

Regional Update: Regional Economy Continues to Recover

Southeastern business contacts described economic activity as advancing modestly in the first quarter of the year. A majority of business contacts maintain a positive outlook regarding future economic activity. Contacts continued to express concern over the impact of higher energy costs on consumer confidence and spending.

Businesses express cautious optimism

Most regional merchants reported that retail activity improved in the first quarter. Sales tax data also reflect positive growth in consumer activity—sales tax revenues are up 6 percent year over year for the combined states of the region. The outlook among retail contacts in the Southeast remains optimistic. However, the rising cost of gasoline and its potential effect on consumer confidence and spending were a source of concern. Automobile dealers described robust sales growth and a strong demand outlook. A few contacts noted that an improvement in consumers' access to credit contributed to the increase in sales.

The region is also benefiting from renewed business and leisure travel. Hotel occupancy rates rose on a year-over-year basis in several of the Southeast's major markets, and convention bookings were also improving. Restaurant contact reports were mixed, and many cited concerns over the rising costs of food products. Airline carriers indicated an increase in both business and leisure travel. Overall, the outlook for tourism remained upbeat.

Real estate remains mired

Unfortunately, there are few signs that residential real estate markets are recovering. Reports from regional homebuilders on new home sales in the first quarter were mixed. Florida and Georgia builders stated that sales were below year-ago levels, while elsewhere in the region sales were similar to year-earlier levels. Homebuilders noted that construction activity remained below last year's level, and inventories eased further. Several residential construction contacts remarked that securing financing remained very difficult.

Southeastern residential brokers indicated that existing home sales growth softened somewhat in the first quarter and were generally similar to year-ago levels. However, Florida brokers were more upbeat, with the majority noting sales gains on a year-over-year basis, which were largely driven by sales of distressed homes. Brokers elsewhere in the region remarked that sales remained below year-earlier levels and were slightly weaker than in our last report. Brokers in the

region stated that home inventories eased on a year-over-year basis and that the number and speed of foreclosures coming into the market had slowed. Several contacts mentioned greater demand for rental property. The outlook for sales growth continued to improve, largely driven by positive reports from Florida brokers.

Nonresidential construction activity remained at low levels. However, the majority of contractors indicated that the pace of commercial development was flat to slightly up compared with a year earlier, which is an improvement from previous reports. Backlogs declined on a year-over-year basis. Contacts noted that material prices were on the rise while competition for available projects remained aggressive. Most contractors anticipate activity to remain flat to slightly below last year's level.

Commercial brokers in the Southeast reported that markets continued to stabilize. Vacancy rates remained relatively unchanged from the end of last year, and declining rents were noticed across much of the region. Commercial brokers anticipate a slow recovery.

Manufacturing makes strides

Manufacturers in the region noted strong growth in new orders and production in the first quarter. They also signaled stable or higher levels of employment and indicated that they will be increasing production in the short term. The Southeast Purchasing Managers Index was 64.4 in March, down 0.4 points from February, the first decrease in the index in six months. This index is compiled by the Econometric Center at Kennesaw State University. The decrease is tied to some deceleration in new orders and production, but remains well above 50, which indicates expansion in this sector.

Transportation contacts noted that shipments and tonnage continued to experience modest increases since the last report. Most firms also cited that they have not yet experienced major disruptions in the supply chain from the Japan disaster, but several are anticipating some temporary interruptions—most notably in the auto and information technology sectors.

Jobs market slowly gathers strength

Labor markets continued to recover gradually across the region. Business contacts indicated that their hiring plans for the year are to leave employment levels unchanged or increase them slightly. Many firms noted that they have no problem finding workers with the necessary skills. However, isolated but increasing reports indicated difficulty in finding qualified candidates to fill specialized, higher-skilled positions.



On a month-over-month basis, the Southeast added 22,400 jobs in March 2011. Florida had one of the largest month-over-month gains in the nation and one-third of the state's gains were in the leisure and hospitality sector. Overall, the Southeast's unemployment rate declined to 10.2 percent in March, down 0.2 percentage points from February. Louisiana remains the only state in the region with an unemployment rate (8.1 percent) below the national rate. Total gains in employment were 45,000 for the first quarter for southeastern states, an increase that follows a net gain of 41,000 in the fourth quarter of last year.

Pricing plans face a cloudy future

We continued to reach out to our contacts regarding their pricing plans. Overall, firms' expectations for unit cost increases over the next year continued to rise, with material costs and employee salaries and benefits cited as sources of potential cost pressures. However, reports of price pass-through continued to be mixed across the Southeast and varied based on industry and the presence of competitive pressures. For example, many retailers noted that strong competition was limiting their ability to raise prices. Homebuilders said that they have been unable to pass through material cost increases because of persistent downward pressure on home prices. However, many manufacturers were more successful in increasing prices to their customers.

Energy production, agriculture pick up

April marked the first anniversary of the Gulf oil spill. Though the number of rigs operating in the Gulf of Mexico is still only about half what it was before the oil spill, deepwater drilling permits began to be issued in late February for the first time since last April. Despite a slower pace of permit issuance, overall regional energy production remains healthy. Regional crude oil inventories continued to rise in the first quarter as the industry started to build stocks in anticipation of the summer driving season. Industry contacts noted that the recent international events, including Japan's nuclear crisis and the unrest in the Middle East, have added uncertainty to their outlooks for investment and hiring.

On the important agriculture front, rainfall totals in many areas have improved, though some parts of the region continued to experience varying levels of drought. Farm contacts noted that prices of fuel and feed continued to put pressure on margins, but prices for many of the Southeast's foremost agriculture products remained strong, particularly cotton, soybeans, and beef. Reports indicated that continued strong global demand has contributed to elevated prices for regional agricultural products. ■

Data Corner: Purchasing Manager Indexes

Faced with a collapsing economy during the Great Depression, President Hoover was frustrated with the lack of current data on the economic health of American manufacturers. He approached the National Association of Purchasing Agents (the present-day Institute for Supply Management) about conducting a regular survey at frequent intervals to gauge the well-being of domestic manufacturers. Today, this survey still exists, with its principal output being the Purchasing Managers Index (PMI), a widely known indicator used to gauge the current health of the U.S. manufacturing sector.

Each month, the Institute of Supply Management (ISM) sends a survey to 400 member companies within the United States representing 20 different industries. Managers who engage in production-related purchasing for their organizations are asked to comment on a few factors

for the current month compared with the activity of the past month. The PMI is then calculated from five survey questions that measure the participants' perspectives on new orders, production, employment, supplier deliveries, and inventories. Respondents may answer that the month's activity for each component rose, fell, or didn't change compared with the previous month. Thus, the PMI measures changes and trends in these indicators rather than the actual levels of new orders or production.

Because the manufacturing sector is so critical to the rest of the supply chain and has implications for a variety of other sectors, the ISM uses the PMI to draw inferences about not only the manufacturing sector but also the U.S. economy as a whole. As one would suspect given this link, the PMI is heavily linked to the business cycle. Indeed, the PMI was a

heavily watched indicator throughout the recent recession and was one of the first signifiers of recovery.

As the PMI is a diffusion measure, a common scale is used to put the results into perspective. If the PMI is above 50, both the manufacturing sector and the U.S. economy are expanding. If it's between 50 and 43, manufacturing activity is contracting, and the overall economy might not be growing. If the index is below 43 on a sustained basis, the manufacturing sector and the U.S. economy are likely to be in a recession. ■

On the Ground: An Interview with Lesley McClure, Regional Executive at the Birmingham Branch of the Atlanta Fed



What do you see as your top priority in taking over the Birmingham regional executive position?

My predecessor, Julius Weyman, worked hard to build a strong network of business contacts, which provides us with timely and relevant information that informs our policy deliberations. My top priority will be to continue developing this network with an eye toward refining our list of target contacts to give us the desired mix of geographic and industry representation. Another priority is to think about ways to improve our emerging processes, such as organizing the information we receive in a more efficient way for our analysts and economists.

What are your initial thoughts with regard to Alabama's overall economic performance?

Alabama's economic performance is lagging a bit compared to the nation as a whole. Manufacturing is showing some modest improvement, and it is an important element of our economy here. We will stay attuned to changes, especially any meaningful increase in employment since our state is underperforming the rest of the country in this regard.

How do you envision your role as regional executive over the course of the coming year?

Initially, I will be working to meet personally with members of our network and to familiarize myself with the many business, academic, and government organizations in the state that

contribute to the vitality of Alabama's economy. I'm also looking forward to getting more involved in the community, with a particular interest in groups that advance financial education initiatives.

What are some of the information-gathering efforts you intend to use in your region?

We have a number of surveys we use to gather information, but my primary focus will be tapping the wealth of knowledge possessed by our network. I am also starting to think about organizations and groups whose forums and events are good sources for information sharing. I look forward to speaking with these groups and building bridges that will be beneficial not only to the Fed's development of monetary policy but also for the business leaders in the region. ■

University Studies

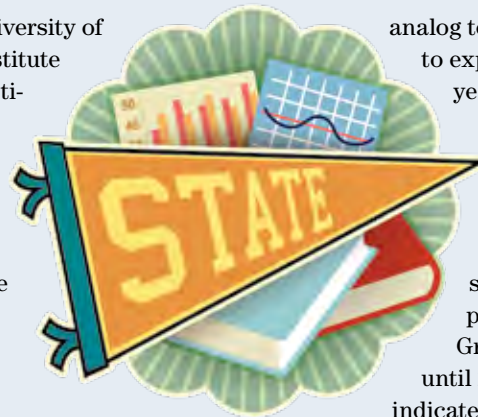
Overall growth of the nation's economy for most of 2010 was tepid, with gross domestic product (GDP) averaging 2.7 percent for the first three quarters of the year. However, in the fourth quarter, GDP increased to 3.1 percent, indicating that the recovery might be picking up steam. As 2011 got under way, commodity prices began to increase, consumer sentiment softened, and GDP for the first quarter increased but at a very slow pace. Many of our Local Economic Analysis and Research Network (LEARN) members found that the same story held true for their respective states and released updates to their outlooks. Here are a few key findings from their state forecasts.

Florida looks to steady growth

Payroll job growth in the Sunshine State is expected to average 0.4 percent in 2011, and unemployment will not fall below 10 percent until the fourth quarter of 2012,

according to the University of Central Florida's Institute of Economic Competitiveness April forecast. The sectors that will experience the strongest growth during the period of 2011-14 are professional and business services (4.8 percent); trade, transportation, and utilities (3.8 percent); manufacturing (2.3 percent); and leisure and hospitality (2 percent).

Researchers at the institute reported that real estate construction had bottomed out in 2009 and new residential starts were expected to grow at a very slow pace. Total starts will grow at an annual rate of 56,800 for the year. Florida's real gross state product, the state-level



analog to GDP, is expected to expand 2.4 percent this year, while real personal income will average 3.3 percent from 2011 to 2014. The state's population will continue to grow slowly but is not expected to return to pre-Great Recession levels until 2014. The Institute also indicated that retail sales will accelerate in 2011.

Alabama anticipates modest improvement

The University of Alabama's Center for Business and Economic Research recently released its second quarter 2011 economic outlook. The report described Alabama's economy as modestly improving. The forecast showed Alabama's

GDP growing to about 3 percent in 2011, primarily because of higher commodity, food, and oil prices, as well as the temporary effects of Japan's natural and nuclear disasters. Supply chain issues from Japan have had an impact on the state's automotive manufacturers, resulting in production cuts at both the Honda plant in Lincoln and the Toyota plant in Huntsville.

The center anticipates payroll employment to increase gradually by 0.8

percent during 2011 and the unemployment rate to remain high as people enter the labor force for the first time or reenter it. The report indicated that the major sources of job growth for Alabama will be from large manufacturing firms, particularly in the transportation equipment sector and the state's service-providing employers. Alabama's tax revenues are expected to increase 2 percent this fiscal year. According to the outlook, Alabama's economy will gain momentum from

segments such as transportation equipment manufacturing (specifically in the automotive and shipbuilding industries), the state's steel manufacturing industry, and health care services. Finally, the challenges facing the state's funding for services and public education will persist as the effects of the federal fiscal stimulus continue to fade and the pace of payroll growth remains modest. ■

Econ 101: Household Formation

Households are such a part of our day-to-day lives that we often take for granted their configuration and relative importance in the economy. As defined by the U.S. Census Bureau, a household consists of a group of individuals who occupy a housing unit such as an apartment or house. Households can include related or unrelated members, hence the census's two major categories of households: family and nonfamily.

A household can form in two main ways: individuals living with parents who move out to form their own household (either as independent renters or homeowners), or spouses or other unrelated individuals who decide to move out and live independently.

So why is household formation important? Household formation and intrahousehold dynamics have social and psychological importance. From an economic standpoint, they have implications for factors such as consumption, savings, human capital development, and production. Conversely, economic

considerations and conditions will in turn effect the construction or destruction of households. (For example, a higher rate of household formation would help absorb the current excess supply of homes.)

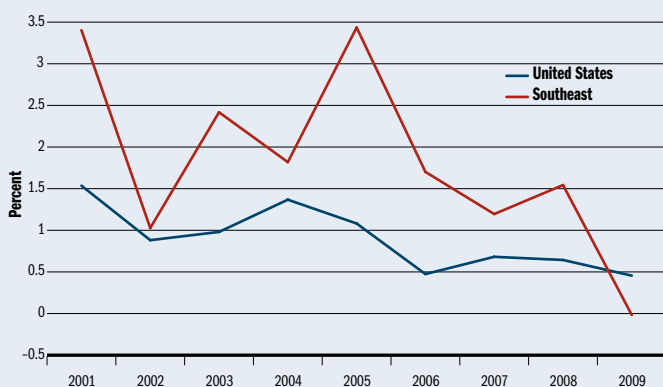
The United States has experienced some noteworthy economic trends in household formation. Among these trends:

- From 2008 to 2010, **the number of one-person households has declined dramatically**, and the number of households with seven or more people has risen, according to Census Bureau data. People moving in together is likely a response to the economic downturn, as a weak economy with high unemployment can reduce household formation.
- The composition of the population and how it partitions into households can affect the **resulting resource-allocation decisions** of households (how it spends money, for example).
- In 2010, year-to-year household formation in the United States **dropped to its lowest level** since 1947 (when such data were first compiled). Between 2009 and 2010, roughly 360,000 new households were formed. In 2007, this figure was 1.6 million.

The Southeast has also seen some notable shifts in household formation trends. The **decline in the rate of household formation** is more pronounced in the Southeast compared with the rest of the nation. Essentially, no new households were formed in the region between 2008 and 2009 (see the chart). ■



Annual Change in Household Formation



Source: U.S. Census Bureau, American Community Survey