

Regional Update: 2014 Seeing Modest Growth, So Far

Overall, business contacts reported that economic conditions continued to improve modestly across the Southeast for the early part of 2014. Sectors driving the mild improvement include energy, manufacturing, hospitality, and real estate.

Energy, hospitality among growth sectors

According to energy contacts, strong production and higher pipeline capacity continued to bolster activity in the Gulf of Mexico. The unusual winter weather also benefited the sector by increasing the use of utilities such as natural gas.

The Southeast purchasing managers index (PMI), a gauge of regional manufacturing activity, expanded slightly in January. After contracting in December, the index increased 2.2 points in January, to 50.6. A reading above 50 represents an expansion in the regional manufacturing sector, and a reading below 50 indicates a contraction. Early reports from contacts indicated that the weather forced some plants to shut down, but the loss in output was temporary and will be made up in the short run. (See the Business Inflation Expectations survey update on page 18.)

Hospitality contacts said that some areas affected by the weather lost revenue as a result of closures of attractions and restaurants. However, most hotels were not as adversely affected. In fact, some saw an increase from businesses that encouraged their essential staff to stay in hotels close to their workplace.

On another positive note, the U.S. dollar's favorable exchange rate is contributing to an increase in the number of international visitors to the states.

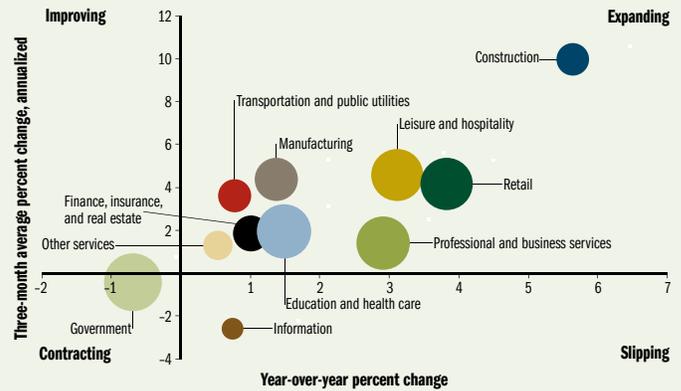
Residential real estate continues to improve for most of the region. According to the Atlanta Fed's February 2014 business contact poll, the majority of builders and brokers said sales were up slightly to significantly compared with a year ago, and home inventory levels had fallen or were unchanged from year-earlier levels. Home prices also continued their ongoing recovery.

Employment holds firm

For the most part, hiring didn't have a notable uptick during the early months of 2014. Businesses continued to experience difficulties filling certain positions with people who had the needed skills and experience, and employers tended toward using overtime and automation before they considered hiring. The modest level of hiring that did occur appeared to be focused on filling revenue-generating positions and mostly in sectors such as construction (see chart 1).

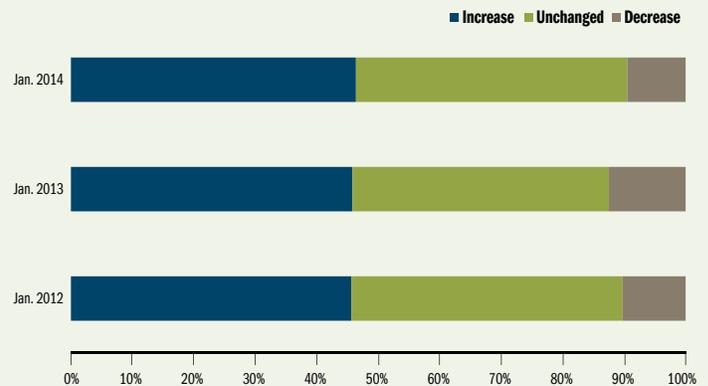
However, to get a better sense of what the hiring intentions were for this year, the Atlanta Fed conducted a survey in early January. Of the 554 survey responses received, 46 percent said they intend to increase employment over the next 12 months and

Chart 1
Southeastern Employment Momentum by Sector



Note: Data are through December 2013, monthly, and seasonally adjusted.
Source: U.S. Bureau of Labor Statistics, Atlanta Fed calculations

Chart 2
Employment Plans: An Historical Perspective

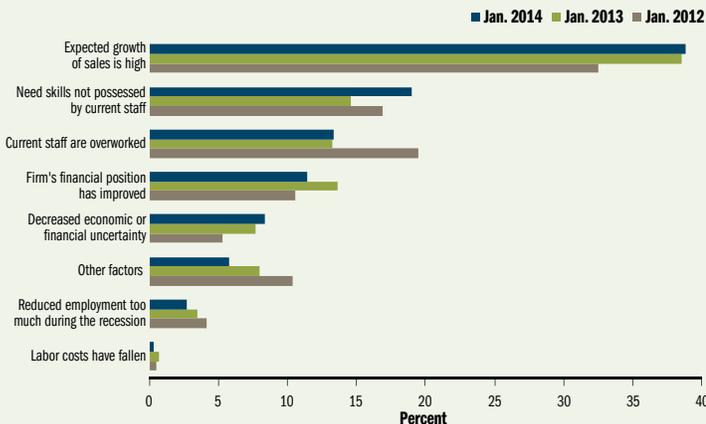


Note: Respondents were asked the question "Do you expect your firm to increase employment, leave employment unchanged, or decrease employment over the next 12 months?" Samples sizes are 421 respondents (January 2012), 670 (January 2013), and 554 (January 2014).
Source: Atlanta Fed business contact poll

44 percent intend to keep employment levels unchanged (see chart 2). Although these results may be seen as generally positive, it's advisable to view them with caution because the previous two years of conducting the same survey showed similar signals, and job growth in the Southeast nevertheless remained slow in both years.

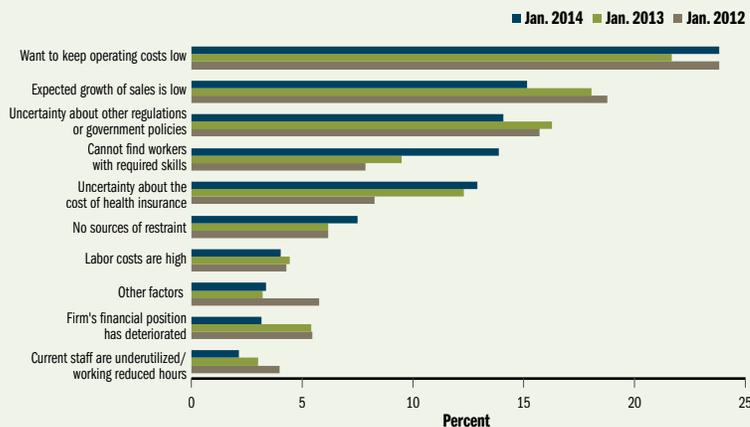
The Atlanta Fed's survey singled out the 46 percent of firms that indicated they planned to increase employment, asking contacts to select the most important factors driving their decision

Chart 3
Factors behind Employers' Plans to Hire



Note: Respondents were asked the question "What are the most important factors behind your plans to increase employment?" Only respondents who plan to increase employment were asked to respond to this question. Participants ranked the three factors in order from 1 (most important) to 3 (third most important).
 Source: Atlanta Fed business contact poll

Chart 4
Factors behind Employers' Plans to Restrain Hiring

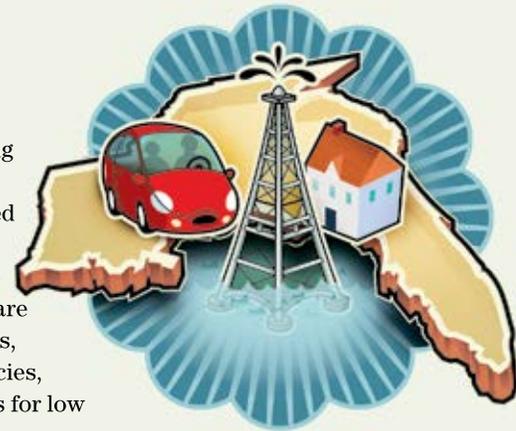


Note: Respondents were asked the question "What are the three most important factors, if any, restraining your hiring plans?" Participants ranked the three factors in order from 1 (most important) to 3 (third most important).
 Source: Atlanta Fed business contact poll

(see chart 3). A majority cited high expectations for sales growth as the most important reason. The second most often cited reason was the firm's need for skills not possessed by existing staff. The third reason was that the firm's current staff were overworked. However, another frequently cited issue was improvement in the firm's financial position.

Conversely, the survey asked all participants to rank (in the same manner as the previous question) the three most important factors restraining hiring activity (see chart 4). Interestingly, in all three categories (first, second, and third most important), a majority selected

the same factor: keeping operating costs low. Other frequently selected reasons were uncertainties related to health care costs, regulations, government policies, and expectations for low sales growth.



Recent data support Atlanta Fed findings of slow but steady gains in regional payroll employment. The latest available data from the U.S. Bureau of Labor Statistics show that district payrolls rose a relatively modest 18,000 in December. The unemployment rate for the district fell 0.3 percentage point in December, to 6.7 percent, mirroring the national trend.

Prices remain largely stable

Similar to 2013, we continued to hear reports of modest and relatively stable input cost pressures. Contacts in the construction industry were a notable exception: the industry has faced significant increases in costs of some materials and labor as this sector's activity improved. In general, our contacts continued to report having little to no pricing power.

The Atlanta Fed's February business inflation expectations (BIE) survey indicated costs were up 1.8 percent from a year ago (see chart 5 on page 16).

Wage pressures remain largely subdued, with the exception of the energy and construction sectors and a few hard-to-fill jobs.

Region's outlook appears to be on the upswing

Looking forward, almost all of the Atlanta Fed's 44 directors believe that sales growth in their businesses will either be sustained at current levels or will accelerate over the next three to six months—a notable improvement from what they expected in October 2013 (see chart 6 on page 16).

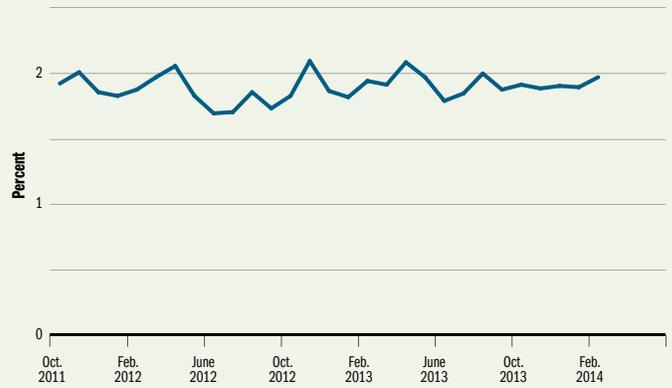
The outlook among regional manufacturers and retailers (including those in the hospitality sector) is also especially optimistic going into the new year. According to the Southeast PMI, manufacturers' optimism rose in January to the highest level since January of last year. The majority of surveyed managers reported expectations of higher production over the next three to six months. Recent inclement weather conditions aside,

Chart 5
Current Unit Costs



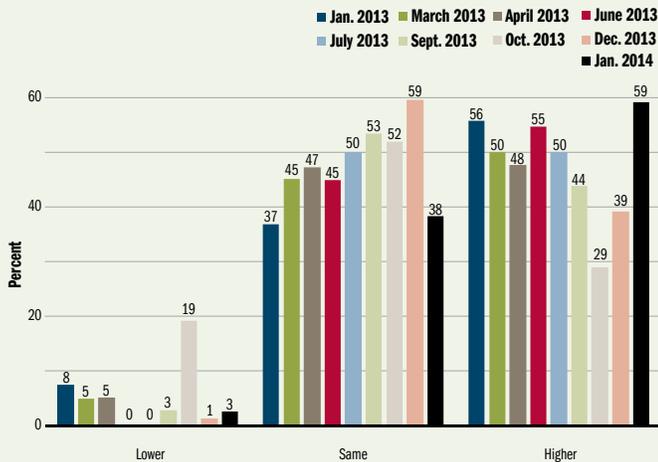
Note: Data compare unit costs to the same time the prior year and are through February 2014.
Source: Atlanta Fed's Business Inflation Expectations (BIE) survey

Chart 7
Year-Ahead Unit Cost Expectations



Note: Survey respondents supplied their cost expectations for the next 12 months. Data are through February 2014.
Source: Atlanta Fed Business Inflation Expectations (BIE) survey

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

retailers also have a generally positive outlook for this year. Hoteliers expect slight growth in occupancy rates for the first quarter of 2014 compared with the same period last year, and they expect room rate and revenues per available room to grow more robustly.

BIE survey results show that prices should pick up slightly, to 2 percent over the next 12 months (see chart 7). Inflation expectations have changed little during the past six months.

Overall, the growing sense of optimism among the Atlanta Fed's regional contacts supports what President Dennis Lockhart said in a speech at the start of the year: "Compared to previous Januaries, we are entering this year on a more solid economic footing," and the economy "seems poised to transition to better conditions" in 2014. ■

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

What are business contacts telling you about their outlook for 2014?

Tom Cunningham, regional executive at the Atlanta Fed: I keep hearing anecdotes from a variety of sources about pretty decent economic growth, but this rather positive news is usually accompanied by

some expression of skepticism or caution. "Things are looking pretty good for us right now but..." is how the conversations typically start. The in-migration of jobs and people to Georgia is clearly picking up, and existing firms are noticing the increasing economic activity. Yet there is still a reluctance to break ground on

major capital projects when investment in existing facilities is sufficient to meet the marginal increase in demand.

I get a strong sense that there is a large pent-up demand for major capital expenditures, particularly in areas where there has been a material change in economic conditions—say, firms concen-

trated in natural gas–related endeavors—but a real reluctance to be the first firm to make the major investment move. Big projects are inherently scary to start, even if you know the end result of the project is necessarily where the industry is heading.

A big problem is that we've been here before, at the beginning of the last few years, and there have been notable midyear swoons. Nonetheless, 2013 ended up with a pretty decent rate of economic growth despite some sputtering in the summer, and there seems to be an increasing willingness to take the plunge for strategic advantage. Some reports of a resurgence of demand for manufacturing space are quite encouraging, and there is a growing sense that this time around, the acceleration has some traction.

Lesley McClure, regional executive at the Birmingham Branch of the Atlanta Fed: My contacts in Alabama have surprisingly consistent expectations for 2014. What's interesting is that their expectations seem to differ a fair amount from the expectations of other parts of the Atlanta Fed's district. The business leaders in Alabama tell me they expect continued growth in 2014, but the level of growth will be modest. Several expressed surprise regarding the improvement in national gross domestic product in the fourth quarter of 2013—from where they stood, they didn't see anything approaching that level of growth.

Often, contacts will elaborate that the growth they expect will be a result of actions they've taken to improve their businesses—entry into new markets or products, as an example—and they don't think there will be much of an impact as a result of a strengthening economy. Many remain concerned about the lack of significant job growth and worry that without meaningful improvement in jobs, the consumers they serve won't be able to increase their consumption. The positive elements for Alabama continue to be manufacturing and a gradually improving housing market.

Chris Oakley, regional executive at the Jacksonville Branch: Central and North Florida business contacts are reasonably optimistic about activity in 2014. Notably, many believe that headwinds have abated and opportunities appear to be increasing. There tends to be a willingness to take on more risk than we have heard in quite some time, though this feedback is more frequently heard from our larger contacts.

Residential real estate markets in this territory continue to improve, with some areas experiencing low inventory levels not seen since before the recession. Relatedly, lenders report increases in purchase mortgages, but these increases are not enough to offset the declines they are seeing in home refinancing. Automobile loans have been a source of increased activity for most lenders.

Tourism remains strong, and expectations for continued strong visitor counts are up. While most retail contacts reported solid holiday sales, a good deal of caution remains.

Consumers are very cost-conscious, and a new era of price transparency appears to be contributing to a ceiling on increases. Perhaps a stagnant employment market is contributing to this feeling. Most employers are not indicating significant job growth, although those individuals with special skills such as engineering and accounting are in demand in most markets. In a nutshell, continued slow improvement seems to describe most perceptions.

Karen Gilmore, regional executive at the Miami Branch: The South Florida business community is generally optimistic as we settle into 2014. One of my colleagues and I recently participated in the annual economic summit hosted by the Greater Miami Chamber of Commerce, which was widely attended by business leaders in South Florida, to discuss the business environment. Our takeaway from the summit and from one-on-one discussions is that the business community is optimistic about the general business environment

and about the prospects for their individual businesses for 2014.

The most significant issue being expressed by many business leaders in South Florida is the difficulty in hiring skilled trade workers and professional-level employees. The mix of available workers in the market and the jobs available are not in sync.

Contacts in the community banking area are reporting increased loan activity and a marked reduction in problem loan issues, so they are generally optimistic about business opportunities going forward. Most community bankers balance their positive outlook with concern about new regulatory requirements under the Dodd-Frank Act. They overwhelmingly express the concern that compliance requirements will weigh negatively on community banks and affect their business models.

Lee Jones, regional executive at the Nashville Branch: My business contacts in middle and east Tennessee are generally optimistic about their companies' prospects. Last year was a good year for most contacts, and the fact that the economy continued to grow even in the face of fiscal and other uncertainties has boosted business confidence and the outlook for 2014. To many, the recovery now seems more sustainable and more certain.

Middle Tennessee has done particularly well in the past few years. The Nashville metro area's economy has been growing rapidly, to a large degree because of the significant presence of the auto industry as well as the vibrant tourism and health care sectors. Economic expansion has generated strong job growth in the area, which in turn has supported a robust recovery in the local housing market.

Perhaps not surprisingly, many of the manufacturers and construction-related companies I've recently talked to across the state are especially upbeat about 2014. Retailers are also expecting a good year. They are hopeful that jobs growth

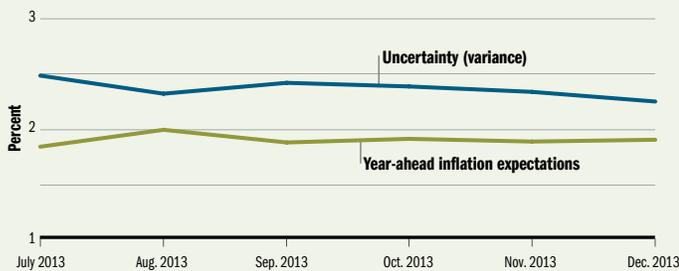
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Business Inflation Expectations Survey

Year-ahead inflation expectations increased somewhat to 2.0 percent in August, before declining to 1.9 percent in September. Expectations remained at this level through January 2014 (see chart 1). Long-term inflation expectations (per year, over the next five to 10 years) increased slightly in January to 3.0 percent but have since declined, fluctuating in the range of 2.7 percent to 2.8 percent over the last several months (see chart 2). Firms' sales levels and profit margins were virtually unchanged over the last two quarters of 2013 (see chart 3), and year-over-year unit costs remained stable in the range of 1.6 percent to 1.8 percent (see chart 4).

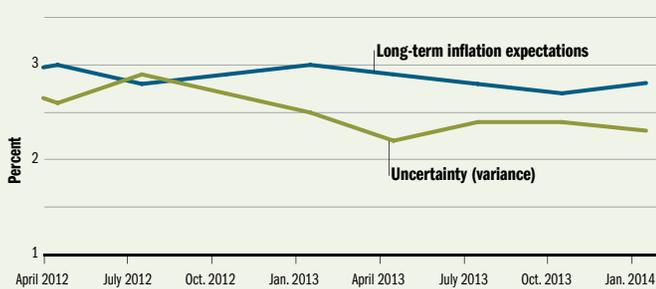
From the June to September readings, the difference between firms' current unit sales levels and what they consider normal sales levels (the "sales gap") increased for businesses of all sizes, with small firms (fewer than 100 employees) reporting the largest sales gap (down 7.4 percent). In December, sales gaps of small and large firms (500 or more employees) continued to grow (down 8.6 percent and 3.8 percent, respectively), while midsize firms (from 100 to 499 employees) noted a significant narrowing of their sales gap (from 6.6 percent down to 2.2 percent down; see chart 5). ■

Chart 1
Year-Ahead Inflation Expectations and Uncertainty



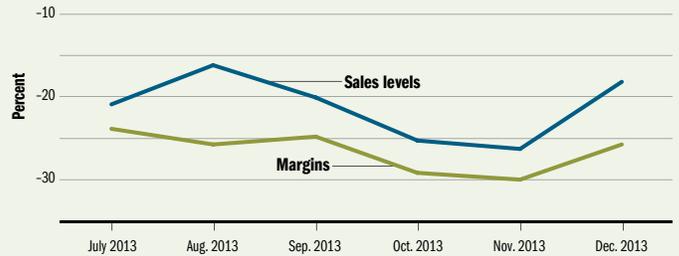
Source: Atlanta Fed Business Inflation Expectations (BIE) survey

Chart 2
Long-Term Inflation Expectations and Uncertainty



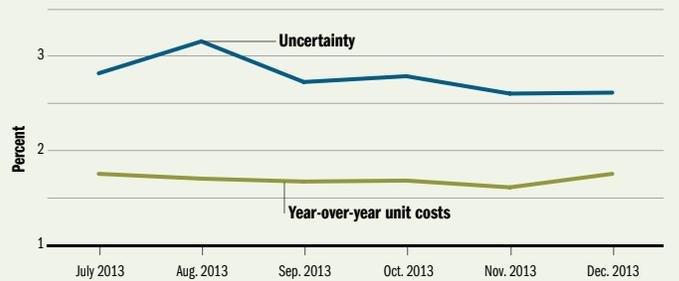
Source: Atlanta Fed Business Inflation Expectations (BIE) Survey

Chart 3
Sales Levels and Margins



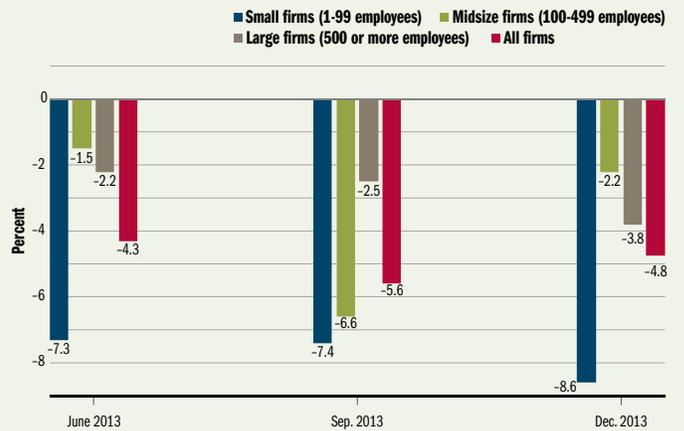
Note: A reading in the diffusion index greater than zero indicates better-than-normal activity.
Source: Atlanta Fed Business Inflation Expectations (BIE) survey

Chart 4
Year-Over-Year Unit Costs



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 normal unit sales levels.
Source: Atlanta Fed Business Inflation Expectations survey

Data Corner: A Look at Regional Manufacturing

Manufacturing growth in the Southeast was moderate but steady in 2013. The average overall purchasing managers index (PMI) reading for the year was 52.0 points, down slightly from 2012's average of 53.9 points. The PMI survey indicated expansion in 10 of 12 months during 2013, and January's reading of 50.6 suggests that the steady pace of growth will continue into the first quarter of 2014 (see the chart).

The Atlanta Fed uses the Southeast PMI, produced by the Econometric Center at Kennesaw State University, to track regional manufacturing activity. A reading on the index above 50 represents an expansion in the manufacturing sector, and a reading below 50 indicates a contraction. The survey provides an analysis of manufacturing conditions for the region in Alabama, Georgia, Florida, Louisiana, Mississippi, and Tennessee. Representatives from various manufacturing companies are surveyed regarding trends and activities in new orders, production, employment, supplier delivery time, and finished goods.

In 2013, the national PMI—produced by the Institute of Supply Management (ISM)—was a bit stronger than the Southeast PMI. (The Southeast PMI is not a subset of the national ISM index.) The national ISM index averaged 53.9 points in 2013, but it lost some momentum from December 2013 to January 2014, when it dropped 5.2 percentage points month over month. Many analysts attributed the decline to unseasonably severe winter weather rather than to a significant slowdown in manufacturing activity.

An encouraging sign in recent Southeast PMI surveys occurred when purchasing managers were asked about their produc-

Southeast Purchasing Managers Index



Note: A reading above 50 indicates an expansion in the region's manufacturing sector. A reading below 50 indicates a contraction. Data are through January 2014.

Source: Kennesaw State University Econometric Center

tion expectations over the next three to six months. Although this question is not a component of the overall PMI, it does provide a glimpse into the industry concerning activity levels in the months ahead. Optimism among purchasing managers had been on the rise in late 2013. When asked in December for their production expectations for the next three to six months, 53 percent expected higher production. In January, the optimism trend increased again, with 62 percent expecting higher production going forward. ■

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and rising home values and wealth will encourage consumers to boost spending.

Still, despite the notable improvement in outlook, many companies remain fairly risk-averse, especially when it comes to hiring and investing. Businesses, for example, are choosing to modernize and expand efficiency at existing facilities such as plants and malls versus building new ones.

Overall, although business optimism has clearly risen, not many of my contacts believe that growth is poised for a takeoff in 2014. As one of my branch directors noted in our January meeting, most of his business contacts had a good 2013, and they expect to have a good or slightly better 2014.

Adrienne Slack, regional executive at the New Orleans Branch: Our regional contacts are optimistic about consistent and steady growth expectations in the near and medium term, which is an improvement over late last year. All contacts anticipate 2014 growth to be as strong as or stronger than 2013, with some industries such as energy and petrochemical construction continuing to see robust demand increases.

Outside of energy, contacts across the Gulf Coast are experiencing an increase in tourism-related business including hotel occupancy, casino traffic, and retail. Further, contacts in our Alabama and Florida beach communities are reporting strong residential and some

commercial real estate activity, including sales of existing properties and new construction.

Additionally, many businesses are investing capital in projects. Office and hotel construction projects that were on the white board through the financial downturn are now coming to fruition. As evidence of the construction confidence upswing, we noted a change in investment strategy by construction contractors. As medium- to longer-term projects become confirmed, construction companies are reporting a shift to purchasing rather than leasing industrial construction equipment. ■