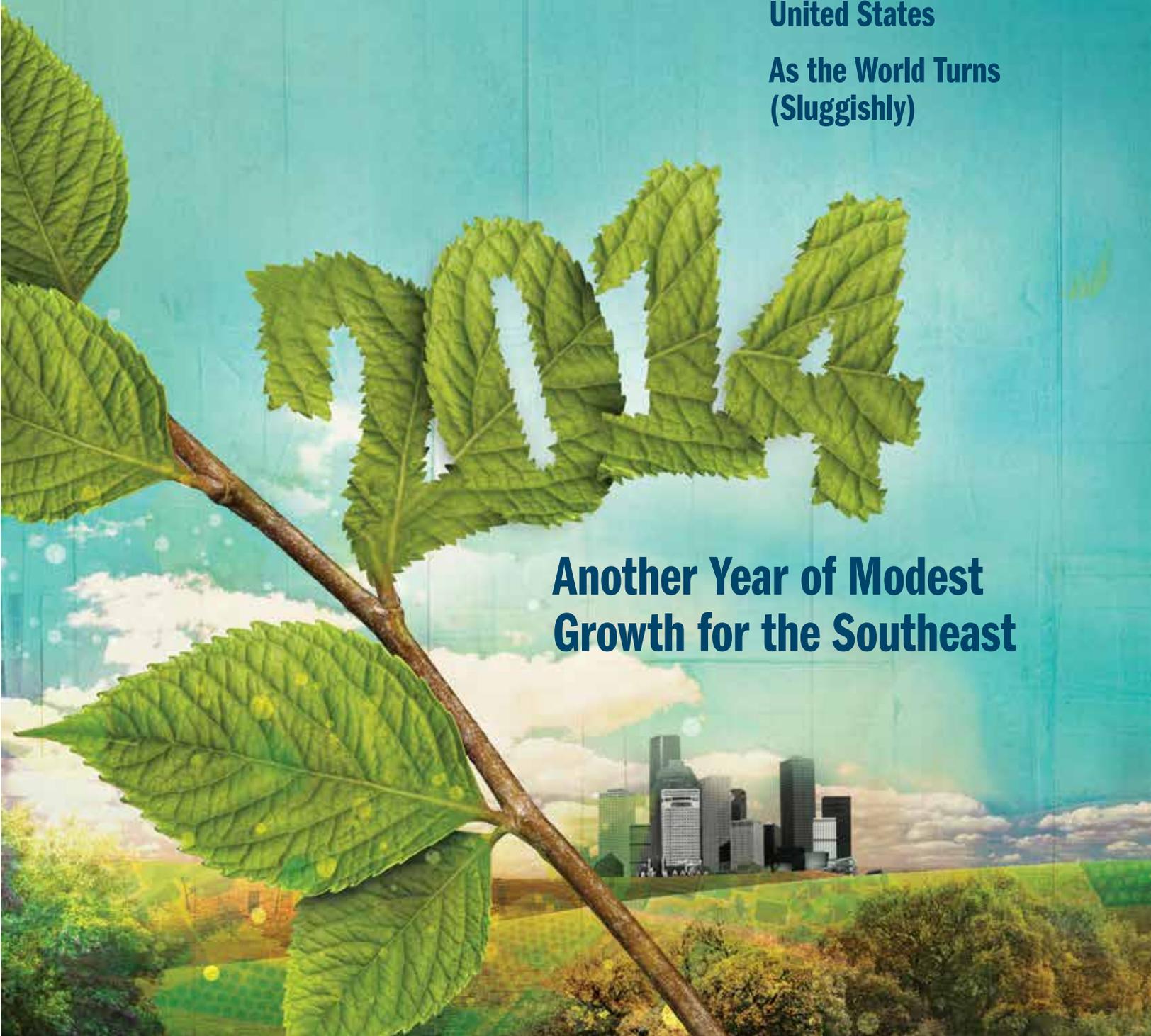


EconSouth[®]

**Divergence: Wealth and
Income Inequality in the
United States**

**As the World Turns
(Sluggishly)**

**Another Year of Modest
Growth for the Southeast**



EconSouth

FEDERAL RESERVE BANK OF ATLANTA SEPTEMBER-DECEMBER 2014



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1 Fed @ Issue

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Divergence: Wealth and Income Inequality in the United States

Some economists have sounded an alarm about growing income inequality in the United States. How significant are the long-term implications of income inequality for the U.S. economy and its productivity?

Another Year of Modest Growth for the Southeast

The Southeast spent much of 2014 in an ongoing struggle to attain prerecession levels in employment, home prices, and construction. In some ways, the region made considerable progress, but consistent growth remains elusive. Is 2015 shaping up to be the year the region regains ongoing traction?

As the World Turns (Sluggishly)

A wide array of events—some foreseen, some not—combined to restrain global economic growth in 2014. Abundant risks to growth lurk on the horizon, so 2015 might also experience slower-than-hoped-for economic expansion.



Remaining Employable in the Evolving Workforce



DENNIS LOCKHART is president and chief executive officer of the Atlanta Fed.

The long-term employability of the American workforce is of great interest to the Federal Reserve, given our dual mandate of low inflation and maximum employment. Based on what we're seeing, the skill sets needed by workers are evolving just as the preferences of employers are also evolving. Workers must be equipped with both soft and hard skills to navigate the future we envision.

Developing soft skills early

When employers consider job candidates, they want to know if the person has the necessary work ethic, will reliably show up for work, can work with others, can act professionally, and can pass a drug test. In the Atlanta Fed's conversations

with employers in the Southeast, we frequently hear about a prevalence of job candidates who fail initial screenings because they lack these softer skills. The sooner workers possess these skills, the more likely they are to have lifelong employment.

One successful program that addresses these concerns is Year Up, which works with young adults in eight metro areas to develop professional demeanor and personal presentation skills. Year Up backs this up with stipends, internships, and college credits—all to put the individual on the path to economic self-sufficiency.

Another successful program is STRIVE, a national program that helps communities build a local education ecosystem with sustainable civic infrastructure. The idea is to create a cradle-to-career approach to development. In Atlanta, we've seen the STRIVE model in action in an organization called New Hope Enterprises. Successful programs like 12 for Life blend work education with content designed to raise students' commitment to, and even passion for, work.

Fostering hard skills

Twenty years ago, I attended a seminar where a presenter asked rhetorically, "Is there anything you would not buy online?" Participants mentioned a number of things that are now routinely purchased online. Fast forward to today. It's worth asking, "Is there any work

Fed @ Issue continues on page 15

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ISSN 0899-6571

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.

Back cover courtesy of the Atlanta Downtown Improvement District (top) and the Library of Congress photographic archives (right).



DIVERGENCE: Wealth and Income Inequality in the United States

Wealth and income inequality in the United States has widened over recent decades. Federal Reserve policymakers are beginning to look into the implications of inequality for monetary policy, and we share some of their views.

Trends in wealth and income inequality have been discussed in economic literature and public discourse for some time, but they made a pronounced leap into public view in recent years. The Occupy movements that sprung up in 2011 greatly invigorated the conversation, as did the 2014 publication of the English translation of French economist Thomas Piketty's popular *Capital in the Twenty-First Century*.

The topic has also been receiving consideration from some Fed policymakers, who are beginning to look into the implications of inequality in the United States for monetary policy. On April 13, 2013, for example, Sarah Bloom Raskin, then a member of the Board of Governors, addressed the question of whether rising inequality contributed in some way to the 2007–09 recession (“Aspects of Inequality in the Recent Business Cycle”). And on October 17, 2014, Federal Reserve Chair Janet Yellen summarized some research on economic opportunity and mobility in a speech she made at the Boston Fed (“Perspectives on Inequality and Opportunity from the Survey of Consumer Finances”).

In the spring of 2014, the Council of Economic Policies and the Atlanta Fed organized a Workshop on Monetary Policy and Inequality, bringing together researchers who have begun to explore potential connections between inequality and monetary policy. A presentation by Simon Yannick and Fouda Ekobena of

the University of Yaounde suggested a link between quantitative easing and poverty relief.

However, because research in income inequality and its monetary policy implications is still in a very early stage, economists and policymakers have drawn few conclusions about the role of monetary policy with regard to inequality. Despite not having a full body of research on the topic, researchers are exploring methods for mitigating the trends in income and wealth inequality.

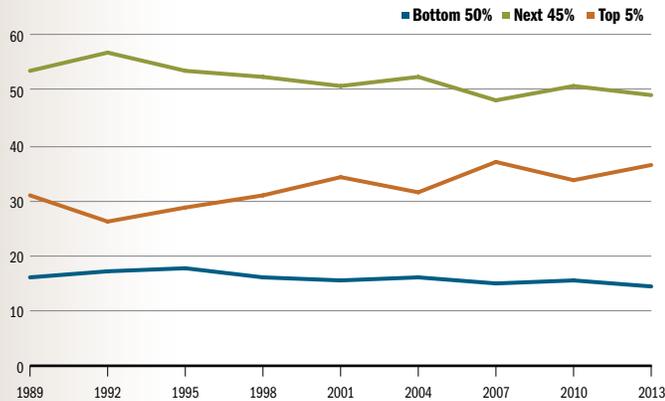
In this article, we look at trends in inequality, highlighting some of the views policymakers hold regarding future economic impact and how potential risks might be reduced.

Income and wealth inequality

Researchers have generally deconstructed inequality into the separate but related topics of income, wealth, consumption, and opportunity. Income and wealth inequality, in particular, have received the most attention and appear to have achieved something of a consensus among economists with regard to their recent trends.

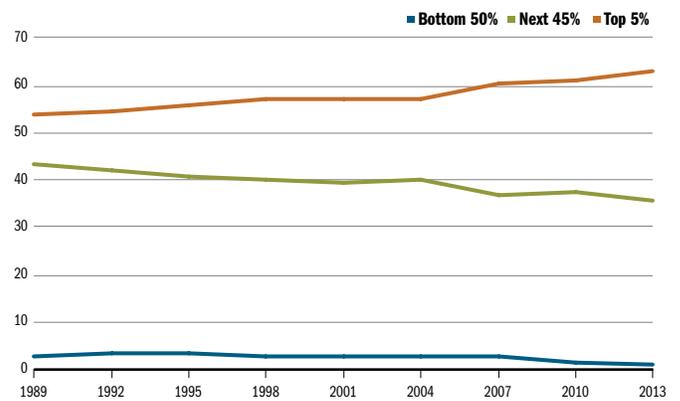
When Yellen spoke last October, she cited research from the Institute for Research on Poverty and the Federal Reserve Board suggesting that the distribution of income and wealth in

Chart 1
Income Share by Income Group



Source: Board of Governors of the Federal Reserve System, Survey of Consumer Finance

Chart 2
Net Worth Share by Net Worth Group



Source: Board of Governors of the Federal Reserve System, Survey of Consumer Finance

the United States—as well as in other advanced economies—has widened steadily for the last several decades. Charts 1 and 2 (from Yellen’s speech) illustrate the increasing shares of income and wealth to the top 5 percent of households.

The trend abated somewhat during the Great Recession because of the larger wealth losses for those at the top of the distribution, but it resumed with the recovery. Labor market recovery and wage growth have been stubbornly slow, which has disproportionately affected those toward the lower end of the distribution. Home prices have yet to fully recover, also a hindrance that’s more pronounced for those lower in the distribution, as their homes are their primary assets. Meanwhile, new stock market highs continue to unevenly benefit those on the upper end of the distribution, as they tend to hold stocks as a larger percentage of their assets. Chart 3 (also from Yellen’s presentation) illustrates this point.

Yellen summarized these trends as “significant income and wealth gains for those at the very top and stagnant living standards for the majority,” and said that “the extent of and continuing increase in inequality in the United States greatly concern me.” Calling out the incompatibility between these trends and the value Americans place on opportunity, she touched on ways to increase equality going forward. We will discuss Yellen’s broad prescriptions later.

Of course, increases in income and wealth inequality do not necessarily reflect declines in living standards for those at the lower end of the distribution. As Yellen observed, “there have been some times of relative prosperity when income has grown for most households but inequality widened because the gains were proportionally larger for those at the top.” In this scenario,

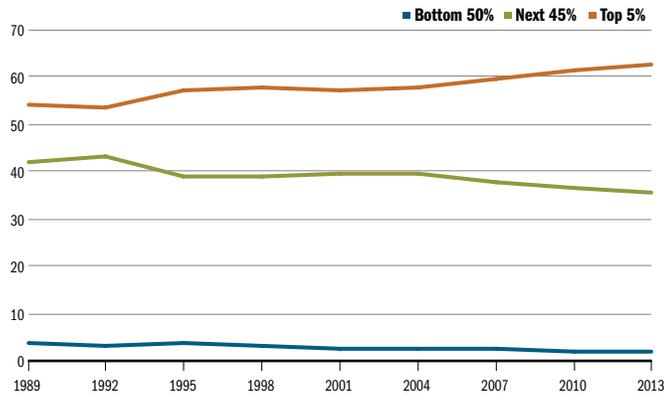
in which economic growth appears to lift all boats, inequality may not be as great a concern. But when inequality widens because of stagnant or declining income and wealth positions for most individuals, it becomes more problematic.

So what causes these diverging outcomes? A May 2014 *Science* magazine article by David Autor, a Massachusetts Institute of Technology economics professor, suggests that disparities in educational attainment are the primary cause of income inequality. In fact, “about two-thirds of the overall rise of earnings [inequality] between 1980 and 2005 [can be] accounted for by the increased premium associated with schooling in general and postsecondary education in particular,” wrote Autor. In addition, the dynamics between the supply and demand for skills may provide insight into increases and decreases in the premium paid for higher-skilled labor over time—“specifically, why the earnings gap between college and high school graduates has more than doubled in the United States over the past three decades,” Autor said. Steven Kaplan and Joshua Rauh stated a similar position in the Summer 2013 issue of *Journal of Economic Perspectives* when they wrote that “skill-biased technological change, greater scale, and their interaction” have resulted in higher incomes for higher-skilled workers.

But it’s not simply the rise in income for top earners that has contributed to income inequality—it’s also the decline in income for lower earners. In his *Science* article, Autor reported on some potential contributors to the decline in real wages among less educated workers, including:

The decades-long decline in the real value of the U.S. minimum wage, the sharp drops in non-college employment opportunities in production, clerical, and administrative support positions stemming from automation, the steep

Chart 3
Share of All Financial Assets by Net Worth Group



Source: Board of Governors of the Federal Reserve System, Survey of Consumer Finance

rise in international competition from the developing world, the secularly declining membership and bargaining power of U.S. labor unions, and the successive enactment of multiple reductions in top federal marginal tax rates.

Impact on the outlook

As to the economic implications of income inequality, former Governor Raskin, in her 2013 speech, put it like this:

Intuitively, one might assume that the growing concentration of income at the top could lead to less consumer spending and aggregate demand, as wealthier households tend to save more of their additional income than others. However, there is no definitive research indicating that these income disparities show mixed results on the question of whether there are stable differences in the marginal propensity to consume across households with different incomes.

She went on to consider the effects of income inequality on gross domestic product:

More generally, the evidence is equivocal as to whether there is an empirical relationship between higher income inequality and reduced aggregate demand. In my view, understanding the links between greater concentrations of income, variation in spending patterns throughout the income distribution, and the effect of that variation on aggregate consumption—and, ultimately, growth—requires more exploration.

Of course, it is not necessarily the direct economic effects of inequality that most concern policymakers, but rather the impact on social mobility. As Yellen described:

To the extent that opportunity itself is enhanced by access to economic resources, inequality of outcomes can exacerbate inequality of opportunity, thereby perpetuating a trend of increasing inequality. Such a link is suggested by the “Great Gatsby Curve,” the finding that, among advanced economies, greater income inequality is associated with diminished intergenerational mobility.

How can these effects be mitigated? Yellen suggested several areas that could influence these trends, including the need to ensure equal access to quality early childhood education. She cited research demonstrating that “children from lower-income households who get good-quality pre-kindergarten education are more likely to graduate from high school and attend college as well as hold a job and have higher earnings, and they are less likely to be incarcerated or receive public assistance.”

Access to affordable postsecondary education was another area Yellen mentioned. As we discussed earlier, higher levels of educational attainment can result in significant wage premiums. Although education costs continue to rise, most people can still benefit from a college degree. New York Fed economists Jaison Abel and Richard Deitz estimate that the annual earnings of full-time workers with a four-year bachelor’s degree are 79 percent higher than the earnings of the median full-time worker with only a high school diploma. The wage premium increases more for those with a graduate degree.

Yellen suggested invigorating new business formation as yet another potential method for curbing the impacts of inequality. The wealth generated through business ownership for those lower in the income distribution was found to be a significant share of their total assets, although only a small percentage of households in the bottom 50 percent “hold equity in a private business,” according to Yellen. The rate of business creation has declined, which some research suggests could slow the pace of productivity, real wage growth, and employment.

Of course, defining *opportunity* and determining how it might be measured are important first steps to ensuring its existence. Some researchers use the term *mobility* in place of opportunity, and the field of mobility research is pursuing answers to these questions. This line of research will undoubtedly contribute to further policy prescriptions that may blunt negative impacts of income and wealth inequality. ■

This article was written by Nicholas Parker, an economic policy analysis specialist in the Atlanta Fed’s research department.





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.

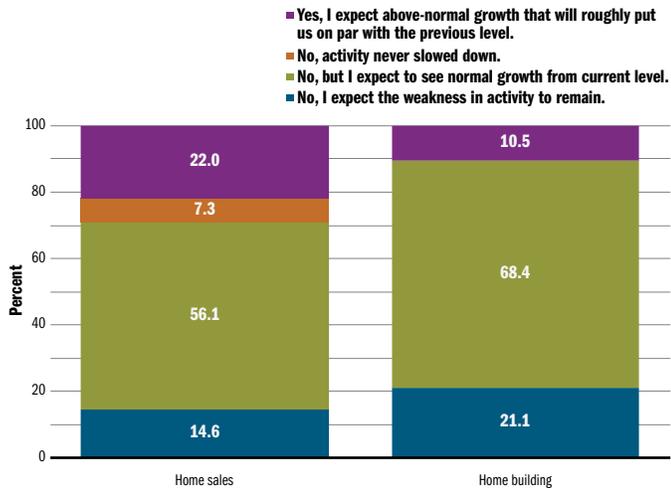
Real estate's pulse strengthens

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).

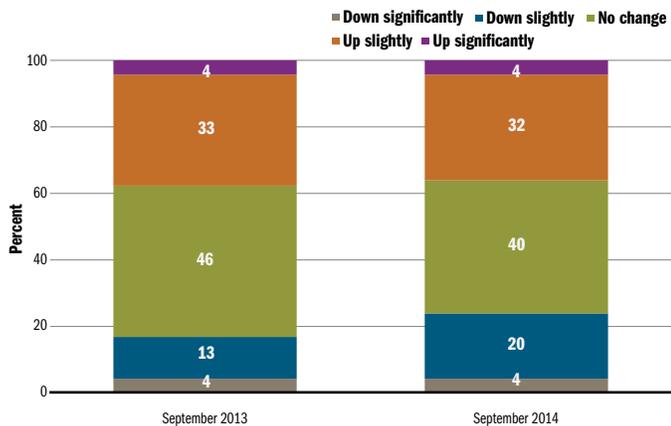
By the end of 2014, contacts' expectations seemed to have been quite accurate. Home sales and construction activity across the Southeast picked up by midyear. Although home sales and construction activity were generally described as ahead of last year's levels, this improvement was relative to historically 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.

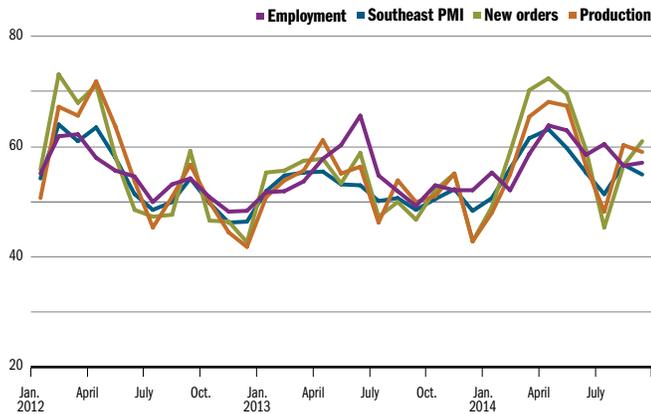
More recently, the PMI has held steady. The September index was 55.0 points, a slight drop from the 56.7 seen in August but still a healthy reading. The new orders subindex registered a solid increase of 4.5 points over August and averaged 60.3 points for the first nine months of the year. Although the 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-

ECONSOUTH NOW PODCAST

Mike Chriszt and Shalini Patel of the Atlanta Fed discuss the regional economy in an interview. On frbatlanta.org, select "Podcasts."





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.

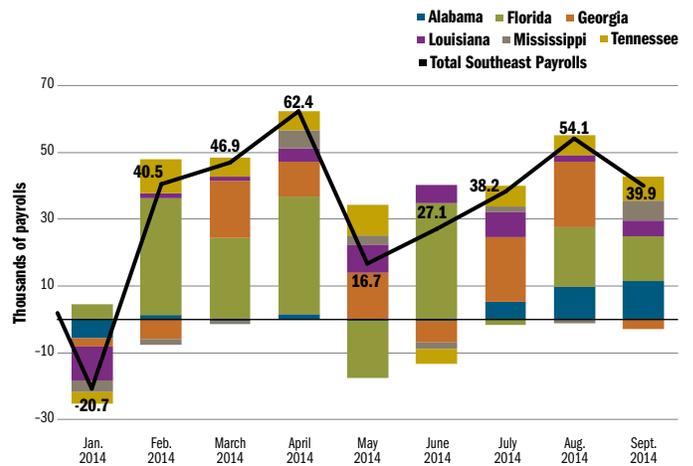
The outlook for the banking industry is improving. Many banks have loosened underwriting standards somewhat, but are keeping credit standards at higher levels than before the banking crisis began.

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

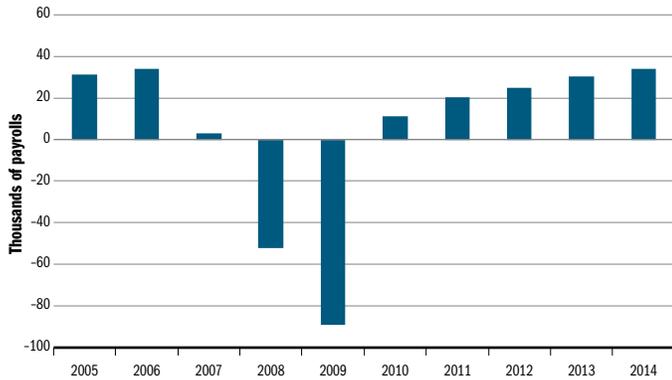


Note: Data are seasonally adjusted and are through September 2014.
Source: U.S. Bureau of Labor Statistics

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).

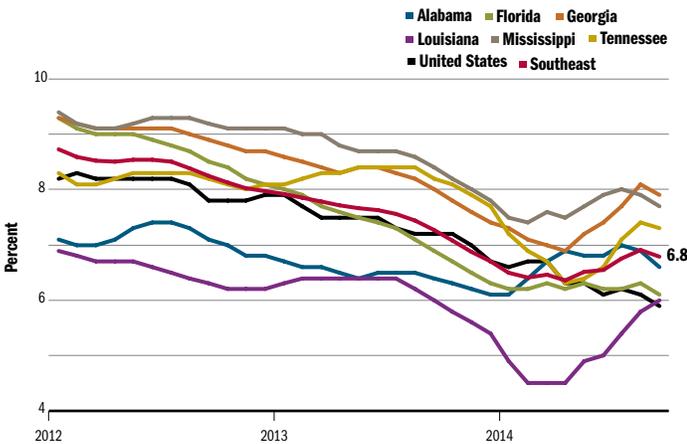
The region's states added an average of 33,900 net new payrolls each month from January to September. During the same period in 2013, each southeastern state added an average of 30,500 jobs per month. In 2012 the monthly net average was 24,700 new payrolls, indicating that regional job growth has followed 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

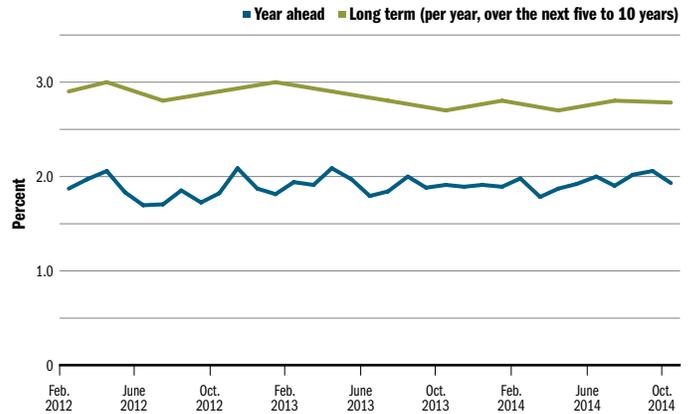


Note: Data are seasonally adjusted and go through September 2014.
 Source: U.S. Bureau of Labor Statistics

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.

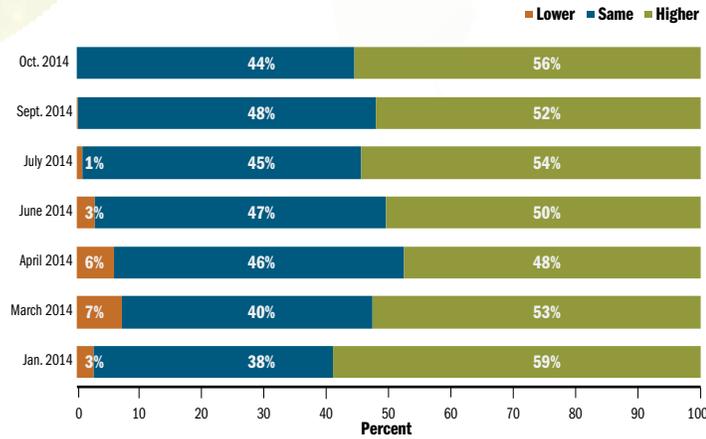
Heading into the end of the year, the industry saw a marked change. Energy contacts reported a glut of crude, and the per-barrel price of oil fell to its lowest level in more than four years. For most of 2014, oil exports from the United States steadily increased and imports fell. However, global demand 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.

Fed @ Issue continued from page 1

machines cannot do?” I predict that many of the tasks you might envision now will be automated in some form in 20 years. Even today, we’re seeing a variety of machine operators become machine tenders who monitor digital interface devices and intervene only if something goes wrong.

Most workers will deal with a digital device of some kind. Familiarity with technology and the literacy and numeracy skills to operate such a device will be essential. In a world where routine and

Workers must be equipped with both soft and hard skills to navigate the future we envision.

repeatable tasks are often done by machine, human work will call for problem analysis and troubleshooting, critical thinking where judgment and discretion are required, and fine, customized work involving customer or colleague interaction and communication.

Workers will need lifelong learning skills to adapt to changing job requirements that the pace of technology dictates.

Changing work arrangements between employers and workers

The share of employed people working fewer than 35 hours a week rose sharply during the Great Recession. Usually, hours are restored in a recovery, but that restoration has not occurred this time. Involuntary part-time employment, which we sometimes refer to as part-time for economic reasons, seems to have become a structural issue. Part-time positions are typically prevalent in certain industries, but our research finds that the use of part-timers has become quite widespread.

Although we anticipate that the use of part-time personnel will continue to decrease, we do not expect it to reach

prerecession levels. One implication of part-time labor is that those workers are less likely to receive employer-sponsored training, which means the burden of training will fall elsewhere.

What does the future hold?

In my view, the employability of young people and adults who are deficient in soft skills will go nowhere but down. Job-specific requirements in most industries and vocations will evolve rapidly and become more digitally demanding. Widening automation and digitization will reduce routine job tasks. Workers will need to trade on what cannot be programmed. And work arrangements with employers may be structured to provide those employers more tactical flexibility in their workforce management.

At the Atlanta Fed, we feel the workforce development system needs to operate with greater coherence, cohesion, and coordination if it is to remain relevant. Through our community and economic development program, we’re working to help workforce training providers, educators, and employers become better aligned. To this end, we’ve catalyzed a program called the Metro Atlanta Exchange for Workforce Solutions (or MAX). This effort brings together more than 25 entities as partners to think and act in a more coordinated and streamlined fashion. It’s our hope it will help prepare the region’s workforce development stakeholders for the reality of a 21st century economy. ■

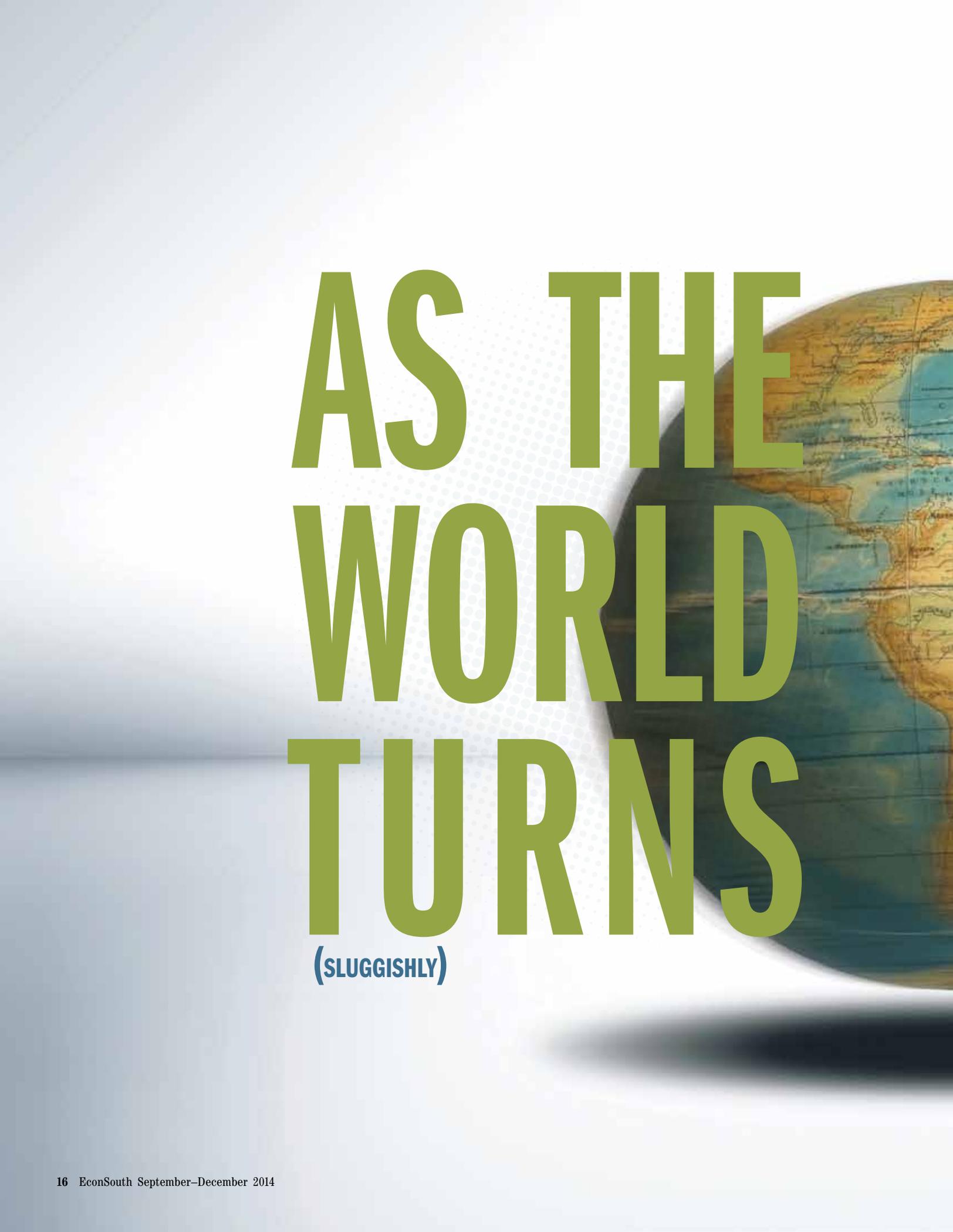
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AS THE WORLD TURNS

(SLUGGISHLY)



When we last looked at the global economy, growth was uneven or even decelerating. Jump to this year, and global gross domestic product growth is still weaker than expected, with a number of developing economies flagging and some euro zone countries flirting with recession. How will the world face this latest economic setback? Stay tuned...

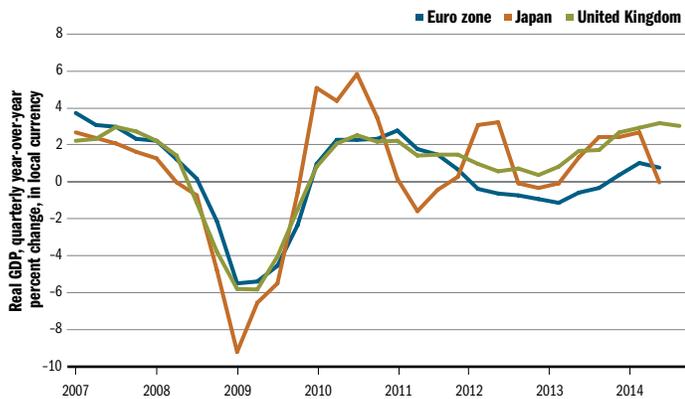
This year has been another disappointing one for the global economy, as the hoped-for acceleration in growth has not materialized. Global gross domestic product (GDP) continued to expand at a subpar rate in 2014, much slower than the robust growth of the middle of the last decade and the year after the recession ended. To be sure, economic growth remained positive, inflation was tame, the number of jobs grew, and incomes rose in virtually every part of the world. But prospects for robust growth are still largely elusive in many large economies, and downside risks to the current moderately optimistic outlook have increased.

Europe's economic recovery flags

In the developed world, the struggling euro zone appears to be the most vulnerable (see chart 1 on page 18). The region endured two recessions during the past seven years. The first recession was caused by turmoil in the global financial markets, and the second was brought on by the region's sovereign debt crisis. As the debt crisis subsided, the euro zone's economy returned to growth in the second quarter of 2013, but that recovery stalled just a year later. Economic performance worsened in the euro zone's three largest economies. Germany's vigor flagged, France's growth stagnated, and Italy slipped back into recession.

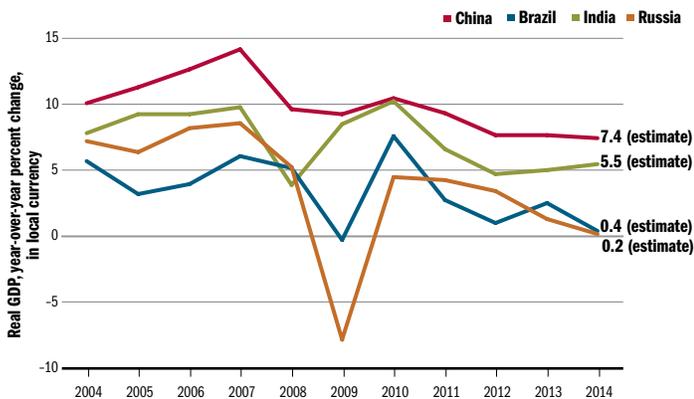
Although preconditions for continued growth in the euro zone seem to be in place—for example, fiscal policy is less restrictive and credit conditions have improved—concerns about another recession have risen as economic data softened and

Chart 1
Economic Growth in Major Foreign Developed Economies



Sources: Haver Analytics/EUROSTAT, national statistical agencies

Chart 2
Economic Growth in Major Emerging Markets



Sources: Haver Analytics/national statistical agencies; 2014 estimates are from October Blue Chip Consensus Forecast

deflationary pressures built. In response, the European Central Bank stepped up its efforts to stimulate the economy by implementing a number of policy-easing measures in 2014.

Japan loosens monetary policy to stimulate its economy

Another major central bank, the Bank of Japan, also eased its policy in a surprising move in October. Japan's economy had actually fared pretty well over the past few years, growing at a 1.5 percent annual pace in 2012 and 2013, an impressive rate for

a country that's suffered deflation for years and has a declining labor force. However, in the first half of 2014, Japan's economic growth swerved when the government increased the consumption tax. (In April, the rate went from 5 percent to 8 percent.) Not surprisingly, consumers moved their big purchases to the first quarter, which boosted GDP growth, and then sharply reduced their purchases in the second quarter, causing GDP to plunge. Unexpectedly, GDP also declined in the third quarter.

Standouts on the world stage

There were two notable bright spots in 2014 among major developed economies: the United States and the United Kingdom. The strong performance of the latter was a surprise to many observers, given the country's increased fiscal austerity and large exposure to the weak economy of the euro zone. Even in the face of those headwinds, the United Kingdom's GDP has grown at a robust rate of about 3 percent, helped by higher consumer spending and business investment, and a strong recovery in residential construction. U.S. economic growth rebounded to an above-trend rate after a weak first quarter, helped by rising consumer spending and business investment. In addition, the labor market showed continued improvement, with solid job gains and falling unemployment.

Emerging economies' growth sputters

Economic fortunes in 2014 also varied among the largest emerging-market countries: China's economy continued to decelerate gradually, Russia's growth halted, and Brazil went into a technical recession (two consecutive quarters of negative GDP growth) in the first half of the year. Meanwhile, India's expansion picked up after nearly two years of disappointingly slow growth (see chart 2).

China's moderating pace of growth continues to be a key component of the global economic picture. After 10 years of growing at annual rates of more than 9 percent, the economy expanded by approximately 7.5 percent in 2012 and 2013 and appears to have slowed a bit more in 2014. The current growth pace is still consistent with the government's target of around 7.5 percent and its efforts to rebalance the country's economy away from its reliance on exports and business investment and toward higher consumption. One of China's main economic stories this year was the ongoing broad slowdown in residential investment. Real estate has been a significant driver of China's economy for a number of years, but the sector's rapid growth led to an oversupply of properties in many cities. To correct those mounting imbalances, China's government has attempted to cool the housing sector, in the process adding to the downward pressure on the overall economy.

Russia's economic growth has been weakening for several years now. In 2014, that weakening was exacerbated by capital flight, decline in investment, and Western sanctions imposed

on the country in response to Russia's military involvement in eastern Ukraine and the annexation of part of Ukraine's territory. Brazil's economy has also lost much of its luster. Inconsistent government policies dampened business confidence, and consumer spending slowed as real wage growth weakened, largely because of higher inflation. Low business confidence and the deteriorating economic outlook held back investment, thus undermining Brazil's longer-term economic prospects.

At the same time, India's growth strengthened, benefiting from reduced political uncertainty that boosted business and consumer sentiment.

The outlook for 2015

As we look ahead, the major trends in the global economy aren't likely to change much in 2015 compared to 2014. Global growth is expected to accelerate, albeit slightly. Forecasters are putting their faith in the apparent strength of the U.S. economy and its ability to lift those economies that derive a major part of their growth from exporting to the United States. However, many

Growth prospects are still largely elusive in many large economies, and downside risks to the current moderately optimistic outlook have increased.

downside risks and uncertainties are fueling concerns that global growth could fall short of expectations yet again.

Among the key risks are a potential recession and a deflationary spiral in the euro zone; China's possible hard landing; financial market shocks, perhaps related to the expected increase in U.S. monetary policy rates; and a gamut of geopolitical risks.

What are the broad contours of the 2015 global economic outlook? Among major developed economies, the United States and United Kingdom are forecast to grow at the fastest rates, while growth in Japan is likely to be anemic. Growth is expected to improve only slightly in the euro zone. The expectations of a pickup in that region are predicated on diminishing fiscal drag, continued accommodative monetary policy, and an improving credit environment. Economic prospects vary within the region: growth is likely to strengthen in Germany, France, and Spain, but Italy could continue to struggle. However, there's an elevated risk that the euro zone's recovery could falter and deflation would set in, further raising the debt burden, which is still quite high in a number of countries. The euro zone's economy is one of the biggest in the world and an important trading partner for most countries. Therefore, any significant deterioration in the region's economy would negatively affect all parts of the world.

In 2015, emerging markets should continue to account for the largest share of global GDP growth. China, the most important emerging economy, is forecast to maintain its growth rate

of around 7 percent. A sharp slowdown in the real estate sector and the huge negative impact that such a slowdown would have on China's financial sector are the biggest risks to a generally optimistic outlook. The slowdown in China has been a headwind for the rest of emerging Asia, although it is still likely that Asia will outperform other regions. China is also a major consumer and importer of commodities, so a crisis there would significantly affect commodity-exporting countries. China's measured slowdown has already led to declines in commodity prices.

Lower commodity prices have dampened the outlook for many countries in Latin America, where growth is unlikely to improve much from 2014's low levels. Moreover, Brazil's expected economic weakness would hold down the growth rate for Latin American countries as a group. Similar to Brazil, Russia's economic malaise will likely continue, as the recent decline in oil prices adds to the pressures from sanctions and the central bank's tightening of monetary policy to stem inflation. The forecast for growth in India, on the other hand, is that it will accelerate.

One of the most important risks to emerging markets in 2015 will be the tightening of U.S. monetary policy, which may lead to economically damaging capital outflows, which happened in 2013.

As we look ahead to 2015, the risks to the global economy are abundant. The outlook is for continued rising prosperity in most parts of the world, with global growth on par or slightly up from this year. ■

This article was written by Galina Alexeenko, director, Regional Economic Information Network at the Atlanta Fed's Nashville Branch.



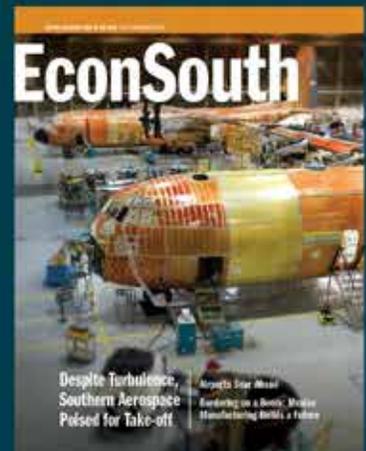
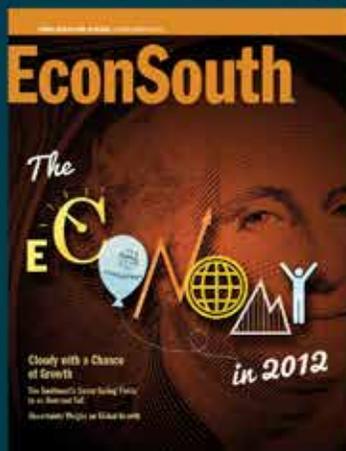
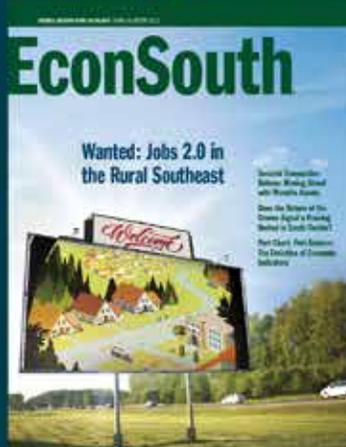
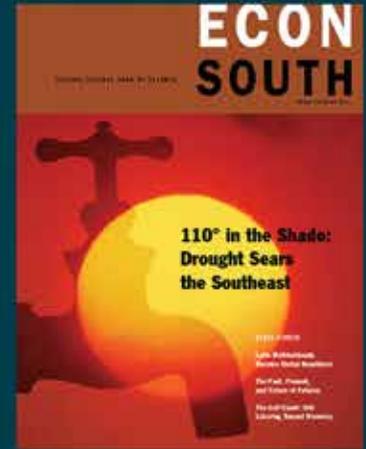
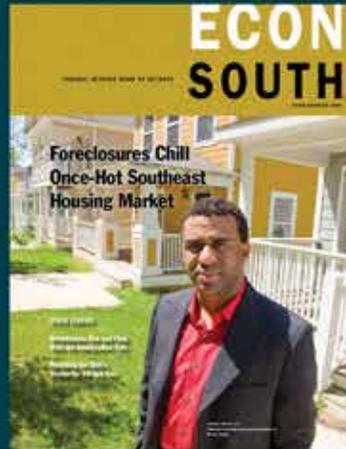
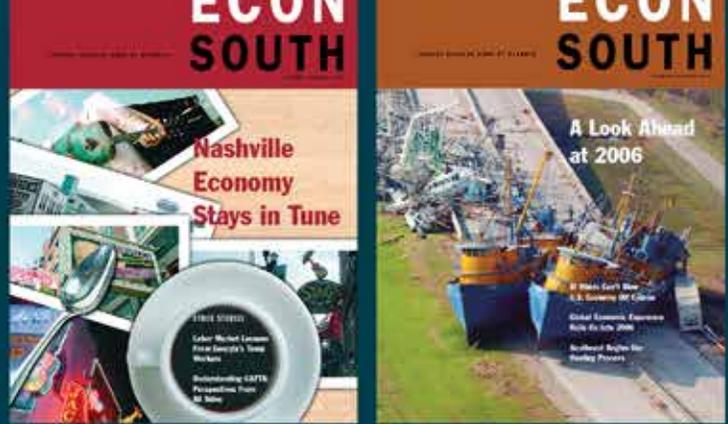
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Closing the Retail Gap

24.4

Amount, in billions of dollars, of retail sales by the nation's department stores in December 2013

Source: U.S. Census Bureau, Monthly Retail Trade Survey



3

Percentage of natural gas distribution pipelines in the U.S. made of iron at the end of 2012. (The rest are made of plastic or steel.)

Source: U.S. Department of Transportation

7

Percent growth forecast for China's gross domestic product in 2015

Source: International Monetary Fund

33,900

Number of new payrolls that southeastern states added each month in 2014 from January to September

Source: U.S. Bureau of Labor Statistics



4.4

Number, in millions, of multigenerational households in the United States in 2013

Source: U.S. Census Bureau, American Community Survey

79

Percentage that the annual earnings of a full-time worker with a four-year bachelor's degree will be higher than that of a full-time worker with only a high school diploma

Source: Federal Reserve Bank of New York

344.6

Barrels of oil, in millions, produced in the Gulf of Mexico in 2014

Source: U.S. Department of the Interior, Bureau of Safety and Environmental Enforcement

66,047

Number of supermarkets and other grocery (except convenience) stores in the United States in 2012

Source: U.S. Census Bureau, County Business Patterns





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CHANGE SERVICE REQUESTED



Atlanta is looking to the past to meet its future transportation needs. Whereas electric streetcars once crisscrossed the downtown area (as in 1939, right), they were eventually vanquished by automobiles. Soon, new streetcars (above) will begin serving passengers in the city's inner core, and city planners hope to take more cars off the roads by gradually expanding the streetcar network.

now and then