





Another Year of Modest Growth for the Southeast

Now that the Great Recession is in the rearview mirror, did the growth of the Southeast's economy finally accelerate in 2014? Or did the region continue to move along slowly, much like it did in 2013?

In 2014, the Southeast's economy took much the same path it did for the last two years—slow and steady growth—according to data and reports from the Atlanta Fed's business contacts. However, 2014 has been characterized by a few, slightly more positive differences as more sectors experienced improvements compared with recent years. Besides the sectors that fared well in 2013—tourism, auto sales, and residential real estate, for example—other sectors, including commercial construction, manufacturing, banking, and hiring, picked up across the region in 2014.

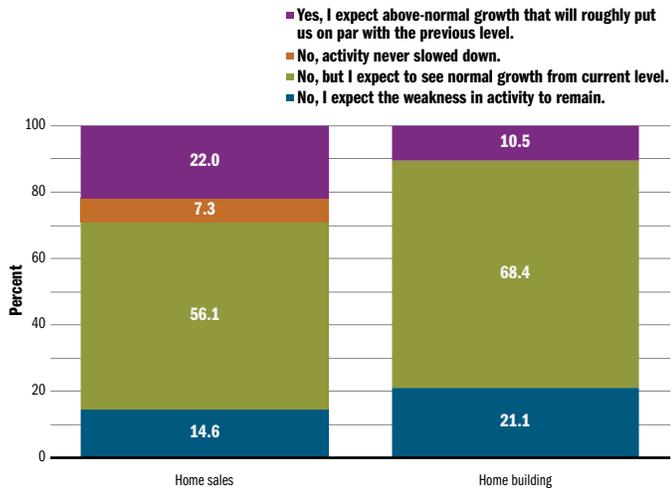
Real estate's pulse strengthens

Housing markets across the Southeast continued to recover throughout 2014, with incremental growth reported by most business contacts who participate in the Atlanta Fed's monthly poll of residential brokers and homebuilders.

In the first half of the year, home sales and new home construction got off to a slow start, inventory levels were low, and home price growth was fairly robust. Many industry observers attributed the lackluster growth in home sales and construction activity to the unusually harsh winter weather. Although participants in the Atlanta Fed's monthly poll agreed that the weather had an impact on their businesses, they suggested other factors were behind the slower growth, including higher home prices, limited inventory, and higher mortgage rates. The majority of business contacts indicated they did not expect to see a return to above-normal growth in home sales and new home construction that would recoup the activity lost in the first few months of the year. Instead, they anticipated normal growth from the current level as the year progressed (see chart 1 on page 8).

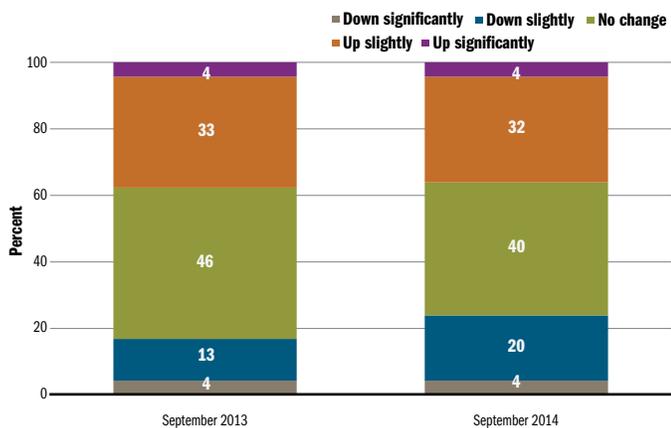
By the end of 2014, contacts' expectations seemed to have been quite accurate. Home sales and construction activity across the Southeast picked up by midyear. Although home sales and construction activity were generally described as ahead of last year's levels, this improvement was relative to historically low levels of activity in the preceding years. Home price appreciation continued in most markets across the Southeast, though the rate of appreciation slowed as the year progressed. The poll indicated that, at least for new homes, difficulty in obtaining a mortgage and supply-chain

Chart 1
Outlook for Home Sales and Construction



Note: Respondents were asked if they foresee a rebound in home sales and home building.
 Source: Atlanta Fed business contact poll

Chart 2
Southeast Builders' Construction Expectations in the Near Term



Note: Respondents were asked about expectations over the next three months. Data depict year-over-year expectations.
 Source: Atlanta Fed business contact poll

constraints (such as the lack of vacant developed lots in viable locations, difficulty finding qualified subcontractors, and challenges in obtaining reasonably priced financing) were bigger obstacles in the second half of the year.

Commercial real estate contacts indicated that the sector's fundamentals improved in 2014, with rents and absorption rising across many property types. Reports from commercial contrac-

tors suggested that the pace of nonresidential construction was ahead of last year's level and that multifamily construction activity remained quite strong.

Looking forward to 2015, the Atlanta Fed's September housing poll indicated that brokers' and builders' outlook for home sales remained fairly positive, with the majority of contacts saying they expect sales to increase or stay the same during the next several months. Builders' expectations for construction activity are somewhat mixed but mirror their expectations from a year ago, suggesting this mixed outlook may stem from seasonal factors (see chart 2). On the commercial side, most construction contacts expect the pace of nonresidential and multifamily construction activity to continue to increase from current levels as 2014 comes to a close.

In retail, customers kept purse strings drawn

The retail sector began 2014 rather sluggishly. Inclement weather early in the year kept large numbers of consumers at home and unable to shop. However, those retailers specializing in winter-specific merchandise fared well. In addition to the weather, an overwhelming unknown that many contacts reported was the impact of increased health care premiums and mandatory health insurance on household discretionary spending, an ongoing concern for merchants.

However, retailing saw some good moments in 2014. For example, Valentine's Day provided a boost to activity following the slow growth during the winter. Some Southeast merchants reported double-digit, year-over-year sales growth during this time. But retailers in 2014 overwhelmingly described the need for heavy promotional activity and discounting, which they especially experienced during the back-to-school shopping season.

Retail's shining star throughout this year was motor vehicle sales, which continued to experience robust growth. Both commercial and consumer automobile sales performed well.

Overall, retailers were optimistic heading into the 2014 holiday season, and auto dealers expect sales to continue to be robust into 2015.

Tourism moved into the fast lane

The hospitality sector remained strong throughout most of 2014 despite a slow start to the year. Adverse winter weather extended the school year for some students, resulting in a soft start to summer vacations, family entertainment venues throughout the region noted. However, activity picked up to expected levels as the summer progressed.

In general, contacts gave upbeat reports throughout the year, with strong demand described in Atlanta, New Orleans, and south Florida. The number of visitors to the Southeast increased year over year, and international tourism continued rising. Tourism contacts reported higher year-to-date occupancy rates at hotels and resorts compared with the same period last



year. Consumer spending primarily increased in luxury restaurants, hotels, and high-end retail stores in many tourist destination areas.

Southeast contacts discussed how expansion in the tourism sector resulted in job growth. Many contacts indicated that technology reduced the need for some labor resources. However, industry executives cite the desire to continually create environments for travelers that require a human touch, resulting in the need for additional workers as the sector expands and new venues open. Tourism contacts expressed concerns about the challenges of finding skilled labor for specialized positions in technology, mathematics, engineering, and management, with some accompanying pressure to increase wages in these specific positions.

During 2014, hospitality contacts reported an increase in capital expenditures across the region, with heavy construction activity for new hotels, sports venues, and other attractions, in addition to renovations of restaurants, hotels, and convention centers. The completion of various new entertainment venues increased demand for leisure travel, and business travel was healthy.

Southeastern contacts anticipated a solid ending to 2014 heading into winter, with strong advance bookings in hotels and conference venues for the first two quarters of 2015.

Manufacturing makes strides

Manufacturing activity in the Southeast performed well in 2014, despite a modest start to the year as a result of adverse weather. The automotive industry was particularly strong, with manufacturers and parts suppliers in the Southeast reporting robust production.

The Southeast Purchasing Managers Index (PMI), which tracks manufacturing activity in the region, confirms the strong activity reported by contacts this year. The index is based on

a survey of purchasing managers from manufacturing firms in Alabama, Florida, Georgia, Louisiana, Mississippi, and Tennessee regarding activity in new orders, production, employment, supplier delivery time, and finished-goods inventories. A reading above 50 for any of the components on the index represents an expansion in the manufacturing sector, and a reading below 50 indicates a contraction.

According to the PMI, the manufacturing sector expanded every month in 2014. Rebounding from the bitter winter weather early in the year, the second quarter was especially strong, and the PMI averaged an overall reading of 59.4 points during that quarter, compared with 56.0 points in the first quarter.

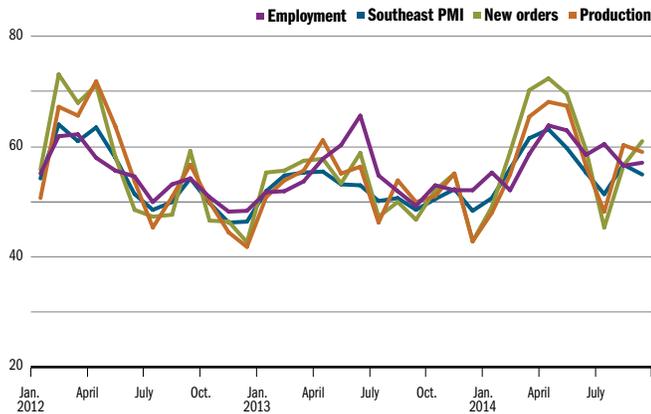
More recently, the PMI has held steady. The September index was 55.0 points, a slight drop from the 56.7 seen in August but still a healthy reading. The new orders subindex registered a solid increase of 4.5 points over August and averaged 60.3 points for the first nine months of the year. Although the production subindex fell 1.2 points from August to September, it still remains strong with an index reading of 59.0 (see chart 3 on page 10). Payrolls at regional manufacturers also increased in 2014. The employment subindex expanded each month during 2014, suggesting that manufacturers were hiring.

Overall, the outlook for regional manufacturing activity appears optimistic. The rise in new orders and solid production and employment numbers in September should bode well for the rest of the year.

Capital investment firms up

As 2014 rolled on, businesses increasingly reported moving forward with capital investments, although firms continued to concentrate on controlling costs and strengthening their balance sheets. Business contacts reported that their core capital expansion plans include investing in technology to increase productiv-

Chart 3
Southeast Purchasing Managers Index



Note: A reading above 50 represents an expansion in the regional manufacturing sector; a reading below 50 indicates a contraction.

Source: Kennesaw State University Econometric Center

ity and manage labor costs. The energy, hospitality, and health care industries reported strong capital expansion plans for upgrading aging infrastructure, replacing aged transportation fleets, and adding new facilities. Contacts in the industrial sector reported capital investment in response to growing demand for products that use technology to heighten warehouse management efficiency. Merger and acquisition activity continued to be robust in 2014, especially in the financial services, technology, health care, and energy industries.

The transportation sector gains momentum

Transportation began 2014 with mixed results brought on by the region's rugged winter, but activity improved in the spring and continued to expand as the year progressed. Southeast trucking contacts reported strong freight volumes and notable increases in tonnage. The railroad industry saw considerable increases in shipments of petroleum products and sand used in the hydraulic fracturing process to produce petroleum fluids, and already strong intermodal traffic gained additional strength. Port

contacts became especially upbeat by midyear, citing a rise in energy exports and record container volumes.

Reports on employment levels varied compared with a year ago, as some logistics companies reported significant additions to staffing levels, and other industries kept staffing levels flat. In trucking,

struggles to find qualified drivers persisted, and industry regulations represented another drag on productivity. Wages increased modestly across most transportation industries with the exception of trucking, where wages have continued to increase about 6 to 7 percent annually for the past several years.

Regarding capital expenditures, contacts reported significant investments for port property and infrastructure expansion, and they noted substantial expenditures in rail infrastructure and rail car capacity. Some logistics contacts cited expansions of hubs and trucking fleets to meet rising demand.

Stories about pricing power were mixed. Most contacts indicated some ability to raise prices, but others reported significant pushback by clients. Contacts noted capacity issues throughout the domestic transportation infrastructure, which contributed to the railroad industry's ability to increase prices.

As the industry looks to 2015, the shortage of truck drivers and increased industry regulations could combine to diminish capacity for the foreseeable future. Trucking rates are expected to go up amid rising demand, reduced capacity, and continued increases in driver pay. Nevertheless, our transportation contacts' outlook for growth improved over the year, and the majority expect higher activity for 2015.

Banking continues to mend

Most financial institutions were better off in 2014 than they were at the height of the financial crisis. Deposit levels remained high as customers turned to the safety of insured deposits for little or no return. Competition for high-quality borrowers also remained high, and although the availability of credit improved, more due diligence was required and the loan approval process took longer.

Southeast banks saw a slight increase in loan growth over the year. Demand for some loans was up from year-ago levels as some businesses expanded and increased their need for working capital. Commercial and industrial (C&I) lending was the strongest portfolio, and some larger banks loosened underwriting standards and extended the terms of fixed-rate loans in an effort to attract new C&I loans. Next to C&I loans, the consumer loan portfolio had the most growth, driven primarily by student and automobile loans.

In 2014, more banks said they were actively making construction loans. Some contacts also noted increased demand for second mortgages and commercial development loans, including those for acquiring residential lots and building speculative warehouse space. Delinquencies were down and have returned to prerecession levels at many institutions. Community banks continued to struggle with the low-interest-rate environment and increased competition for loans.

Although mortgage rates remained near historically low levels in 2014, total mortgage applications fell on a year-over-

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year basis. Some lenders reported a rise in purchase mortgage activity, but not enough to offset the decline in refinance. Mortgage demand overall was lower than last year, and most banks attempted to avoid interest rate risk by making short-term adjustable-rate mortgages instead of fixed-rate ones.

The pace of bank failures slowed nationwide, and Florida and Georgia were each home to only one failure year to date. Together, the two states account for almost one-third of all bank failures in the nation since the beginning of 2008.

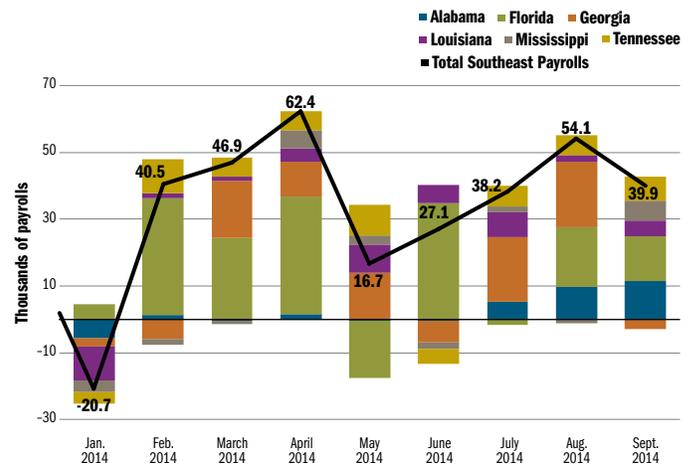
The outlook for the banking industry is improving. Many banks have loosened underwriting standards somewhat, but are keeping credit standards at higher levels than before the banking crisis began.

Employment gains muscle

The Southeast's labor market showed signs of improving in 2014. Overall, employment reports from business contacts were positive. However, just as in 2013, demand continued to outweigh supply in certain highly skilled positions.

During 2014, contacts continued to cite challenges finding qualified labor (for example, truck drivers, skilled tradesmen, construction workers, and information technology and financial services professionals). By midyear, business contacts indicated the difficulty had both intensified and broadened across the skill and occupation spectrum—compliance, accounting, management, and analytical positions joined the difficult-to-fill category. To address the situation, some business leaders in the region expanded training and mentor/apprentice programs for new employees, and others increased wages to attract qualified workers and stay ahead of the competition. A number of other contacts expressed concerns that the challenges were difficult to resolve as many attributed part of the problem to a lack of soft skills among applicants.

Chart 4
Contributions to Change in Net Payrolls by Southeastern State

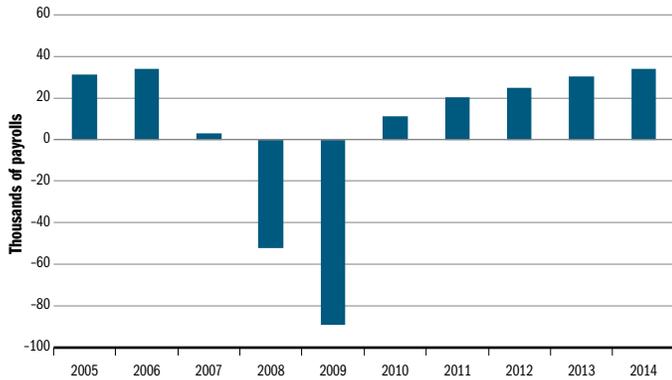


Note: Data are seasonally adjusted and are through September 2014.
Source: U.S. Bureau of Labor Statistics

Although a number of regional business contacts struggled to fill specific positions, employment growth was mostly positive in 2014. Payroll creation varied from state to state, though most saw net increases each month (see chart 4).

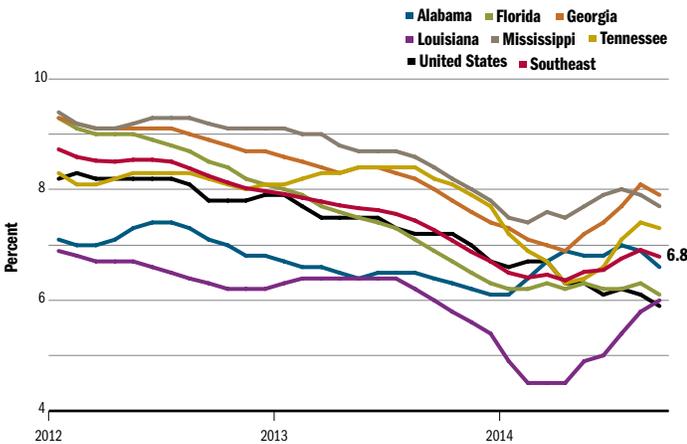
The region's states added an average of 33,900 net new payrolls each month from January to September. During the same period in 2013, each southeastern state added an average of 30,500 jobs per month. In 2012 the monthly net average was 24,700 new payrolls, indicating that regional job growth has followed a positive path during the last few years and is now hovering around prerecession averages (see chart 5 on page 12).

Chart 5
January–September Average of Contributions to Changes in Net Southeastern Payrolls



Note: Data are seasonally adjusted, represent a regional aggregate, and go through September 2014.
 Source: U.S. Bureau of Labor Statistics

Chart 6
Unemployment Rates for Southeastern States, 2012–14

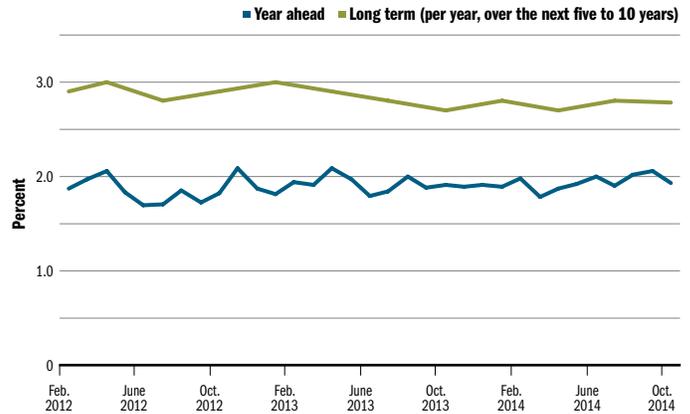


Note: Data are seasonally adjusted and go through September 2014.
 Source: U.S. Bureau of Labor Statistics

At the start of 2014, the region's aggregate unemployment rate was 6.5 percent. After a few months of teetering at that level, the aggregate rate began to tick up around midyear. As of September, the rate was 6.8 percent, still much lower than rates during the recession (see chart 6).

Of the Atlanta Fed's business contacts who did not increase permanent staff in 2014, many said they preferred to use technology and overtime and employ contract or temporary labor. Some contacts indicated they did not increase staffing levels because

Chart 7
Inflation Expectations



Note: Longer-term inflation expectations are measured on a quarterly basis. "Long term" is defined as per year over the next five to 10 years. Data are through October 2014.
 Source: Atlanta Fed business inflation expectations survey

of uncertainty surrounding health care reform. By midyear, firms began discussing their renewed investment in leadership development and training programs for existing staff, which had been put on hold for a few years.

Looking ahead to 2015, several business contacts said they expect growth in overall demand, which could result in the need for additional workers to handle anticipated business growth.

Inflation remains tame overall

Inflation remained subdued for 2014, a condition likely to continue through the coming year. Input costs varied over time and industries. On the construction side, reports of materials' price pressures that were common early in the year dissipated in the late spring. This reduction of price pressure was particularly notable for materials used intensively in single-family housing as opposed to commercial construction. The hospitality sector continued to report price pressures with food proteins. During the year, business contacts expressed the inability and reluctance (or both) to pass price increases on to the customer. Some restaurants reported trying to pass on some of those price increases, with varying degrees of success. Overall, little difference exists in what contacts are saying this year regarding input prices and price pass-through and what they said in the last couple of years.

Contacts reported that wage pressures are exhibiting marginal increases. Most businesses noted wage increases of 2 percent to 3 percent. Larger increases in some specific parts of the labor market are becoming more common, although very few businesses are reporting no changes in wages. The largest increases in wage pressures are coming from the usual suspects: information technology specialists, welders, transportation, and some hospitality segments.



Changes in benefits costs—particularly medical insurance—have varied widely, with some firms experiencing very little increase in insurance premiums and others seeing double-digit increases. Contacts suggest that this large variation in outcomes will continue into 2015.

Although prices of some categories (such as energy) have been volatile and of others (such as foods) generally rising, price increases in other categories have been muted and in many cases falling. On balance, contacts have reported rising housing prices and rents, but increases have occurred at a somewhat slower pace than earlier in the year. Service providers indicated that their prices have been very mixed, with many firms reporting no change for the last several years. A few firms in specific markets have been able to pass on price increases that have actually improved their margins.

The Atlanta Fed conducts a monthly business inflation expectations survey to assess what firms expect in the near and longer term, and those expectations remain fairly consistent (see chart 7 on page 12).

Even with the relative stability of business inflation expectations, the year-ahead measure exhibits more volatility. Nevertheless, it is clear that for the last couple of years, businesses expect near-term inflation to be around 2 percent. It's also apparent that although long-term expectations are higher than those of the near term, those longer-term expectations have been edging down, strongly suggesting that firms are incrementally lowering their long-term expectations.

Energy churned in 2014

In early 2014, the energy industry experienced increased demand, pricing, and productivity for crude oil and natural gas. Natural gas producers' storage levels were low as a result of increased withdrawals, which were necessitated by the unusu-

ally cold weather. Utility contacts reported that commercial and residential demand for power—natural gas, in particular—also intensified during this time. However, companies used excess natural gas reserves to meet the increased demand.

Throughout the remainder of the year, strong production coupled with enhanced pipeline capacity supplied Gulf Coast refiners with adequate amounts of oil and gas. Heavy natural gas flows to south Louisiana prompted a number of companies to announce future investment projects in the region. Generally, the projects include chemical manufacturers and refiners that use natural gas to fuel their operations, and most are scheduled to break ground in the 2016–18 time frame. However, many energy contacts expressed concerns that project start dates may have to be delayed because of the industry's inability to find skilled workers, specifically engineers and tradespeople.

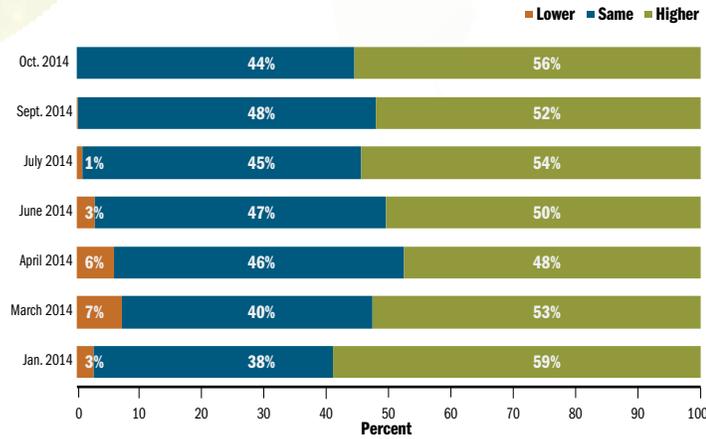
Heading into the end of the year, the industry saw a marked change. Energy contacts reported a glut of crude, and the per-barrel price of oil fell to its lowest level in more than four years. For most of 2014, oil exports from the United States steadily increased and imports fell. However, global demand for crude weakened as the year progressed. Contacts expressed concern that the strength of the U.S. dollar would make oil exports more expensive to the rest of the world.

The outlook for energy among contacts was generally optimistic, though uncertainty about global events and their influence on pricing, productivity, and demand for oil and gas remains a concern.

Agriculture grows robustly

Prices and weather are usually dominant stories in agriculture, and 2014 proved no exception. Agriculture prices, both rising and falling, made headlines this year. Beef, hog, and broiler prices increased since the beginning of the year, and corn, cot-

Chart 8
Near-Term Outlook for Business Growth



Note: Respondents were asked, "What is your outlook for the rate of growth in your business over the next three to six months compared to current rates?"
Source: Atlanta Fed business survey

ton, rice, and soybean prices fell. Although lower corn prices hurt corn producers, they benefited the bottom line of protein producers who use corn for feed.

As for weather-related issues, the Southeast had a bit of everything. Some areas suffered drought conditions, and others had excessive rain, snowfall, frost, tornadoes, or hail. Where these conditions caused severe damage and loss, the U.S. Department of Agriculture (USDA) designated those places as natural disaster areas, allowing affected producers to qualify for assistance.

Business contacts reported that they continue to focus on areas of production such as labor, efficiency, and cost containment. Where unskilled labor is required, finding workers remains a challenge. However, with technological advances—and investments in these technologies—the new paradigm seems to be a model with fewer but better-skilled laborers and expectations of paying more for those skills. Recent lower fuel prices have been a bright spot for agriculture producers with hopes that lower petroleum prices will result in fertilizer and pesticide cost containment.

When agriculture contacts are not juggling weather problems, pricing issues, labor, or efficiency concerns, they face other challenges. One is how to respond to increasing consumer demand for information about health and wellness and sustainability processes. Also, like many other businesses, agriculture producers are watching to see what impact a strengthening dollar or a slowdown in foreign economies will have on product demand and prices.

Going into 2015, the outlook among agriculture contacts is mostly positive. While Florida citrus growers continue to

fight the effects of citrus greening—a bacterial disease with no known cure—there is welcome news of increased research funding from the USDA, which also reported that the forecast for Florida's orange crop production in 2014–15 is slightly higher than the last growing season's production. In terms of other USDA crop projections for 2015, cotton projections show increased production and slightly lower exports compared with 2014 estimates, and rice and soybean producers are projected to increase production and exports in 2015. Beef production and exports are slightly lower, and pork and broiler projections are higher in both production and exports. Overall, protein prices are forecast to remain high with the exception of hog prices, which are predicted to be somewhat lower based on increased supplies.

What's in store for 2015?

Forecasts generally indicate that the nation's real gross domestic product should accelerate in 2015. Given the broad-based improvements this year in overall economic conditions in the Southeast, the region should experience much of the same growth in output.

One way the Atlanta Fed gauges the outlook for growth is through the boards of directors at the Atlanta head office and its five branches (44 directors in total). Each week prior to the Federal Open Market Committee meeting, the directors respond to a poll regarding the outlook for their businesses. At the end of 2013, the outlook among directors and business contacts was optimistic, and that optimism carried all the way through 2014. The most current results show that the outlook for the next three to six months is positive, with 44 percent of directors expecting the same rate of growth over the next three to six months and 56 percent expecting a higher rate of growth. None of the directors indicated that growth in their business would be lower in the near term (see chart 8).

These results are an improvement over 2013 largely because the number of unfavorable factors decreased in 2014. In 2013, contacts voiced concerns over the effects of the debt ceiling, the partial federal government shutdown, the Affordable Care Act (ACA), and the regulatory environment. In 2014, there are concerns regarding the ACA, the strengthening dollar, and some regulatory issues, but these concerns are not as pervasive as they were last year.

In general, most Atlanta Fed contacts expect growth in the near term to continue on the same trajectory as in 2014, with modest acceleration in 2015. ■

This article was written by Sarah Arteaga, Troy Balthrop, Tom Cunningham, Marycela Diaz-Unzalu, Jessica Dill, Rebekah Durham, Pam Frisbee, Teri Gafford, Shalini Patel, Gail Psilos, and Christine Viets.