

EconSouth

The background of the cover is a collage of three distinct images. The top right shows a woman in a workshop setting, wearing a light-colored shirt and blue overalls, focused on working with a large mechanical component. The middle section features a close-up of a hand in a blue sleeve using a white paint roller to apply paint to a brick wall. The bottom right shows a diverse group of people standing together, looking towards the camera, suggesting a community or a public gathering.

**The Big Impact of
Small Business**

**Uncertainty Lies Ahead
for the World Economy**

The Southeast in 2011

**Good News, Bad News
in 2010 Color Outlook
for 2011**

EconSouth

FEDERAL RESERVE BANK OF ATLANTA FOURTH QUARTER 2010



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Good News, Bad News in 2010 Color Outlook for 2011

The national economy has recently exhibited some signs of renewed health, but it has also encountered some significant headwinds. Although the economy in 2011 is poised for growth, some fundamentals bear watching.

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The Big Impact of Small Business

Small business—long one of the primary engines of the economy—endured a particularly difficult time during the recession, and the sector is just beginning to show signs of a rebound. How will today's tight credit markets affect small businesses as they retrench for tomorrow's challenges?

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Uncertainty Lies Ahead for the World Economy

The recent financial crisis raced around the globe, touching virtually every major economy. Since then, the rate of recovery is varying dramatically among economies. This uneven recovery and the possibility of diverging trade and monetary policies combine to create a 2011 rife with uncertainty.

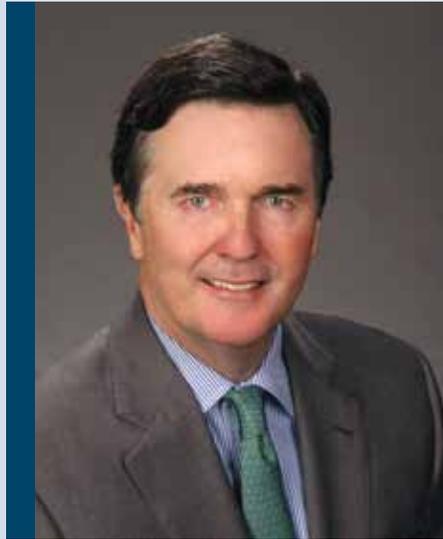
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The Southeast in 2011

Despite its previous robust growth, the Southeast didn't escape the recession unscathed. As the regional economy emerges from a slump that hit virtually every sector, in 2011 the region is hoping to recapture the growth that had made it one of the nation's fastest-growing areas.



Bringing Perspective to Recent Policymaking



DENNIS LOCKHART is president and chief executive officer of the Federal Reserve Bank of Atlanta.

On Nov. 3, 2010, the Federal Open Market Committee (FOMC) announced a policy decision to conduct further purchases of Treasury notes over the coming eight months, with these purchases accumulating up to \$600 billion.

This policy has come to be known as *QE2*. The QE stands for *quantitative easing*, and the “2” represents a second round. At a technical level, I don’t think this is the best term for the policy. The term quantitative easing is best reserved for a policy that operates primarily through the expansion of bank reserves. The November 3 action is not expected to work through that channel. Rather, the policy is expected to work mostly through other transmission mechanisms in financial asset markets. In my view, the

Fed’s current policy is more in the spirit of its 2009 large-scale asset purchase program (LSAP), which at the time was described as *credit easing* to distinguish it from a policy aimed at broad money growth.

I supported the policy decision in the deliberations of the FOMC on November 2 and 3. This policy is designed to further improve financial conditions and thereby support a faster recovery, reduce the potential of deflation, and accelerate the eventual achievement of the Fed’s two statutory mandates—maximum employment and price stability.

The Fed’s large-scale purchases of Treasury securities can stimulate the economy through various channels, the main one being asset prices. Increased demand for Treasury securities should bring down their yields. In search of higher yields, private investors will buy stocks, bonds, and other assets, and prices of those assets will rise. Higher asset prices will make people feel better off and should lower borrowing costs, thus encouraging households to consume and businesses to invest.

The FOMC’s decision to purchase additional assets has been controversial both here in the United States and abroad. There are four major views that critics of the policy seem to hold: the Fed is monetizing the federal debt; the Fed is purposefully devaluing the dollar; the policy is unconventional, with unknown risks, and may create serious unwanted inflation; and finally, this additional easing simply won’t work.

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Editor’s note: Throughout this issue, Southeast refers to the six states that, in whole or in part, make up the Sixth Federal Reserve District: Alabama, Florida, Georgia, Louisiana, Mississippi, and Tennessee.

Photos on pp. 20-23, 26, 28, 32, 34, 36, and back cover (right) courtesy of the Library of Congress photographic archives

A collage image with a black background. In the upper left, a hand holds a credit card. In the center, a large splash of blue liquid is shown, with a single drop falling from the bottom. In the lower right, the Colorado State Capitol building is visible. The text is overlaid on the blue splash.

**Good News,
Bad News
in 2010 Color
Outlook for 2011**



Over the course of the past year, the U.S. economy exhibited some signs of renewed health—increased spending by consumers and more robust business investment, for example—but also persistent headwinds. The relative weakness of some significant economic fundamentals is likely to restrain growth in 2011.

In September 2010, the National Bureau of Economic Research—the body that determines the start and end dates of recessions—declared that the Great Recession had come to an end in June 2009. At 18 months in duration, it was the longest contraction in real gross domestic product (GDP) since the Great Depression (which was more than twice as long at 43 months). The 2007–09 downturn lasted about eight months longer than the average of the other 11 recessions since World War II, though just barely longer than the relatively severe contractions in 1981–82 and 1973–75, both of which lasted 16 months.

Technically, the U.S. economy has been expanding for nearly a year and a half. During the first three quarters of 2010, GDP expanded at an average pace of 2.6 percent, compared with an average pace of just 0.25 percent in 2009. The economy went from losing an average of about 390,000 private sector jobs every month in 2009 to gaining an average of just over 100,000 per month through October 2010. Business investment spending increased briskly, and even consumer spending picked up. All much welcomed progress.

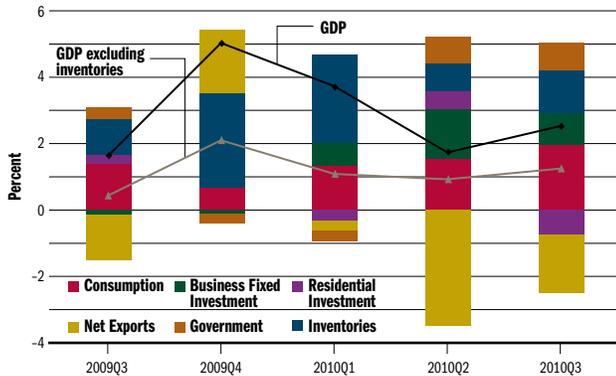
Despite these improvements, economic performance has been somewhat disappointing. The recovery has not been strong enough to meaningfully reduce the unemployment rate. Throughout the year, the unemployment rate has remained well above 9 percent. Income growth (excluding transfer payments made by the government) has been weak—up less than 1 percent for the year on an inflation-adjusted basis. The housing market is struggling in the face of continuing foreclosures despite a variety of tax incentives and historically low mortgage rates, and the commercial real estate sector likewise has not recovered. This theme of improvement in some areas and ongoing weakness in others illustrates the unevenness of the recovery and more uncertainty than normal about future economic prospects.

2010: Off to a fast start, and then...

The economy appeared to enter the year with substantial momentum. After expanding at an annual pace of nearly 6 percent in the fourth quarter of last year, GDP rose at a still-healthy rate of 3.7 percent in the first quarter. Better-than-expected increases in several economic indicators in the spring led many economists to revise up their growth estimates. A quick snap-back in the economy, as has been typical in most other deep recessions in the post-World War II era, seemed a distinct possibility.

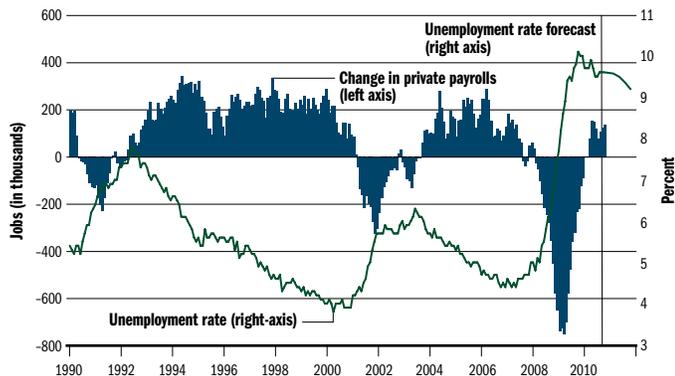
However, such a snap-back was not to be. It is now clear that some of the rebound in growth stemmed from a rebuilding of depleted inventories in the first quarter (see chart 1) and the waning influence of various government spending programs. By summer, the incoming economic data had weakened considerably, and the pace of expansion in the major expenditure categories raised the specter of a step backward into contraction. Indeed, research from Marcelle Chauvet, an economist

Chart 1
Contributions to GDP Growth



Source: U.S. Bureau of Economic Analysis

Chart 2
Labor Market Weakness



Note: The payroll data reflect change on a three-month average.
Source: U.S. Bureau of Labor Statistics, Blue Chip Economic Indicators (Nov. 10, 2010)

at the University of California, Riverside and formerly at the Atlanta Fed, indicated that the probability the United States was in recession had risen to a troubling 28 percent in June, up from just 2 percent in April.

With the benefit of hindsight, both the optimism of the early part of the year and the pessimism that developed in the summer may have been overreactions to the vagaries of short-term data. Bumpy growth for an economy transitioning out of a recession is not unusual. For example, GDP jumped by 3.5 percent in the quarter immediately following the end of the 2001 recession, but it then slowed to just 0.1 percent three quarters later. To date,

that pattern of growth proceeding in fits and starts has certainly been representative of this recovery.

Growth and its challenges

Growth in consumer spending has improved during the year, outpacing total GDP growth in the second and third quarters. But it remains constrained by high unemployment, weak income growth, lower housing wealth, and tight credit. The weakness of the labor market has particularly been weighing on households. Chart 2 shows that employment has failed to rebound with the vigor necessary to substantively reduce the unemployment rate, which was 9.8 percent in November compared with 9.7 percent in January.

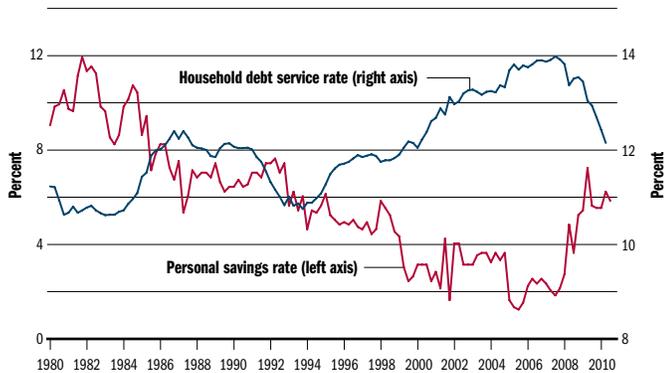
Wages and salaries, which account for just over half of total personal income, are edging up at their slowest postrecession pace since the data were first collected in 1959. Firms have noted that in some cases they have had difficulty finding workers with the needed skills, scarcity that has in some cases pushed up wages for specific types of workers. But the combination of a large number of unemployed workers looking for jobs and a general hesitancy on the part of firms to hire has restrained wages considerably.

In addition to the dampening effect of weak wage growth, consumption spending has been restrained as households have continued on their path of aggressive deleveraging, or debt reduction. In fact, consumers have made significant headway in repairing their finances. The percentage of disposable income going to service mortgage and consumer debt fell sharply to 12 percent in the second quarter of 2010, which was its lowest level in a decade (see chart 3). Consistent with the movement toward greater frugality, the consumer savings rate has been maintained at levels significantly higher than was seen before the recession. While the efforts to repair household balance sheet positions bode well for the future, they are acting as an impediment to near-term consumption growth.

Despite a temporary boost during the spring associated with the homebuyers' tax incentives, activity in the housing market remains depressed. New single-family home sales have remained close to their lowest levels since the government began compiling the monthly statistics in 1963. At just over 4 million, the number of existing homes available for sale would take nearly 11 months to clear at the current sales pace—a much higher pace than the historical average of about seven months for single-family homes. If the number of homes going through the foreclosure process (frequently referred to as the shadow inventory) is factored into the estimate, the months' supply of homes doubles to nearly two years.

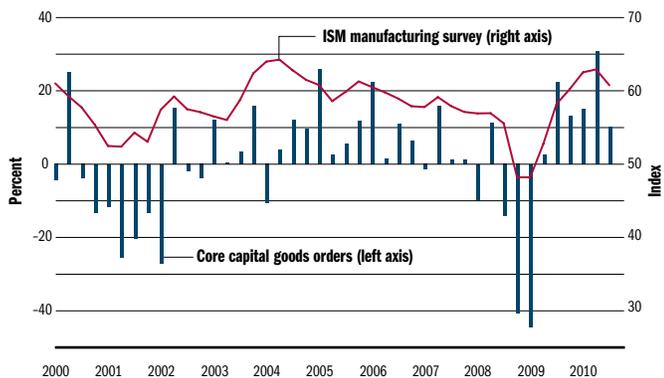
Furthermore, many mortgages have principal balances that are greater than the homes' current value. CoreLogic estimated that the share of mortgages with negative equity was about 23 percent in the second quarter of 2010. These data suggest that

Chart 3
Debt Service Ratios and Saving Rates



Source: U.S. Bureau of Economic Analysis and Federal Reserve Board

Chart 4
Manufacturing Activity, 2000-10

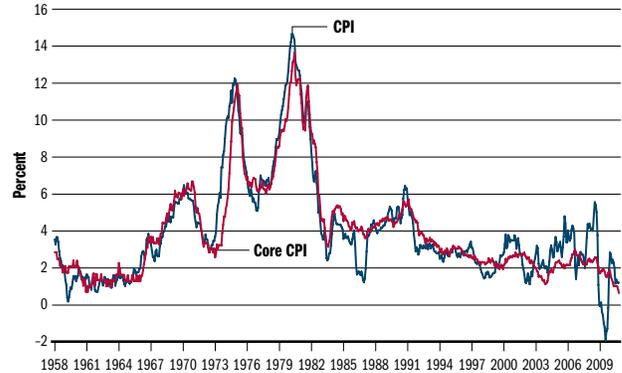


Note: Core capital goods orders represent annualized quarter-over-quarter percent change. Manufacturing survey data represent a quarterly average, with greater than 50 representing expansion.
Source: U.S. Census Bureau and Institute of Supply Management

defaults and foreclosures will likely remain elevated for some time. Taken together, the supply and demand imbalances are likely to place additional downward pressure on home prices, further impeding household wealth and restraining construction activity. With housing continuing to work through immense difficulties, this sector is unlikely to contribute much to near-term growth.

One of the brightest spots in 2010 has been the pace of business investment, which is crucial for the economy's long-run productive capacity. Equipment and software (E&S) investment skyrocketed at an average annual rate of over 20 percent during the first three quarters of the year, with some of that rebound

Chart 5
Inflation, 1958-2009



Note: Core CPI excludes food and energy.
Source: U.S. Bureau of Labor Statistics

stemming from replacement that was postponed during the recession. Although recent indicators, such as capital goods orders and manufacturing surveys, indicate that the rapid pace of E&S investment and industrial activity has slowed some, the pace of business investment remains quite healthy (see chart 4).

The travails in Europe that have played out over the course of the year have somewhat clouded the picture, but many developing economies have been expanding briskly. In general, countries around the world have been, like the United States, on the road to recovery, spurring demand for U.S. exports and contributing to overall domestic growth in 2010.

Inflation falls to historic lows

For consumer prices, 2010 was a historic year. The core consumer price index (CPI)—a widely used gauge of inflation measuring year-over-year price changes, excluding volatile food and energy prices—slid to its lowest level on record (see chart 5). The magnitude of the underlying disinflation, combined with the apparently large amount of unused capacity in the economy, has introduced a more recent concern: the possibility of outright price declines, a scenario known as *deflation*. Atlanta Fed economist Patrick Higgins used data from the Treasury Inflation Protected Securities (TIPS) market to estimate the probability of deflation in the next five years, finding that this probability had jumped from 13 percent in early May to about 30 percent in August 2010. Perhaps not surprisingly, this period of time was also associated with declines in inflation expectations derived from TIPS yields (though measures based on household surveys and surveys of professional forecasters moved little).

Concerns about the potential for further unwanted disinflation have received considerable attention by the Federal Open Market Committee (FOMC), as indicated in its November 3 policy

statement: “[M]easures of underlying inflation are somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate.” In choosing to provide additional monetary stimulus in the form of purchasing \$600 billion in Treasury securities by the end of the second quarter of 2011, the FOMC was following through on a policy action that had been building since Chairman Bernanke discussed the policy at the Kansas City Fed’s annual economic symposium in August. It is notable that, since August, TIPS-based estimates of expected inflation and deflation probabilities have returned to their levels of last spring.

Looking ahead to 2011

The November 2010 Blue Chip consensus forecast calls for GDP to finish 2010 at about 2.4 percent higher than a year earlier and foresees growth averaging 2.9 percent in 2011. The unemployment rate is expected to remain elevated, declining to only 9.1 percent by the fourth quarter of 2011 (see chart 1), and CPI inflation is forecast to rise by an average of 1.7 percent during 2011.

At least part of the evolution in the labor market will depend on how much unemployment stems from structural factors, such as a mismatch of skills between job seekers and employers, and how much is attributable to cyclical factors, such as a decline in spending on goods and services. The divide between the two is crucial because they imply different amounts of economic slack, wage and price pressures, and policy prescriptions—all key variables of the outlook. While the debate among labor market experts is ongoing and opinions vary greatly, Atlanta Fed President Dennis Lockhart recently provided his view on the topic: “In my opinion, the evidence either way is not conclusive. My best assessment is some unemployment is structural in nature and some of it represents weak demand. That so-called natural



rate of unemployment is probably now well above the very low level of joblessness we saw prior to the recession, but it is not the current rate of 9.6 percent.”

The incoming data as well as reports from the Atlanta Fed’s business contacts are broadly consistent with a relatively restrained growth trajectory. There are, in fact, several factors that will plausibly inhibit the pace of the expansion. Weakness in residential and commercial real estate is ongoing. Business and consumer attitudes are still extremely cautious, and slow spending growth by businesses and households is continuing to hold back inflation. Over the near term, additional business spending appears likely to be geared primarily toward activities such as targeted mergers and acquisition and further increases in efficiency rather than toward pure expansion. Slow and uneven sales, opportunities to reduce costs through increased productivity, structural adjustments in labor markets, and uncertainty over government policy—including changes in labor and environmental rules, tax policy, and financial regulations—are restraining job creation. Slow job growth, naturally, implies that unemployment could remain elevated for some time.

Of course, risks lurk on both the upside and downside for the outlook, but there are reasons for optimism. Financial firms and households have made significant headway in repairing their severely compromised balance sheets, and most are in a much better financial position than they were a year-ago. Businesses in particular have substantially more liquidity and significant capacity to deploy capital to new projects. Some of the uncertain-

ECONSOUTH NOW PODCAST

Julie Hotchkiss of the Atlanta Fed’s research department discusses the economy in an interview. On frbatlanta.org, select “Podcasts.”





ties that have vexed private decision makers, such as the course of near-term tax policy, may finally be abating.

To date, the apparent reluctance of businesses to expand seems to derive from a perception that the risks are not worth the uncertain rewards. But rising confidence among both businesses and households will be critical in driving their spending decisions. Rising confidence is one of the critical factors affecting how quickly the process of economic recovery accelerates. Recent surprises in the economic indicators have been predominantly to the upside, which is a very good sign. If such positive surprises persist, and confidence in the economic environment grows, it could be that current estimates for only slight improvement in 2011 have been too modest. ■

This article was written by Mike Hammill, economic policy analysis specialist in the Atlanta Fed's research department, with John Robertson, a vice president in the Atlanta Fed's research department, and Dave Altig, research director at the Atlanta Fed.

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The Big Impact of Small Business

Entrepreneurship and small business creation are integral to the U.S. economy and, indeed, are embedded in the national character. The economic slowdown, however, has posed stiff challenges to this employment segment. How will small businesses confront today's environment?

The ode to the yeoman small businessperson has become an American mantra. "Small business accounts for the majority of all new jobs in America." "Small business is the backbone of the U.S. economy."

There's considerable truth in those statements. About half of all Americans work at small businesses, and small firms account for about 60 percent of gross job creation, according to Federal Reserve Chairman Ben Bernanke. But like any label, "small business" contains nuances. For starters, analyzing small business as a monolithic economic component is difficult because of the diversity of that class of firms. That variety also makes it challenging to assemble definitive data about smaller companies as a group.

Moreover, recent research by John Haltiwanger, an economist at the University of Maryland, indicates that young firms, which tend to be small, are a major source of job creation. Bernanke noted in a July speech that over the past 20 years, start-up companies less than two years old generated about one-quarter

of gross job creation even though they employed less than 10 percent of the nation's workforce.

It follows, then, that young, mostly small, enterprises will play a vital role in an economic recovery. "Our findings highlight the important role of business start-ups and young businesses in U.S. job creation," according to research Haltiwanger, Ron Jarmin, and Javier Miranda published in August. "Business start-ups contribute substantially to both gross and net job creation."

That typically smaller size of new firms, however, has a direct bearing on their ability to generate jobs. "Size matters mainly because, conditional on survival, young firms grow faster than older firms and tend to be small," Atlanta Fed vice president and senior economist John Robertson said.

Squeezed by the downturn

Like the rest of the economy, small companies have felt the sting of the recession and financial crisis. In most cases, smaller businesses lack the financial cushion or global expansion opportunities of large corporations. Resulting caution and limited growth mean the job-generating energy of small business, which could help propel economic recovery, has stalled.

"If small and, importantly, young firms are a significant jobs engine and they are not growing, then it means a slower recovery," said Paula Tkac, assistant vice president and senior economist at the Atlanta Fed.

The observation that a severe recession would result in fewer new companies might appear obvious. In fact, the financial crisis and ensuing recession have had mixed effects







Home Foreclosures, Bank Failures Roil Banking in 2010

Banking conditions in the Southeast remained weak during 2010. The region struggled with high unemployment, foreclosures, bankruptcies, and bank failures. Areas that had benefited from rapid growth in the mid-2000s suffered as construction and development stalled and housing prices plummeted, further intensifying the economic slowdown. When homeowners and developers defaulted on loans, banks foreclosed, clogging their balance sheets with real estate that in some cases contributed to their failure.

Low mortgage interest rates don't spur lending

Mortgage rates hit all-time lows in 2010, and many homeowners refinanced their existing loans. However, bank lending in the second quarter fell relative to last year, even as bankers reported their willingness to lend to qualified customers. Banks in the Southeast continued to report muted loan demand in 2010 as economic uncertainty reduced the demand for loans from both businesses and households. Credit standards remained elevated as loan applications required more documentation and were under more scrutiny than in the past. Credit card usage also fell

on business formations, according to research presented at an Atlanta Fed small business conference in October. As might be expected, the number of new companies formally incorporated fell, especially in wealthy nations and those nations that felt the financial crisis more acutely.

"I was surprised at how quickly and sharply the number of new firms dropped," said Leora Klapper, a senior economist at the World Bank, who presented a paper at the conference titled "The Impact of the Financial Crisis on New Firm Creation."

However, the study by Klapper and fellow World Bank senior economist Inessa Love did not take into account more informal, one-person businesses. In fact, the number of people going into business for themselves after losing a job during the recession has increased, according to "The Great Recession and Entrepreneurship," a paper by Robert W. Fairlie, an economist at the University of California, Santa Cruz. These so-called "entrepreneurs of necessity" tend to start operations—such as babysitting or lawn care services—that might not be formally in-

corporated and are unlikely to employ many, if any, other people. The incidence of necessity entrepreneurship, Fairlie points out, is greatest in metropolitan areas with higher unemployment.

"Individuals who have fewer labor market opportunities are responding to that [level of unemployment] by starting businesses," Fairlie said.

Regardless of size or complexity, small-business operators have been beset by challenges, some obvious and some not. Underpinning any set of business challenges is the nation's biggest cyclical dip in employment in more than 60 years. The United States has lost more than 8 million jobs since December 2007. Amid a slow economy, consumers and businesses have generally cut spending, reducing demand in general for the goods and services of small and large companies alike.

Banks tighten standards, purse strings

Meanwhile, during 2009 and early 2010, many banks tightened lending standards for smaller firms, making it more difficult for

FDIC-Insured Bank Failures in the Southeast

	2007	2008	2009	2010
Alabama	0	0	3	1
Florida	0	2	14	28
Georgia	1	5	25	18
Louisiana	0	0	0	1
Mississippi	0	0	0	1
Tennessee	0	0	0	0
Southeast	1	7	42	49

Note: 2010 data are through November 30.
Source: FDIC press releases

as consumers showed their reluctance to borrow, relying more on cash and debit cards for spending.

Southeast bank failures led the pack in 2010

The Southeast led the nation in bank failures as Florida and Georgia this year, with a combined total of 46 failures from January through November, were home to almost one-third of the failures that occurred nationally during the year. From January through November, 49 banks failed in the Southeast, surpassing the 42 failures the region experienced in 2009 (see the table). Unlike last year, when failures were mostly younger banks located in metro Atlanta and the southern coastal areas of Florida,

them to secure financing. Small business loans by commercial banks declined by more than \$40 billion between the second quarter of 2008 and the second quarter of 2010, according to U.S. Bureau of Labor Statistics data cited by Federal Reserve Bank of Boston researchers. (It's also worth noting that loan demand decreased with the decline in sales during the recession.)

With small business loans remaining near record lows, less than one-third of small businesses in the Southeast reported borrowing on a regular basis during the third quarter of 2010, "not surprising given the persistent emphasis on cost cutting and the curtailment in capital expenditures," according to the Atlanta Fed's September *Small Business Trends* report. "Borrowing that does occur tends to be for the purpose of smoothing cash flow rather than for funding expansion or hiring," says the report.

Other difficulties facing entrepreneurs are less apparent: household wealth, for example. A large majority of new companies are financed by the business owners themselves, according to William Gartner, professor of entrepreneurial leadership

failures in 2010 were more geographically dispersed throughout Florida and north Georgia and struck banks young and old.

Bank charter expansion ground to a halt in 2010—only one true de novo bank was opened in the Southeast through October. Other recently chartered banks were used as vehicles to acquire the assets of failing institutions. Georgia, with 48 bank failures since the beginning of 2008, is home to the most failures in the United States since the banking crisis began.

Credit standards to remain high

The current banking landscape reveals that banks are no longer tightening credit but they are maintaining high credit standards. Indeed, most bankers expect their lending standards to remain high for the foreseeable future. A reduction in the number of problem banks and bank failures will most likely lag the economic recovery. Southeast bank performance remains weak but is improving as banks work to shore up their balance sheets weakened by loan losses from the housing market and pending foreclosures. The outlook for the banking industry remains cautious as reforms are implemented to address the issues that precipitated the banking crisis. ■

This sidebar was written by Pam Frisbee, an analyst in the Atlanta Fed's research department.

at Clemson University, who presented a research paper at the Atlanta Fed small business conference. In 2005–06, some 82.5 percent of entrepreneurs, according to data Gartner cited, relied mainly on personal contributions to launch their businesses.

Between the end of 2007 and the second quarter of 2010, the total assets of U.S. households and nonprofits fell \$11.2 trillion, or 14 percent, according to Federal Reserve data. Plunging home values explain much of that lost wealth. American homeowners' equity in real estate in the second quarter of 2010 was \$6.2 trillion, or 47 percent, lower than it was in 2005, even after rebounding from a trough in early 2009, according to the Fed's Flow of Funds Accounts of the United States. That dip in home equity has sapped a key source of financing for entrepreneurs, Fairlie pointed out.

That decrease in household wealth has had another effect. Not only is personal wealth a direct source of new-business financing, it is also commonly used as collateral to obtain business loans, Fairlie said. Atlanta Fed surveys of small business



Though small business was hit hard by the recession, signs of a turn-around for this important economic engine have begun to emerge.

operators reinforce that point. For companies less than four years old, loss of the owner's personal wealth, including home equity and other assets, was the primary obstacle to accessing credit, according to the Atlanta Fed's second quarter small business survey.

Glimmers of hope?

Heading into 2011, even amid the significant gloom, signs of optimism for small firms have begun to appear. The second-quarter Atlanta Fed survey of 432 small business owners in the Southeast indicates that credit availability appears to be improving. In addition, more than half of the respondents said they expected their sales to increase in the next six months. Only 14 percent of respondents said they had been denied credit by a lender, down from a rate of 40 percent in a first-quarter 2010 survey.

On the other hand, many more offers of credit were refused by the borrower, suggesting more applications were being approved, just not at terms acceptable to the businesses. That dynamic—more small companies finding credit available, just not on conditions they like—appears to be continuing, according to preliminary findings from the Atlanta Fed's third-quarter small business surveys. What is more, the Fed's senior loan officer surveys show that in the third quarter of 2010, the percentage of financial institutions continuing to tighten lending standards was falling, compared with the proportion either loosening terms or leaving them unchanged.

These findings do not suggest that obtaining credit is easy, but that it is available for sound small businesses, Tkac noted. "I think the picture is getting somewhat better," she said.

Nationally, small business optimism inched upward in September. The National Federation of Independent Business's index of small business optimism was higher than its recent low during late 2009 but still well below levels before the financial

crisis and recession. In another sliver of promise, small business employment in the Southeast climbed in October 2010. Florida and Georgia small business employment increased 0.3 percent and 0.2 percent, respectively, according to Intuit's small business employment index.

A rapid resurgence of small and young firms does not appear likely, but this key engine of job creation could play a crucial role in bringing down the nation's persistently high unemployment rate. For that reason, the Atlanta Fed has renewed its focus on small business research, both at the grassroots and scholarly levels, and has created the Small Business Focus website at frbatlanta.org/research/smallbusiness/. The *Small Business Trends* newsletter, the two dozen research papers presented at the October small business conference, and other resources are available on this site. ■

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

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Uncertainty Lies Ahead for the World Economy

Federal Reserve Chairman Ben Bernanke put it best when describing the prospects for economic recovery in 2011: “unusually uncertain.” Uneven recovery among world economies and the possibility of diverging trade and monetary policies combine to make 2011 rife with uncertainty.

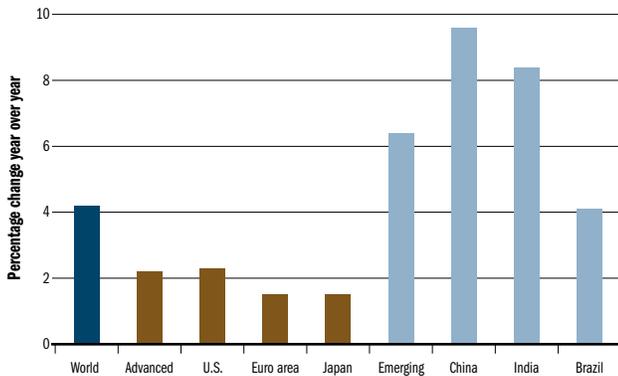
Economies around the world are struggling to emerge from the most severe global recession since the Great Depression. Following the recession of 2007–09, the International Monetary Fund (IMF) projected global output to rise 4.8 percent in 2010 and then 4.2 percent in 2011 (see chart 1). While 2010 saw growth higher than many analysts expected, and the forecast for 4.2 percent growth in 2011 is surely a welcome one, the key question is whether this growth is sustainable.

There are several factors that pose downside risks to the forecast. For one, the recovery is uneven—emerging and developing economies’ growth is strong, but the outlook for most developed economies is sluggish. Other concerns are the ongoing risk of diverging economic policies in response to countries being at different stages of recovery. These diverging policies relate to issues such as trade protectionism and exchange rate manipulation or a repeat of the spring 2010 European scare, whereby fiscal strain in one country morphs into a broader financial market contagion, for example. The road to recovery for the global economy looks like an uneven one in 2011.

Not all recoveries are created equal

The frequently cited research of Carmen Reinhart and Kenneth Rogoff, found in their book *This Time Is Different*, makes the case that economic expansions following recessions induced by a financial crisis are more painfully slow compared to “normal” postrecession growth. The slower growth is caused by the deleveraging of households, companies, and (sometimes) governments. (*Deleveraging* is the paying down of debt.) In the two decades following such a recession, they estimate that growth is

Chart 1
Growth Forecasts for 2011



Source: International Monetary Fund

1.5 percentage points lower than it would be otherwise.

As a stark representation of this growth differential, chart 1 shows the IMF projected 2011 growth rates of the advanced and emerging economies. Advanced economies are forecast to grow by 2.2 percent and emerging economies should soar ahead with 6.4 percent growth. Among the advanced economies, the euro area and Japan are currently the most sluggish, with growth rates forecast at 1.7 percent and 1.5 percent, respectively. Among the world's large economies, China's expected 2011 growth leads the way at 9.6 percent, but India is not far behind at 8.4 percent. Brazil, after a very strong recovery in 2010 of over 7 percent, should moderate to just over 4 percent.

These estimates of faster growth in emerging economies are not surprising for two reasons. First, emerging economies tend to have higher trend growth rates, given the greater marginal returns on investment and the "catch-up" phenomenon of importing technology from advanced economies. Their lower domestic wages also allow them to more readily attract capital. Second, the recent financial crash originated in the advanced economies—

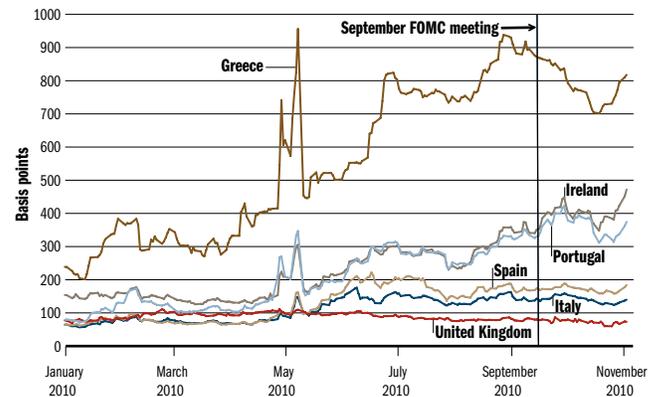
particularly the United States, United Kingdom, and the euro area—and then grew into a global recession with heightened risk aversion, decreased world trade, and the subsequent collapse of demand. These hard-hit Western countries are now particularly burdened with weakened financial systems. Their financial systems were most exposed to the now-soured securities that precipitated the freezing of credit markets and failure, or near-failure, of several systemically important institutions.

But aside from these reasons, the growth differential between advanced and emerging economies going forward is still worrisome. While the nature of an imbalanced recovery is no surprise, it is the degree of asymmetry in growth rates that poses a problem for global economic policymaking.

Greece spillover a slippery problem

One of the underlying causes for the asymmetry of growth is, as previously mentioned, the debt overhang in advanced economies following the financial crisis. Arguably the most significant event that altered the global outlook this past year was the fiscal crisis in Europe. Just as news of the Greek financial crisis began to fade, news came out in November that

Chart 2
European Bond Spreads



Note: Data represent a 10-year bond spread over German bonds.
Source: Bloomberg

Ireland requested support from the European Union and the IMF.

The crisis began in late 2009 with scrutiny over the budget reporting by the Greek government. Greece's deficit problem was much more dire than investors in Greek debt had been led to believe, and the outlook for Greece's ability to grow out of its debt burden was becoming more unlikely. After the early stages of the crisis centered on the fiscal scenario in Greece, market stress eventually spread to all the so-called PIIGS (Portugal, Ireland, Italy, Greece, and Spain) and even appeared to threaten the wider euro zone. Following an assortment of unprecedented interventions—highlighted by the 750 billion euro (approximately \$1.05 trillion) rescue package from the European Union (through the European Financial Stability Facility) and support from the IMF—market confidence slowly grew, and since June 2010, various measures of financial market functioning have stabilized. See chart 2 for a time plot of European debt spreads; these spreads represent how much more investors demand to be compensated for holding a given country's debt over that of Germany's debt.

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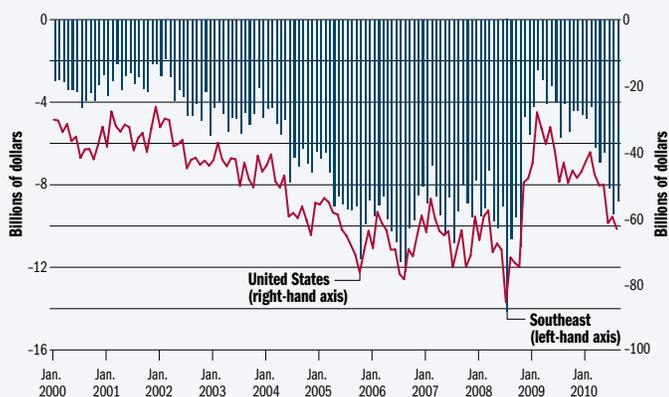
Trade Seeks Traction in 2011

Export growth has become an important national priority. President Obama's national export initiative has set a policy goal of doubling U.S. exports by 2015, an increase that would come as good news to southeastern ports. The recent performance of international trade, however, will make reaching this goal particularly challenging.

The nation's and the region's trade gap grew in late 2010, suggesting that net exports could be a drag on economic growth next year. During most of 2010, the growth in the value of imported merchandise expanded faster than the pace of exports for both U.S. and southeastern ports, increasing the trade gap. By September 2010, the nation's trade gap surged to \$59 billion, up from \$50 billion a year earlier (see the chart). Likewise, the region's trade imbalances jumped to \$8 billion, up from \$5 billion in September 2009.

The continued national economic recovery will probably support import demand for consumer, capital, and intermediate

U.S. and Southeastern Ports' Trade Gaps



Source: U.S. Department of Commerce, U.S. Census Bureau

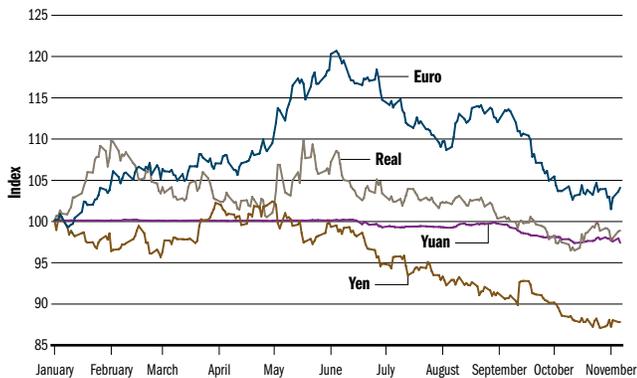
Like a number of regional ports, the port at New Orleans (shown above) has benefited from increased overseas demand for some U.S. products. Part of the challenge lies in translating the growing demand for exports into increased employment.

goods across regional ports. Depending on the market price of petroleum and related fuels, petroleum's share of imports, now accounting for about one-fifth of all imports, could further set the direction of the nation's trade gap. On the export side, industries located in the region will continue to benefit from a more competitive U.S. dollar that makes U.S. goods more attractive to overseas consumers and businesses.

Port districts such as Miami, New Orleans, and Savannah have seen a rise in global demand for regional products, such as chemicals, agriculture, and transportation equipment. Growth in these exports, however, typically has only limited impact on job creation. The challenge ahead, with the goal of doubling future export values in mind, will be to expand high-value manufacturing shipments like automobiles, high tech, and other goods. ■

This sidebar was written by Gustavo A. Uceda, an analyst in the Atlanta Fed's research department.

Chart 3
Currency Movements Against the U.S. Dollar in 2010



Notes: Movements indicate daily activity and are indexed so that Jan. 4, 2010 = 100. Data are through November 9.
 Source: U.S. Bureau of Economic Analysis

Chart 4
Brazil's Real Exchange Rate



Notes: Data represent the daily nominal board effective exchange rate. The year 2000 = 100.
 Source: U.S. Bureau of Economic Analysis

CONTINUED FROM PAGE 16

From the summer through October, news of European fiscal deficits, financial market stresses, potential sovereign debt defaults, and even a breakup of the euro zone faded into the background. The focal points of global economic policy have shifted to the sluggish recovery in developed countries and potential for further unconventional monetary stimulus. But the threat of overly indebted advanced economies lacking the ability to fulfill their debt obligations remains a significant threat to the global economic recovery. As chart 2 shows, the cost of

financing for Greece, Ireland, and Portugal remains quite high, and the successful implementation of various economic reforms across Europe has yet to occur.

The (ongoing) currency disputes

Another headwind facing the global recovery is the ongoing, contentious issue of currencies. The problem is complex but can be simplified into two interrelated disputes. The first problem is China's currency, the renminbi. By the renminbi's being artificially undervalued, Chinese exports are cheaper and imports into China more expensive than would otherwise be the case if the renminbi were allowed to float freely and appreciate. (Economist Fred Bergsten of the Peterson Institute for International Economics estimates that the renminbi would appreciate from 25 percent to 40 percent if allowed to trade freely.)

It is well documented that Chinese authorities, through the country's central bank, intervene in currency markets by selling their own currency and buying foreign assets to prevent this appreciation. The primary foreign currency they purchase is the U.S. dollar. As a by-product of these interventions, China has amassed around \$2 trillion in foreign currency reserves; of that amount, just

under \$1 trillion are U.S. Treasuries. By preventing the renminbi from appreciating and thus sustaining a de facto peg against the U.S. dollar, China is subsidizing its export industries to maintain domestic economic growth rates of around 10 percent.

Although the renminbi is the name of China's currency, the denomination of bills (or the unit by which prices are measured) is called the yuan. The strength of the yuan was nearly constant against the U.S. dollar until June (see chart 3), which is when Chinese authorities announced they would allow it to appreciate some. Since then, it has appreciated nearly 3 percent against the dollar.

Why does this appreciation pose potential problems? When the yuan is pegged to the U.S. dollar, U.S. exports to China become more expensive and thus work to limit Chinese demand for U.S. goods, preventing a source of postrecession growth. Faced with sluggish growth, U.S. leaders have increasingly fewer feasible options to speed up the recovery. The Federal Reserve is increasingly using whatever tools at its disposal. A new political climate may prevent further government fiscal stimulus. Thus, one possible avenue is a yuan-dollar adjust-





ment to spur growth in U.S. export industries. One way to do this is through diplomatic pressure on China from the U.S. government in such forums as the G20 summit meeting. Also, in September the U.S. House of Representatives passed legislation (with a large bipartisan majority) giving the Obama Administration the option to impose tariffs on Chinese imports.

Aside from the de-pegging of the Chinese renminbi from the U.S. dollar, other emerging economies are focused on a second, broader issue: the excessive appreciation of their currency against a basket of currencies. Brazil's currency, for example, has appreciated nearly 50 percent on a trade-weighted basis since December 2008 (see chart 4). This trend hammers Brazilian export competitiveness and in September led the Brazilian finance minister, Guido Mantega, to warn of a potential currency war. While competitive devaluation has not been sufficiently widespread to earn the currency-war label, tensions remain evident in nations seeing their currencies appreciate strongly.

This problem is broader than that of an undervalued Chinese renminbi and reflects the difficulty of managing large capital inflows without damaging economic competitiveness. As mentioned above, there are stark growth rate differentials between advanced and emerging economies. These emerging countries, awash with high-yielding investment opportunities, are facing massive influxes of foreign capital. For example, U.S. investors seeking the growth potential in the Brazilian mining industry are sending

Tension over some countries' varying approaches to budget discipline and fiscal austerity simmered at November's G20 meeting, which brought together the heads of the world's major economies.

their capital into Brazilian markets, causing the real—Brazil's currency—to appreciate. One controversial response to this blessing in disguise is capital controls, through which the government regulates foreign investment. Brazil instituted a tax on foreign investments earlier this year to try to curb just this problem.

Looking ahead to 2011

On November 11–12 in South Korea, the group of advanced economies known as the G20 met in an attempt to reach compromise on a range of issues. Regarding the fiscal problem, tensions are bubbling among G20 members on the issue of implementing austerity measures. Many European nations, particularly the United Kingdom and Germany, want to see an agreement to reduce deficits in the short term, while others, primarily the United States, want to focus less on immediate deficit reduction and more on spurring growth.

As for the matter of global imbalances and currency adjustments, several ideas are on the table, but the makings of any international agreement remain unclear. The United States, through

Treasury Secretary Timothy Geithner, proposed a current account surplus/deficit target of around 4 percent of gross domestic product. But that idea was quickly taken off the table following protests by Germany and China. Meanwhile, at its November 2010 meeting the Federal Reserve announced plans to purchase \$600 billion in Treasury bonds, and the dollar subsequently depreciated further. So while the United States continues its criticism of the undervalued renminbi, other nations are criticizing the latest efforts of the Fed because of its impact on the dollar exchange rate.

While measures of global output, trade, and employment have recovered from the depths seen during the recent financial crisis and recession, fragilities remain. Whether that fragility is best represented by a fiscal crisis in an overly indebted advanced economy or a failure to reach compromise on global imbalances and currency valuations, several downside risks to the global economy lurk in 2011. ■

This article was written by Andrew Flowers, an economic analyst at the Atlanta Fed.

THE SOUTHEAST IN 2011

FROM ITS EARLY ROLE

as an agricultural center to its current growing significance in manufacturing, the Southeast's economy has continuously evolved in response to economic challenges and changing conditions. In 2011, the regional economy will have to surmount a number of obstacles before it can resume the growth that made it one of the nation's most dynamic economies.

With residential home sales at only 58 percent of their 2006 peak, **LOUISIANA** has the slowest-recovering real estate market among states in the region. On the upside, through the first three quarters of 2010, Louisiana regained the greatest percentage of jobs lost during 2009 (39 percent) and continues to enjoy the lowest unemployment rate among southeastern states. In addition, the announcement of a new facility producing electric and hybrid boats and other recreation vehicles in the state will further boost the region's growing green manufacturing sector. In spite of weak economic conditions, New Orleans once again saw record-breaking attendance at its many festivals and celebrations, including Mardi Gras.

MISSISSIPPI

has been slow in regaining jobs. Through the first three quarters of 2010, the state has regained only 7 percent of jobs lost in 2009. Only Georgia recovered a smaller share of lost jobs (less than 1 percent). On the other hand, Mississippi manufacturing is jumping on the green machine with the announcement of a start-up firm planning to manufacture energy-saving electrochromic windows and, over the next few years, the arrival of three biofuel plants.

ALABAMA has shown some of the strongest job growth among southeastern states, regaining in the first three quarters of 2010 about 18 percent of the jobs it lost in 2009. These job gains are reflected in one of the more dramatic drops in unemployment the region has seen since the recession. A fortunate implication of stronger job growth—and the greater spending expected to follow—is that Alabama is projecting the smallest state budget shortfall in the region for the current fiscal year. With the greatest share of pending stimulus projects among southern states, Alabama is poised for those projects to complement its current path of recovery.

A historical map of the Eastern United States, showing Tennessee, Georgia, and Florida. The map is color-coded with green for land and blue for water. Major cities and states are labeled in a stylized, serif font. Tennessee is highlighted with a white background and a red border. Georgia and Florida are also highlighted with white backgrounds and red borders. The map shows the Atlantic coast and the Gulf of Mexico.

TENNESSEE is looking forward to when Volkswagen's automaking plant in Chattanooga begins production in 2011. The addition of the Leaf electric vehicle from Nissan, whose Smyrna manufacturing plant will be under construction through 2012, will add to the state's history of innovative automaking endeavors. The Volunteer State has enjoyed the fastest growth among southeastern states in personal income in 2010, resulting in one of the smallest projected shortfalls in state budgets in the region for the current fiscal year. The state is also one of the three leaders in the United States for clean technology jobs: 2010 saw the addition of hundreds of solar manufacturing jobs in Tennessee, and increased manufacturing of electric car-charging stations could produce further jobs in coming years. On the downside, flooding in 2010 devastated tourism in Nashville during the traditionally busy summer months.

The illustration on these pages is a detail from a map published in Harper's Weekly on Feb. 23, 1861.

GEORGIA holds the dubious honor of being home to the most bank failures in the United States since the banking crisis began and also faces the highest projected budget shortfall of the southeastern states for the current fiscal year. In spite of these financial challenges, farmers in the state have benefited from historically high cotton prices in 2010. In addition, biofuels have become big business in Georgia. The ready availability of privately owned forests has even attracted European manufacturing to the state to create jobs in the biofuel sector. The state has also topped others in the region in terms of tourism growth. Employment in that sector is growing at nearly twice the pace of tourism employment in the next fastest-growing state.

After suffering the hardest fall in real estate in the Southeast, **FLORIDA** has seen the most dramatic recovery, with total residential sales through most of 2010 at 71 percent of their peak level seen in 2005. Florida is also experiencing its share of the relatively strong performance of manufacturing in 2010. Over the next few years, a drinkware manufacturer and a medical product manufacturer plan expansions there. Another boost to the state's economy in 2010 came from foreign travelers taking advantage of the weak dollar to visit the Sunshine State. On a more somber note, Florida is projecting one of the highest state budget shortfalls among southeastern states in the current fiscal year.

AUTO PRODUCTION REVS UP

Notwithstanding unprecedented cutbacks in production during the recession, regional vehicle manufacturing recovered in 2010. The region's production outlook is encouraging because of favorable consumer demand for products made here and additional plants that will expand production capacity in the coming year.

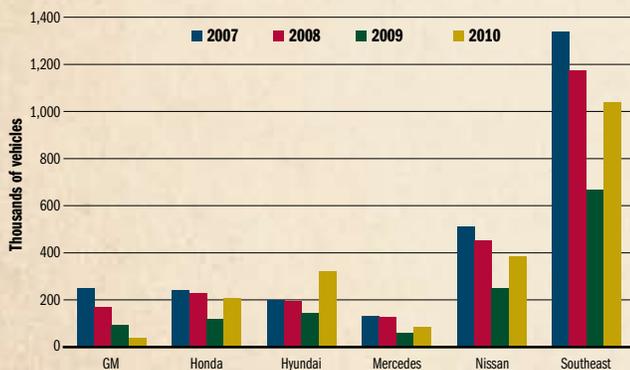
Rising production led to moderate job gains

U.S. sales and production of vehicles assembled in the Southeast rose as demand for popular models strengthened throughout the year. By late 2010, regional plants' production and average utilization rates, defined as the share of vehicle production in relation to their capacity, improved from depressed 2009 levels (see the chart). Increases in vehicle production benefited the Southeast's auto-related employment, with regional plants reporting approximately 22,200 jobs by midyear 2010, or about 1,000 more than in 2009. Additionally, according to data from the Bureau of Labor Statistics (BLS), employment at parts suppliers and parts manufacturers that locate near assembly plants reached roughly 53,000 workers, about the same as last year.

Despite lower volumes, production mix and new plants brighten outlook

While auto production and demand are rebounding nationwide, overall U.S. auto sales remain much lower than in previous years. According to industry estimates, the annual selling vehicle rate for 2011 is hovering around 12 million, well below the 16 million

Production by Regional Vehicle Companies, 2007-10



Note: Data are through Sept. 2010.
Source: MonthlyAutocast.com



At right: Ford Motor Company's assembly line in Jacksonville, Fla., 1948



to 17 million in yearly sales seen earlier this decade. Improved demand for the mix of vehicles produced in the region has sustained production capacity levels, restoring plant capacity usage across the region, with companies like Hyundai and Mercedes recently reporting increases in temporary jobs and longer hours.

The near-term regional production outlook will also be bolstered by the addition of two automakers, Toyota and Volkswagen (VW), currently finishing construction and installing equipment to their facilities. VW's plant in Chattanooga, Tenn., will launch a still-unnamed midsize sedan in early 2011. The plant will have capacity to build 150,000 vehicles a year and employ about 2,000 people. Also, Toyota's Blue Springs, Miss., plant is expected to start production of the Corolla in late 2011, with a similar production capacity and job count. Longer term, the region's production outlook is brightened by the addition of the nation's first electric vehicle (EV) segment. The Nissan Leaf EV, initially imported for five U.S. markets in late 2010, will be assembled in late 2012 in Nissan's Smyrna, Tenn., plant.

On less encouraging notes, two troubled GM plants in Spring Hill, Tenn., and Shreveport, La., continued to face an uncertain future. By late 2012, the Shreveport plant will likely cease production, eliminating about 800 jobs. Recently, the plant stopped producing the Hummer H3, leaving the Chevrolet Colorado and GMC Canyon as its only products. Meanwhile, Spring Hill's production of the Chevrolet Traverse ended in early 2010, and the plant is currently used to produce power trains. ■

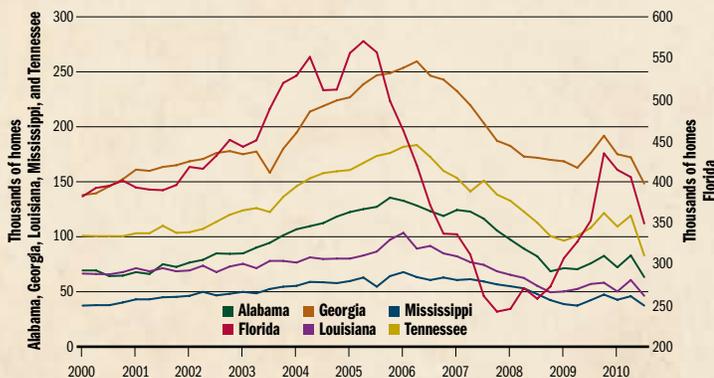
REAL ESTATE SLOWLY REBUILDS

The Southeast's residential housing market benefited from the extension of the federal housing stimulus during the first half of 2010. Existing home sales continued to experience year-over-year gains during this period, and new home sales in particular got a temporary bump in activity in the spring. In addition, home prices were bolstered by the increase in demand in the early part of the year. However, the market experienced a sharp drop-off in sales when the stimulus expired. Furthermore, the number of foreclosures remained at high levels, and distressed home inventory, which typically includes short sales and real-estate-owned (REO) inventories (homes owned by lenders because of foreclosure), continued to place downward pressure on home prices across the region. As the stimulus impact waned during the second half of 2010, home sales activity and prices softened.

Stimulus spurs sales and prices

Existing home sales were uneven in 2010. According to the National Association of Realtors (NAR), existing home sales in Florida and Georgia, on a seasonally adjusted basis, continued to soften modestly after peaking during the fourth quarter of 2009 (see chart 1). The rebound in sales seen in Alabama and Louisiana during the second quarter of 2010 exceeded their most recent peak in the fourth quarter of 2009. While also rebounding, sales in Mississippi and Tennessee did not quite reach their recent high levels. These rebounds in the second quarter of 2010

Chart 1
Southeast Existing Home Sales



Note: Data are seasonally adjusted, represent an annual rate, and are through Sept. 2010.
Source: National Association of Realtors



The entrance to the Riverside Park development in New Orleans, September 1938

are widely attributed to the extension of the federal housing stimulus. However, reports from Southeast sources indicate home sales for the region overall softened again in the third quarter, down 18 percent from 2010.

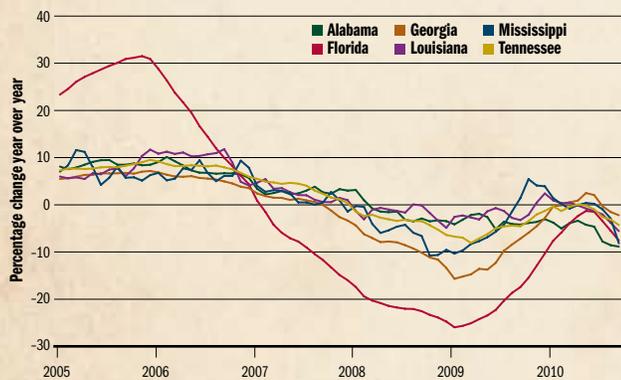
The stimulus—and the resulting stronger housing demand—appears to also have had a positive effect on home prices. According to CoreLogic, home price declines continued to moderate across much of the region on a year-over-year basis through midyear 2010; the exception was in Louisiana, where prices continued to weaken (see chart 2). Georgia and Mississippi markets experienced positive year-over-year growth during the spring, while declines in Alabama, Florida, and Tennessee abated somewhat. In July and August, however, home price declines deepened across the region as sales softened.

Residential construction also rallies

New single-family home construction in the Southeast saw increased demand during the first half of 2010. Single-family housing permits in the Southeast experienced strong year-over-year gains—albeit from very low levels—during the first half of the year. But as of June 30, the close of the home buyer stimulus, approached, permit growth turned negative again. Contacts reported that securing financing for development remained extremely difficult. Year-over-year multifamily permit growth was negative in the region during the first half of the year but



Chart 2
Southeast Existing Home Prices



Note: Data include distressed sales and are through Sept. 2010.
Source: CoreLogic

rebounded strongly, exceeding the year-earlier level. Growth was largely in the apartment sector; the condominium sector remained mostly dormant.

Florida slowly digs itself out

Home sales in Florida slowed during 2010 after their most recent peak in the fourth quarter 2009, according to the NAR. However, sales remained well above the year-earlier level during the first half of the year. Florida Realtors reported that single-family existing home sales increased 20 percent during the second quarter of 2010 on a year-over-year basis, but sales in the third

quarter turned negative, down 7 percent compared with a year ago, the first such decline since the second quarter of 2008. Condominium sales growth also weakened but remained above the year-earlier level in the third quarter of 2010. Sales increased 15 percent over last year, following a 42 percent increase the prior quarter. Many contacts noted that sales weakened further late in the third quarter, when many banks placed moratoriums on their REO properties as concerns arose over improper paperwork.

Florida residential real estate contacts reported that buyers remained interested in discounted properties. Distressed sales continued to garner a larger share of the Florida home sales market. The Orlando Regional Realtors Association (ORRA) reported that distressed sales (typically REO and short sales) accounted for 71 percent of total home sales in September 2010, compared with 56 percent a year earlier. The Northeast Florida Association of Realtors also noted a rise in the share of distressed sales; distressed sales accounted for 55 percent of sales in September compared with 39 percent a year earlier. Contacts also noted that investor sales had picked up notably. Many of these investors made purchases with cash. In an October press release, a Miami Realtor Association executive noted an increase in the number of cash transactions—close to 70 percent of condominium sales transactions did not involve a mortgage. An ORRA report on September activity indicated that 53 percent of home sales transactions were all cash, compared with 43 percent a year earlier. Florida contacts noted that sellers often preferred cash buyers and were even willing to negotiate lower prices to secure a cash transaction.

Commercial real estate

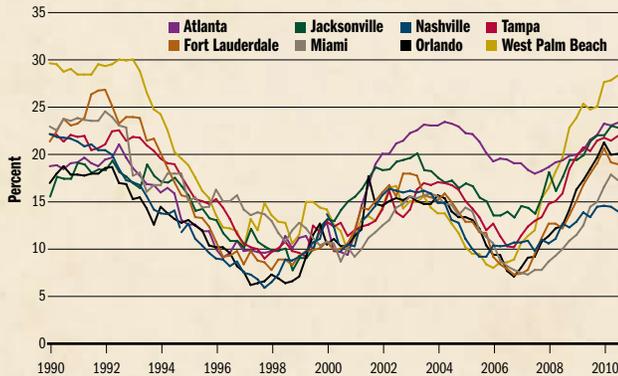
Commercial real estate markets in the Southeast remained weak in 2010 but evidence of stabilization began to emerge in some markets. Private construction continued to hit new lows, while public-sector spending improved somewhat in 2010 after slowing late in 2009. Vacancy rates were mixed across the region, though rents remained depressed. By the third quarter of 2010, at nearly

Chart 3
Office, Retail, and Warehouse Construction in the Southeast



Note: Data are through Aug. 2010.
 Source: McGraw-Hill/TWR Pipeline

Chart 4
Metro Office Vacancy Rates



Note: Data are through Sept. 2010.
 Source: CB Richard Ellis

20 percent, Orlando and Atlanta were posting the highest industrial vacancy rates among metropolitan areas in the Southeast.

The number of projects under way continued to dwindle across the region as the number of projects abandoned and deferred remained at elevated levels (see chart 3). Weak demand for projects along with challenges in securing financing continued to reduce commercial construction activity. Contractors did note an increase in tenant improvement activity as landlords sought to ready properties for prospective tenants. Hotel development appeared to stabilize at low levels across the region during 2010.

A bright spot in the region was the development in Chattanooga, Tenn., of the Volkswagen plant, along with the growing

number of suppliers attracted to the region and the infrastructure improvements made to support production there that will get under way early in 2011. The Nashville market also experienced a bump in construction activity as repairs were made to properties after the flooding this past spring that hit industrial areas of the city particularly hard. Otherwise, construction activity remained very limited, with mostly build-to-suit developments.

Commercial real estate markets remained firmly in favor of tenants during 2010, although it appeared that some Southeast markets had found bottom. By the third quarter, modest improvements in net absorption were noted in parts of the Southeast as vacancy rates eased in some industrial and office markets from earlier in the year. However, these vacancy rates remained mostly ahead of year-earlier levels (see chart 4). Contact reports indicated that retail leasing activity had also been uneven across the region. Demand was strongest at grocery-anchored shopping centers and among value-oriented retailers.

Looking ahead to 2011

Real estate markets in the Southeast will likely remain weak by historical standards. The housing market will continue to stabilize in terms of home sales, while foreclosures will continue to place downward pressure on home prices. Without the influence of the stimulus, the housing market will return to more normal seasonal patterns. Single-family home construction will remain at low levels as builders continue to compete against an increasing supply of REO properties, which typically sell below construction costs. Access to construction financing will continue to be challenging for home builders. However, apartment construction will likely improve as demand for rental properties increases. Job growth will be critical to improvements in the housing market in the future.

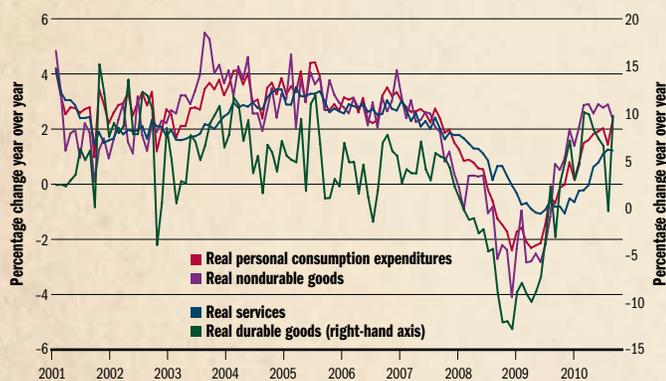
The Southeast commercial real estate market should slowly gain traction in 2011 as the economy begins to expand. Because of the extremely low levels of construction in recent years and very few projects in the pipeline, commercial construction, particularly in the industrial sector, will gradually begin to improve in late 2011. Improvements in economic conditions and employment will continue to unfold slowly, and leasing activity will follow suit. Small improvements in absorption will continue into 2011. Because the supply of new space has been so limited, firming rents will likely take hold. ■

CONSUMER SPENDING HAS UPS AND DOWNS

Following the large downturn in consumption during the recession, consumer spending has grown slowly but steadily in 2010, although not back to prerecessionary levels. Spending on services, which makes up most of what consumers spend their money on, rose about 1 percent in September compared to a year earlier. Although technically after the recession, consumer spending fell by 1 percent in November 2009 compared to a year earlier, marking a historical low. Spending on services remains low compared with an average of about 3 percent year-over-year growth in this category seen during other economic expansions. Spending growth on nondurables, such as food and gasoline, has kept a steady pace of about 2.7 percent year-over-year since the beginning of 2010. In contrast, spending on durable goods, made up of big-ticket items such as motor vehicles and furniture, has been volatile but has improved overall in 2010 compared with the large declines seen in 2008 and 2009 (see chart 1).

The modest increase in spending during 2010 was reflected in sales tax revenues across the Southeast. In the third quarter, sales tax revenues turned positive in all of the states in the region compared to a year earlier. Revenues in Georgia and Tennessee have recovered the most, posting increases of 8.5 percent and 6 percent in September 2010, respectively, compared with a year earlier. Meanwhile, sales tax revenues in Alabama, Florida,

Chart 1
Real Personal Consumption Expenditures



Note: Data are through Sept. 2010.
Source: U.S. Bureau of Economic Analysis



At right: Browsers outside a New Orleans bookstore in March 1943



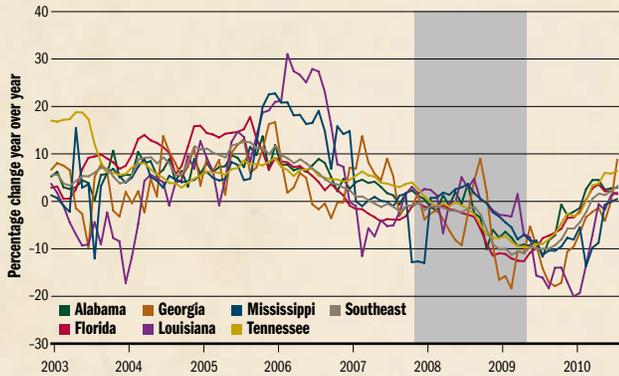
Louisiana, and especially Mississippi have experienced sluggish growth and remain well below annual prerecession growth rates (see chart 2).

Retail remains volatile

Southeast retailers reported some improvement in 2010, but this development was not without its ups and downs. Contacts reported that sales shot up in the beginning of the year but then subsided during the summer before inching up again in the fall. The U.S. Census Bureau's retail sales report for the country also showed some encouraging increases in August and September. The Atlanta Fed conducted an informal survey of southeastern retailers in October. Retailers reported that sales and traffic continue to be slow, but low-end products were strong sellers as customers remain value-minded. Most retailers reported little change in their inventories and said they are satisfied with their current levels. Retailers have been keeping inventories lean and operating on a just-in-time basis. Although consumers still seem cautious, retail contacts expect an increase in demand. The majority of surveyed retailers, nearly 60 percent, expect an increase in sales into 2011 even though holiday sales expectations were somewhat positive.

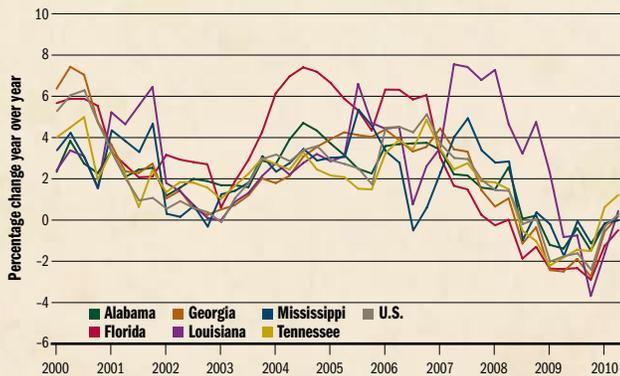
Not surprisingly, the modest increase in spending mirrors the modest increase in income through the year. Income growth in the Southeast began to recover in 2010 from the steep declines seen in 2009. Tennessee led the way, with a 1.2 percent increase in the second quarter. Income growth in Georgia, Louisiana, and Mississippi turned positive in second quarter 2010, but Alabama and Florida's income growth remains negative compared with a

Chart 2
Sales Tax Revenue in the Southeast



Note: Data are through Sept. 2010 and represent a three-month moving average. The gray bar indicates recession.
Source: State departments of revenue

Chart 3
Real Personal Income Growth



Note: Data are through Sept. 2010.
Source: U.S. Bureau of Economic Analysis

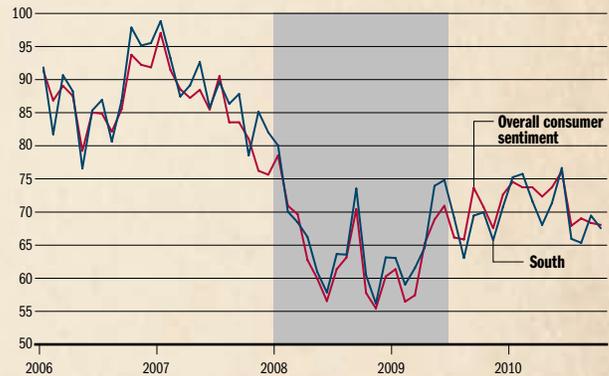
year earlier. All states in the region are still far from the income growth that occurred during the last economic expansion, which ranged from 2 percent to 6 percent year over year (see chart 3).

Economic hardships throughout the recession caused consumers to reduce spending and save more of their income. Household wealth had taken a huge hit from the fall in equity and house prices, job losses, and increased debt. Many households began to rebuild their balance sheets by paying down debt and increasing savings. The savings rate climbed throughout the recession, hitting a peak of 8.2 percent in May 2009 and then edging down to 5.8 percent beginning in August 2010—a rate still among the highest seen in the past six years.

Spending is not likely to return to prerecession levels until consumers feel more secure about the economy. With slow

income growth, a tough labor market, and weak house prices, it's no wonder that consumers' confidence in the economy has not rebounded. Measures of consumer confidence remained depressed in 2010, although they are slightly higher than they were in 2008 and 2009. The University of Michigan's consumer confidence index shows that consumer confidence across the United States and in the South has not returned to the levels of previous economic expansions (see chart 4). Similarly, the University of Florida and Middle Tennessee State University conducted consumer confidence surveys in 2010 that show protracted low levels of consumers' perceptions of the economy in Florida and Tennessee.

Chart 4
University of Michigan Consumer Confidence Index



Note: Data are through Oct. 2010 and are indexed so that first quarter 1966=100. The gray bar indicates recession.
Source: Reuters/University of Michigan

Looking ahead to 2011

Consumers may continue to be wary of spending in 2011 and consequently continue to maintain high rates of saving, which would repair consumers' balance sheets but would not bode well for the balance sheets of retailers or for the general economic outlook. A large part of the U.S. economy is supported by consumer spending—more than 70 percent of gross domestic product is made up of personal consumption expenditures. Still, the improvements that already took place in 2010 show that consumers are getting back on track, even if at a slow pace.

Much of the outlook for consumer spending hinges on the employment outlook. In general, as the job market improves, so do incomes and consumers' confidence. The modest improvement in employment in 2010 across the nation and the Southeast suggests that consumer spending will at least be headed in the right direction going into 2011. ■

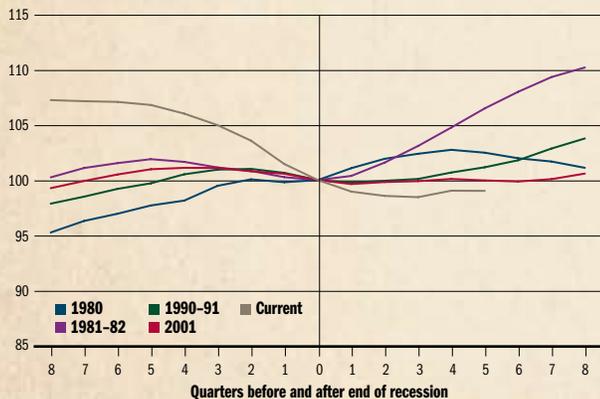
REGION'S EMPLOYMENT SEEKS TO REGAIN MUSCLE

Southeastern states, like the rest of the nation, experienced large-scale employment losses for much of the past two years. The pace of job losses began to slow in the fourth quarter of 2009, and a few states in the region began to see employment growth in the first quarter of 2010. Despite modest employment gains through the third quarter of 2010, employment levels remain below prerecession levels.

Employment in the Southeast fell much farther during the most recent downturn than it had in previous recessions. From the start of the recession in December 2007 through the fourth quarter of 2009, southeastern states lost 1.5 million jobs, or 7.6 percent of the employment level in December 2007. Subsequently, the region as a whole added only 134,000 private-sector jobs during the first three quarters of 2010, only a small fraction of recent employment losses. While the labor market is typically the last part of the economy to recover following a recession, it has recovered even more slowly after this last downturn than after any of the past four recessions (see chart 1).

Unemployment in southeastern states continued to climb to its highest level since the 1981–82 recession, according to the U.S. Department of Labor. The regional unemployment rate reached a peak of 11 percent during the first quarter of 2010. The

Chart 1
Southeast Employment Level Index During Recessions



Note: Data are indexed so that 100 = employment level at the end of a recession.
Source: U.S. Bureau of Labor Statistics/Haver Analytics



At left: Miami's Acme Employment Office, January 1939

region's jobless rate of 10.4 percent in September 2010 remains well above the national average and is the highest since 1983 (see chart 2). The Atlanta Fed's regional business contacts have reported that they remain cautious about hiring and will take their time rebuilding their workforces.

Florida was the largest contributor of private-sector job gains in the Southeast in the first three quarters of 2010, with almost all of these gains occurring in the second quarter (see chart 3). However, Florida also accounted for the bulk of employment losses in the region in the first three quarters of 2009 and experienced the third-largest job loss in the nation during the same time period. Job losses in Florida's key industries, such as construction and leisure and hospitality, slowed at the end of 2009. The state's largest contributor of private employment gains in the second and third quarters of 2010 was the leisure and hospitality industry, despite the fact that it had shed jobs early in the year. This industry was also the largest contributor of private payroll growth in Alabama through the third quarter of 2010.

Education, health care gain traction

Education and health care employment remained robust throughout the recession, being the only industries in the Southeast that did not lose jobs in 2009. Therefore, it is no surprise that these industries accounted for a large portion of employment gains in the Southeast this year. Through the third quarter of 2010, growth in education and health care made up the bulk of employment gains in Florida, Georgia, and Louisiana. On the other hand, the professional and business services industry led private employment growth in Mississippi and Tennessee during the same period.

Movements in government employment were the most dramatic through the first three quarters of 2010, but were mostly

Agriculture Looks Ahead to Growth

The Southeast farm sector enjoyed rising prices in 2010 despite hot, dry weather in some areas. Farm prices were largely driven by favorable global market conditions this year that, if they continue, could make 2011 a bright year for the region's farm sectors.

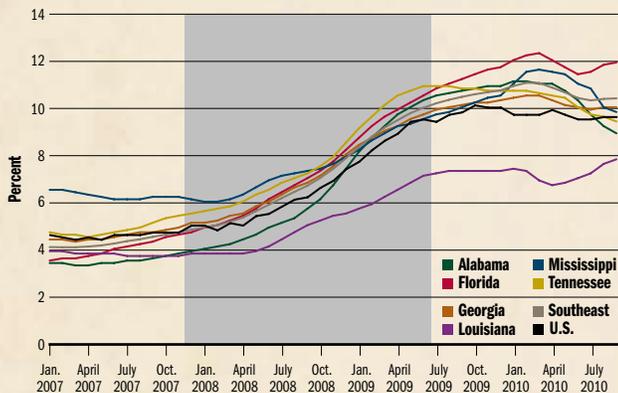
Poultry is by far the region's top agricultural cash-producing sector, accounting in 2009 for almost \$10.3 billion in cash receipts. Alabama, Georgia, and Mississippi are the region's top poultry-producing states. Price trends were positive through most of 2010. A modest U.S. economic recovery contributed to a moderate pickup in domestic demand and production. A drop in exports tied to trade restrictions in Russia and China were not wholly offset by increased shipments to Mexico, Korea, and other emerging markets. A continuing risk for poultry producers in 2011 is the growing cost of feed, which could lower profit margins and limit broiler production.

Soybeans are the Southeast's second-largest farm income sector, reporting \$1.9 billion in cash receipts in 2009. A vital ingredient in livestock feeds and the world's most important source of protein, soybeans are a critical regional cash crop. Tennessee and Mississippi lead the region in soybean production. Strong global demand firmed prices through 2010. According to estimates from the U.S. Department of Agriculture (USDA), the crop's outlook for 2011 is bright as long as demand from China, the top U.S. export market, holds steady.

Citrus growers, located exclusively in Florida, could see a large crop in 2011, according to recent estimates. Because of favorable weather conditions, the total fresh and processed on-tree revenue for oranges, grapefruit, and specialty citrus could be 25 percent above last year's estimates. The cost of disease control continues to be a major risk to the near-term outlook, and reports of increasing abandonment of citrus groves have added to uncertainties because these areas often become havens for diseases like canker and greening.

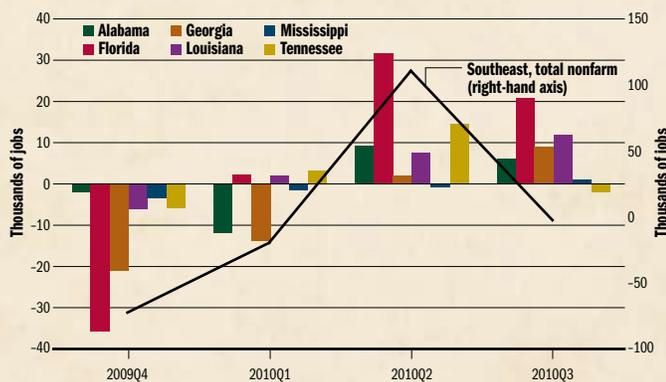
Market conditions for **cotton** in 2010 were very good; cotton prices reached historic highs. As the region's fourth-largest farm income group, cotton continued to enjoy double-digit price increases during most of 2010 because of increased global market demand and tight supply. According to USDA estimates, the outlook for cotton is bright as major mill producers like China, India, and others are expected to rely more on U.S. cotton supplies than anticipated. Based on cotton futures prices and favorable market readings, growers could have a good year. Georgia is the region's dominant cotton producer. ■

Chart 2
Unemployment Rate in the Southeast



Note: Data are through Sept. 2010. The gray bar indicates recession.
Source: U.S. Bureau of Labor Statistics/Haver Analytics

Chart 3
Southeast Private Employment Growth



Note: Data are through Sept. 2010.
Source: U.S. Bureau of Labor Statistics/Haver Analytics

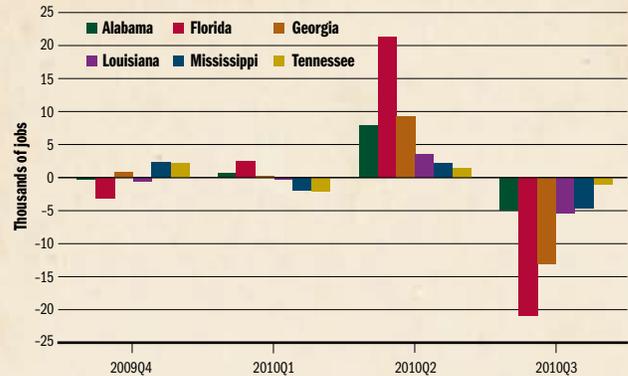
not related to the economic business cycle. The U.S. Census Bureau hired temporary workers throughout the nation to conduct the 2010 Census; these workers that were added to federal government payrolls peaked in May 2010 at more than 560,000. As of September 2010, only 6,000 of these workers remain on the payrolls. Government hiring in southeastern states also reached its peak in May 2010, with about 90,000 jobs added from January through May. Government payrolls then shed 106,000 jobs, from June through September (see chart 4).

In addition to mostly falling unemployment rates and some modest employment growth, southeastern labor markets began to show other signs of stabilization in 2010. Labor force participation in the Southeast grew in the first half of the year after



Chart 4

Government Employment Growth in the Southeast



Note: Data are through Sept. 2010.
Source: U.S. Bureau of Labor Statistics/Haver Analytics

Chart 5

Southeast Unemployment Insurance Claims



Note: Data are through Sept. 2010. The gray bars indicate recession.
Source: U.S. Bureau of Labor Statistics/Haver Analytics

seeing steady declines from the end of 2008 through 2009. A slight turnaround in employment growth has likely drawn those workers previously discouraged by their job prospects back into the labor force. In addition, the total number of unemployed persons in southeastern states declined in the second quarter of 2010 for the first time since early 2007.

Unemployment claims fluctuate

While initial unemployment insurance claims in the Southeast fell for most of 2009, signaling fewer workers entering the ranks of the unemployed, they have held relatively steady through the second quarter of 2010 (see chart 5). Continuing unemployment insurance claims also declined through the second quarter of 2010, to their lowest level since the fourth quarter of 2008. However, the reason for this decline is unclear—it could be attributed to workers going off the rolls because they found jobs or because they have exhausted their benefit time limits. The uptick in both initial and continuing claims in the third quarter of 2010 coincides with the large declines in government payrolls in the Southeast. As of September 2010, both initial and continuing unemployment claims had declined again and are in line with the lower levels seen earlier in the year.

Many analysts point to federal and state unemployment insurance extension programs as one reason why the number of people receiving unemployment insurance remains at such elevated levels. During most of the recent recession, as people exhausted their regular unemployment insurance benefits, they were often able to move on to receiving extended benefits

through the federal Emergency Unemployment Compensation (EUC) program and state extended-benefits programs. In July 2010, the unemployment extension bill, which restored the EUC program after it expired on June 2, extended the program through November 2010 and retroactively provided benefits to those whose payments were cut off when the program expired. The bill also extended federal funding of state extended benefit programs to Dec. 1, 2010. Up to 73 weeks of benefits extensions are available: 53 weeks of EUC and up to 20 weeks of extended benefits in states with high unemployment. When added to the 26 weeks of regular unemployment insurance benefits, a maximum of 99 weeks of unemployment benefits is available. In early December 2010, Congress approved another extension of jobless

benefits through 2011. Jobseekers who have already received benefits for 99 weeks are ineligible.

Although the economy is recovering and labor markets in the Southeast have begun to stabilize, a high level of joblessness remains. Labor productivity growth, or output per hour of work, may be contributing to continued high unemployment. During the economic downturn, employers aggressively cut workforces. By seeking technological improvements and asking employees to work longer hours, firms have been able to meet demand without adding to depleted payrolls. According to Atlanta Fed business contacts in the Southeast, firms are holding employment at or near recession levels, investing in labor-saving technology, and generally reorganizing businesses to operate more efficiently. According to the U.S. Bureau of Labor Statistics, average weekly overtime in the manufacturing sector has risen almost 40 percent from its trough from the second quarter 2009 to the third quarter 2010. Average overtime hours have another 20 percent to go before reaching more stable, prerecession levels, which is when employment might start growing again more rapidly.

Looking ahead to 2011

As job losses began to ease in 2009, the question was when would labor markets begin to expand. In 2010, after a few months of economic growth and some modest employment expansion, the question becomes when will labor markets fully recover. Productivity growth could continue to support high unemployment into 2011, as businesses may still be able to increase hours without hiring. Numerous regional business contacts indicated that they would most likely respond to unanticipated sales growth by first seeking productivity gains from current workers. It is unlikely that this type of productivity growth will continue indefinitely, as squeezing more and more out of a diminished workforce is not sustainable.

As labor productivity growth levels off, further economic growth will result in employment gains. The pace of hiring, however, is likely to be slow. Wary of the future business environment, firms will likely turn to temporary and contract workers before adding full-time employees. Some businesses may have reorganized their firms to maintain production levels and earnings with a smaller workforce and will simply require fewer employees in the future. Plant closings in the Southeast have likely resulted in permanent job losses in industries such as construction and manufacturing. The region's auto parts manufacturers, specifically, have suffered from auto plant closings. Overall, labor markets in the Southeast have shown some signs of improvement, but they still have a ways to go. ■

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TOUGH FISCAL CHALLENGES CONFRONT STATE GOVERNMENTS

After a year of rapidly declining tax revenues, state governments were hoping for a fiscal turnaround in 2010. Even with some shortfall mitigation by way of the American Recovery and Reinvestment Act of 2009, however, southeastern states have been forced to continue service cuts and spending reductions. In addition, many government payrolls continued to decline as budgetary pressures built throughout the year.

States are still not collecting the level of revenues they were accustomed to before the recession. For example, Georgia collected 6.7 percent more tax dollars in September 2010 than it did in September 2009, but total collections were down 10.3 percent from the same month in 2008. This pattern holds true for most southeastern states: year-over-year comparisons appear positive, but comparisons with revenues before the recession continue to be discouraging. The year-over-year revenue increases have managed only to moderate continued cuts in services and payrolls.

The southeastern state with the most challenging fiscal picture is Louisiana, which has faced more than its share of additional economic pressures in 2010 because of the oil spill. The state posted dramatic declines in revenues in 2010, even when these numbers are compared with depressed levels seen in



Employees at the State Capitol leave work in Montgomery, Ala., March 1943.

2009. In May 2010, Louisiana's revenues had declined by roughly one-third from May 2009, when the state posted a 16 percent year-over-year decline. Tennessee, by contrast, has managed to keep its revenues fairly steady postrecession and, as of September, has been posting gains in revenues over the past two years. But these gains have not been easy to come by, resulting as they have from conservative revenue management paired with dramatic cuts in the state's government workforce.

However, the economic upturn was good news for state departments of revenue since the nation's economy directly affects state government revenues (see chart 1). Although the first quarter of 2010 saw double-digit year-over-year declines in tax collections, the second and third quarters brought welcome gains, and year-over-year growth in both sales tax and personal income tax revenues in southeastern states returned to positive territory (see chart 2). The increased sales tax revenues indicate that people began to increase spending on goods and services. Sales tax receipts for the fall months almost resembled receipts in the months preceding the recession.

How are states getting by?

States are managing by cutting deeply into expenses and looking for new or additional sources of revenue. For example, the University System of Florida recently decided to raise tuition

Chart 1
Sales and Personal Income Tax Collections in the Southeast



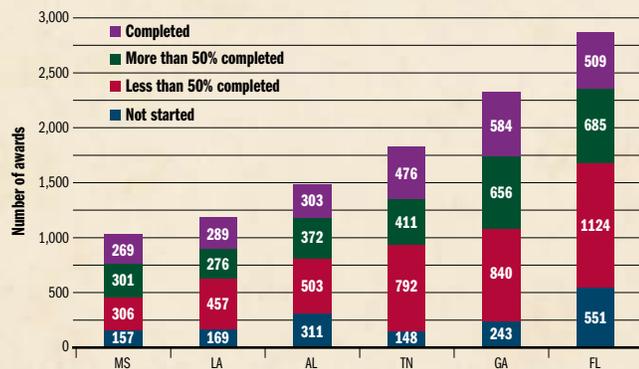
Note: Data are through Sept. 2010.
Source: States' departments of revenue

Chart 2
Coincident of Economic Activity Indicator and Total Tax Revenues for Southeastern States



Notes: Data are through Sept. 2010. The gray bars indicate recession. The coincident indicator summarizes four state-level indicators into a single statistic.
Source: Federal Reserve Banks of Atlanta and Philadelphia, states' departments of revenue

Chart 3
The Status of Stimulus-Funded Projects



Note: Data and are through Sept. 21, 2010.
Source: Recovery.gov

15 percent, after an increase of roughly the same size in 2009. The governor of Georgia, in lieu of \$375 million stimulus dollars in 2009, has called for a 4 percent across-the-board spending reduction on top of previously enacted cuts. State agencies have been asked to prepare for further cuts in 2011.

Hiring freezes have gone into effect for all southeastern states, and furloughs remain common. In 2009, the Tennessee governor announced elimination of more than 2,000 state positions, which represent 5 percent of the state's 2008 workforce. Observers widely agree that layoffs and workforce cuts would have been more severe if it had not been for the federal stimulus funds.

Southeastern States' Budget Gaps for Fiscal Years 2011 and 2012

	FY2011		FY2012	
	Total budget shortfall (\$billion)	Total shortfall as a percentage general budget	Projected shortfall (\$billion)	Total shortfall as a percentage general budget
Alabama	0.586	8.3	na	na
Florida	4.7	20.2	2.5	10.8
Georgia	4.2	26.2	1.7	10.6
Louisiana	1.0	12.5	1.7	21.2
Mississippi	0.716	16.1	1.2	27.6
Tennessee	1.0	9.8	0.374	3.7

Notes: State governments closed all budget shortfalls before adopting a FY2011 budget. Data were not available for Alabama for 2012.
Source: Center on Budget and Policy Priorities

The federal stimulus was designed to create jobs through new work projects, which were mostly infrastructure projects. Still, job creation is not at hoped-for levels. States have been using a large portion of federal stimulus dollars to maintain service levels and prevent further cuts.

Most southeastern states received the largest chunk of their stimulus dollars through their transportation departments, which channeled the money into road construction and maintenance projects. Georgia used its money for these projects as well as to plug a budget gap for the state's largest mass transportation system. Emergency funds also went to struggling local governments across the Southeast.

In large part, job growth has not come about because some or most of the money has yet to be spent (see chart 3). For instance, as of late September, Florida had 551 stimulus awards for projects that the state had not yet begun, and more than 1,000 projects were less than 50 percent complete.

Looking ahead to 2011

According to the Center on Budget and Policy Priorities, states will continue to face budget shortfalls as a result of the recent recession through 2011 and well into 2012 (see the table). The year 2011 will be the third year running that states have felt significant recessionary pressures, and governors are gearing up for another lackluster fiscal year, with planned cuts deeper than those already made. Mississippi, for example, is planning a 9 percent cut in K-12 education funding and a 12 percent reduction in most state agencies' budgets to close a shortfall that represents around 16 percent of its entire budget. While states can take heart in rising economic activity and in the somewhat brighter outlook for 2011, recovery to prerecession levels of overall revenues is still likely to be years away. ■

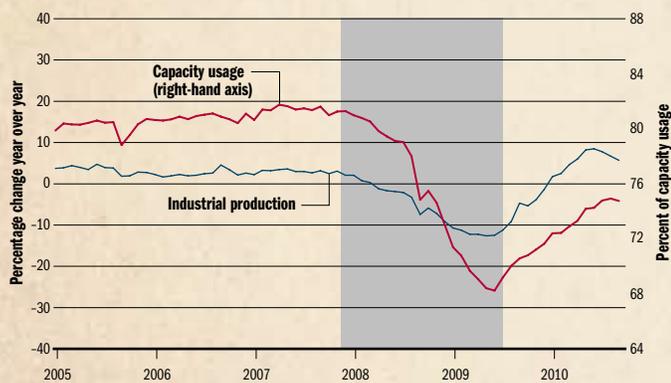
MANUFACTURING MAINTAINS MOMENTUM

While many sectors of the economy were sputtering well into the recovery, the manufacturing sector started off strong in 2010, in the country as a whole and in the Southeast. Business investments in machinery, technology, and other capital expenditures boosted orders and production indices to levels not seen in years. Likewise, retailers and wholesalers began to restock inventories from the low levels they had maintained during the recession. Both overall industrial and manufacturing production grew strongly in the first half of the year. In testimony to Congress in April, Federal Reserve Chairman Ben Bernanke acknowledged the strengths in the manufacturing sector in an otherwise bleak economic outlook.

Employment in the industry remained weak in 2010, however, even as production and inventory picked up. Hiring by cautious southeastern manufacturing firms was slow to nonexistent in 2010. Factors other than an increased workforce helped employers boost production: the remaining workers and temporary employees picked up the slack, a trend evidenced by a continued rise in overtime hours that began in early 2009. Manufacturers' investments in productivity-enhancing technological improvements, seen in the rising orders for machinery and technology that began in the spring, also boosted productivity. These orders continued to grow rapidly throughout the summer and slowed later in the year.

Capacity utilization rates improved throughout 2010, but failed to catch up to pre-recessionary levels (see chart 1). Capac-

Chart 1
Industrial Production and Capacity Usage



Note: Data are through Sept. 2010. The gray bar indicates recession.
Source: Federal Reserve Board of Governors



A shoemaker in his Kenner, La., shop in September 1938



ity utilization had reached only about 75 percent by September; 80 percent is considered a historical norm.

Southeast's trends mirror the nation's

Almost every recovery sees a rapid rise in manufacturing indices at first and then a leveling off to normal rates of growth. In September, the Institute for Supply Management's (ISM) new orders index dropped to 51.1, indicating slower growth than the year's average to that point. Retailers and wholesalers began to order less as their shelves became restocked.

Southeastern trends in manufacturers' orders largely followed those of the United States as a whole. Earlier in 2010, Kennesaw State University's (KSU) manufacturing index lifted above the 50-point threshold indicative of growth, then spiked in late summer/early fall, indicating stronger growth in new orders. The fall brought a moderation in the growth of new orders, as is common after the initial effects of a recovery (see chart 2).

Production around the Southeast, as measured by KSU's purchasing managers index, ramped back up in 2010 after a lackluster 2009. The majority of survey participants indicated that outlooks and present levels of production were increasing. Nationally, the speed of recovery among manufacturers depended on the type of product manufactured. Manufacturers of information-processing equipment and communication equipment saw better-than-average production rates in late 2010; fabricated metals and business equipment manufacturing also saw an above-par year.

Many hesitant manufacturing firms are more optimistic, including those in the Southeast. Florida saw expansions from

Chart 2
Southeast Purchasing Managers Index and Components



Notes: Data are through Sept. 2010. A reading higher than 50 indicates expansion; lower than 50, contraction. The gray bar indicates recession.
 Source: Kennesaw State University Institute for Supply Management

Tervis Tumbler Company, a manufacturer of insulated drinkware, and Sarasota Medical Products. These expansions are estimated to create about 300 new jobs over the next five years. ThyssenKrupp began production of carbon steel at its Mobile, Ala., facility in late 2010 after the firm announced it would have 1 billion euros of pre-tax profits in its 2010–11 year—after the firm lost 2.4 billion euros in its 2008–09 year.

Foreign investment in the Southeast’s manufacturing sector increased in 2010. Construction on Volkswagen’s Chattanooga, Tenn., plant began in 2010, and the first car is scheduled to roll off the assembly line in 2011. The firm is currently taking applications for employment. Many parts suppliers are setting up nearby, ready to supply Volkswagen with needed materials and the region with jobs. The Volkswagen plant plans to employ 2,000 people directly while estimates for secondary/supplier jobs lie in the neighborhood of 9,500.

Southeast manufacturing goes green

Southeast manufacturing saw the emergence of environmentally friendly, or green, production firms in 2010. As the European Union implemented mandates on renewable energy and clean production standards, several German manufacturers, including Volkswagen and Wacker Chemie, took an interest in Tennessee, particularly in manufacturing related to renewable energy. The weaker dollar plus the state’s generous tax benefits for renewable-energy-producing firms helped lure this development.

Biofuels from Georgia have recently interested European firms seeking to meet clean energy mandates as the state has the largest amount of forested private land owned in the United States. Two companies from Germany and Sweden, operating jointly as Georgia Biomass LLC, opened a \$150 million woodchip production facility in Waycross, Ga., in 2010, creating 75 jobs and

producing 750,000 tons of wood chips a year. Most of the woodchips produced will be shipped back to Europe and converted to electricity to satisfy more stringent environmental demands related to energy production imposed by the European Union in 2010.

The Southeast also welcomed domestic manufacturers that have jumped on the green machine. Epic Wake Boats will employ 400 people at a new production facility in Vivian, La., over the next two years, where they will manufacture a line of electric and hybrid boats as well as a line of hybrid recreational vehicles. High-tech manufacturing related to renewable energy also fared well in the Volunteer State: in 2009, the Clean Energy Economy Study from the Pew Charitable Trust listed Tennessee as one of the three leading states for clean technology job growth. Confluence Solar continued this trend into 2010, opening a \$250 million manufacturing facility in Clinton, Tenn., that brought 250 new jobs to the area. eTec, a firm that manufactures electric car-charging stations, continued expansions in 2010 in the state and is on track to create 750 jobs by 2012. Even construction-related manufacturing, which is lagging in this recovery, has found a spot in clean manufacturing. In August, Soladigm, a manufacturer of energy-saving electrochromic windows, announced \$130 million in capital investment and 300 new jobs in Olive Branch, Miss.

Looking ahead to 2011

Most analysts agree that manufacturing prospects for 2011 are generally much brighter than they were for 2010. New orders and production are still growing, though at a slower pace than they were in the early fall. Consumers are showing a tendency to spend more on durable and nondurable manufactured goods, which bodes well for future orders and production. As of September, more than one-third of manufacturers in KSU’s Purchasing Managers Index indicated they were planning for an increase in production in the near term.

The manufacturing industries to watch in 2011 will include clean energy and high tech firms, which have seen a surge in the Southeast over the past couple of years. Kior (Texas-based) plans to open three facilities across Mississippi over the next five years that will bring an estimated 1,000 new direct and indirect jobs and an investment of \$500 million to the state.

Health care-related manufacturing also seems to have an extended interest in the region. Medline Industries, an Illinois-based manufacturer of health care products, plans to open a manufacturing facility west of Atlanta in 2011, creating 141 jobs.

It appears, though, that just as the 2010 recovery experience in manufacturing varied greatly across products, 2011 will likely bring a feeling of déjà vu. ■



The shoreline in Silver Springs, Fla., 1951



TOURISM TAKES OFF

Tourism is a vital part of the southeastern economy. Compared with about 10 percent of total U.S. employment in leisure and hospitality, four out of the six southeastern states in the Atlanta Fed's district have employment shares at or above that level (see chart 1). Tourism took a big hit during the recession as both domestic and international visitors cut back on their spending, especially on vacations. The industry started to improve in 2010, and Atlanta Fed regional contacts are optimistic about the future.

Vacation vitality reviving

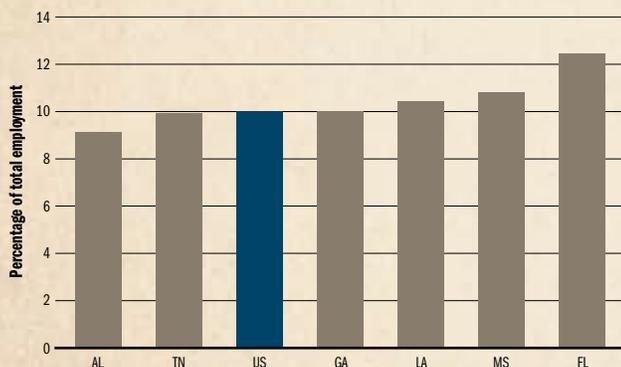
Nearly every aspect of tourism improved in 2010. According to the Bureau of Economic Analysis, tourism spending in the United States increased in the first and second quarters of the year, at an annual rate of 5 and 3 percent, respectively. As tourism spending improved, so did the industry's employment growth. Leisure and hospitality payroll employment increased in the region compared with 2009. Tourism employment is still modestly declining in Mississippi and Tennessee but not nearly as quickly as it was a year ago (see chart 2). The Gulf oil spill posed serious challenges to tourist destinations in Alabama, Mississippi, and Florida (see the sidebar).

According to the Federal Aviation Administration, several of the busiest airports in the United States are located in the Southeast. Of the 50 busiest airports, Atlanta's ranks number

one. The airports in Orlando, Miami, and Fort Lauderdale, Fla., are also on the list. Passenger traffic at these airports increased in 2010 compared to 2009 (see the table). The biggest increases at these airports were in international passenger traffic, which rose between 2.5 percent and almost 10 percent versus a year ago. These increases bode well for the tourism industry, as international visitors tend to stay longer and spend more than domestic visitors.

After a weak 2009, hotel bookings and occupancy rates in 2010 saw modest improvements in a number of major Southeast cities, including Atlanta, Miami, Nashville, New Orleans, Orlando, and Tampa (see chart 3). Miami's occupancy rate exceeded the U.S. average rate as of the third quarter of 2010. Still, despite the increase in occupancy, hotels' pricing power has not returned to all cities in the region, as the average daily rate in some cities is still below their year-ago levels.

Chart 1
Leisure and Hospitality Employment



Note: Data represent an average from Jan. 2010 through Sept. 2010.
Source: U.S. Bureau of Labor Statistics

Conventions numbers strengthening

Business travel rebounded in 2010, as companies that had reduced corporate travel the previous two years began ramping up again. Atlanta, a hub for business travel, gained from the increase and also saw a rise in convention center bookings. In Alabama, most tourism consists of Gulf Coast leisure travel, but the rest of the state received a fair amount of business travel, especially from international companies with operations there.

Contacts in New Orleans reported increased convention bookings in 2010 as well as for 2011. In addition, 2010 was a very successful year for festivals in New Orleans. According to the New Orleans Convention and Visitors Bureau, several record attendance levels were broken in 2010. The French Quarter Festival in April had 512,000 people. Mardi Gras, the grand-

Oil Spill Disrupts Gulf Coast's Tourism Footing

One of the biggest setbacks in recent history for the southeastern tourism industry was the April 2010 Gulf oil spill. Both the U.S. Travel Association and Oxford Economics predicted that the economic losses for Gulf Coast tourism could top \$23 billion over the next three years.

Over the summer, reports of cancellations of rental homes and hotel rooms increased while sales of vacation properties decreased. However, some hoteliers noted high occupancy rates in part because of the influx of cleanup workers, oil company personnel, and National Guardsmen. Reports of oil reaching Southwest Florida and the state's eastern coast had a negative impact on hotel and rental property bookings there. Contacts from Naples/Fort Myers and the greater Miami area reported that reservations slowed significantly for both leisure and business groups despite the fact that no oil reached Florida beaches outside of the Panhandle.

Some contacts reported some increased tourism activity in the unaffected coastal areas of the Southeast. For instance, contacts on Florida's East Coast and in Georgia and Tennessee noted increases in hotel bookings.

According to data from the U.S. Census Bureau, around 124,000 people are employed by firms in the leisure and hospitality industry in the counties along the Gulf Coast from Louisiana to Panama City. While there were several reports of reduced seasonal hiring by hospitality businesses, employment data for these areas showed no obvious impact. The number of employees in leisure and hospitality for Gulf Coast metro areas (excluding New Orleans) was up slightly in the summer of 2010 compared with 2009 and is in line with the average for summers over the past decade, according to data from the U.S. Bureau of Labor Statistics (see the chart).

The challenge ahead for the southeastern tourism industry is travelers' perception of the Gulf Coast. A risk factor for the tourism industry is long-term damage to the Gulf Coast brand as a fishing, recreation, and tourism destination. ■

Chart 2
Leisure and Hospitality Payroll Employment



Note: Data are through Aug. 2010. The gray bar indicates recession.
Source: U.S. Bureau of Labor Statistics

Change in Airport Passenger Traffic

Airport	Domestic	International
Atlanta	0.4 (July)	2.4 (July)
Miami	3 (August)	5.3 (August)
Orlando	1 (July)	9.8 (July)
Fort Lauderdale	3.2 (August)	9.9 (August)

Note: Figures represent percent changes in passenger traffic for the month indicated in 2010 versus 2009.
Source: Local aviation authorities

daddy of the city's events, typically draws between 800,000 and 1 million attendees every year, but 2010 marked the largest crowds in 25 years, drawing well over 1 million. Also, more than 800,000 people gathered in New Orleans in February 2010 for the Saints' Super Bowl homecoming victory parade.

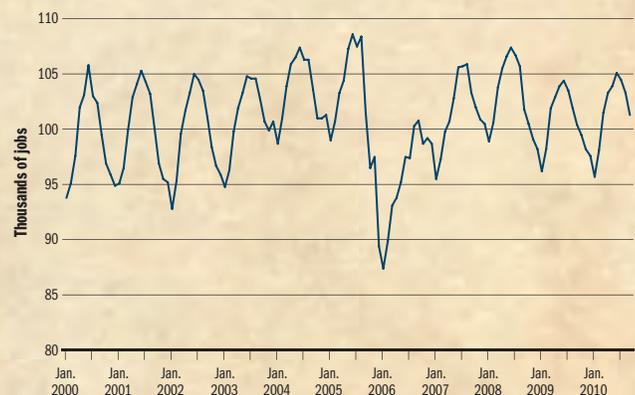
Attractions gaining traction

Leisure travel in the Miami and Fort Lauderdale area also improved in 2010. Group sales and bookings in South Florida increased modestly in 2010 and are picking up for 2011. The area attracts travel groups from all demographics, domestically and internationally.

One of Florida's biggest attractions, Disney World in Orlando, experienced a slight decline in attendance during 2010, compared to a year ago. The park will likely restore its higher pre-recession prices as demand picks up. Universal Studios, also in Orlando, experienced a slight increase in attendance in 2010 for the first time in several years and is keeping pace with Disney in terms of increasing its ticket prices.

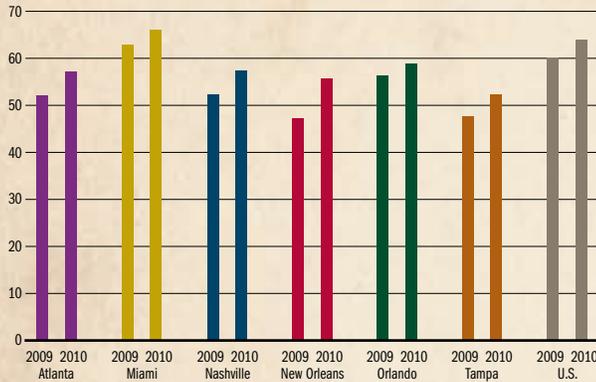
Other attractions in the region faced more challenges than just a weak economy. In Nashville, Tenn., the 2010 spring flood-

Employment in Leisure and Hospitality, Gulf Coast Cities



Note: Data are through Sept. 2010 and are not seasonally adjusted.
Source: U.S. Bureau of Labor Statistics

Chart 3
Hotel Occupancy Rates



Note: Data for both years are for the month of August.
Source: Smith Travel Research

toward improvement. However, analysts are also cautious about other environmental impacts, such as from the Gulf oil spill (see the sidebar) or hurricanes. Despite the challenges that faced the tourism industry in 2010, the overall outlook remains positive. ■

Mark Carter, Amy Ellingson, Sandra Kollen, Whitney Mancuso, and Gustavo Uceda of the Atlanta Fed's research department, as well as Lon Lazzeri of the Atlanta Fed's Miami Branch, contributed to this article.

ing had a profound impact on the community and tourism. The Grand Ole Opry, the Wildhorse Saloon, the Gaylord Springs golf course, and the Gaylord Opryland Hotel and Convention Center all sustained floodwater damage and were closed for various periods of time. The most significant damage occurred to the Grand Ole Opry, which lost millions of dollars of tourism business during the height of the summer season.

Although travel has improved in 2010, tourists are still looking for deals and discounts. Southeastern contacts in the cruise line industry reported that while demand still exists for cruises, it is for less exotic and less distant cruises. Occupancy on cruises has been strong, but cruises have not been able to raise prices to prerecession levels. In addition, passengers are not spending onboard as much as they did before the recession began.

Travelers are being frugal in restaurants as well as on cruises. Across the region, restaurants have seen a decline in revenues. Not only are individuals eating out less often, but when they do go out, they are buying cheaper meals and going to cheaper restaurants. Customers are still looking for discounts and deals, much as they did throughout the economic downturn, and restaurants have responded with smaller portions, special offers, and greater menu variety.

Looking ahead to 2011

Most analysts anticipate gradual continued improvement in regional tourism and expect a comeback by the industry as the economy continues to improve into 2011. Leisure tourism will benefit from a recovering economy as households, both here and abroad, increase their discretionary spending. Southeastern contacts expect the momentum of business travel to continue into 2011, and convention bookings for next year already point

CONTINUED FROM PAGE 1

Addressing monetization concerns

A policy of monetizing debt would be most properly understood as a policy in which the Fed ties its purchases of Treasury securities to new debt issues by the Treasury. In this situation, the intent would be to enable the government to finance near-term deficits, eventually inflate away some of the nominal value of government debt, or both. This is *not* the objective of the Fed's November decision.

In my view, the current policy is designed to support the expansion of the economy and to maintain inflation near the FOMC's desired objective for price stability. Although not explicit, this objective is understood to be a level of core CPI of 2 percent or lower. I have every confidence the policy will revert to reducing the size of the Fed's holdings as those conditions are met.

I feel it is particularly important to understand that the FOMC's purchase program is conditional and will be evaluated in light of developing economic conditions. When conditions warrant, these purchase operations will cease, and eventually sales will be instituted. I am confident these decisions will be made independent of fiscal considerations.

Preserving the value of the dollar

It has also been argued that the Fed's asset purchases have the intent—and also the effect—of devaluing the dollar. As I see it, there is no monetary policy intent to engineer specific values—or even a direction—for the dollar. In other words, this policy was *not* undertaken to prompt dollar depreciation.

Prices of many types of assets are affected by monetary policy actions. The monetary transmission mechanism works by altering the relative price of various assets. The effectiveness of the policy will not hinge on dollar depreciation and, therefore, the price of the dollar in foreign exchange markets.

For those concerned about the dollar's value, I believe it is important to stress that the most critical factor in maintaining the dollar's value is a strong economy with stable inflation. It is true that the short-term effect of the Fed's policy put some downward pressure on the dollar for a time as markets reacted to the prospects of lower interest rates for a longer period and less risk of deflation. But the purpose of the policy is to strengthen the U.S. economy, which is in the world's interest.

Avoiding unwanted inflation and other risks

A number of people have raised a third concern: namely, that this approach is new and unconventional and fraught with risks that are going to harm the economy over the longer term.

It's true that a large-scale asset purchase program is an unfamiliar policy in the sense that we are not targeting the federal funds rate. And I acknowledge there is uncertainty associated with this policy approach as compared with fed funds rate targeting. Much of that uncertainty revolves around scale and lags—how large do the purchases need to be to have a noticeable effect? And how quickly will we discern that effect? In my mind, the perceived risks—particularly the risk of overshooting inflation—must be weighed against the risks that could be associated with a policy of inaction. Chief among those risks is a recessionary relapse possibly tipping into a long spell of deflation. Through the summer there were some signs of renewed disinflation, which could have led to deflationary expectations taking hold. This did not happen.

I believe it is important to stress that our experience in dealing with inflation versus deflation is not symmetric. In the event of a policy overshoot, inflation containment requires the implementation of the mostly familiar strategy of raising short-term interest rates. In the event of an undershoot, however, dealing with a

deflationary spiral and the attendant real consequences would be far less familiar territory for policymakers.

Will it work?

A final criticism levied against the asset purchase program is that it will fail to foster economic growth and price stability—that is to say, it won't work. It's important, I believe, that we be measured in our expectations about how much more stimulus can accomplish in the current environment. I don't have outsized expectations. I see it as a precaution aimed at reducing or eliminating downsides. I also see it as an insurance against deflation.

Further, in terms of near-term economic activity, I see the additional asset purchases as buttressing the ongoing effects of policies that have already been put in place. I expect it should have some incremental positive effect on overall demand. With regard to price stability, this policy has already shown some signs of success by altering inflation expectations and reducing the risk of unwanted disinflation.

Managing inflation expectations requires following through with policy actions consistent with stated objectives—in this case, ensuring that inflation trends remain in a desired zone. The FOMC's November decision should be seen in that light. ■

This article is adapted from a November 2010 speech by Dennis Lockhart.

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1

In millions, the number of 2010 Mardi Gras attendees, the event's best attendance in 25 years

Source: New Orleans Metropolitan Convention and Visitors Bureau, as cited in *EconSouth's* article, "Tourism Takes Off"

8.5

Improvement, in percent, of Georgia's sales tax revenues in 2010 over 2009 collections

Source: Georgia Department of Revenue, as cited in *EconSouth's* article, "Consumer Spending Has Ups and Downs"

60

Percent of U.S. jobs created by small business

Source: Federal Reserve Chairman Ben Bernanke, as cited in *EconSouth's* article, "The Big Impact of Small Business"

23

Share, in percent, of U.S. mortgages with negative equity

Source: CoreLogic, as cited in *EconSouth's* article, "Good News, Bad News in 2010 Color Outlook for 2011"

85

Number, in millions, of bottles of water consumed daily in the United States

Source: National Public Radio feature, "War on Tap"



15.2

Number, in millions, of automobiles recalled in the United States in 2009

Source: National Highway Traffic Safety Administration

72.7

Area, in millions of acres, devoted to growing corn in the United States

Source: U.S. Department of Transportation

25,482

Miles of waterways in the United States

Source: Central Intelligence Agency

79

Percent, in volume, of fish and shellfish imported into the United States, 2000-05

Source: U.S. Department of Agriculture

12,000

Miles of U.S. waterways used for commerce

Source: Central Intelligence Agency



15,079

The number of airports in the United States

Source: Central Intelligence Agency



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The Atlanta Fed's conference on Small Business, Entrepreneurship, and Economic Recovery (left), held in October 2010, was a much more sedate affair than the inaugural Conference of Small Business Men held on Feb. 2, 1938, in Washington, D.C.; nearly 1,000 businessmen from 45 states attended the conference.

now **and** then