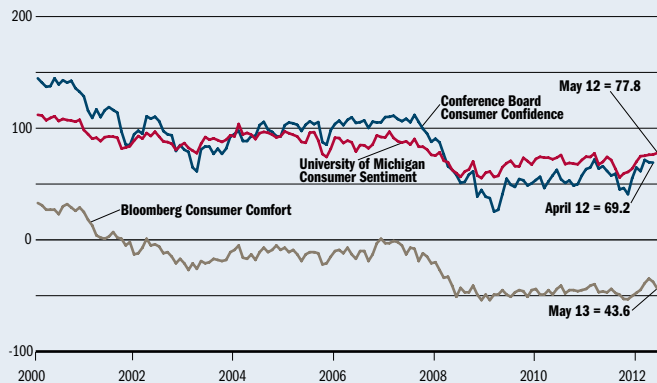
Spending on goods and services accounts for roughly 70 percent of gross domestic product (GDP), making it the single biggest contributor. Theoretically, the way consumers perceive their current and future wealth can significantly affect their spending habits. For this reason, a number of surveys have been established in an attempt to measure consumer attitudes. The three main national indices are the Consumer Confidence Index from the Conference Board, the Consumer Sentiment Index from Reuters and the University of Michigan, and the Consumer Comfort Index from

Bloomberg. Each of the surveys asks slightly different questions and thus can provide different perspectives on consumer attitudes (see the chart). Although consumer confidence measures tend to be volatile, when the indices are smoothed or combined, they can be useful predictors of future consumer behavior.

Overview of national surveys

Both the Consumer Confidence Index and the Consumer Sentiment Index are conducted monthly and have two main sets of

Consumer Confidence Indices



Note: Data are through May 2012. Conference Board data are seasonally adjusted, and 1985 = 100. Reuters/University of Michigan data are not seasonally adjusted, and 1966Q1 = 100.
Sources: The Conference Board, Reuters/University of Michigan

questions. One set of questions focuses on the current state of the economy, and the other set focuses on expectations. The Consumer Comfort Index, however, is conducted weekly and focuses only on the current state of the economy (see the table).

Question variation

The Conference Board's Present Situation Index is based on consumers' perception of local business conditions and local availability of jobs. The Reuters/University of Michigan Current Conditions index is slightly different in that it asks about attitude toward big-ticket purchases and whether personal finances have improved over the past year. Unsurprisingly, these indices do not end up being precisely correlated. The Bloomberg Consumer Comfort Survey is somewhat hybrid in nature, probing consumers about their perception of the current state of the national economy, their personal finances, and the buying climate.

Both the Conference Board and the Reuters/University of Michigan surveys contain future components that contain fairly similar questions. The Conference Board asks respondents to project about six months ahead about business conditions, jobs,

	Conference Board	Reuters/University of Michigan	Bloomberg
Indices produced	Consumer Confidence, Consumer Expectations, and Present Situation	Consumer Sentiment, Consumer Expectations, and Current Conditions	Consumer Comfort
Frequency	Monthly; advance and final estimates published	Monthly; advance and final estimates published	Weekly
Survey size	About 3,500 monthly	500 monthly	1,000 (polls 250 people weekly and gives a four-week moving average of responses)

and income. The Reuters/University of Michigan survey also asks about changes to business conditions and income, but over a longer time horizon. Instead of giving a six-month-ahead window, it asks about expected changes to finances over the next year and expected changes to business conditions over the next year and five years.

In addition to the five core questions used to compute the Consumer Sentiment indices, Reuters/University of Michigan also asks a series of other questions. These questions cover government economic policies, inflation, unemployment, interest rates, gas prices, the housing market, or anything else that could be affecting consumer behavior. These questions are often useful when trying to understand movements in the sentiment indices.

Usefulness of surveys

Many studies have shown that even after including various hard data indicators in forecast models for predicting consumer spending, adding measures of consumer confidence improves accuracy. The Conference Board also uses its measure of consumer expectations as an input to its index of leading economic indicators. ■

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

The energy sector has been a source of strength for the region in terms of exploration, production, and related manufacturing activities. At the same time, high energy prices have had a negative effect on many businesses and consumers. When you talk to your business contacts

and other officials, how are they viewing these developments? How do you see the impact on the economy in terms of growth and inflation?

Tom Cunningham, regional executive at the Atlanta Fed: Since I focus on Georgia,

there aren't a lot of people saying positive things about higher energy prices. I would assume our colleagues in New Orleans have a different on-the-ground experience, but here, there is little joy.

First, consumers get hit. Lower-income households face some very difficult

direct budget constraint issues. Higher-income households still face a change in spending that may immediately come out of potential savings but will ultimately re-direct spending dollars away from things they otherwise would have purchased. In both cases, the forced redirection of spending isn't good for the economy and is usually bad for the households.

Second, business gets hit. Whether explicitly or implicitly, businesses have some plan for spending over some future horizon. When energy prices rise unexpectedly, those spending plans get disrupted. As in the case of consumers, the pain of the change in plan will vary by business, but in all cases it is disruptive.

The importance in both cases is the disruption to economic activity. It might be that energy prices are bouncing around a more or less stable long-term level, in which case price level effects may wash out over time. But the disruption to real activity won't. This is a recurrent theme in my discussions.

Finally, there is a serious gap in the impact between urban and rural economies. On the household side, there are not the transportation alternatives in a rural area that there are in a city. For getting to work and for the everyday business of life, mass transit, carpooling, or other alternatives—walking!—simply aren't feasible in rural areas, so they have much less flexibility in adapting to changing fuel prices.

On the business side, it may not matter much if the firm is selling into a market that is larger than the immediate area—both urban and rural firms are going to have to pay the higher fuel costs. But firms that are selling into just the rural market are going to find higher shipping costs for their goods than their urban counterparts. Moreover, they are also going to be facing the customers described above that don't have the alternatives that urban residents have and consequently may have more of their spending diverted to the higher fuel costs. Rural small business then gets squeezed from both ends, much

more than those same types of business located in a larger city.

Lesley McClure, regional executive at the Birmingham Branch of the Atlanta Fed:

I've heard very few stories from business leaders that suggest they are modifying their processes or business plans as a result of higher energy prices. Of course, there are expectations that higher fuel costs will translate into higher prices for many products, especially produce trucked in from Florida, but overall businesses seemed resigned to deal with the continued stress on their margins. I am hearing a bit more about plans to pass along price increases across a broad range of products and services, and all companies acknowledge the challenge of finding the right balance for prices given the strains on the consumer. Several leaders have talked about the continued pressure on low-income families that results from higher prices at the pump. And although Alabama's unemployment rate continues to decline, the number of people who have exited the labor force remains a concern.

Chris Oakley, regional executive at the Jacksonville Branch: During the most recent cycle of discussions, central and north Florida REIN [Regional Economic Information Network] participants certainly had the cost of fuel and its impact on the consumer at top of mind. As a matter of fact, for most, fuel-cost volatility had moved into the top position in terms of worries, displacing concerns about the situation in Europe. Even so, most contacts indicated that the threshold for a significant shift in consumer behavior had likely shifted to a number north of \$4 a gallon, citing a "been there, done that" mentality among most consumers. Of course, for those with low and moderate incomes, any move upward requires offsetting reductions in other spending. The more recent easing of prices has resulted in a collective sigh of relief among those with whom I've talked recently.

From a business perspective, REIN participants indicated some level of success with passing on fuel cost increases to their customers, primarily through the

use of surcharges. Typically, businesses are not able to recoup rapid increases but work to make up shortages on the back end as prices ease. Interestingly, some transportation contacts indicated that price volatility is forcing at least the consideration of alternatives, like compressed natural gas. There is a movement afoot to create fueling stations that could accommodate vehicles built or retrofitted to run on such fuels. Creating this type of lower-cost option may be a silver lining to volatile fuel-price clouds.

Juan del Busto, regional executive at the Miami Branch: Fuel costs continue to be a concern for most of our contacts. The exception seems to be the automotive industry, where sales continue to be brisk. Better-performing and more fuel-efficient vehicles have helped push back the shock factor of \$4 per gallon fuel. In fact, some industry experts have said that they see \$5 per gallon as the new threshold for extreme concern.

In the travel and tourism sector, business continues to be good for hotels, conventions, etc. However, contacts are very concerned about the potential impact on business if fuel prices continue to rise, particularly for summer vacation traffic. One airport contact tells us that fuel is now 35 percent of airline costs and continued escalation will result in an adverse impact on not only their business but also their suppliers, etc.

Cruise contacts report that the higher fuel costs have resulted in scaling back their normal level of capital expenditure investments—for example, in new ships. As a result of higher fuel costs, both their profits and distributions to their shareholders have suffered. Their outlook is one of cautious optimism for very modest growth in 2012–13.

Restaurant operators have had to pay more for their food as a result of higher fuel shipping charges. They've seen their margins shrink where they cannot competitively pass on the costs to the customer.

In summary, higher fuel costs have had an impact on many sectors. While

some are doing better than others and some are doing fairly well, it continues to be a concern everyone is watching closely. **Lee Jones, regional executive at the Nashville Branch:** Nashville directors and REIN contacts reported hearing little to no major adjustments in the spending patterns of consumers tied to rising fuel costs. However, it is a concern on the minds of many. Sticker shock at the cost of a fill-up at the gas pump is prevalent, but reports of altering business practices are minimal, with the exception of those who drive a lot between business locations. Often, they are choosing to move their schedules around to minimize back-and-forth driving. Several directors noted that lower-income workers, particularly those living in rural areas with long commutes to the job, are disproportionately impacted negatively by rising fuel prices.

Several REIN contacts, along with branch director Bill Krueger, vice chairman of Nissan Americas, observed that

rising fuel costs have created a demand for more fuel-efficient vehicles and have shifted the mix away from big trucks toward smaller cars. Because this is the third run-up in fuel prices in recent years, many observed that consumers and businesses are not panicking and are counting on prices to recede again soon. Businesses with a shipping component are passing on fuel surcharges to the customer or are focusing on reducing fuel consumption and costs through shipment consolidations.

Anecdotes from our contacts included observations that some companies—such as a local delivery service—were using GPS technology to map out routes more efficiently and minimize left-hand turns. A Knoxville director heard reports of grade schools modifying pickup-line policies around “no idling.” A carpet cleaning vendor indicated that if gasoline reached \$5 per gallon, he will become more diligent in scheduling numerous appointments in one area of town and

enforcing his minimum ticket price per customer.

Robert Musso, regional executive at the New Orleans Branch: High energy prices have not had much impact on companies and the way they conduct their business. While many companies acknowledge it has an impact on the consumer, the companies also admit it has not had a negative effect on consumption of their products and services.

The price of energy is viewed as a temporary bump and, depending on the type of business, it may not be passed on to the consumer or is done so temporarily through a fuel adjustment surcharge, where it can be readily and easily withdrawn as prices go down. Increases in the cost of energy must be sustained over longer periods than those we have recently experienced to permanently have an impact on production costs and pricing. ■

Grassroots continued from page 5

The coastal casinos are a bulwark of the Biloxi-Gulfport economy. The metro area represents the nation's third-largest casino market, behind only Las Vegas and Atlantic City.



8.8 percent and the United States' 8.1 percent rate. The population is down only about 4 percent from its pre-Katrina total, compared with the roughly 9 percent reduction in the New Orleans metro area. Combined revenue from the coastal casinos has fallen from its 2007 peak of \$1.3 billion. But it has been remarkably stable at \$1.1 billion in each of the past three years, according to the Mississippi

Department of Revenue. “The gaming industry on the Mississippi Gulf Coast has proven to be very resilient,” King said.

Even better, a spate of recent investments—some private, some public—is raising hopes. The Port of Gulfport is undergoing a \$500 million expansion funded by federal money for Katrina recovery. On the casino front, Landry's Inc. announced in March that it plans to buy the Isle of

Capri Casino Hotel in Biloxi, rebrand it as the Golden Nugget, and invest \$150 million to add restaurants, amenities, and upgraded hotel rooms. Also, Jimmy Buffett's Margaritaville Casino & Restaurant-Biloxi opened just before Memorial Day. The \$60 million project employs about 1,000 people. Margaritaville's opening marks the first time since Katrina that the coast had 12 casinos.

Add in a recently opened art museum as well as technology and marine science attractions, and the Biloxi-Gulfport area hopes to attract a diverse group of visitors.

“If you can look out beyond a one- or two-year myopic view of where we are on the coast,” Dennis said, “the horizon is extremely bright.” ■

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