

## Regional Update: Cautious Optimism Grows Even More Cautious

In the previous issue of *EconSouth*, we wrote in the early spring months, “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.”

### What a difference a quarter makes

By early August, the mood had shifted. Regional economic data revealed slowing economic activity, and information gathered from our business contacts confirmed that current economic activity had slowed and the outlook had deteriorated for the second half of the year. The cautious optimism we detected in the early summer has given way to a degree of resignation that economic activity may not improve much in the months ahead. The resulting low level of expected growth is resulting in more modest hiring and capital expenditure plans, according to our contacts. In short, cautious optimism has become even more cautious.

That said, business contacts did not indicate plans to make significant cuts to their workforce. Most contacts said they are planning to continue operating on the assumption that demand for their goods and services will not grow rapidly in the near term. In some respects, a pickup in the pace of growth may indicate some potential upside risk that businesses are ready to expand should they experience a sustained increase in sales above their modest expectations. The downside risk, of course, is that should demand deteriorate, companies would likely adjust to a lower level of activity, which could well result in some negative impact on their workforce.

Interestingly, when Atlanta Fed contacts were asked about the balance of risks to their outlook, most respondents said they felt risks were more balanced than they were in June, when a majority felt risks were weighted to the downside. That shift in attitude may represent an acceptance of the downside risk they were expressing at that time into their actual outlook rather than any real improvement in expectations.

Looking farther down the road, the longer-term outlooks of the majority of our contacts have not changed much. Most contacts anticipate improvement in 2013 from current levels of activity. However, even these longer-term outlooks appear to be a bit softer than they were earlier in the year.

The scale of this anticipated improvement is difficult to assess, as are the catalysts for a shift from the current slow-growth environment. From our conversations with businesses over

the last several weeks, it's clear they are having great difficulty forecasting in the current environment. This limited visibility is resulting in a reduction or postponement in capital investment and hiring plans for several very large businesses that represent most sectors of the economy. Reasons for the decline in visibility are well known—financial uncertainty emanating from Europe, fiscal policy uncertainty (mainly surrounding future tax rates and the “fiscal cliff”), and a lack of clarity from regulatory agencies.

Simply put, the Southeast appears to be in a sluggish period in an already slow-growth environment. While this sluggishness makes the economy more susceptible to event risk, very few of our contacts are actually anticipating an outright decline in economic activity.

### Mixed results by sector

A deeper look into some important sectors shows that most retailers are reporting generally slower sales, except for those tied to the tourism industry, which remains rather robust. Discount retail operations are performing a bit better than their more traditional department store counterparts. Luxury goods sales, which had been uniformly strong earlier in the year, turned a little more mixed in July but are still healthy. Restaurant operators were also less positive in recent weeks. On a more positive note, auto sales continued to grow at a solid pace.

Trucking and railroad contacts noted a deceleration in shipments and lowered expectations for the second half of the year. While contacts at regional ports said that volumes have recently surprised to the upside, few are expecting activity to increase in the coming months. Several contacts reported a falloff in shipments to Europe and Asia, but trade with Latin America remained robust.

Manufacturing has clearly slowed. The Southeast Purchasing Managers Index, produced by Kennesaw State University, fell from 51.3 in June to 48.5 in July A reading below 50 points represents a contracting in manufacturing activity. The current production component of the overall index decreased a monthly 8.4 points to 45.3. The important new orders component decreased 1.3 points in July to 47.2. Regarding future production, only 26 percent of survey respondents expected production to be higher.

Auto production, again, is a major exception to the broader slowdown in factory activity. Energy-related activity also continues to expand at a healthy pace, and significant investments in this sector are moving forward. More broadly, several large industrial projects currently in development pointed to stronger



output and job growth in the near future, most notably in Alabama and Georgia.

On the issue of capital expenditure, Atlanta Fed contacts report that some major firms were postponing planned investment in information technology (IT). In June, an Atlanta Fed survey showed that several respondents said they planned to increase capital purchases of IT equipment in the near future. If that outlook has changed, and this spending is in fact being deferred, it could pose a downside risk to expectations for business fixed investment. That said, other contacts have noted that IT spending was likely to remain on track because businesses feel pressure to provide consumers with regular IT upgrades. Firms also continue to invest in technology for cost savings in the face of weak demand and limited ability to raise prices.

Real estate continued to show slow improvement, although progress is not uniform. Adjusted for weather, sales of electricity to residential customers rose and new utility hookups grew. Banking contacts reported that their mortgage business is up for both refinances and originations. Also, several Atlanta Fed contacts whose businesses are related to the homebuilding sector are sharing reports of increases in activity, all of which may result in some potential upside risk to the region's residential investment outlook.

Looking at more detail, the Southeast's residential brokers indicated that home sales were flat to slightly up compared with year-ago levels. Reports indicated strong sales at the middle price points, while several brokers noted that declining inventories of foreclosed homes were limiting investor-driven sales. Brokers also reported that the decline in inventories has helped stabilize home prices in many areas. Most brokers reported that home prices were flat to slightly up compared with a year earlier. However, contacts continued to note some downward pressure on home prices resulting from low purchase offers and appraisals that were coming in well below asking and offering prices. The sales outlook among brokers remained positive, with most brokers anticipating continued modest year-over-year home sales gains.

Regional homebuilders reported that new home sales and construction rose modestly compared with year-ago levels. The majority indicated that new-home inventories declined further on a monthly and an annual basis. Most builders reported that new home prices were flat to slightly up compared with a year earlier. Price gains were strongest among Florida builders. Contacts noted that multifamily construction remained robust. In the near term, homebuilders expect sales and construction to post modest gains compared with a year earlier.

Apartment sector gains drove improvements in the region's commercial real estate markets, as occupancy rates rose and rental rates increased. The region's office and industrial sectors saw small improvements as vacancy rates moderated somewhat. However, reports on southeastern retail real estate continued to be more mixed. The majority of commercial contractors said that construction activity was flat on a year-over-year basis. The

majority of contacts anticipate a modest increase in private commercial construction activity through the remainder of the year, while public works projects are expected to decelerate.

### Labor markets stalled

Very little movement on employment is evident, which may reflect firms' having limited visibility on what the future holds. As noted earlier, many Atlanta Fed contacts noted with frustration that their forecast horizons have become shorter and shorter.

Recent data on regional employment have been disappointing as well. The Southeast as a whole shed a net 11,100 jobs in June, following a small gain of 7,700 in May. July showed a net increase of 9,600 jobs in the region (see table 1).

Table 1  
Payroll Employment Changes in the Southeast

Alabama	-4,900
Florida	9,000
Georgia	2,200
Louisiana	-1,500
Mississippi	-3,800
Tennessee	-12,100

Note: Data indicate net employment changes from May to June 2012.  
Source: U.S. Bureau of Labor Statistics

The decline in Tennessee's total payroll employment was largely a result of a decline of 15,300 jobs in government employment. Large declines in June government employment have been recorded in previous years as well in Tennessee, so taking this trend into account, the overall reading for the region was not so negative. Nonetheless, job growth remains anemic in the Southeast.

The Southeast's unemployment rate, which is an aggregate of the six states in the Atlanta Fed's region, rose to 8.5 percent in June from 8.3 percent in May. With the exception of Florida, which held steady at 8.6 percent unemployment, all states in the region reported increases in the unemployment rate over the previous month (see table 2).

Table 2  
Unemployment Rate Changes in the Southeast

Alabama	from 7.4% to 7.8%
Florida	unchanged at 8.6%
Georgia	from 8.9% to 9%
Louisiana	from 7.2% to 7.5%
Mississippi	from 8.7% to 8.8%
Tennessee	from 7.9% to 8.1%

Note: Data indicate percent employment changes from May to June 2012.  
Source: U.S. Bureau of Labor Statistics

The idea that the mild winter and firms' "staffing up" to make up for deep cuts made during the recession contributed

to unseasonal employment gains has been largely confirmed in conversations with business contacts over the past several months.

Contacts continued to note difficulty in finding qualified applicants for many highly technical positions, and some reported problems finding candidates for some lower-skilled positions. Many manufacturing and trucking contacts continued to note challenges in attracting applicants with the necessary skills. The skills mismatch problem has been especially hard on low-wage individuals, according to community and economic development contacts.

### Prices appear stable

Prices have also seen little movement. Businesses reported some relief on input prices and little change in wage plans, although some employers noted that they were increasing starting pay for workers with high-demand skill sets. Reports from Atlanta Fed

contacts did not indicate downward pressure building on prices or wages. Firms responding to our July business inflation expectations survey reported steady unit cost expectations: survey respondents indicated that, on average, they expect labor and material costs to rise 1.7 percent over the next 12 months. While it was the same as June's reading, that number is down from 1.8 percent in May and 2.1 percent in April.

### Overall, a summer swoon

The Southeast experienced very modest growth in economic activity in late June and July, and business expectations deteriorated. Employment growth slipped and unemployment rates edged up. Prices were largely stable. The region is clearly not performing as well as it did earlier in the year, and little leads observers to believe an improvement is imminent. That said, the recent deceleration in regional economic activity will not necessarily lead to an outright decline. ■

## Data Corner: Home Price Indices

Fluctuations in home values affect household wealth. In turn, household wealth can significantly affect the economy through consumer spending and saving behavior, the availability of credit, and employment in the residential sector (see this issue's "Fed @ Issue," which discusses these connections). Given the strong ties between the housing market and the health of the economy, tracking the movement of prices over time by using a home price index can be very informative.

Constructing a home price index, however, is more involved than constructing price measures for other types of goods, because each home is unique and infrequently traded. Reconciling these two particular aspects is challenging because existing data sources have incomplete and uneven coverage of home prices. As a result, several approximate measures of home prices have been developed instead of one definitive measure.

While each home price index makes a trade-off in how it addresses the uniqueness and infrequent trading of homes, all indices generally employ one of three common approaches.

### Median sales price

One approach to creating a home price index has been to track the median sales price over time, the approach the National Association of Realtors (NAR) took when it created its existing home median sales price index. The NAR draws on sales data reported by 160 Realtor networks across the country to construct its index. The NAR's large pool of sales data helps mitigate the fact that homes are infrequently traded, but the median-value approach fails to control for the uniqueness of homes. Because prices vary among property types and can be affected by the

condition of the home, this failure to control for uniqueness is a major weakness of this approach.

### Repeat sales

A second approach—the repeat sales method—considers only pairs of sales transactions on the same property over time. Unlike the median sales price approach, by creating a ratio of sales price on the same home over time, this index attempts to control for the uniqueness of homes. Drawbacks are that the requirement of pairs shrinks the number of overall observations to homes that have sold more than once and may effectively overweight submarkets with considerable turnover. It also assumes the quality of a home stays constant over time, ignoring renovations or depreciation. The Federal Housing Finance Agency (FHFA) House Price Index, S&P/Case-Shiller National Home Price Index, and CoreLogic National Home Price Index all use the repeat sales approach. However, these repeated sales measures differ in source data as well as their application of weighting techniques. Also, FHFA data do not capture as much market movement as Case-Shiller and CoreLogic data do.

The FHFA index weights its sales by share of single-family properties in each state, not by price, and its data come solely from conforming, conventional loan data provided by Fannie Mae and Freddie Mac. S&P/Case-Shiller and CoreLogic both apply weights to values so that trends for higher-priced homes have more influence. These firms also both mine public records data for purchase sales transactions. However, CoreLogic takes data mining one step further by supplementing the public records data with loan performance data.

A third approach, called the *hedonic* method, uses a model that controls for home renovations and conditions, but the drawback is that this approach requires detailed data that may not be readily available.

### Many approaches, same story

Despite the differences in methodology and source data, the major national home price indices tell a fairly consistent story,

especially over the longer term: home prices began to fall in late spring 2007 and began to rise in early spring 2012. Unfortunately, with a look at home price indices at a more granular level and over shorter time horizons, this correlation between indices begins to dissipate, revealing more disparity. Consulting more granular indices is informative given that home price recovery has been uneven across markets, but it requires caution given the important differences in the indices. ■

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

**Recent housing data have shown stabilization and even some improvement. What's your read on the housing recovery in your region? What are your contacts saying about the outlook for this important sector?**

**Tom Cunningham, regional executive at the Atlanta Fed:** In general, housing is showing signs of improvement. This improvement is most evident in multi-family construction, particularly apartments, where activity is most apparent. Construction cranes are up in Atlanta, and apartment vacancies have generally decreased across the state to the point where rents are going up. Single-family construction is also picking up, but this activity is much more selective. Indices that attempt to capture local housing prices have generally been, at best, flat, and more typically declining over anything other than the very short term, suggesting that problems of excess inventory are being worked off. Some urban infill construction is beginning to take place in particular neighborhoods in cities across the state, but there is still a large inventory of undeveloped lots. Some bulk land deals are being done, but these deals have been characterized as a play on depressed prices and not really a signal that construction is imminent. Overall, it's fair to say that activity is beginning to show some real signs of picking up, but that is always said with the understanding that any pickup is coming off a very, very low level.

**Lesley McClure, regional executive at the Birmingham Branch of the Atlanta Fed:** My contacts report a definite sense of improvement in housing. Granted, the improvement is over very weak levels, and it is very location-specific, but homebuilders are starting to have some hope. In the Birmingham area, our real estate contacts tell us June home sales are up 13.2 percent over the same month last year, and housing inventory is coming down. There are approximately 7.5 months of housing supply, which is getting closer to the six-month inventory level that is generally considered equilibrium. On the Gulf Coast, we're hearing reports that real estate prices are rising and new construction projects are getting under way. I even heard predictions that the numbers of developed lots in some locations—which had been in great oversupply—may be inadequate to support future housing demand. And a supplier of products for building contractors noted sales improvement tied to multifamily construction. Taken together, these reports seem to indicate that we are headed in the right direction. On the other hand, I continue to hear about the lack of affordable housing units for our state's lower-income populations, so we'll continue monitoring to see if production of those units eventually meets the need.

**Chris Oakley, regional executive at the Jacksonville Branch:** Sentiment from our real estate contacts has improved noticeably over the past six months. In

some markets, prices have stabilized and are starting to tick up. We have even heard reports of increased numbers of homes selling at or above list price. Inventory levels are reduced and, in some cases, non-existent. Pending sales are up, and along the Gulf Coast, sales of new homes are rising as a result of a diminishing supply of available existing homes. Distressed and lender-mediated closings continue to decline. Cash investors are fueling the market as they seek better returns in a low interest rate environment. However, these same cash investors appear to be shutting out first-time qualified borrowers in the entry-level home market. Some brokers expressed concerns about interest rate risk: if rates rise, investors will pull out of the market, and the result will be a significant drop in home prices.

Overall, activity has been described as better, and most of our contacts are cautiously optimistic for the future. Still, some think the housing market in Florida remains fragile, with a long way to go in terms of its residential real estate recovery.

**Juan del Busto, regional executive at the Miami Branch:** The housing market has been steadily recovering in South Florida over the past several months. It appears that prices have hit bottom and are actually increasing, particularly in Miami-Dade and Broward counties. Additionally, the inventory has dropped to its lowest level in the past few years, also fueling the pricing stabilization. Over the last year, the inventory of residential listings

in Miami-Dade County has dropped 33 percent. Currently, information from real estate contacts tells us there are 4.2 months of supply in Miami-Dade, well below the national level. The anchor that continues to hold prices down and inhibit an even stronger recovery is the distressed properties that are slowly working through the system.

A significant factor in the improvement has been the international buyers who for months have been scooping up bargains in both single-family residential homes and condominiums. Additionally, the vast majority of the foreign purchasers buy with cash, circumventing the more difficult challenges of trying to acquire financing. Another sector that is moving very well is the high-end homes, \$1 million or more, that are moving at a rate of at least one sale daily in South Florida.

The condo glut near downtown Miami, when more than 20,000 condos were built during the precession boom, has virtually all been sold, versus the

previous 90 percent vacancies of just a few years ago.

**Lee Jones, regional executive at the Nashville Branch:** In July, the Atlanta Fed held a real estate forum in Nashville to understand the housing market conditions in Middle Tennessee. The participants, mainly real estate brokers, developers, and lenders, conveyed a sense of cautious optimism, supporting the impression that the residential real estate market in the region appears to be recovering. Home sales have begun to rise in Middle Tennessee and are expected to continue increasing, in part boosted by the relocation of large firms to the region. Inventory levels are down.

Condo inventories are particularly low in Nashville, and there's even a sense that a shortage of condos is likely within the next 12 months. The inventory of distressed homes is also falling. There are now no distressed sales in many subdivisions where there were foreclosures and

short sales just a year ago. Low inventories combined with rising sales are putting upward pressure on home prices. Local builders are starting to increase sales prices of new single-family homes. In fact, none of our forum participants expected a decline in home prices for the remainder of the year, although price appreciation should be very modest.

**Robert Musso, regional executive at the New Orleans Branch:** Housing prices have stabilized throughout southern Louisiana and southern Mississippi. For example, Orleans Parish is showing pockets of price increases in existing homes tied to strong demand. Inventories are falling in most locations. Jackson and Mobile are noting rising demand in new and existing homes in the \$250,000-and-less range. One contact cited strong sales since the beginning of the year in high-rise condos in several Gulf Coast areas. ■

## Econ 101: GDP

GDP stands for gross domestic product, and is a measure of the value of goods and services a country produces over a certain period of time (usually quarterly). Breaking that definition down further reveals three important measurements: GDP measures newly produced goods and thus excludes used goods; GDP only tallies transactions according to market prices, and so excludes nonmarket production (such as unpaid housework and child care); and, finally, GDP is a measure of a specific country's domestic production, as defined by physical location—so a foreign company, based in the United States, counts toward U.S. GDP, but the production of a U.S. company working abroad is not included in U.S. GDP.

Economists often examine GDP's component parts by area of *expenditure*: consumption, investment, net exports,

inventory accumulation, and government spending. Consumption is spending by households on durable goods (such as cars), nondurable goods (such as food), and services (such as haircuts or health care). It is the largest share of GDP, at about 70 percent. Investment spending comes in two general forms, residential investment (such as the building of homes) and business fixed investment. The latter kind of investment occurs when businesses spend money on new structures (like a factory) or on new equipment and software. Net exports are the total value of exports minus imports; inventory accumulation is firm production it hopes to sell in the future; and government spending is

just that—spending by federal, state, and local governments.

Lastly, GDP is often discussed in two variations—nominal GDP and real GDP.

Nominal GDP is reported in current prices of goods and services at the time of calculation. Because inflation and deflation change the prices of goods and services over time, real GDP reports inflation-adjusted prices. Thus, when comparing nominal GDP from 1980 with nominal GDP in 2010, it is hard to determine if the more recent statistic is higher because prices are higher in 2010 or because actual (that is, “real”) production of goods and services increased. For most purposes, it's more useful to use real GDP. ■

