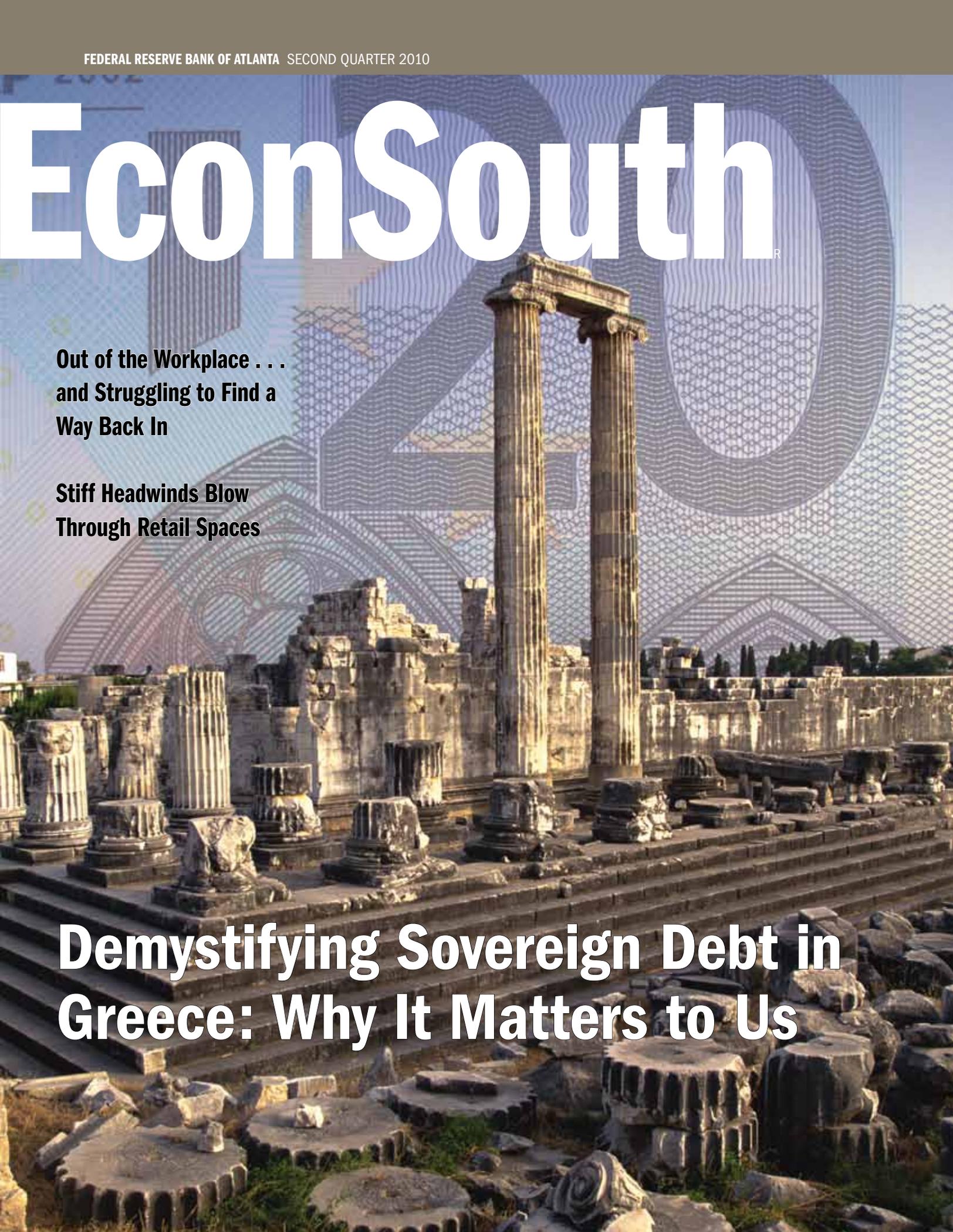


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**Out of the Workplace . . .
and Struggling to Find a
Way Back In**

**Stiff Headwinds Blow
Through Retail Spaces**

**Demystifying Sovereign Debt in
Greece: Why It Matters to Us**



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FEDERAL RESERVE BANK OF ATLANTA SECOND QUARTER 2010



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Demystifying Sovereign Debt in Greece: Why It Matters to Us

The fiscal crisis in Greece sent aftershocks through Europe and the rest of the world. How did one nation's overreliance on sovereign debt threaten to undermine an entire continent's monetary union?

Stiff Headwinds Blow Through Retail Spaces

When the economic expansion was going strong, developers eagerly supplied new retail space. In the wake of the recession, a plethora of abandoned stores and shopping centers dot the Southeast, dragging down banks' balance sheets.

Out of the Workplace...and Struggling to Find a Way Back In

Recovering the jobs lost in the recession remains a daunting challenge. For the long-term unemployed, surmounting that challenge is doubly difficult.



Sovereign Debt: A Greek Drama

This issue's feature on the sovereign debt crisis in Greece and its far-reaching implications is a vivid reminder of how the world truly has become more interconnected. The story's writer, research analyst Andrew Flowers, said he took note of how, in a country with plenty of history, history has repeated itself. "I was struck by how old such crises are and how frequently they have occurred. In a truly excellent book, *This Time Is Different*, by Kenneth Rogoff and Carmen Reinhart, I read about just that," Flowers said. "In there, the authors

claim that Greece has been in default for more than half of the years since 1800." Flowers also saw another salient issue in the flexibility of labor markets—the ability to hire and fire employees easily and negotiate wages smoothly. "Among economists, most point to the United States as having relatively flexible labor markets but fault many European economies for being more rigid," he said. "These structural problems are very hard to solve and so are really hampering the recovery in Europe."

Continued on page 12

The Gulf Oil Spill and Southeast Fishing: A Follow-Up

In an earlier article, "Southeastern Fishing Faces Strong Currents" (*EconSouth* Q1 2010), we explored some of the pressures faced by the region's fishing industry. Now the industry is facing a threat of uncertain proportions from the BP oil spill off the coast of Louisiana.

The April explosion and collapse of the Deepwater Horizon oil rig, which claimed the lives of 11 workers and left crude oil spewing into the Gulf of Mexico, pose a potentially significant threat to the coast's environment and economy. The disaster is already affecting important economic engines such as commercial fishing and seafood-related businesses, recreation, and tourism. However, the severity of the damage is virtually impossible to estimate at this point, says Alex Miller, an economist at the Gulf States Marine Fisheries Commission. Its impact depends on many factors, including ocean currents, weather conditions, the duration of the leak, the effect of the dispersants being used, and the eventual success of containment and clean-up efforts. One thing is certain, however—the longer oil continues to gush from the ruptured well, the more severe the environmental and economic impact.

The disaster could have a potentially devastating effect on the fishing industry.

At press time, slightly more than 22 percent of federal waters in the Gulf were closed, causing commercial and recreational fishing in some areas to grind to a halt. Further, the closures could last for some time depending on how the situation unfolds, says Julie Anderson, a fisheries specialist at the Louisiana Sea Grant and the Louisiana State University Agricultural Center.

The oil spill could also negatively affect fish populations in the Gulf, but it will probably take years to determine the extent of the damage, Anderson said. Oil is spilling into the Gulf during prime spawning season for many species, threatening fish eggs and larvae, which are highly sensitive to the toxins. The oil also threatens the delicate wetlands that make up most of the Louisiana coast. Oil has already made its way into the marshes, which are crucial incubators for many lucrative fisheries such as shrimp, crab, oysters, and other marine life. As the oil seeps into the marshes it smothers or poisons the vegetation, in the process destroying the root structure that holds everything together.

The Atlanta Fed is closely following the oil spill and will continue to monitor its effects on the regional economy. Visit the Atlanta Fed's Web site at www.frbatlanta.org for analysis and commentary. ■

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

Photos on p. 5 courtesy of Northrup Grumman (left) and NOAA; pp. 18–23 by Filip Chalifant; p. 28 by Brad Newton; back cover (right) courtesy of the Atlanta History Center.



MELINDA PITTS is a research economist and associate policy adviser at the Atlanta Fed.

When Are U.S. Jobs Coming Back?

As the economy recovers from a severe and prolonged recession, many people have begun wondering when employment will recover. The data indicate employment growth has turned positive: the U.S. economy added 290,000 jobs nationally in April. Today's payrolls have just over 130 million workers, a number that is 7.8 million jobs fewer than at the beginning of the recession. More than 15 million people were unemployed in the United States in April, which is twice the number from when the recession began. After a slight decline for the last two months, the nation's unemployment rate rose from 9.7 percent in March to 9.9 percent in April, driven up by an increase in the size of the labor force.

Although initial unemployment insurance claims have fallen, their levels are still high, with the current level close to the peak in the last two recessions. Furthermore, continuing claims also are at historically high levels as the average duration of unemployment reached approximately 30 weeks—the highest level in the 60-year history of these data. Also, underemployment in the workforce is prevalent. The underemployed include both discouraged workers—those who want to work but are not actively seeking

work, generally because of a prolonged lack of success in finding it—and individuals who want to work full time but are only able to find part-time work. Combined, the percentage of unemployed and underemployed is just over 17 percent.

What will improvement require?

Moving forward, two things will need to happen for the unemployment rate to decrease and the labor market to recover. Of course, the first is the creation of new

So will the nation get back to prerecession levels of employment? The answer likely is not any time soon.

jobs. The level of job openings declined sharply during the recession, and while job openings have increased in recent months, the level is still well below any measured in the last 10 years. One explanation is that labor productivity is extremely high, suggesting, along with

anecdotal evidence, that firms are learning to produce more without expanding their workforce. If this explanation is the case and firms have become more efficient, then large gains in production will not be met with similar increases in hiring.

Moving forward, two things will need to happen for the unemployment rate to decrease and the labor market to recover. Of course, the first is the creation of new jobs. The level of job openings declined sharply during the recession, and while job openings have increased in recent months, the level is still well below any measured in the last 10 years. One explanation is that labor productivity is extremely high, suggesting, along with anecdotal evidence, that firms are learning to produce more without expanding their workforce. If this explanation is the case and firms have become more efficient, then large gains in production will not be met with similar increases in hiring. However, Federal Reserve Bank of Atlanta President Dennis Lockhart said in a recent speech that he does “not expect the recent outsized productivity growth to continue indefinitely and become a new, permanently higher trend rate. Some degree of ‘wait and see’ behavior is at work and is no doubt reflected in the productivity numbers. With growing economic momentum, deferral of hiring will become riskier.”

The second factor that could be affecting the unemployment rate is a change in the time it takes to fill those job vacancies that do become available. The fact that job vacancies held steady for most of 2009 while unemployment continued to rise suggests the existence of what labor economists call “match inefficiencies.”

Grappling with inefficiency

Two main types of match inefficiencies occur in the labor force. One is geographic mismatch, meaning people don’t reside where the job opportunities exist. In 2008, the percentage of individu-

als living in a different county or state from the previous year is the lowest recorded in more than 50 years of data, likely because people may be reluctant to relocate to take a new job if the value of their house has declined. Further, many who would like to move are underwater in their mortgage, making it difficult or impossible to sell their homes.

The second inefficiency is skills mismatch, which occurs when a more or less permanent change in the composition of jobs results in a large number of available workers without the skills required for the jobs that are available. By way of example, construction employment may not be likely to return to prerecession levels, and these construction workers may not have the skills to move into, say, the healthcare sector. This type of skills mismatch will require new training. Anecdotal information indicates that this retraining is occurring, especially for men. For example, Miami-Dade College, which is the largest college in the nation and has several degree options including vocational and associate degrees, has identified this trend as especially relevant for men in their 20s.

So will the nation get back to prerecession levels of employment? The answer is likely not any time soon. If the job growth of 290,000 that occurred in April was repeated for a year, keeping labor force participation constant and controlling for projected population growth, the unemployment rate would drop only to 9.1 percent. To put this into perspective, the average monthly job growth during the expansionary period between the 2001 and 2007–09 recessions was fewer than 100,000 new jobs per month.

So while the trend in U.S. labor markets appears to be headed in the right direction, it is quite possible economic recovery—even a modestly paced one—could be well advanced before any significant reduction of unemployment materializes. ■

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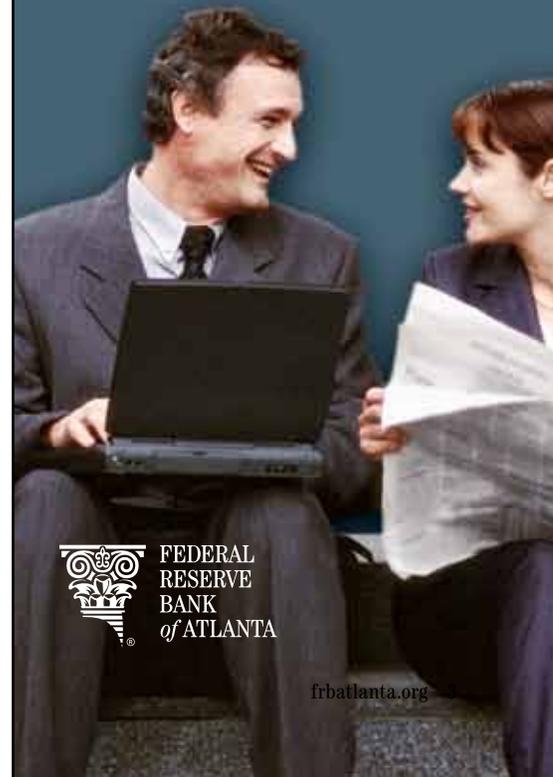
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Pascagoula, Mississippi

Pascagoula Aims to Stay Shipshape

If Mississippi has an industrial heartland, it's at the southern end of the state. There lies Pascagoula, home to Mississippi's largest private employer, Northrop Grumman Shipbuilding's Ingalls Operation. The shipyard's workforce of more than 12,000 anchors an economy grounded in heavy industry.

Manufacturing accounts for an extraordinarily high 30 percent of nonfarm employment in the Pascagoula metropolitan area, according to the U.S. Bureau of Labor Statistics (BLS). That share is more than triple the share of national employment that is factory jobs and more than double the percentage throughout Mississippi.

Most of Pascagoula's 16,400 manufacturing jobs are at Northrop Grumman and Chevron's largest U.S. oil refinery, which employs 1,640 people. "Those two are the linchpins that hold the economy together here in Pascagoula," said Mayor Robbie Maxwell, a Pascagoula native. "When somebody sneezes at Northrop Grumman, everybody tenses up."

They are not tensing up much lately, the mayor said. On the contrary, Pascagoula's manufacturing base was a bedrock through the recent recession. Pascagoula's manufacturing employment was 4 percent higher in March 2010 than 12 months earlier, BLS figures show. Most of the area's job losses during the economic downturn were construction related, according to

Moody's Economy.com. Unemployment in metro Pascagoula peaked at 11.2 percent in January and fell to 10.3 percent in March, compared with 9.7 percent nationally.

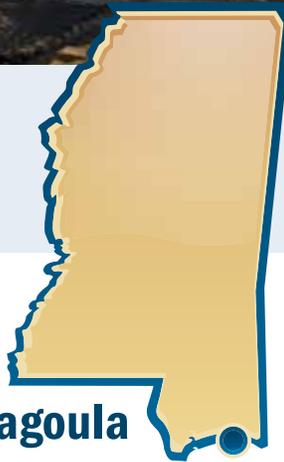
Shoring up homes, businesses

The bigger concerns in Pascagoula are the cost of homeowners' insurance after Hurricane Katrina and expanding the retail base. (Pascagoula officials were also worried about the Gulf oil spill, but the full economic impact of the spill was not known as *EconSouth* went to press.) "This insurance thing," Maxwell said, is Pascagoula's biggest economic obstacle. "If we can solve this problem, then we're poised to do great things."

Skyrocketing homeowners' premiums have discouraged some post-Katrina rebuilding. Carla Todd, president of the Jackson County Chamber of Commerce, said annual premiums on her Pascagoula River home rose from \$2,300 to \$5,000. And, she said, her home suffered no water damage in the hurricane. A group of local businesspeople have even raised their own fund to insure 1,000 homes as a pilot project, Maxwell said.

On the retail front, the mayor and city government are recruiting private-sector partners for a couple of ambitious projects. Downtown, the city has razed derelict warehouses and started building a parking deck on a site with 850 feet of Pascagoula River frontage. Permit issuance, streets, and other infrastructure are in place, but firm development plans are not. Maxwell envisions retail space, a hotel, and a restaurant on the site where diners would sip cocktails and watch the sun set over the water.

He and the city also have designs on land a few miles upriver. The city is pursuing private partners and grant money to build a marina, maritime museum, condos, and pathways through the marsh on Lowry Island. The city would lease the land from the state. City leaders hope the proposed Lowry Island project will showcase the decommissioned 567-foot warship Ticonderoga, which was built in



Pascagoula

Pascagoula, Miss.

Population	20,164
Jackson County population	129,619
Median household income	\$39,600
Median owner-occupied home value	\$113,300

Source: U.S. Census Bureau, 2008 American Community Survey

Pascagoula in 1980. That project could be a long shot, though, given the high cost of towing the ship from the Philadelphia Navy Yard and installing it in Pascagoula, Maxwell said.

Company town: A city built on shipbuilding

Ships have been to Pascagoula what cars once were to Detroit. Likewise, the city's reliance on Northrop Grumman in particular and shipbuilding in general could have drawbacks. Along with Northrop Grumman, two other builders of ships and offshore oil and gas rigs—Signal International LLC and V.T. Halter Marine Inc.—rank among metro Pascagoula's seven biggest employers. The focus on a single industry could keep other types of companies out, according to a report on Pascagoula's economy by Nathan Topper of Moody's Economy.com. He notes that the area's "industrial diversity is already among the lowest in the nation."

That absence of diversity is all right with the mayor and Todd. Maritime construction has supplied thousands of good jobs in south Mississippi for decades, they

pointed out. What's more, stable manufacturing employment helped Pascagoula companies withstand the recession, as business bankruptcies did not rise much in 2009, Topper wrote.

As industries go, you could do worse than shipbuilding and Northrop Grumman. In Pascagoula, the huge defense contractor builds surface ships for the U.S. Navy, and the order book is stuffed, according to the company. Northrop Grumman Shipbuilding's revenue and operating income in the first quarter of 2010 were up 21 percent and 26 percent, respectively, from the same period a year earlier. Moreover, the shipyard's union contract runs through 2012, so there won't soon be a repeat of the monthlong strike that took place in 2007.

The shipyard has two Navy destroyers under construction and was awarded a "long lead time material contract" in December 2009 to restart work on another class of destroyers, according to Northrop Grumman's first-quarter 2010 report filed with the U.S. Securities and Exchange Commission. The company noted in that document that it figures U.S. defense spending will remain high amid the nation's "multi-front, multi-decade struggle" against terrorists.

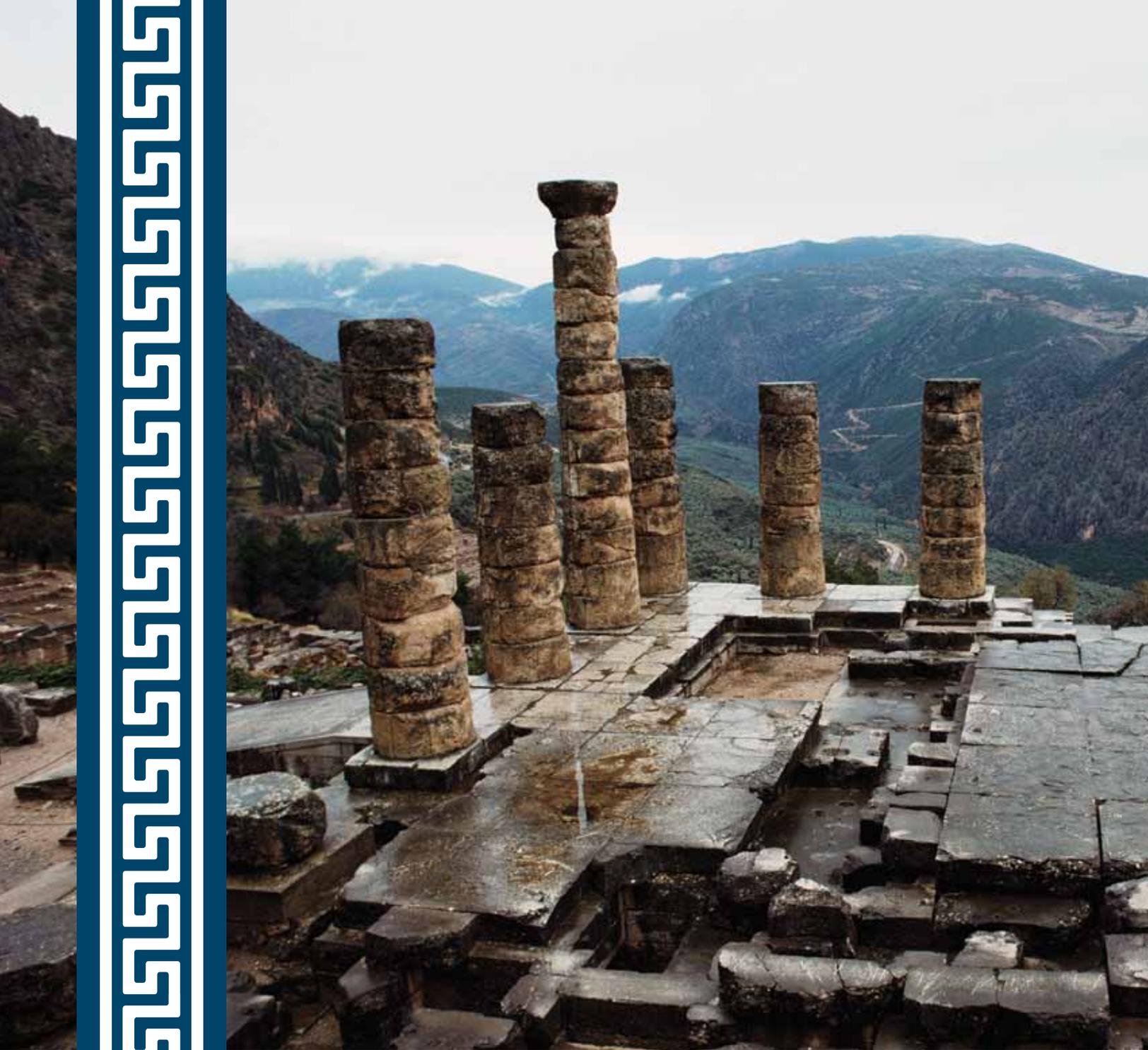
Northrop Grumman's shipyard has deep roots in Pascagoula. It began as Ingalls Shipbuilding Corp. in 1938.

Ingalls was acquired in 1961 by Litton Industries, which Northrop Grumman bought in 2001. The shipyard flourished building ships for the Navy during World War II and helped draw many residents to Pascagoula. Before the war, it was a fishing village of 5,000 people. Today, the city's population is more than four times that size, and the metropolitan area exceeds 150,000. The Northrop Grumman shipyard has for many years been Mississippi's biggest private employer, but its current workforce is about half its mid-1970s peak of 25,000.

Pascagoula is the Mississippi Gulf Coast's manufacturing center, located next to Biloxi-Gulfport's casinos and military bases. People have been building ships there for about 300 years. A look at a map makes it obvious that water is Pascagoula's lifeline. In addition to shipbuilding and energy, another core economic component is the Port of Pascagoula, the nation's 23rd busiest seaport in terms of cargo volume in 2008, according to the American Association of Port Authorities. The city's retail development plans are likewise focused on its riverfront, and the U.S. Army Corps of Engineers recently pumped in sand to restore a mile-and-a-half beach along the Gulf of Mexico.

"We want to build on our strength," Maxwell said, "and that is the water." ■

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



Demystifying Sovereign Debt in Greece: Why It Matters to Us



Greece's fiscal crisis has led to a cycle of government threats of austerity and civil unrest. The crisis also has repercussions for the euro area and possibly the worldwide economy. How did Greece's reliance on sovereign debt put the country in such a difficult position?

Until recently, many Americans, when they thought of Greece, were likely to envision a beautiful Mediterranean vacation destination, complete with flavorful dishes dripping with olive oil and goat cheese, and perhaps relics of ancient Greek civilization such as the Acropolis in Athens. These pleasant images may now be going the way of the drachma, Greece's former currency. Greece, one of the 16 European Union (EU) members that has adopted the euro, has been at the center of an evolving debt and financial crisis that threatens to upturn Greek society and the stability of the euro, and even derail the nascent recovery of the world economy. The thoughts that might come to mind now for Greece could include political and civil unrest, EU bailouts, and possible bankruptcy.

How did Greece get to this point? How has a crisis in a small country in southern Europe morphed into a wider crisis engulfing the whole continent? And what are the greater lessons of this Greek drama about government debt, budget deficits, and possible default?

Act I: Unrestrained government borrowing

To understand the Greek crisis, we have to refresh our understanding of some basic facts of public finance and balance of payments accounting. In any given fiscal year, a government has revenues (tax receipts, for example) and expenditures (appropriations for defense, interest payments on debt, and so on). For many governments, these two sides of the ledger don't necessarily balance. Governments can run surpluses as well as deficits. When a government runs a deficit, in most cases it issues debt, or IOUs—called *sovereign debt* because the government, a sovereign entity, backs it. The purchasers of these debt securities can vary: central banks, pension funds, commercial banks, corporations, and foreign private entities or countries. This last category of debt purchase, also known as *external financing*, is where balance of payments accounts, or the record of a country's international transactions, matter. Japan, for example, has a large debt burden but a relatively large portion of it is financed domestically. On the other hand, a relatively larger portion of Portugal's debt financing is held by foreign entities.

To offer an example with a little more detail, we can look at the United States. The U.S. Treasury Department regularly issues debt—Treasury securities that differ in maturity from four weeks to 30 years—backed by the “full faith and credit” of the U.S. government. This borrowing capacity is how the United States ran a budget deficit in fiscal year 2009 equal to about 10 percent of gross domestic product (GDP) and had a total stock of public debt equal to 83 percent of GDP, according to the Office of Management and Budget (OMB).

However bad the U.S. fiscal situation may seem to some of its citizens, Greece's is far worse. The latest data from the Greek Ministry of Finance show that in 2009 Greece had a

budget deficit of 16.35 percent of GDP and a debt-to-GDP ratio of 125 percent. This situation is not new, of course. After joining the Economic and Monetary Union (EMU) of the EU in 2001, Greece experienced nearly a decade of above-average real GDP growth (an average annualized growth of nearly 4 percent between 2001 and 2008). Along with the growth, however, Greece also ran large deficits (averaging 7 percent of GDP between 2003 and 2008; see chart 1).

While Greece's fiscal situation was worse than most of the other euro countries, it was not alone in running large deficits or having high debt-to-GDP ratios. Italy, for example, has had a debt-to-GDP ratio above 100 percent since 1992. In 2009, it peaked at 115 percent. Furthermore, while Greece may have the largest budget deficit, Ireland, for example, is not far behind, at 15 percent of GDP in 2009. According to the Economist Intelligence Unit, forecasts for the budget deficits in the developed world are deeply in the red, but it's particularly bad in the United Kingdom (UK) and the so-called PIIGS—the popular acronym for Portugal, Italy, Ireland, Greece, and Spain (see chart 2).

Act II: Financial markets lose confidence in Greece

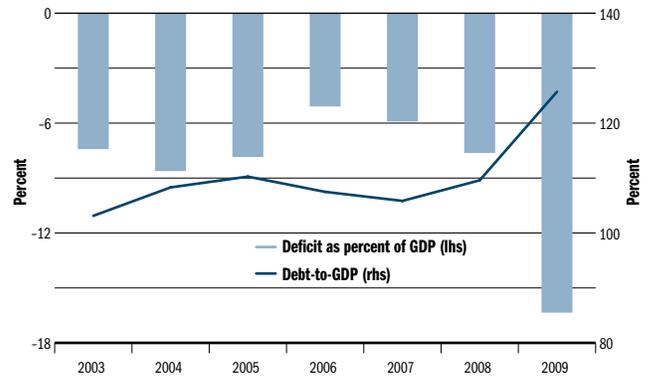
After George Papandreou became Greece's prime minister in October 2009 and his Panhellenic Socialist Movement (PASOK) party took power, the Greek Ministry of Finance—equivalent to the U.S. Treasury Department—revealed what many had already suspected: Greece's fiscal situation was much worse than had been presented. The previous conservative government had manipulated the budget statistics to produce a less dire picture. Following this disclosure, investors in Greek bonds became increasingly uneasy, and yields on Greece's sovereign bonds (which move inversely to prices) shot up. Simultaneously, ratings agencies such as Moody's and Standard & Poor's began to put Greek debt on "negative watch," an ominous sign of the ratings downgrades to come.

The bond market is a reflection of the reluctance of investors to finance European debt. For euro-area sovereign bonds, the 10-year German bond serves as a benchmark, so the Greek-to-German bond spread is a useful indicator for how financial markets view the risk to Greek debt. Beginning in November 2009, the Greek-to-German 10-year bond spread began to widen when Greece overtook Ireland as the most fiscally strained euro-area country (see chart 3). This trend continued through the first quarter of 2010, and it was not until April that other euro-area debt spreads began to widen substantially, along with a meteoric rise in the Greek spread.

Another useful gauge of market confidence is the market for credit default swaps (CDS), which are derivative securities used to protect a bondholder in the event of a "credit event" such as a default or restructuring. A CDS on a Greek sovereign bond can be thought of as an insurance contract, or protection against the possibility of not being repaid on an investment. In this market,

Chart 1

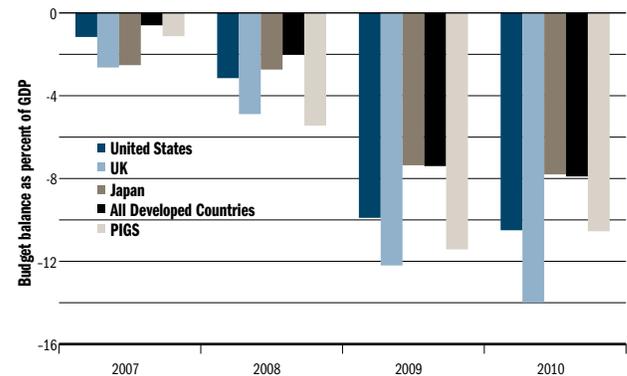
Greece's Budget Deficit and Debt-to-GDP



Source: Greek Ministry of Finance, Haver Analytics

Chart 2

Budget Deficits of Developed Countries



Notes: Developed countries are OECD countries. The PIIGS countries in this chart include Portugal, Ireland, Greece, and Spain. Italy is not included because of distortion (low budget deficit, high debt/GDP). Results for the PIIGS countries reflect the average of the countries.

Source: Economist Intelligence Unit

the CDS spread on a given debt security reflects investors' view of the creditworthiness of the underlying country. As with the bond spreads, the CDS spreads show the increasing price that an investor pays to purchase protection against a Greek default (see chart 4).

Following a downgrade by Fitch on December 8, 2009, Prime Minister Papandreou unveiled a plan to cut the 16.35 percent budget deficit by 4 percentage points. (Note that as late as October 2009, the government had expected the 2009 budget deficit to be 6 percent of GDP.) In the face of rising interest costs and to convince financial markets of their creditworthiness, Papandreou announced the first of several austerity measures,

including budget cuts, tax hikes, and other fiscal changes (such as cracking down on tax evasion) aimed at narrowing the immediate budget deficit and lowering the debt-to-GDP ratio in the future. Nevertheless, as the widening bond spreads indicate, many holders of Greek debt were skeptical such reforms could be successfully carried out. Further confirming the difficulty of enacting these reforms, protestors who objected to the cuts immediately began striking in the streets of Athens.

The political and financial drama in Greece has since oscillated between greater protests and renewed, bolder austerity plans, all alongside the steady loss of market confidence, demonstrated in the widening bond and CDS spreads. In some sense, Greece began to be caught in a vicious cycle of losing market confidence. As the country's interest costs rose, budget reforms were proposed to regain access to market financing, yet those reforms were likely to dampen growth in the near term (if they could be carried out at all, over public protest). These concerns created greater pessimism that Greece could grow out of its debt burden, thus prompting a further selloff in Greek bonds and yet higher interest rates. Furthermore, because Greece is a member of the EMU, it could not devalue its exchange rate and so gain competitiveness in exports. Being locked into the single currency, at first a blessing with above-average GDP growth, had suddenly become a restraint on Greece—one less tool to use to grow out of its debt.

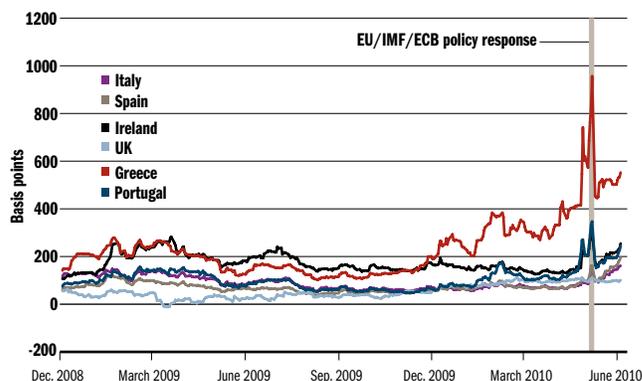
Act III: The crisis spreads to Europe

Greece has lost much of its access to financial markets. Complicating the situation is the fact that bond redemptions are imminent. The lack of a solid plan to consolidate its finances has engendered fears of a default or restructuring. What does this mean for the rest of the world? Indeed, Greece represents a small, 2.4 percent share of the total 16-member euro-area GDP (see chart 5 on page 10) and an even smaller sliver of the world economy, so it might seem unlikely that its financial disturbances could affect the broader world economy.

Yet the crisis in Greece has some analysts worried it could lead to contagion in the rest of Europe, and possibly beyond, for several reasons. Other countries' banking systems are large holders of Greek sovereign debt and are vulnerable to

Chart 3

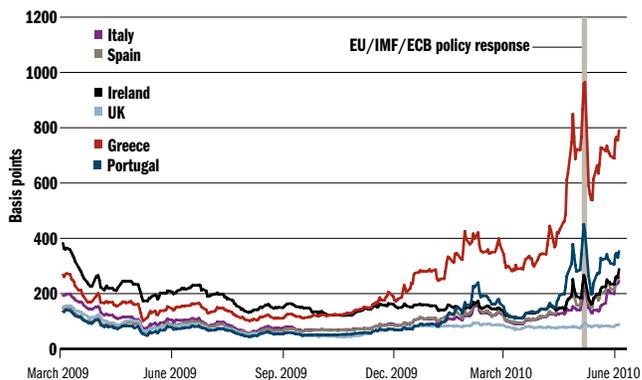
European Bond Spreads: 10-Year Bond Spread to German Bonds



Note: Data are through June 2010.
Source: Bloomberg

Chart 4

5-Year European CDS Spreads

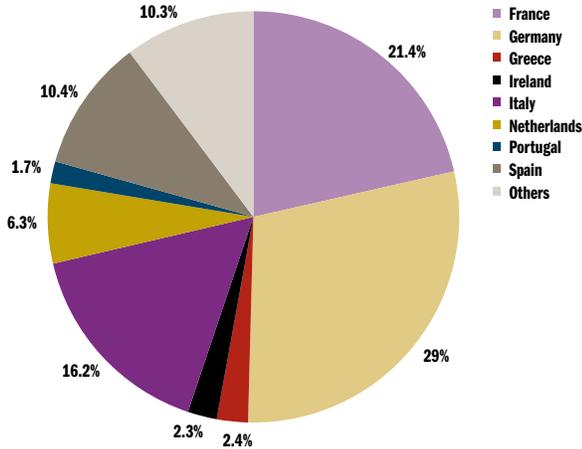


Note: Data are through June 2010.
Source: Bloomberg

credit events, such as if Greece were to restructure the payments on its bonds leading to a partial default. The liquidity shocks to the wider global banking system could be significant if a large European financial institution were to fail, as happened when Lehman Brothers collapsed in the United States and roiled global markets. According to data from the Bank of International Settlements, the largest holders of Greek debt outside of Greece and the European Central Bank (ECB) are French and German banks.

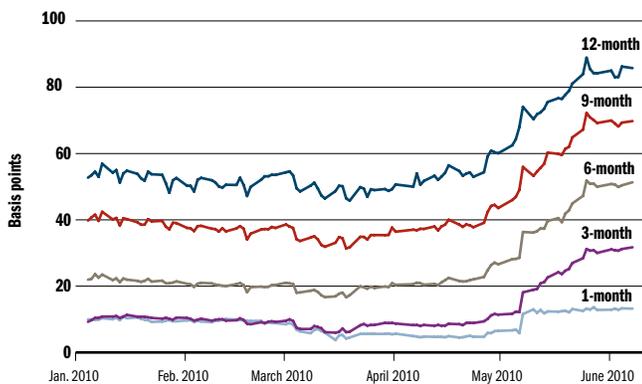
This type of contagion also has the potential to spread outside of Europe. Aside from the declines in stock markets across the globe (but especially in Europe), financial markets have seen other worrisome signs of strain. One of these indicators

Chart 5
Euro-area GDP



Source: Statistical Office of the European Communities

Chart 6
Dollar LIBOR-OIS Spread



Note: Data are through June 2010.
Source: British Bankers' Association, Bloomberg

is the rates charged in the interbank lending market. The best proxy for this is the London Interbank Offered Rate (LIBOR), which is set every day by a panel of 16 large commercial banks based across the globe. The spread between the LIBOR rate and the Overnight Index Swap (OIS) rate, which tracks the expected path of monetary policy, reflects the amount of credit risk banks suspect in one another.

Chart 6 shows how this spread, across various maturities, has crept upward over the last several weeks in the second quarter. The three-month spread, for example, tripled from 10 basis points (bps) on April 27 to 31 bps as of May 27. The difference in the spread paid by the three U.S. banks on the panel and the



13 non-U.S. banks has also widened, reflecting the increasing perception of credit risk in European banks. Because the LIBOR-OIS spread is often used as a benchmark for other interest rates, increases in the LIBOR-OIS spread have consequences for consumers and businesses across the globe—creating a channel through which fears of a possible default in Europe could add stress to bank lending and lead to raised interest rates worldwide. Still, the LIBOR-OIS spread is well below the peaks it reached during the recent financial crisis.

Aside from the financial market disturbances that would accompany a credit event on Greek bonds, the situation has other potential for contagion. The PIIGS countries all have fiscal difficulties of varying degrees, with Greece's the most severe. If investors become increasingly reluctant to hold the debt of these other countries, fearing that like Greece they will be unable to implement the necessary reforms to lower their debt burdens or boost economic growth, then contagion will have occurred. Indeed, the bond and CDS spreads began to widen in the spring for countries other than Greece, indicating that investors were beginning to think twice about the debt of several European governments. Over the last few months, in line with Greece, ratings agencies have downgraded the debt of Spain and Portugal, further exacerbating the stress in sovereign funding markets.

It has been with such concerns in mind that investors have increasingly demanded over the last few months a more coordinated, pan-European response from policymakers to the debt and fiscal crisis.

Act IV: The rescues

With Greece effectively locked out of the bond market for financing and with repayments due in May 2010, something had to be done beyond the austerity measures proposed by the Greek government. On April 23, 2010, Prime Minister Papandreou officially requested \$56 billion from the EU and the International



A Return to Central Bank Swap Lines

On May 10, 2010, the U.S. Federal Reserve reopened “temporary reciprocal currency arrangements,” known as swap lines, with the European Central Bank (ECB) and the central banks of England, Japan, Canada, and Switzerland. With renewed worries about contagion from the Greek sovereign debt crisis, the Fed reestablished the swap lines set up during the 2007–08 financial crisis.

The swap lines allow the Fed to send U.S. dollars to the central banks in exchange for equal value in the currency of those countries. The goal is to provide liquidity to financial institutions around the world. Under the agreement, the ECB, for example, requests dollars from the Fed and in return sends to the Fed the same value in euros—hence the term swap. The foreign central banks auction the dollars to the highest bidders, typically financial institutions that need dollars to meet short-term obligations. The highest bidder pays the most interest on the dollar loan after a set term, usually about 84 days.

The underlying notion of the swap lines is banks and businesses around the world do business in U.S. dollars in addition to their home currency, so the foreign banks need money in both currencies. If the dollar shortages in Europe and other markets were to worsen, the problems could spread to the United States.

When the arrangement expires in January 2011, the Fed and the central banks will swap again—the Fed returning the euros and other currencies, and the ECB and other central banks returning the dollars. These transactions do not expose the Fed to foreign exchange risk because the exchanges occur at the same rate at the start and the finish. ■

Monetary Fund (IMF), but following further downgrades by credit ratings agencies and jittery financial markets, this figure was clearly not enough.

European governments, including the German government, were initially reluctant to act. But after urgent negotiations with German leaders concluded on May 2 of this year, the European Commission, in conjunction with the IMF, agreed to a \$140 billion rescue package for Greece. The initial response was a sharp tightening in spreads and a surge in European stocks. However, this optimism gave way to growing skepticism that the bailout would be anything more than a temporary fix. In effect, Greece is now insulated from having to issue bonds for the next three years. Some analysts suggest this is a disincentive for the Greek government to actually get their finances in order.

Indeed, following the initial euphoria of the \$140 billion package for Greece, European markets began to decline across the board. Some investors feared full-blown contagion was under way. After a weekend of around-the-clock negotiations, the European Commission announced in the early hours of May 10 that it had assembled a rescue package of some \$957 billion for distressed European governments. Of this, \$76 billion was to be made available through an EU fund originally used to provide

ECONSOUTH NOW PODCAST

Andrew Flowers of the Atlanta Fed's research department discusses sovereign debt and the Greek fiscal crisis in an interview. On frbatlanta.org, select “Podcasts.”



stability to countries suffering from balance of payments problems during the financial crisis. However, the major commitment was a \$560 billion “special-purpose vehicle” operated by the euro area. Although operational details are still unclear, this vehicle is essentially a way to raise funds collectively to provide financing to euro-area countries that are otherwise locked out of markets. In addition, the IMF would provide up to \$321 billion in support through its usual mechanisms—though it has never before initiated a rescue package on this scale. Further, the ECB announced it would begin purchasing public and private debt through a “securities market program” to stabilize financial markets. In fact, a week later the ECB purchased \$21 billion in European sovereign debt. The response from the markets to this rescue package was strong. In addition, the U.S. Federal Reserve reopened credit swap lines on May 10 with the ECB as well as other central banks (see the sidebar on page 11).

Following the second, more comprehensive response that included help for the whole euro area, investors let their hopes rise—and markets surged as a result—only to pare back their expectations because of the lack of clear details surrounding implementation of the programs. The success or failure of the euro-area countries in stabilizing their economies will depend on whether they can enact the necessary reforms to shore up their budget deficits, lower debt ratios, and regain competitive-

ness in terms of labor costs. However, the euro/dollar exchange rate has so far in the second quarter steadily decreased, and many analysts forecast further depreciation.

Lessons about sovereign debt

The lesson for the euro area relates to the troublesome nature of having a common monetary policy with disparate fiscal policies, according to many economists, including Barry Eichengreen, an economist at the University of California, Berkeley, who has written extensively on the subject. Without adequate intra-euro fiscal monitoring to make the currency union work, countries like Greece, with policies that both elevate public debt and allow the loss of competitiveness, have the potential to find trouble. A broader lesson to be drawn from Greece’s fiscal crisis applies to any country that tends to overspend—that is, the threat of a crisis of confidence, or the unwillingness of investors to trust a country to get its finances in order.

Time will tell how Greece and its European partners will regain stability and the confidence of investors. For other countries, the Greek fiscal crisis has been a sobering reminder of how precarious government finances are in this postrecession world. ■

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

On Point Continued from page 1

One of the more visible reminders left in the wake of the recession is the number of vacant shopping centers and retail outlets, a mark of the impact on commercial real estate. In the article “Stiff Headwinds Blow Through Retail Spaces,” staff writer Charles Davidson explores the factors that came together to result in so much unused square footage. In researching the story, Davidson said two characteristics of retail real estate were especially striking. “One is the impermanence of retail development today,” he said. “Big chains and shopping center developers don’t view a new center or store as something that will last forever, or maybe not even 10 or 15 years—they have to keep moving to stay in the right place geographically for the moving target of consumers’ fickle tastes. The second characteristic is that retail real estate is highly localized. Metro Atlanta currently has one of the highest retail vacancy rates in the country. Empty space abounds in some pockets, while other areas teem with shoppers sampling the latest retail concepts.”

Despite the recession’s end nearly a year ago on paper, long unemployment lines persist. In his article “Out of the Workplace . . . and Struggling to Get Back In,” staff writer Ed English explores a growing phenomenon of recession: long-

term unemployment. English looks at some of the structural shifts in the U.S. economy and their profound impact on the workforce. He said the article brought home some of the lessons learned by an earlier generation of Americans: “As a baby boomer, I and many of my contemporaries viewed our Depression-era parents as overly cautious spenders and unnecessarily risk-averse investors. Now that the long-term unemployed make up nearly half the unemployment rolls, there’s a growing respect for the former generation’s wisdom. Without a nest egg and manageable debt levels, the structural shifts in employment can be devastating for many workers.”

As the economic recovery progresses, in coming issues *EconSouth* will continue to examine the aftereffects of recession from a variety of perspectives, giving readers a fresh take on what the economy has endured. We will also follow up on past articles, when new developments change the course of an economic topic, such as the impact of the Gulf oil spill. ■

Lynne Anservitz
Editorial Director

Regional Update

Regional Economy Improves, but Job Gains Prove Elusive

Economists see growing evidence that a sustainable recovery is under way. In the first quarter of 2010, retailers saw an increase in traffic and sales, and their outlook improved. Auto sales increased on a year-over-year basis, while revenues in the Southeastern tourism sector stabilized (notwithstanding the impact of the oil spill). Although commercial contractors continued to cite weakness in nonresidential construction activity, residential real estate contacts indicated that both new and existing home sales improved and were above weak levels from a year earlier. Regional manufacturers noted further improvement in new orders and production. Nevertheless, despite some signs that labor markets are healing, the increased economic activity has not resulted in an increase in employment in the first quarter.

The region's retailers were more upbeat than in previous months. Traffic as well as sales increased. Merchants continued to keep inventory levels low, and all contacts reported they were satisfied with their inventory levels. Backing these positive reports was the fact that all states in the Southeast experienced an increase in sales tax revenue from February to March.

Auto sales also improved. According to contacts and industry data, small-vehicle segments continued to drive the growth of the region's vehicle sales from the weak levels of a year earlier. Sales of vehicles assembled in the Southeast were up 24.5 percent year over year.

Tourism-related spending was described as stable in most parts of the region. Contacts in Atlanta, Miami, Nashville, New Orleans, Orlando, and Tampa reported hotel occupancy rates above the national average from February to March. Cruise lines noted increased demand and have rolled back some earlier price discounting. The near-term outlook among hospitality contacts remained generally upbeat. However, corporate bookings remained at very low levels at some high-end resorts.

Real estate activity was somewhat mixed. Reports on home sales were more upbeat in March, and construction data continued to improve from very low levels. In particular, reports on existing home sales were stronger as time to take advantage of the housing incentive for first-time buyers began to run short. However, it did not appear that the second round of the house-buying stimulus was as strong as the results experienced last fall. The outlook among both Realtors and homebuilders was cautious, however. Expectations are that home sales and construction activity would at best hold steady as the latest stimulus expired at the end of April. In addition, commercial development remained weak across the Southeast.

Industrial activity showed signs of improvement. Kennesaw State University's Southeast purchasing managers index increased from 56.8 in February to 59.9 in March. (A reading above

Gulf Oil Seeps Into Regional Economy

In late April, a blowout on an offshore oil drilling platform resulted in a large oil spill in the Gulf of Mexico. The spill directly affected Southeastern states with Gulf coastlines (Louisiana, Mississippi, Alabama, and Florida), though contacts emphasized that the full economic and environmental consequences of the spill will be difficult to determine for some time given the uncertainty about the weather, spill rate, and leak-stop timeline.

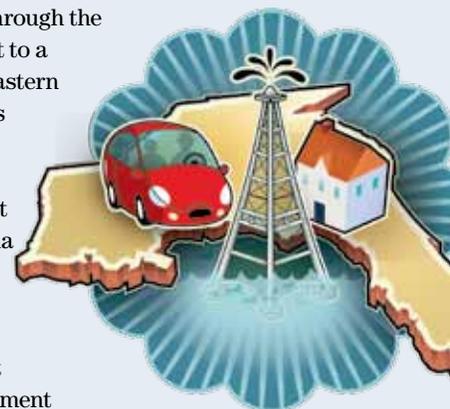
Regional oil output felt little immediate impact from the spill, though industry members expressed concern about the effect on future production. Following the spill, supply vessels were able to reach existing rigs without interruption. Meanwhile, district refinery operations saw little immediate impact from the spill, and Gulf Coast crude oil and gasoline stocks remain near the top of their seasonal average for this time of year.

The regional fishing industry reported a significant impact resulting from the spill, with fears of water contamination and safety concerns prompting a federally mandated ban on both commercial and recreational fishing in zones affected by the spill.

50 indicates expanding manufacturing activity; below 50, contracting activity.) The 3.1 point increase was attributed to continued gains in production, employment, and new orders. The new orders component gained 2 index points to reach 67.1, while the production component experienced another sharp monthly increase of 9.5 index points to reach 70.

Through mid-April, vehicle production in the region was up sharply from 2009's low readings, but production was still far below levels reported in 2008. Automakers are continuing to set production plans ahead of demand levels.

Increased economic activity has not translated into a rise in employment through the first quarter, but some signs point to a healing of labor markets. Southeastern states shed a further 20,300 jobs in the first quarter of 2010. This loss nevertheless represents an improvement over the 73,000 lost in the last quarter of 2009. Florida and Louisiana experienced net increases in total employment, while Alabama, Georgia, Mississippi, and Tennessee saw a net decline. The combined unemployment



rate for Southeastern states rose to 11 percent at the end of the first quarter of 2010 from 10.7 percent in the fourth quarter of 2009. All Southeastern states except Tennessee logged an increase in their unemployment rates; Tennessee's remained unchanged.

On the positive side, initial claims for unemployment insurance have decelerated to under 60,000 from a peak of 90,000 in April 2009. In Florida, temporary employment decreased just under 5 percent year over year in the first quarter of 2010, compared with a drop of 10.8 percent in the fourth quarter of 2009. In Georgia, temporary employment rose nearly 2 percent year over year in the first quarter of 2010, compared with an 11.9 percent decline in the last quarter of 2009. In addition, average weekly hours for all workers in the private sector rose in all Southeastern states in March. These indicators point to improved labor markets for the remainder of 2010.

The flow of bank credit to businesses remained subdued. Bankers in the Southeast continued to indicate that ample credit

was available to qualified borrowers, yet many noted that the volume of loan applications was low for households and small businesses. In contrast, several firms noted that tighter credit standards were making it difficult for them to obtain loans. Some contacts suggested that trade credit terms also tightened, with some suppliers having modified terms or reduced credit without regard to payment history.

Overall, the Southeastern economy continues to stabilize, with increasing signs of a sustainable recovery. However, regional unemployment rates remain high and job gains have been elusive through the first quarter of 2010. Overall, the regional outlook is similar to that of the nation. Recovery largely depends on repairing credit access, reaching a definite bottom in the housing market, and sustaining the rebound in consumer spending. These trends should be supported by modest increases in employment going forward. ■

University Studies

The last week in March marked the second conference of the Atlanta Fed's Local Economic Analysis and Research Network (LEARN). The conference included economic outlooks for Southeastern states.

Fitful recovery foreseen in Alabama

Sam Addy, director of the University of Alabama's Center for Business and Economic Research, reported that Alabama's economy is recovering. Economic growth is expected to be 1.9 percent in 2010, but employment growth will likely be flat. He cited challenges facing the Alabama economy in 2010, including continuing but slowing job losses, declining consumer spending and income, declining revenue to fund public education, decreasing federal government spending, and continuing problems in commercial and residential real estate.

Road to recovery long in Tennessee

Matthew Murray, from the University of Tennessee's Center for Business and Economic Research, told conference participants that the state should begin seeing some improvements in economic conditions as 2010 unfolds. However, few expect a strong and vigorous rebound, he said. Even if rapid growth occurs, he said it would be at least two years before Tennessee's economy returns to prerecession levels. Murray also expects the state's labor market to recover slowly, adding that the state's unemployment rate will likely average 10.4 percent this year and remain above 10 percent through 2011.

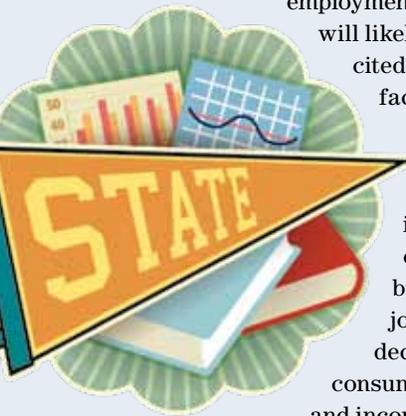
Mississippi looks ahead cautiously

Mississippi felt the brunt of the recession later than most states in the region, but its recovery will closely track that of the nation as a whole, according to Philip Pepper, state economist and assistant commissioner of institutional research for the Mississippi State Institutions of Higher Learning. Pepper pointed out that average growth during economic expansions has decelerated over time, and he anticipates that growth in the United States and Mississippi will be below the

long-term average for the foreseeable future. In particular, job growth will be anemic in Mississippi, Pepper said, and state revenue growth will be slow coming out of the recession as consumers remain cautious.

Georgia holds dampened expectations

Real estate continues to cast a long shadow in Georgia, according to Jeffrey Humphreys, director of the Simon S. Selig Jr. Center for Economic Growth at the University of Georgia. He noted that the state will continue to suffer from its heavy exposure to the real estate downturn. The economy has been geared toward new residential and nonresidential development, and going into this recession, Georgia had an outsized construction industry, a huge supply of residential and nonresidential properties, and a high concentration of manufacturing industries closely allied to construction. The overdependence on development meant the financial crisis did much more damage to Georgia's banks than to the nation's. Humphreys concluded that Georgia's economy will underperform the national economy until real estate and construction stabilize, sometime in 2011. ■



Data Corner: Retail Sales

Because it makes up about 70 percent of U.S. gross domestic product, consumer spending is an intensely scrutinized economic barometer. For this reason, retail sales is a closely watched measure of economic activity.

The national retail sales data come from the U.S. Census Bureau and are available on a monthly basis. Month-to-month and year-over-year comparisons allow short- and long-term readings of trends.

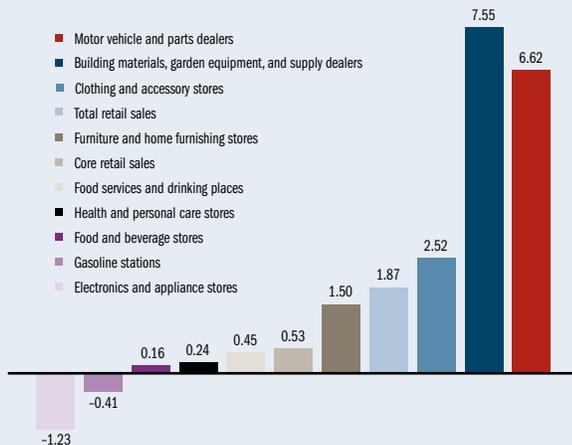
Every month, the Census Bureau collects information from thousands of retailers about what consumers are buying and how much they are spending. This information goes into developing the two most widely examined series: total retail sales and core retail sales.

Total retail sales include broad categories of consumer goods such as motor vehicles and parts, furniture, electronics, building materials, food, gasoline, clothing, and general merchandise.

Core retail sales exclude autos, building supplies, and gasoline. These categories tend to be volatile and can skew the overall consumer spending numbers. For example, if the price of gas increases but consumers still buy the same amount, the total retail sales number will go up even though consumers bought no more gas than they did before the price increase. Autos and building supplies—usually big-ticket items—can also alter the interpretation of the data.

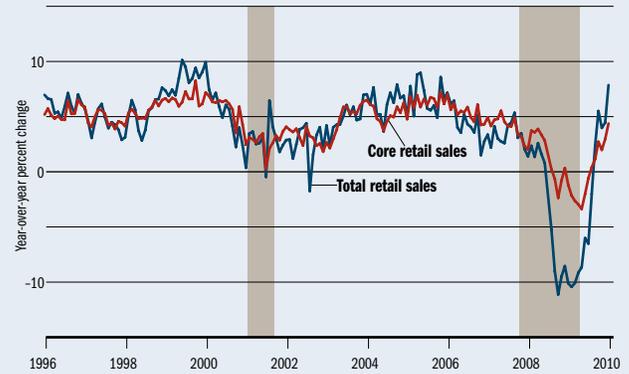
Although retail sales are a very important indicator of economic activity, they only provide a measure of the goods that consumers are spending money on, but not what they're spending on services. Services, such as haircuts, dry clean-

U.S. Retail Sales Components



Note: Data are for March 2010 and indicate month-over-month percent change.
Source: U.S. Census Bureau

Retail Sales



Notes: The chart assumes the recession ended in June 2009. March 2010 total retail sales = 7.6 percent; March 2010 core retail sales = 4.4 percent.
Source: U.S. Census Bureau

ing, and banking, account for a larger portion of consumer spending than do goods. However, retail sales data have the advantage to economists of being released well before the overall tally of consumer spending that includes services.

Recent retail sales data show an increase in consumer spending, coming on the heels of the historical lows in retail sales seen during the recession. Core retail sales were up 4.4 percent in March on a year-over-year basis, a vast improvement from the low of -3.4 percent in July of last year. Total retail sales showed a similar pattern, albeit an even more drastic one, given the large swings in gas prices and car sales. Given the importance of consumer spending to economic growth, retail sales will continue to attract scrutiny as an indicator of economic recovery. ■

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The D6 Factor

The D6 Factor ended the first quarter of 2010 at -1.9, an increase of almost 2 index points from the previous quarter. Although a negative value indicates that economic conditions are weak, the index has steadily been trending upward from its record low of -5.4, set in August 2009. This positive trend signals improving conditions for some of the underlying series that are used to compute the index. ■

About the D6 Factor

The D6 Factor is an estimate of the trend common to 25 distinct monthly series of economic data for the six states of the Sixth Federal Reserve District. It provides a broad measure of Southeastern economic conditions that is available more frequently than estimates of gross domestic product (GDP) for the six states. Also, unlike an average of state-level GDPs or other factors, the D6 Factor can filter out idiosyncratic shocks that disproportionately affect individual states. For detailed information on the D6 Factor's construction, see "When More Is Better: Assessing the Southeastern Economy with Lots of Data," by Pedro Silos and Diego Vilán (*Economic Review*, Third Quarter 2007).

The D6 Factor



Note: The growth rate is normalized to zero. Data are through March 2010.
Source: Federal Reserve Bank of Atlanta

Econ 101: The Discount Window

The discount window—a Federal Reserve lending facility—provides short-term loans to depository institutions that face temporary liquidity strains during times of stress. The discount window has three different programs: primary credit (the main program), secondary credit, and seasonal credit.

The interest rate charged on primary credit (often referred to as the discount rate) varies but is set above the Federal Open Market Committee's federal funds target rate to provide an incentive for financially sound banks to seek funding in the market at lower rates.

In the event that private market rates are prohibitively high, banks can use the discount window as an alternative funding source.

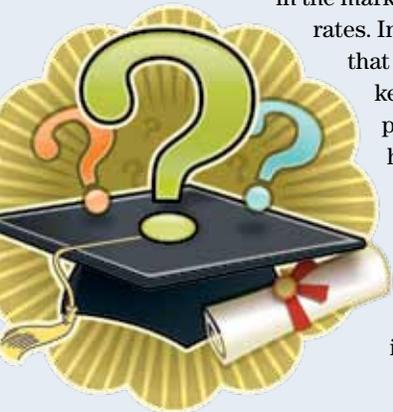
(Secondary credit—extended to institutions that do not qualify for primary credit—has historically been set 50 basis points (bps) above the primary rate. The rate for seasonal credit, which is extended to institutions that experience large seasonal swings in deposits and loans, is set by averaging the fed funds rate and the interest rates on 90-day certificates of deposit.) Typically, the primary credit rate had been 100 bps above the federal funds target rate, although it is currently only 50 bps above the upper end of the target range of 0 percent to 0.25 percent. The discount window rate structure also helps to carry out monetary policy because the discount rate should act as an upper bound on short-term interbank rates.

To obtain primary credit, a depository institution must be deemed in sound financial condition by its regional Reserve Bank. All credit provided to institutions is fully secured to the satisfaction of the lending Reserve Bank by acceptable collateral (such as U.S. Treasuries, real es-

tate loans, or consumer loans). During the recent financial crisis, many depository institutions faced a shortage of liquidity, and many received discount window loans. At the height of the crisis, primary credit borrowing reached more than \$100 billion in October 2008 and was instrumental in helping solvent institutions continue their operations. More recently, as short-term private funding markets have improved, primary credit borrowing has declined markedly, to about \$5.5 billion at the end of April 2010.

The Federal Reserve Board of Governors provides a weekly report showing the total borrowing under each discount window lending program and the amount borrowed within each Federal Reserve district. ■

—By Mike Hammill, economic policy analysis specialist at the Atlanta Fed



On the Ground: An Interview With Juan Del Busto, Regional Executive at the Atlanta Fed's Miami Branch



What are some of the primary ways you gather economic data about the South Florida region?

We have a number of ways of gathering data. For example, we go to Chamber of Commerce and Latin Builders Association meetings and make contacts. We also host business leader roundtable meetings not only to provide the Fed's

outlook on the economy, but to receive their feedback regarding what they are experiencing and seeing from their industry and geographic sectors. Also, travel and tourism is a key area for our region. We have so many cruise lines here, and we gather information through them. We have some real estate industry representatives, both commercial and residential. We seek out those individuals to obtain their input on the state of the residential and commercial real estate markets.

Another economic area we're interested in learning about is agriculture, so we seek out individuals for their input in agriculture either in the Homestead area or further north in South Florida, like the Vero Beach area, where the farmers grow fruit, vegetables, and flowers. Agriculture is an important economic industry in the region. Fort Myers and Naples are also important areas in our zone, and there are a lot of construction businesses there. We network to attend meetings in these areas to find out about their business and real estate there. We look for people who can contribute timely economic information to help us formulate monetary policy. And we maintain relationships with those contacts, so if there's something that happens nationally, in the district, or in the state, we can go back to those individuals and gather key economic information. We try to maintain a two-way flow of information with these important contacts by providing the Fed's outlook through speeches to their groups and reports from their sectors, like the monthly research surveys in real estate, manufacturing, and retail.

You mentioned the importance of travel and tourism to your region. How is that sector holding up in the economic recovery? Travel and tourism are actually coming back. We have all three major cruise lines on our travel and tourism advisory council [a group of industry leaders brought together by the Miami Branch of the Atlanta Fed], and we've received information that pricing has improved. Not only has price per individual improved, but onboard spending has improved. Tourists are spending more money now in the casinos, on food and drink, onboard shopping, things like that. Our advisory council members in the convention and visitors bureau business and hotel operators have reported an uptick in occupancy and a fairly good increase in future convention bookings.

Though the oil spill's effects are not yet fully known, has it had an effect on your region's economy? Our tourism contacts are wary and keeping a close eye on things, as are their custom-

ers. To date our contacts have reported receiving numerous calls asking if their beaches are open, and there have been some cancellations on the west coast of Florida, particularly from international travelers, with some rebookings on the east coast of Florida from folks who have canceled. We are all hoping the leakage will be capped soon and the cleanup goes quickly and thoroughly. There is the potential for a significant hit on tourism if the current situation continues.

What do your contacts tell you about the recovery of the South Florida housing market? The housing market has improved. South Florida was one of the nation's first markets to experience stress. In addition, we have a lot of condos in South Florida, and that part of the market has also continued to improve. The improvement in the condo market has been due in large part to foreign buyers. And they don't get financing—they pay for condos with cash. The higher-end homes—greater than \$1 million—have not yet hit bottom regarding prices.

Has the tone of conversations you've been having with your contacts changed over the course of the past year? They've definitely changed. Our contacts are feeling more positive. However, they're still very, very cautious on the employment side. Let's say a company laid off six or eight individuals. Even if they see growth in their company, they may not hire all those people back. They might hire two or three of them back, but they're definitely trying to do more with fewer people. Additionally, educational institutions like Miami-Dade College, for example, have seen growth. Miami-Dade College's enrollment has increased 7 percent, and they have 400 job openings. In the finance area, the college has 34 openings. College contacts say that if they fill 11 of those openings, they can work years with that staffing level. Some individuals have permanently lost their jobs. I think a lot of companies won't rehire the same number of people they previously had on board. They're just going to try to have people do two or two-and-a-half jobs going forward. Now, it's not likely that can be sustained over time, so we'll see what happens.

How do you envision your role as regional executive over the course of the coming year? I'm definitely going to continue expanding my contacts. I am very well connected in Dade and Broward counties, which is the Miami-Fort Lauderdale area. I need to make sure I am as connected in the outlying areas of our region. I need to go to Vero Beach, Fort Myers, Naples, Englewood, and the Keys and establish more relationships with high-level individuals. I want to be able to call on those individuals, and I want Dennis [Lockhart, Atlanta Fed president] to be able to call on them as needed to get real-time, anecdotal economic information. I have some good contacts in those areas, but I want to broaden my base. That's my goal for this year. ■



Stiff Headwinds

Blow Through Retail Spaces

Robust consumer spending prior to the recession brought on a significant expansion of retail space in the Southeast. Absorbing the postrecession surplus development into the marketplace remains a challenge.



Atattered awning flapping in a spring breeze is the only sound at a shopping complex just north of Atlanta. Abandoned CompUSA and Marshalls stores stand surrounded by acres of cracking, empty asphalt. At an intersection two miles away, a strip shopping center once anchored by a Publix supermarket is more than half empty. A sign in the window of a baby products store welcomes shoppers on public assistance. At a larger retail complex across the street, a cavernous empty space squats at one end.

These shopping complexes are hollow shells despite plenty of hustle around them. About a mile away from those vacant centers, 7,500 cars fly past every hour, on average, on the Georgia 400 expressway. The surrounding Roswell-Alpharetta area is home to roughly a quarter million people, with a median annual household income of more than \$90,000, far higher than Fulton County's five other census subdivisions, according to the U.S. Census Bureau.

A picture repeated all over

This slice of north metro Atlanta mirrors a nationwide retail real estate slump brought on by a mixture of economic and demographic factors. Some of these factors are straightforward: recession and slow income growth lowered consumer spending, forcing many stores out of business after a development boom had added vast supplies of new retail space. Fueled by abundant financing, development was particularly intense and vacancy rates high in certain Southeast markets such as Atlanta, Nashville, and Birmingham, according to statistics from F.W. Dodge Pipeline, which tracks commercial real estate development.

Other factors are more subtle. Shopping patterns are fluid in high-growth areas such as Atlanta's north Fulton County. A decade ago, for instance, the intersection in Roswell, Ga., vacated by Publix was a regional retail nexus, said Ruth Coan, principal with The Shopping Center Group, a real estate services

firm with 23 offices across the Southeast. However, along with high-end residential development, north Fulton's shopping hub has migrated several miles up Georgia 400 to the Northpoint Mall area. Consumer tastes have also shifted away from traditional enclosed malls and neighborhood strip centers and toward lifestyle centers designed to resemble traditional downtowns.

At the root of the retail space glut, though, is a fundamental imbalance of supply and demand, experts said. During the past couple of decades, the nation's retail space per capita has more than doubled, according to the International Council of Shopping Centers and the National Research Bureau. In three years, 2007 through 2009, developers across the country added nearly 700 million square feet of retail space, according to F.W. Dodge.

"We built an awful lot of retail space in the past three years, and now half of it is unleased," said K.C. Conway, subject matter expert in the Atlanta Fed's Center for Real Estate Analytics. In that recent period, metro Atlanta added 20.9 million square feet of shopping space, roughly equivalent to about 17 super-regional malls. Only Phoenix and Chicago added more retail real estate during the past three years. In 2009, developers finished more retail space in Atlanta than in any other metro area in the country, according to F.W. Dodge.

As the supply of space has mushroomed, Atlanta's retail vacancy rate has risen each year since 2004. It reached 15.5 percent

Nationwide, vacancies at the larger malls reached a record high in the fourth quarter of 2009, while neighborhood and community shopping centers were their emptiest since 1991.

in the fourth quarter of 2009, according to data compiled by the Atlanta Fed's Center for Real Estate Analytics. (Another measure, by the real estate firm CB Richard Ellis, put the vacancy rate as high as 25 percent at the end of 2009.) Likewise, store spaces are emptying across the Southeast. In the fourth quarter of 2009, 26 of the region's 28 largest markets saw retail vacancy rates climb from the year before, REIS Inc., a New York-based real estate research firm, reported.

It's happening here, there, and everywhere

The Southeast's high vacancy rates aren't unique. Nationwide, vacancies at the larger malls reached a record high in the fourth quarter of 2009, while neighborhood and community shopping centers were their emptiest since 1991, according to REIS. Atlanta



and Los Angeles at the end of 2009 had more excess retail space than any other U.S. market, reported the CoStar Group, another commercial real estate information service.

"New space is cannibalizing older space," said Julian Diaz, professor and chair of the Real Estate Department at Georgia State University's J. Mack Robinson College of Business in Atlanta. Explaining the highly visible problem of vacant retail space is more complicated than simply saying developers built too much space and then recession hit. For example, Coan said, changing traffic and shopping patterns helped the Roswell, Ga., strip center vacated by Publix devolve from a choice retail location a decade ago into a property with traffic, access, and visibility problems.

That sort of change is not unusual. Major retail real estate development is a fluid business. Retail chains and their landlords do not view a lease agreement as a lifetime arrangement. Major anchor tenants typically sign a 10-year lease when they move into a center, according to Coan and other real estate experts. Arthur C. Nelson, a well-known urban planner and director of the University of Utah's Metropolitan Research Center, has calculated that the average life span of a retail structure in the United States is only about 25 years, as opposed to more than 150 years for a home and 60 years for office buildings.

Changing consumer preferences have also affected development as developers in recent years have built few, if any, enclosed malls. According to various news reports, no indoor mall has opened in the United States since 2006, after about 140 opened every year on average in the mid-1990s.

Overabundant retail space, constrained consumer spending, and a rising tide of troubled commercial real estate loans have combined to create many scenes like this one, an empty shopping center in Atlanta.



As retailers settle into the new centers, they leave behind empty spaces. Malls, meanwhile, are falling victim to impatience. A major reason enclosed malls have fallen out of fashion is that hurried shoppers don't want to walk too far, said Harold Hunt, a research economist in Texas A&M University's Real Estate Center. Rather than browsing, today's "more driven, purposeful shopper" wants to park near the destination to save time, Hunt said, adding that developers have turned increasingly to U-shaped centers, where shoppers can park in the middle and walk a similar distance to most stores. His research focuses on retail centers in Texas. Nevertheless, he figures that the state's intense heat, similar to the summer weather in much of the Southeast, will keep existing indoor malls around for many years to come.

Sizzling summertime temperatures didn't save Palm Beach Mall. The South Florida retail center that opened in 1968 as the largest enclosed mall in the Southeast closed in February. Similarly steamy Orlando's oldest mall has also fallen victim to recession and fickle shoppers. Opened in 1973, Orlando Fashion Square early this year had about 40 empty storefronts out of about 130, according to the *Orlando Sentinel*.

Developers develop, property owners adjust

As property owners' plans shift in response to changing consumer behavior, this change of plans can, in some cases, lead to intentional retail vacancies. A couple of largely vacant retail centers near the 25-year-old Gwinnett Place Mall outside Atlanta, for

instance, are empty primarily because the owners are considering a major redevelopment with different types of tenants and thus have structured leases to essentially clear out the space, Coan said. "There are different motivations creating vacancies in different space," she said. "And some of it is just overbuilding."

Recession can also force retail property owners to agree to enter into less conventional arrangements with their tenants. Under a co-tenancy agreement, for example, if a new anchor or set of tenants does not move into a center as planned, or if they leave a center, then the rest of the tenants are free to leave or get concessions such as lower rent. As many major retailers are closing stores and scaling back expansion plans, these clauses are kicking in more often, Conway said. "It devastates cash flow in a retail property and is unique to retail," he said. "Other commercial real estate does not have this feature in their leases."

Co-tenancy deals become problematic for landlords because there is more space than the market demands. Why does that sort of surplus happen? Classroom theory holds that developers are like any other entrepreneurs: they see an unmet need and they fill it, Georgia State University's Diaz said. In practice, though, that's not always the case. "What developers actually respond to is supply of money," Diaz said. "As long as a developer has money, they are going to develop. That's their business."

Until the recession's full force hit in 2008, money was plentiful. Among Georgia-based commercial banks, for example, commercial real estate loans—including retail and other types of properties—climbed from \$8.5 billion in 1999 to a peak of

Retail Property Owners, Lenders Face Refi Crunch

Commercial real estate owners and their lenders face an approaching wave of commercial loan refinancings at a time when retail properties have been losing value.

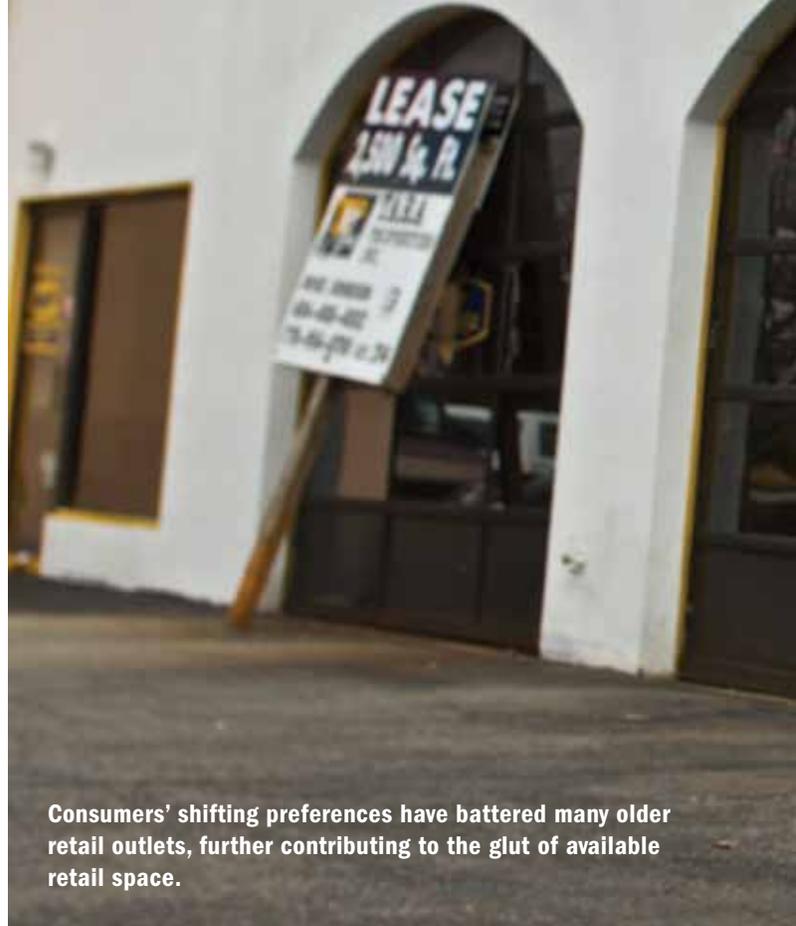
Commercial real estate (CRE) loans made during the past decade across the United States totaling \$1.4 trillion will require refinancing in 2011 through 2014, according to a February report from the Congressional Oversight Panel on the Troubled Asset Relief Program (TARP). Those loans include money to finance retail properties along with office space, industrial buildings, hotels and apartments. The concern: Nearly half of the loans are underwater, according to the report, meaning the borrower owes more on the loan than the underlying property is worth, making it hard for a lender to justify a new loan.

Commercial property values in general have fallen more than 40 percent since the beginning of 2007, according to the Congressional Oversight Panel's report. At the same time, retail rents have declined 33 percent, depressing the value of retail properties.

Many CRE loans have three- to 10-year terms that will soon expire. They require refinancing because the monthly loan payments are not designed to repay the loan during the original term. Thus, at the end of the term, the entire balance of the loan comes due, meaning the borrower must take out a new loan to finance continued ownership of the asset. If not, the lender can move to foreclose on the property.

The report says "a wave of commercial real estate loan losses over the next four years could jeopardize the stability of many banks, particularly community banks." Community banks hold a large share of CRE loans relative to their size. At the end of 2009, the 1,026 commercial banks based in the Southeast with assets less than \$1 billion carried \$56 billion in CRE loans, according to FDIC data.

As K.C. Conway of the Atlanta Fed's Center for Real Estate Analytics pointed out, it is difficult to refinance a loan on a retail center with large vacancies because the owner's cash flow is low. This concern is widespread, Conway said, because half of the roughly 700 million square feet of retail space built in the nation from 2007 through 2009 is vacant. ■



Consumers' shifting preferences have battered many older retail outlets, further contributing to the glut of available retail space.

\$35.2 billion in 2008, according to the Federal Deposit Insurance Corporation (FDIC).

Simple timing also complicates the dynamic that leads to an oversupply of retail space. There is, of course, a lag between the planning of a retail center and its opening. "Developers nevertheless make decisions based on projections weighted heavily toward recent sales and rental trends," says a FDIC report on commercial real estate. "If the market in question is experiencing unsustainable growth (a 'boom' period for example), then such projections are likely to lead to an overly optimistic outlook for future demand."

Diaz described a "spiral" that in his view operates outside the bounds of a natural real estate business cycle. It works like this: a region like metro Atlanta experiences huge population growth, creating a clear need for shopping centers. Developers rush in to fill the demand, with abundant financing at their disposal. Because the new space does not open for a few years, demand for retail space intensifies, driving up rental rates and spurring still more development, ultimately leading to an excess of space relative to the original demand, Diaz said. Eventually, as new space opens, it takes tenants away from older retail centers.

Banks' woes put the brakes on development

Capital for commercial real estate development, including retail, has become scarcer in the wake of widespread real estate-related problems at Southeastern banks (see the sidebar). Federal Reserve lender surveys in late 2009 found that large numbers of banks



had tightened their standards on commercial real estate lending. The Shopping Center Group's Coan said she has seen even solid retail projects stalled recently because developers could not secure financing.

It appears that many retail projects have been shelved. The volume of retail development that has been abandoned or deferred over the previous four quarters is a telling barometer. As of the end of 2009, according to data compiled by F.W. Dodge, those numbers were substantial in many Southeastern markets: 17 million square feet in metro Atlanta, 6.8 million square feet in Birmingham, 5.3 million square feet in Miami, 6.3 million square feet in Nashville, and 5.6 million square feet in Tampa. Nationwide, F.W. Dodge reported that 68 million square feet of retail space was under construction in January, a sharp reduction from the 166.2 million square feet completed in 2009 and the nearly 700 million square feet built in the past three years. For industry watchers, that reduction is good news. The last thing an overbuilt market needs is more supply.

In another positive sign for retailing, consumer spending has been inching upward again after a plunge, rising in March for a sixth straight month, according to the U.S. Department of Commerce. And the U.S. Department of Labor reported in May that the nation added 290,000 jobs in April, the biggest monthly gain in four years. According to the Atlanta Fed's Regional Economic Information Network, the employment situation in the Southeast in March 2010 continued to improve on a year-over-year basis as the rate of job losses slowed. On the downside,

however, business bankruptcies—which many analysts consider a leading indicator for retail real estate—continued climbing early in 2010 in the Southeast's biggest markets.

A healthier economy, of course, will be the strongest tonic for retail real estate. For now, plenty of empty stores remain, unsightly and disheartening reminders of recession and overbuilding. And while signs of improvement are emerging, the forlorn parking lots and hollow retail shells appear likely to be with us for some time. ■

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

Out of the Workplace . . . and Struggling to Find a Way Back In



Long unemployment lines put a human face on the high jobless numbers that the recent recession has left us with. For the long-term unemployed, finding new jobs is an increasingly challenging prospect.

The reverberations of the unemployment spike triggered by the 2007–09 recession have directly or indirectly touched just about everyone in America, both the jobless and the jobholder. Many statistics related to this downturn are startling, but the potential trends affecting employment have received much of the attention. The recession may have shined a spotlight on the long-term unemployed (those out of work for 27 weeks or longer), but this cohort is not the only group affected by the current labor situation.

The numbers tell a somber story

The national unemployment rate was 4.5 percent before the housing and credit bubble burst in 2007, according to data from the U.S. Bureau of Labor Statistics (BLS). After reaching more than 10 percent in 2009, the national unemployment rate receded to 9.7 percent in the first quarter of 2010 before edging back up to 9.9 percent in April 2010. Total employment fell by roughly 8 million workers, from 138 million in September 2007 to 130 million at the end of 2010's first quarter. At its peak in the first quarter of last year, job losses reached 2.3 million.

The Southeast has endured its share of suffering in these job losses (see table 1 on page 26). Florida closed the first quarter of 2010 with the Southeast's highest unemployment rate (12.3 percent) after averaging 10.5 percent for 2009. These double-digit numbers are a far cry from April 2006, when Florida had an unemployment rate of 3.3 percent, its lowest since the BLS began tracking these figures. Alabama, which ended the first quarter of 2010 with 11 percent unemployment, averaged 10.1 percent in 2009 after recording its historical low in April 2007, also 3.3 percent. Only Louisiana, with an unemployment rate of 6.9 percent, has dodged double-digit unemployment during this recession—in part because of Hurricane Katrina-related rebuilding efforts. Despite the slightly improving national unemployment numbers in early 2010, Southeastern states nevertheless showed higher unemployment rates at the end of 2010's first quarter than their average overall unemployment rate for 2009.

Effects of long-term unemployment

Certain economic impacts associated with the long-term unemployed on the population as a whole are difficult to quantify. An increase in foreclosures may result in depressed home values for entire neighborhoods. Scarcity of jobs can also depress wages. Tax revenues may fall because fewer wages are earned, leading to reduced services or increased tax rates for those who are employed. Tax breaks provided to those receiving unemployment benefits or income from government stimulus packages can also affect the tax burden of job holders. However, the actual cost of these outlays and effects to those with jobs is hard to capture in dollar terms.

What can be measured, conversely, is the increased government spending on benefits for the unemployed. According to a Pew Economic Policy Group's study of three Congressional Budget Office reports, federal spending on unemployment benefits could reach \$168 billion in fiscal 2010, a five-fold increase over prerecession levels. Not quite half of this figure (\$81 billion) represents spending on regular benefits. The remainder (\$87 billion) is for additional aid from Congress that is already approved or in the works for those who have been unemployed for six months or longer. Between 2005 and 2007, the spending on unemployment insurance ranged between \$31 billion and \$33 billion. Five key programs are in place to assist the long-term unemployed. Three of them have been a response to the recent downturn and have contributed to the sharp increase in government spending.

- **Unemployment insurance** (begun in 1935): This joint federal and state program provides benefits for up to 26 weeks. The amount varies by state and replaces from 50 percent to 70 percent of wages.
- **Extended benefits** (1970): This joint federal and state program provides an extra 13 weeks of benefits during times of high unemployment.
- **Emergency unemployment compensation** (2008): This joint federal and state program extends benefits to 79 weeks

Certain economic impacts associated with the long-term unemployed on the population as a whole are difficult to quantify.

in states with unemployment above 6 percent and to 66 weeks in states below that mark.

- American Recovery and Reinvestment Act of 2009:** This federal initiative guarantees that the federal government will cover 100 percent of benefit extensions. The act also sent money to the states to allow them to liberalize unemployment insurance eligibility rules, increased monthly benefits paid by \$25, provided a tax exemption for the first \$2,400 of benefits from federal income tax, and instituted premium reductions for health benefits under the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985.

- Worker, Homeownership, and Business Assistance Act of 2009:** This federal program added 19 weeks of benefits to the 26 weeks already provided in those states with unemployment at 8.5 percent and above. An additional 13 weeks were added in states with between 6 percent and 8.4 percent unemployment. This act also provided tax cuts for struggling businesses and extended and expanded tax credits for homebuyers.

Confounding the rebound

Historically, job recovery is one of the last indicators to rebound after a recession, and most economists cite the summer of 2009 as the end of the recent recession. How quickly employment rebounds after this recession is up for debate.

“It’s not unreasonable to expect that the speed of the recovery in the labor market will be faster than that of the two previous recessions,” said Pedro Silos, research economist and assistant policy adviser at the Federal Reserve Bank of Atlanta. “In fact, after less than a year into the recovery, we have already seen growth rates in employment that took three years to achieve after the 2001 recession. It is also true that the number of jobs lost in this last recession has been enormous. Even with high growth rates of employment, it will take a while to restore all those jobs lost.”

Lakshman Achuthan, managing director of the research firm Economic Cycle Research Institute (ECRI), is not quite as optimistic. Noting that employment growth has been increasingly weak following the recessions in the last three decades, he believes there is no reason to think that pattern will change. Achuthan bases this view on two trends associated with the recent cycles of expansion and recession—weak postrecession job growth and a quickened pace of recession and recovery. To illustrate the pattern of weakening postrecession job growth, Achuthan points to BLS data that reveal an annual 3.5 percent

Table 1
Unemployment Rates in the Southeast

State	Historic low		2008 average	2009 average	May 2010
	Date	Rate			
Alabama	April 2007	3.3	5.2	10.1	10.8
Florida	May 2006	3.3	6.3	10.5	11.7
Georgia	Dec. 2000	3.3	6.2	9.6	10.2
Louisiana	July 2006	3.6	4.5	6.8	6.9
Mississippi	April 2001	4.9	6.8	9.6	11.4
Tennessee	May 2000	3.9	6.7	10.5	10.4

Note: Figures represent percent of labor force unemployed.
Source: U.S. Bureau of Labor Statistics

growth of American private sector jobs the economic expansions of the 1950s, '60s, and '70s but fell to 2.4 percent annually in the 1980s and '90s, and finally to 0.9 percent annually in the last decade. The low numbers for the current expansion are less a product of job losses and more attributable to job creation not occurring fast enough.

This reduced rate of job growth during expansions has dramatically lengthened the recovery of jobs following recessions (see table 2). According to an analysis of U.S. Department of Labor data by the National Employment Law Project and the Economic Policy Institute, 46 months passed after the 2001 recession before employment returned to its prerecession peak. After the previous recession in 1991, 31 months went by before the lost jobs were recovered. Prior to 1990, the average time needed to restore jobs lost in recessions was 21 months.

Shorter expansion-and-recession cycles, which ECRI's forecasts call for, also pose a threat to the long-term unemployed, Achuthan said. When slower and smaller job recovery rates are combined with shorter recovery cycles, long-term unemployed workers may find re-entering the job market even more daunting.

An emerging class

The U.S. Department of Labor examines the nation's workforce from multiple angles: age, gender, educational level, and geography, to name a few. Among these demographic categories, the growth of long-term unemployment is apparent. In April 2009, 27.5 percent of the nation's unemployed had been out of work 27 weeks or longer, according to BLS data. By December, that number had jumped to 39.8 percent of the unemployed. By April of 2010, the number was drawing close to half of unemployed workers at 45.9 percent, practically double the rate from the previous recession, which peaked at 23 percent.

The BLS won't release the 2009 data concerning the duration of unemployment numbers segmented by state until July 2010. However, the most recent numbers (for 2008) indicate that southeastern states are faring roughly the same as the rest of the country. Nationally, 19.7 percent of the 8.9 million workers unemployed at some point in 2008 were jobless for 27 weeks or longer, with 10.7 of them jobless for 52 weeks or more. For the same year, the Southeast's numbers were slightly higher, with 21.6 percent jobless for 27 weeks or more and 11.3 percent jobless for 52 weeks or more.

The bad news goes beyond the discrete unemployment numbers provided by the BLS. A group known as the marginally attached includes people not looking for work but who indicate they want a job and have looked sometime in the last year; discouraged workers (a subset of the marginally attached, they have given a job market-related reason for not currently seeking work); and people working part time for economic reasons (for example, those who want and are available for full-time work but have had

Table 2
Rebounding From Recessions

Recession	Months until labor force returned to prerecession level
Before 1990	21
1990	31
2001	46

Note: "Before 1990" includes all post-World War II recessions preceding 1990.
Source: National Employment Law Project and the Economic Policy Institute

to settle for a part-time schedule). The U.S. Census Bureau places the combined percentages of the unemployed and marginally attached at around 17 percent of the potential labor force, which comprises the employed, unemployed, and marginally attached.

Silos cites age as a factor for those who have fallen into the long-term unemployed group.

"An aspect of the last recession that could contribute to longer duration of unemployment is the larger fraction of older workers that have lost jobs compared to previous downturns," Silos said. "Most likely the amount of firm-specific or occupation-specific human capital is large for workers between 50 and 60 years of age, compared to younger workers. For these workers, retraining is usually an investment with a very low rate of return. Consequently, they are at a higher risk of suffering a substantial loss of earnings when they become re-employed."

A trio in trying times: Construction, manufacturing, credit

Achuthan points to a structural shift in three areas as having a significant impact on the ranks of the long-term unemployed: construction, manufacturing, and credit. "In recent recoveries, what we see is that the economy stops losing factory jobs. We never get them back," Achuthan said of manufacturing. As for employment levels in the construction and credit sectors, he believes the collapsed bubbles that helped trigger the recession are unlikely to recur, so the jobs lost can't be completely replaced during the next expansion.

Combined, those three sectors left a big imprint on the recession's job losses. According to the BLS, the construction and manufacturing job sectors accounted for more than half the jobs lost nationally between September 2007 and the end of the first quarter of 2010. Construction lost 2.6 million jobs, representing 28 percent of the jobs lost nationally, while manufacturing was not far behind, losing 2.4 million jobs and accounting for 26.3 percent of jobs lost. While losses in the financial sector were not as large, they were still significant, with 700,000 jobs lost, representing 8 percent of the total.

Manufacturing was also a big jobs loser in the Southeast between September 2007 and March 2010.



The Southeast was well represented in these numbers. BLS data show the region lost almost 450,000 construction jobs between September 2007 and March 2010. Florida led the way with 250,000 construction job losses. The losses in Florida represented 41 percent of construction jobs in the state and accounted for 34 percent of the 730,000 nonfarm losses in that state. With the exception of Louisiana (which lost only 8.2 percent of its construction jobs), the other states in the Atlanta Fed's district (Alabama, Georgia, Mississippi, and Tennessee) lost 20 percent or more of their construction jobs.

Manufacturing was also a big loser in the Southeast between September 2007 and March 2010, according to BLS data. Georgia lost 93,000 manufacturing jobs, representing 26 percent of the jobs lost in the state. While the total number of manufacturing jobs lost was smaller in Alabama, Mississippi, and Tennessee, their share of manufacturing jobs lost was higher. In Mississippi, the 31,000 manufacturing jobs lost represented 42 percent of state's job losses between September 2007 and March 2010. Job losses in the manufacturing sector also accounted for 37 percent (or 58,000 jobs) of Alabama's total and 32 percent (or 75,000 jobs) of Tennessee's total.

Switching sectors: Panacea or pipe dream?

It might behoove workers in areas with shrinking job prospects to move into another line of employment, but such career changes are easier said than done. "You can take a construction worker and retrain [that worker] in a relatively short time to become a landscaper," Achuthan said. "But some things aren't as easy. Can

you retrain a factory worker to become a physical therapist? That might take a long time."

Barry Hirsch, the W.J. Uesery chair of the American Workplace in the Andrew Young School of Policy Studies at Georgia State University, agrees that shifting workers between job sectors does not lend itself to simplistic policy decisions. "It's really not easy. That's the problem," Hirsch said. "When you have structural unemployment, it's either a mismatch in skills and/or a mismatch in location. And skills do not get changed quickly."

Part of the challenge in shifting workers between sectors—often referred to as job retraining—is that the workers require significant resources dedicated to an uncertain outcome. "They take planning in advance and by the time you implement them, you may well be training individuals for where there are not really many jobs," Hirsch said. "I'm not saying we shouldn't do job training, but it's no magic bullet. When jobs are out there, people will train and move into them fairly quickly. The problem is, we don't see large sectors where there are real shortages of workers."

Hirsch sees problems with other policy efforts as well, citing difficulties in stimulating employment through means such as wage subsidies. "You may create a few new jobs from those [stimuli], but you're also typically heavily subsidizing," he said. "Most of your expenditures are for jobs that would have been created or filled anyway. It's very costly to create jobs that way. It's frustrating both for observers and economists to be saying we don't have any easy policies up our sleeves, but I really think that's the case." ■

This article was written by Ed English, a staff writer for EconSouth.



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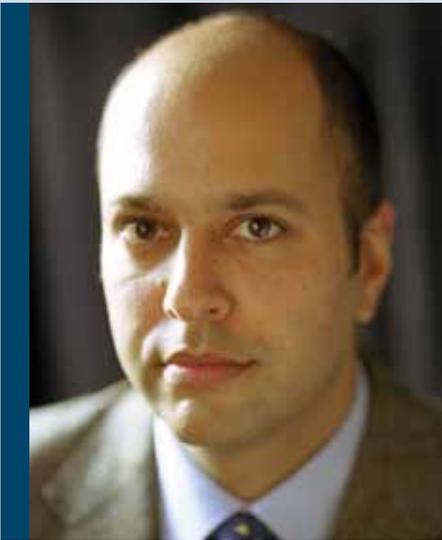
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“Long Expansions Are Very, Very Useful”

An Interview With Lakshman Achuthan, Economic Researcher



LAKSHMAN ACHUTHAN

Title	Managing director
Organization	Economic Cycle Research Institute
Web site	www.businesscycle.com/
Other	Achuthan has been at the Economic Cycle Research Institute since April 1996. He has been a board member of the Levy Economics Institute of Bard College since 2004. From 1991 to 1996, he was director of marketing for Columbia University's Center for International Business Cycle Research. His book, <i>Beating the Business Cycle</i> , was published in 2004.

Economists pore over myriad data to understand past economic events better, to get a clearer idea of the present economic situation, and to try to anticipate what is around the corner. Lakshman Achuthan, managing director of the Economic Cycle Research Institute, focuses on studying business cycles: what causes them, how they affect the overall economy, and what they can tell about future economic events. He specializes in forecasting economic and inflation cycles for major economies around the world.

EconSouth: *Why do you foresee the peaks and troughs of expansion and recession getting shallower and closer together in the future?*

Lakshman Achuthan: Basically, this observation is different than our leading index observation where we're forecasting things out based on these leading indicators. Rather, it's an observation where we step back and look at really big cyclical patterns. We see two trends or patterns that are pretty well developed that virtually dictate more frequent recessions, or getting these troughs bunched closer and closer together than anyone's been used to, say, in the last quarter century. I need to describe each of these two ingredients in some detail.

First, a recession is when growth goes below zero for the key coincident indicators in the economy and stays there

for more than a couple of quarters. It's a pronounced decline in activity that persists for more than a couple of quarters, and it's pervasive across all aspects of the economy. In thinking about it, there are two ways to avoid having the cycle go below zero. One way to avoid having the down cycle go negative is to just lift up the trend growth rate of the economy. If the trend growth was a couple of percent and if you lifted it up a couple of percent, even a downturn—while slower growth—wouldn't be negative growth.

ES: *Can you cite an example of lifting trend growth?*

Achuthan: A really good example of an economy where this trend growth has happened would be China. For the past 20 years, the Chinese trend growth rate for its economy has been about 10 percent. Even though they've had downturns in growth, it's never taken them to negative growth, to a recession. So they haven't had a recession in almost two decades.

ES: *Is there another way to avoid downturns?*

Achuthan: The other way you can avoid an economy's downturn in growth is to have a smoother cycle, where the volatility, the amount of the downturn, is less than it used to be—a more moderate, a smoother, or a tamer business cycle. A good example of that is actually the U.S. economy from the period of the mid-1980s

until 2007, [when] the size of the fluctuations up and down in U.S. economic growth was really, really low. And the economists and academics—including Fed Chairman Ben Bernanke—talked about this period as the “great moderation” of the business cycle.

ES: *How do you see growth trends in this country?*

Achuthan: If we look at growth trends with respect to the United States, we find that the news is not very good. In terms of our trend growth during expansions, we can see that the trend growth rate has been getting weaker and weaker for decades. It’s a very well-established trend that the key coincident indicators—GDP [gross domestic product], jobs growth, sales, production, or income, all of these coincident measures of aggregate activity—show that the trend growth rate during expansion has been stepping down since the 1970s. That’s a very well-established trend. The last expansion was the weakest expansion on record on every one

We have to be prepared that the cyclical volatility, which has already increased, will remain higher than what we’ve seen between the mid-1980s and 2007.

of those counts: GDP, jobs, sales, and income. Every one of those was the weakest in the whole post-World War II period. And it continues this very clear trend from the 1970s until now.

So, judging by that trend, we’re failing. The United States is not doing well. And I don’t know of anyone or any theory or any reason why we can argue that that trend is about to change and go in the other direction. I don’t know of any clear argument as to why our trend growth rate

is now going to start increasing. When we get to the next recession, I think there’s a very good chance that the trend growth in this expansion of those coincident indicators is basically a continuation of that weaker trend growth that we’ve seen for decades.

ES: *You mentioned a second component involved with the frequency of recessions.*

Achuthan: The second component of how you get a recession is through volatility, or this great moderation. This great recession that we just [came through] certainly breaks the trend of that great moderation and really calls into question if it can continue or if we’re going to revert back to some sort of low-volatility business cycle. On this score, we have to be prepared that the cyclical volatility, which has already increased, will remain higher than what we’ve seen between the mid-1980s and 2007.

If we have higher cyclical volatility and the low trend growth rate of the expansion, then the opportunity for us to fall into a new recession is dramatically higher. The odds go up very quickly. We’re unlikely to see an eight-, nine-, or 10-year expansion, which is what a lot of people have experienced during their lifetimes. [Americans] have kind of come to expect long expansions.

ES: *What’s the value of long expansions?*

Achuthan: Long expansions are very, very useful because they give governments the opportunity to adjust their debt loads. They give central banks the opportunity to raise interest rates. They give the job market an opportunity to heal. On all of those scores, if we have a short expansion, then you have to start really seriously thinking about going into a new recession with elevated unemployment, a weakened balance sheet nationally, and not a lot of room for cutting of interest rates because they probably haven’t been raised that much. If anything, those kind of scenarios may limit the ability to

make the next recession softer—in other words, more volatility.

To put this in perspective, we’re not necessarily talking about going back to the booms and busts that we saw in the United States before the Great Depression. Those were really of a whole other ilk. But I think it is reasonable to think about the kind of recession frequency that we saw in the United States in the 1970s. From the late 1960s into the early 1980s, we had four recessions. You can also look at Japan over the last couple of decades, where it’s had fairly low trend growth, and again you see a few recessions in a fairly short period of time. Each expansion there averaged about three years. That’s a very different environment than what most decision makers have become used to. ■

This interview was conducted by Ed English, a staff writer for EconSouth. The views expressed by Lakshman Achuthan are his and do not necessarily reflect the views of the Atlanta Fed.

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\$1.4

Amount, in trillions, of commercial real estate loans that will require refinancing during the next four years

Source: Congressional report, as cited in *EconSouth's* article, "Stiff Headwinds Blow Through Retail Spaces"

\$140

Size, in billions, of the Greek rescue package approved in May by the European Commission in conjunction with the International Monetary Fund

Source: European Union report, as cited in *EconSouth's* article, "Demystifying Sovereign Debt in Greece: Why It Matters to Us"

410

Number, in billions, of gallons of water used each day in the United States

Source: U.S. Geological Survey (2005)

12.3

Percent of Florida's labor force unemployed in the first quarter of 2010

Source: U.S. Bureau of Labor Statistics, as cited in *EconSouth's* article, "Out of the Workplace . . . and Struggling to Find a Way Back In"

2.5

Number, in millions, of people living in the United States in July 1776

Source: U.S. Census Bureau

309.6

Number, in millions, of people living in the United States in July 2010

Source: U.S. Census Bureau

656

Amount, in thousands, of barrels of biofuels produced each day in the United States in 2008; daily production was 223,000 barrels in 2004

Source: U.S. Energy Information Administration

46

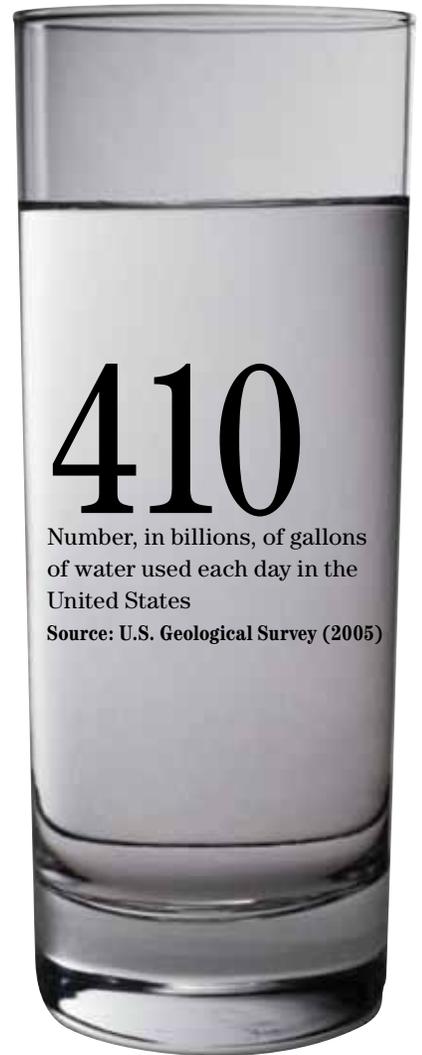
Duration, in months, required for employment to reach prerecession levels following the 2001 recession

Source: U.S. Bureau of Labor Statistics, as cited in *EconSouth's* article, "Out of the Workplace . . . and Struggling to Find a Way Back In"

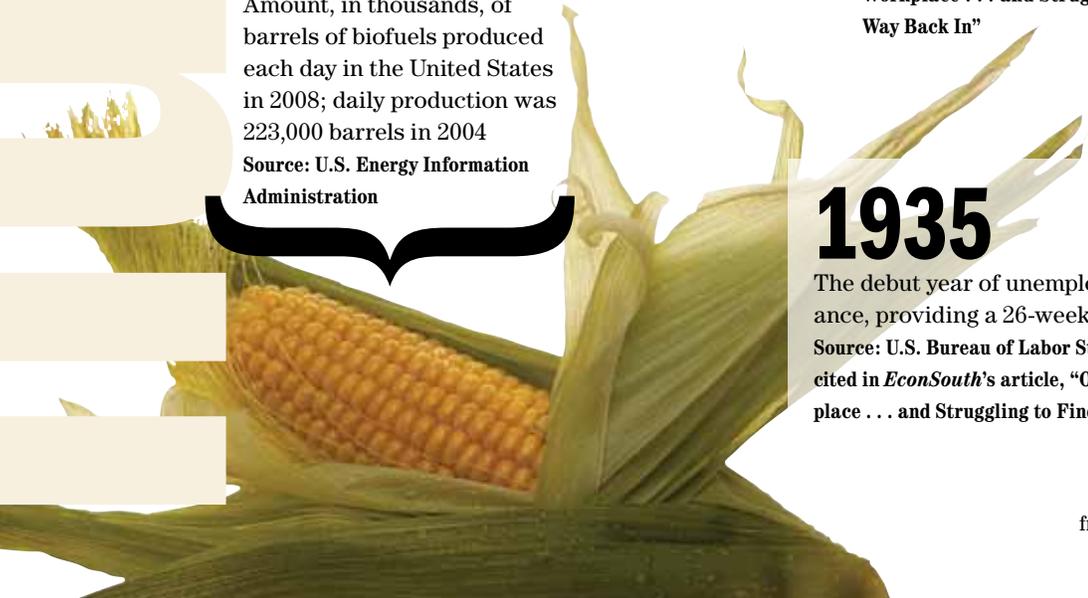
1935

The debut year of unemployment insurance, providing a 26-week benefit

Source: U.S. Bureau of Labor Statistics, as cited in *EconSouth's* article, "Out of the Workplace . . . and Struggling to Find a Way Back In"



closing



FEDERAL RESERVE BANK OF ATLANTA
PUBLIC AFFAIRS DEPARTMENT
1000 PEACHTREE STREET, N.E.
ATLANTA, GEORGIA 30309-4470

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When Atlanta's Lenox Square opened in 1959 (above), it was the city's first enclosed mall and the largest one south of New York City. Today's retailing environment faces turbulent conditions, resulting in many shuttered locations and troubled loans bearing down on the balance sheets of retail developers and lenders.

now **and** then