

Regional Update: Halfway Through 2014, Activity Moderate

Business activity in the Southeast moderately improved in the second quarter of the year. Many contacts attributed the growth to a strengthening economy rather than simply a rebound from a weak first quarter.

Contacts reported the consumer environment was improving gradually across most of the region, particularly in major metropolitan areas. The auto industry reported robust sales growth. The hospitality sector was overall enthusiastic regarding activity, and the number of visitors—especially international travelers from Latin America and Europe—to New Orleans, Atlanta, and most parts of Florida increased.

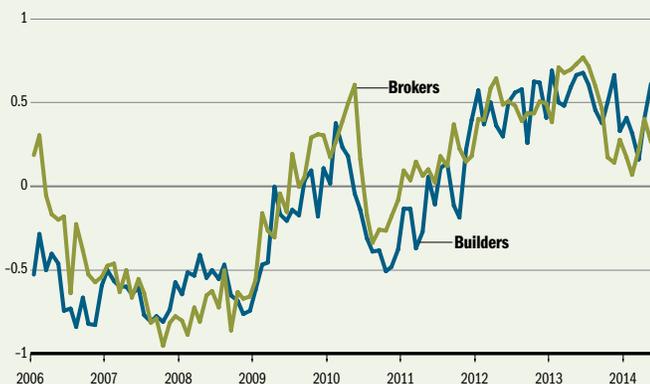
Banking contacts indicated that loan demand continued to improve, with some growth coming from increased credit line usage and corporate borrowing as businesses took advantage of low interest rates. These contacts also indicated that competition, particularly related to pricing and structure, was strong.

Energy activity in the Southeast continued to expand as new discoveries, production, and oil field development increased across the Gulf Coast, where refineries continued to run at near-record levels, as they have for much of 2014. Crude oil production, in particular, was especially solid, leading to record-high inventories for the region.

Real estate improves its foothold

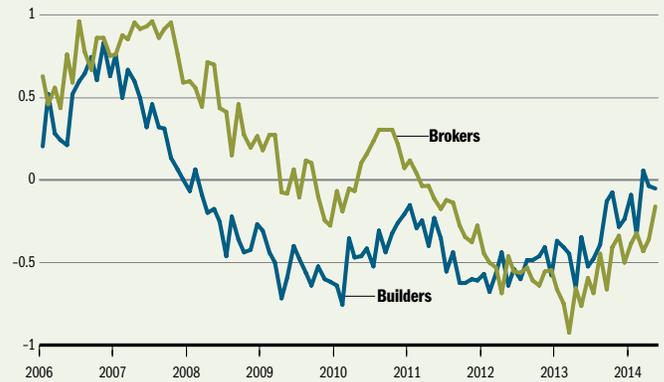
Residential real estate contacts reported that activity continued to be positive in May. However, the pace of growth has slowed in recent months. Results from the Atlanta Fed's monthly survey of residential brokers and homebuilders indicated a slight decrease in the number of brokers who reported home sales had increased from a year earlier. The majority of builders reported that new homes sales were ahead of a year ago (see chart 1). The survey

Chart 1
Southeast Home Sales versus a Year Earlier



Note: Data are through May 2014.
Source: Atlanta Fed business contact poll

Chart 2
Southeast Home Inventory versus a Year Earlier



Note: Data are through May 2014.
Source: Atlanta Fed business contact poll

Chart 3
Home Prices versus a Year Ago



Note: Data are through May 2014.
Source: Atlanta Fed business contact poll

also revealed that fewer brokers and more builders noted that inventory levels were down from a year earlier (see chart 2). Most brokers and builders continued to report that home prices appreciated slightly compared with year-ago levels (see chart 3). The number of builders who reported an increase in construction activity decreased slightly (see chart 4).

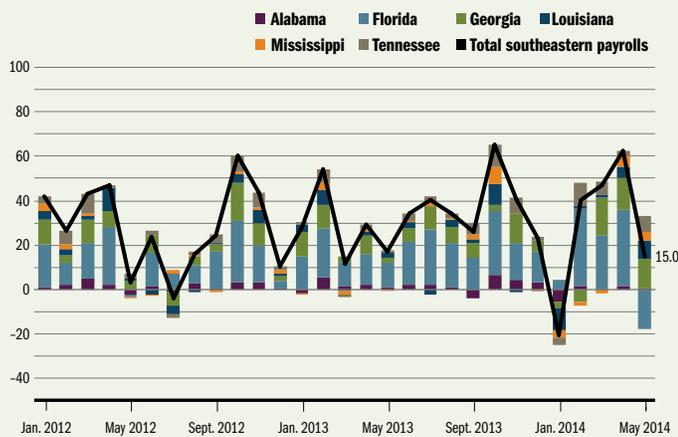
On the commercial real estate front, demand for commercial real estate continued to improve. Absorption remained positive, though contacts indicated that the rate of improvement varied by metropolitan area, submarket, and property type. Construction activity continued to increase at a modest pace from last year. Most

Chart 4
Southeast Construction Activity



Note: Data are through May 2014.
Source: Atlanta Fed business contact poll

Chart 5
Contributions to Changes in Net Payrolls in the Southeast



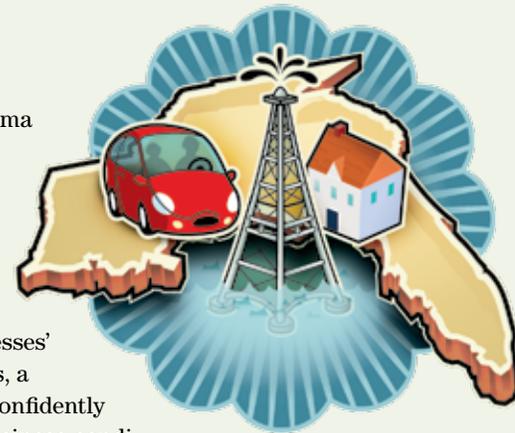
Note: Data depict changes in thousands of seasonally adjusted net payrolls.
Source: U.S. Bureau of Labor Statistics

contacts reported that their current backlog was ahead of year-earlier levels. Contacts indicated that apartment construction remained fairly strong and reported that the level of construction activity across other property types remained steady.

Manufacturing makes strides

Automotive contacts noted that manufacturers and their suppliers were operating at or near full capacity or will be in the near future. According to the Southeast Purchasing Managers Index (PMI), a gauge of regional manufacturing conditions, overall manufacturing activity continued to expand (see the PMI update on page 15). Of the southeast-

ern states, Alabama and Florida had index readings higher than the region's—at 62.9 and 65.5, respectively.



Large businesses' visibility—that is, a firm's ability to confidently predict future business conditions—improved in the short term. The improvement was enough to initiate capital projects for some of these contacts. We heard reports of capital investment plans from a variety of sectors, such as steel and chemical manufacturing, transportation, health care, construction, and some retail. Cash and nontraditional financing continued to play a major role in capital investment funding. However, the story was different for small businesses, where uncertainty continued to weigh heavily on business decisions and appetite for risk.

Transportation contacts continued to cite expanding activity in the second quarter. Railroads saw considerable increases in the movement of petroleum products and heavy equipment as well as continued expansion in intermodal traffic (see the related feature article on page 6). Trucking companies reported robust freight volumes.

Employment and hiring show some muscle

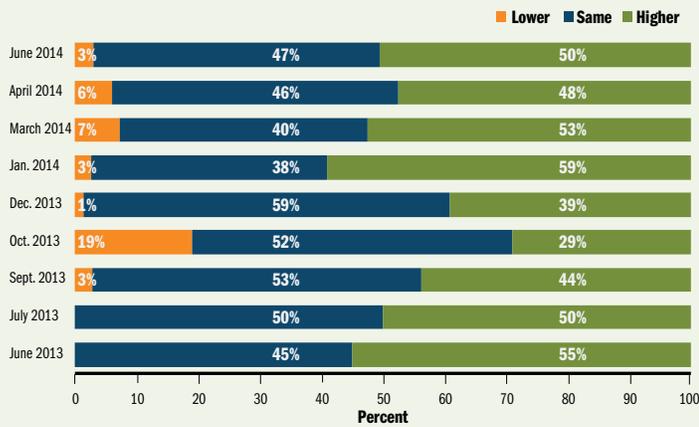
On balance, firms reported modest improvements in hiring, though most remain cautious in their approach. Recent data confirm this growth. In May, the region added 15,000 net jobs, following a net increase of 62,400 in April. Florida, which had been responsible for adding the largest number of payrolls in the region for the past several months, subtracted 17,900 payrolls, on net. The remaining states made job gains in May (see chart 5).

Contacts continued to express difficulty filling certain skilled positions, specifically in the fields of information technology, construction, and trucking.

Costs, prices inch up

Firms noted price increases in construction materials, commercial leasing, auto lending, hotel rooms, food, and trucking services. In a notable change from previous cycles, a growing number of contacts indicated their firm was able to implement price increases. However, many contacts said that passing along these increases was a

Chart 6
Firms' Outlook for Growth for the Next Three to Six Months



Note: Respondents were asked the question "What is your outlook for the rate of growth in your business over the next three to six months compared to current rates?" Percentages may not add to 100 due to rounding.
Source: Atlanta Fed directors poll

challenge that required a great deal of negotiating with customers, and those contemplating doing so were concerned about their customers' willingness to accept the new prices.

The Atlanta Fed's business inflation expectations (BIE) survey indicated that firms' unit costs were up 1.9 percent compared with this time last year and, on average, they expect unit costs to rise 2.0 percent during the next 12 months, up slightly from May's reading (see the BIE update on page 16).

Wage growth was largely constant, with most contacts still reporting increases in the 2 to 3 percent range, except in some high-skill fields with a relatively low supply of candidates. Construction contacts across the region noted significant wage pressures.

On the Ground: An Interview with Karen Gilmore, Regional Executive at the Atlanta Fed's Miami Branch



EconSouth: *You've been on the job as the Atlanta Fed's Miami Branch regional executive since January. Tell us a little about your job. What impressions have you*

formed about the economy in South Florida?

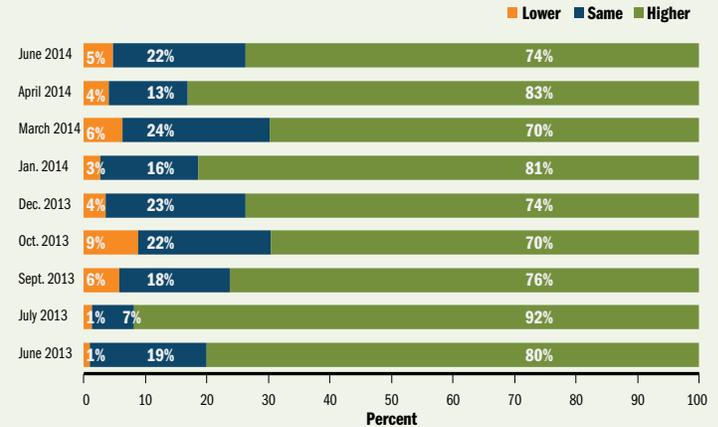
Karen Gilmore: I represent the Atlanta Fed to the South Florida community with the primary goal to enhance the Bank's reputation. At the same time, I want to have the business community participate

and feel a part of the monetary policy process.

I have had the opportunity to meet with several top executives in a number of the larger companies within the South Florida region. I have also spent time with community bankers, developing a stronger relationship between them and the Federal Reserve. These bankers come into contact with many midsize to small companies, so they are a wealth of information as to what is happening.

I have traveled throughout the region meeting folks in different kinds of

Chart 7
Firms' Outlook for Growth for the Next Two to Three Years



Note: Respondents were asked the question "What is your outlook for the rate of growth in your business over the next two to three years compared to current rates?" Percentages may not add to 100 due to rounding.
Source: Atlanta Fed directors poll

Business outlook largely standing firm

The outlook among the Atlanta Fed's board of directors improved slightly this quarter. Just under half of the directors anticipate the same rate of growth in their business, and the other half expect even higher growth over the next three to six months (see chart 6). Directors also expressed continued optimism over the medium term (see chart 7).

All in all, our contacts were upbeat about a strengthening economy and shared information that points to progress. Most notably, some of them increased capital investment as their outlook brightened, and some felt better positioned to raise prices. ■

venues, such as convening key business leaders for a roundtable discussion in Naples, participating in an economic council in Fort Lauderdale, and meeting with key executives in companies as far north as Vero Beach. We have a number of very large companies hidden in some of our smaller communities. I have also done a few presentations highlighting the Federal Reserve's current policy positions and provided a general economic overview. I will say there is a lot of meeting and greeting, and someone always has something to share with you!

ES: *In your information-gathering and outreach activities, what have you found to be most surprising or unexpected?*

Gilmore: I have received a very open and warm welcome from the business community in taking on this role. The community bankers within the region in particular seem to be very pleased to have a former banker in the position. I have been most impressed with how well the Federal Reserve is perceived by business. The Bank is looked at as having a great deal of credibility and integrity. As a banker for so many years, I guess I just never dwelled on it until I actually began representing the Fed. I am impressed with how many Fed watchers are out there. The business community has been very open and willing

to share experiences and thoughts. I have found that executives and other business leaders really appreciate being asked to participate in the process.

ES: *Looking ahead, what are some of the challenges the South Florida economy faces?*

Gilmore: Miami has such an interesting business environment and culture. The city has a tremendous amount of foreign capital and wealth coming in every year. The region as a whole seems to be enjoying good business activity and a high level of optimism about the economy. Business leaders throughout the region talk about the growing wealth and are expressing concerns about wealth disparity and the cost factor to live in South Florida. This is-

sue just adds concerns for employers about their ability to attract employees to live and work here. The large urban areas are also challenged with infrastructure issues, particularly in transportation.

ES: *What questions are you most often asked when traveling throughout your region?*

Gilmore: I smile when I think of the most common question I am asked: "How's my money doing?" Generally it is asked in jest, but I think it symbolizes that people truly believe in the Federal Reserve Bank and that they feel a high level of comfort and safety that their money is safe and that the system functions. There is enormous confidence in the central bank. ■

Regional PMI: A Look at Regional Manufacturing

Manufacturing activity in the Southeast gained momentum in the first quarter of 2014 and continued to expand into the second quarter, according to the Southeast Purchasing Managers Index (PMI). After a modest start to the year, which was partly the result of severe winter weather, the PMI picked up steam in February and has averaged a solid overall reading of 60.1 during the last four months (see the chart). A reading on the index above 50 represents an expansion in the manufacturing sector, and a reading below 50 indicates a contraction.

The Atlanta Fed's research department uses the PMI to track manufacturing activity in the Southeast. The PMI is produced by the Econometric Center at Kennesaw State University and provides an analysis of market conditions for the manufacturing sector in Alabama, Georgia, Florida, Louisiana, Mississippi, and Tennessee. The index is based on a survey of purchasing managers from manufacturing firms in the Southeast states regarding activity in new orders, production, employment, supplier delivery time, and finished goods inventories.

The overall PMI ticked down in May to 59.8, following an overall reading of 63.2 in April and 61.5 in March, yet remained in expansionary territory for the fifth consecutive month. The new orders and production components of the PMI have been especially strong during the past three months. The employment component has also contributed to the strong PMI, indicating that hiring at manufacturing firms has been increasing. At the state level, manufacturing activity in all southeastern states was in expansionary territory in May except for Mississippi, which fell slightly below the 50 threshold, to 49.9.

Southeast Purchasing Managers Index



Note: A reading above 50 indicates expansion. A reading below 50 indicates contraction. Data are through May 2014.
Source: Kennesaw State University Econometric Center

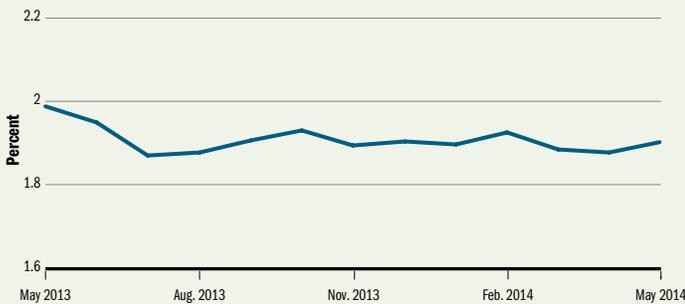
Purchasing managers who participate in the Southeast PMI are also asked about their outlook for production over the next three to six months. In May, 41 percent of survey respondents indicated they expect production to be higher in the coming months. The April and May responses to the survey question were more subdued compared with earlier in the year. The survey question is not a component of the overall PMI. It does, however, gauge optimism among purchasing managers. ■

Business Inflation Expectations Update

In the second quarter of 2014, firms' year-ahead inflation expectations had moved little from their long-term range of 1.8 to 2.0 percent for the last several months (see chart 1). Most recently, long-term inflation expectations (per year, during the next five to 10 years) decreased slightly in April to 2.7 percent, reflecting a slight downward shift from the first half of 2013 (see chart 2). The three-month moving average of the firms' sales levels measure has shown a steady upward trend since November 2013, and profit margins appeared relatively flat during the same period (see chart 3). The recent trend in year-over-year unit costs also showed little movement, remaining around 1.7 percent (see chart 4).

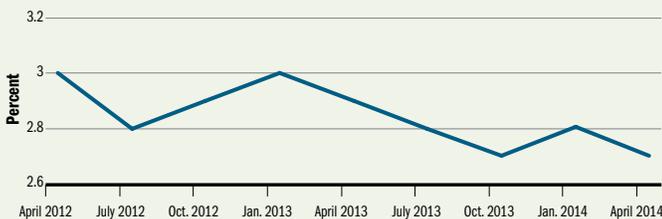
From the September 2013 to March 2014 reading, firms' average percentage below normal unit sales levels (the "sales gap") decreased for midsize firms (those with 100–499 employees). Large firms (500 or more employees) and small firms (fewer than 100 employees) reported increases in their sales gap during the same period. Midsize firms' sales gap shrank from 6.6 percent in September to 5.6 percent in March, and small and large firms' sales gaps increased 1.7 percentage points and 0.5 percentage point, respectively, in the same period (see chart 5). ■

Chart 1
Year-Ahead Inflation Expectations



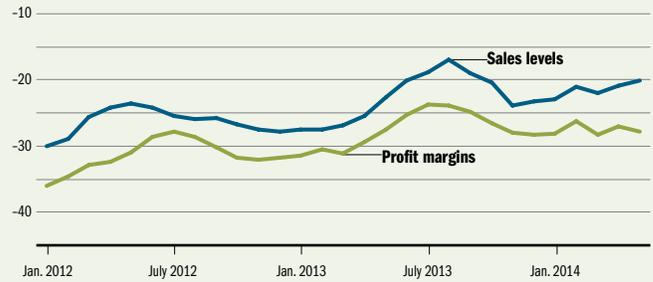
Note: Data indicate a three-month moving average.
Source: Atlanta Fed Business Inflation Expectations (BIE) survey

Chart 2
Long-Term Inflation Expectations



Note: Data indicate expectations per year during the next five to 10 years.
Source: Atlanta Fed Business Inflation Expectations (BIE) survey

Chart 3
Sales Levels and Profit Margins



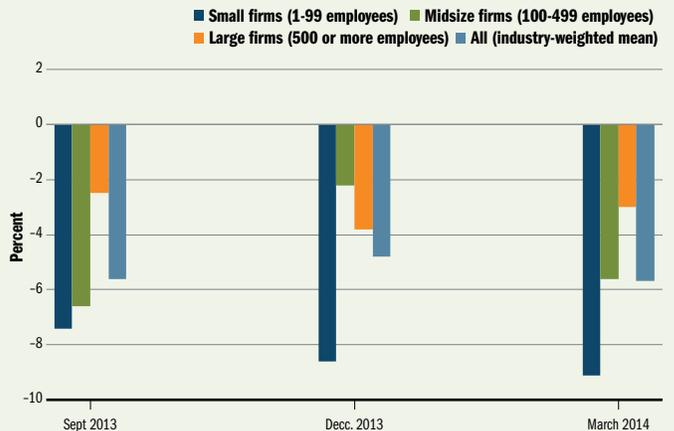
Note: A reading in the diffusion index greater than zero indicates better-than-normal activity. Data depict a three-month moving average compared with a normal level of activity.
Source: Atlanta Fed Business Inflation Expectations (BIE) survey

Chart 4
Year-over-Year Unit Costs



Note: Data depict a three-month moving average.
Source: Atlanta Fed Business Inflation Expectations (BIE) survey

Chart 5
Firms' Unit Sales Levels



Note: Respondents described their unit sales levels at that time versus what they consider normal unit sales levels.
Source: Atlanta Fed Business Inflation Expectations (BIE) survey