The Southeast's Economy: Review and Outlook

by Charles J. Haulk

Perhaps there never was a more confusing year than 1979. The year started with most observers talking about a mild recession followed by a mild recovery. The Southeast would fare better than the nation in most of the forecasts. But most observers were wrong.

After an unexpectedly strong fourth quarter in 1978, some slowing could have been reasonably expected nationally in the first half of 1979. However, with the gasoline shortages, the truckers' strike, and weather problems, the first and second quarters were decidedly downbeat. Car sales, housing, and employment slowed appreciably. Then, in the face of rapid money and credit growth, the national economy rebounded strongly in the third quarter, propelled by resurgent retail sales and home buying. Just when most forecasters were talking as if the recession were well under way, third-quarter sales, profits, and real GNP data became available, indicating a strongly rebounding economy. The unexpected turnaround resulted, by and large, from a sharp drop in personal savings and a renewed expansion of consumer credit. Faced with this rebound, worsening inflation, and a falling dollar in the exchange markets, the Federal Reserve on October 6 moved abruptly and dramatically to stem rapidly increasing money and credit growth.

Once again the economy abruptly changed direction from the rebound to a period of contraction in some sectors. The instantaneous and sharp rise in both short- and long-term interest rates led to a dramatic slowing of mortgage commitments, which would have a lagged effect on home building rates. Car sales slipped back to the weak second-quarter pace. Layoffs in auto and auto-related industries, the lumber industry, and the steel industry became widespread by December. Truck assemblies had also fallen. In the meantime, real personal income continued to slide in the face of 13-percent inflation compared with the 8-percent wage growth that conformed to Presidential guidelines. After a weak first half, then, the U. S. economy was surprisingly strong in the second half.

The Southeast in 1979. In the Southeast, home building was flat through the year but terribly uneven from state to state. Florida and Georgia continued well ahead of their 1978 pace, while the other states were lagging, particularly Louisiana and Alabama. Nonresidential construction maintained a strong pace throughout the Southeast.

Employment growth was marginal through the first nine months, just enough to keep the unemployment rate from rising. The typical fourth-quarter surge appeared to be under way in

Although the predicted recession did not arrive in the Southeast, 1979 saw substantial increases in inflation and household illiquidity. The recession should finally appear in second-quarter 1980 and should be, at worst, no deeper or longer than in the nation. If persistent inflation requires tighter monetary policy, however, the economy could slow even more than expected.

October as jobs grew in almost every category. The unemployment rate, after dipping below 6 percent early in the year, held steady at just over 6 percent for the last half of 1979.

Farmers had a respectable year, with the exception of hog and poultry growers who got caught in a cost-price squeeze during the fall months. Crop acreage expanded dramatically in response to the outlook for favorable market prices for most commodities at planting time. Good weather through the summer months increased yields sharply from their drought-depressed levels during 1977 and 1978. Crop prices remained strong, thanks to brisk export demand, and cash crop income jumped an estimated $1 billion above 1978's level, with the majority of the increase coming from a one-third larger crop of soybeans. In total, 1979's farm cash receipts were about 20 percent above the $12.7 billion recorded for 1978.

Banking activity was strongest in the acquisition of time and savings deposits. Money market certificates were an important source of time and savings deposit growth at banks and savings and loan associations. Demand deposits and loans grew only moderately, and loan growth had fallen well below the national pace.

In sum, the year was a little better than expected for employment and income growth but was disappointing in light of soaring inflation and increased household illiquidity.

After such perplexing developments, what can we look for in 1980? To forecast regional economic activity, we are forced to consider three things. First, we need to know how the national economy will perform. Secondly, we need to know how the region typically behaves relative to the nation, and finally, we must take into account noncyclical or random factors that could cause future behavior to differ from past cyclical behavior. By random or noncyclical factors, we mean such things as new military contracts, hurricane damage repair, and new government programs that will result in increased employment.

The main problems with this kind of forecast, of course, are that national performance can be known only with wide tolerance and that the interaction of cyclical and noncyclical regional factors is not always clear. Therefore, we must recognize that regional forecasting can be doubly hazardous—there are simply more things to go awry.

The National Outlook. By all accounts, the immediate outlook for the nation's economy is generally downbeat. The consensus among several major forecasters reviewed by this author at the end of 1979 would call for continued inflation at

near current levels before a break in late 1980, a rise in the unemployment rate to the 8-percent range, and negative real economic growth for at least the first half, if not the first three quarters of 1980. The Georgia State Forecasting Project, for example, puts real GNP growth in the negative for four quarters starting with fourth quarter 1979, with a year-over-year drop of 0.4 percent.

Recent events have made many forecasts somewhat outdated. It would appear likely now that if the recession comes, it will be strongly felt through at least the first half of 1980, with lagged effects on unemployment through the end of 1980. If inflation persists, it could require a tighter rein on monetary and fiscal policy for a longer period than many thought until very recently. That restraint could mean a longer recession and perhaps a considerably deeper one. The monetary authorities have set their course. Fiscal policy, however, is difficult to call at this point. Whatever its effects, they will not be felt until later in the year.

An optimistic forecast would call for a 1.5- to 2-percent drop in real GNP peak to trough, a moderate forecast would put the drop at 3 percent, and a pessimistic forecast would be for a 4- to 5-percent drop on the same order of magnitude as the 1974-75 recession.

How will that drop be divided among regions? The people in the Southwest and West argue that although they might slow down, they won't show an actual income decline. Their performance in the 1974-75 recession gives credence to that assertion. In the Pacific, Mountain, and Southwest regions, employment declined less than half as much as in the nation as a whole and about one-third as much as in the Southeast. If that pattern is repeated, then a disproportionate share of the recession must fall on other regions.

We know that in most recessions, housing and consumer durable goods are the first to suffer, followed by nonresidential construction and capital spending. If the recession is unusually severe, certain postponable nondurables, such as apparel, can be hurt badly.

Cyclical Factors in the Southeast. Because of its relatively low share of durables manufacturing (which is hit hardest in a recession), the Southeast since the late Forties had escaped the severe inventory corrections which result in large numbers of unemployed.

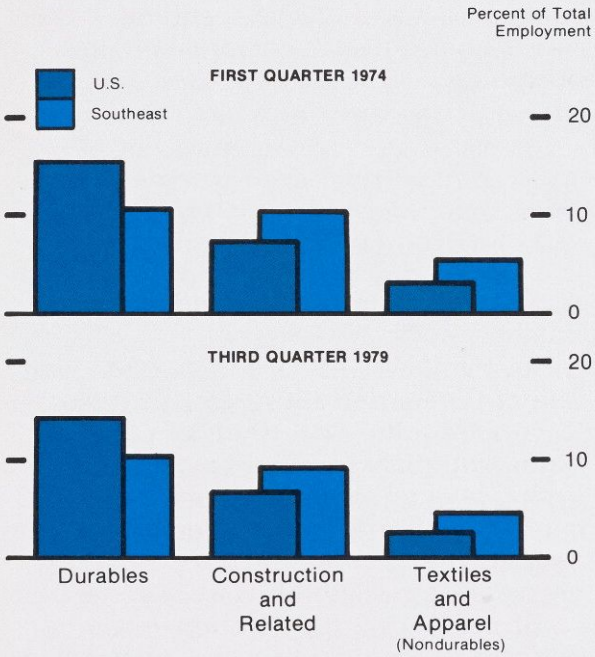
However, in 1974-75, construction was one of the hardest hit sectors because of the disintermediation (shifts of consumer funds from banks to open market securities) at savings and loan associations, combined with euphoric overbuilding. Because the Southeast had a greatly disproportionate share of its work force in construction and construction-related industries, it incurred sharp job losses. In addition, the textile and apparel industries had income drops that percentagewise were similar to the declines in furniture and motor vehicles. Petroleum and chemicals, services, and state and local governments actually had income gains.

Chart 1 shows that in 1979 the Southeast was in somewhat better condition in employment in both construction and durables manufacturing but had about the same share of nondurables employment as it had in 1974.

Other sectors, including government, services, trade, transportation, utilities, and finance, generally maintain stable employment through an economic downturn. The Southeast has about the same proportion of these service-oriented jobs

CHART 1

SOUTHEASTERN INDUSTRY MIX RELATIVE TO THE NATION



Southeast in 1979 had less concentration in construction and durables employment than in 1974; about the same in nondurables.

as the nation, although government is slightly larger and services slightly smaller in the Southeast.

Because of the increased share of government employment and the decline in construction and manufacturing share, **the Southeast's economy should be somewhat better positioned to withstand a recession than it was in 1974.** Moreover, we have not seen the overbuilding that we did in 1973-74.

Besides the industry mix and the absence of overbuilding, there is another important stabilizing factor at work in the nation and the Southeast. That factor is transfer payments. When the recession of 1974-75 hit, 12.1 percent of the Southeast's personal income was derived from transfer payments (pensions, Social Security, unemployment payments, etc.). The U. S. ratio was 11 percent. By the first quarter of 1975, when the economy hit bottom, 15 percent of the Southeast's income and 13.4 percent of the nation's personal income were transfer payments. The higher proportion of transfer payments kept the Southeast's income decline below that of the nation even though the region's unemployment rate was higher. Unemployment compensation in the South increased sixfold as a percentage of total income during the recession.

It seems reasonable to argue that transfer payments will act to soften a downturn. The problem with transfer payments is that, as we saw in 1974-75, although they cushion income drops, they cause a greater burden of the battle against inflation to fall on cyclically sensitive industries like construction and manufacturing.

Another variable that deserves special attention is population and labor force. Three demographic factors will heavily influence short-term economic behavior. The first is the growth in the working-age population and the rates at which those people participate in the labor force. The second is the rate of household formation, which, in turn, drives demand for housing, appliances, furniture, carpeting, etc. The third factor is the overall population growth. Population growth through migration has been a primary source of economic expansion in several southeastern states, with Florida the obvious big beneficiary, followed by Georgia and Tennessee.

In 1980, household formation in both the Southeast and the U. S. will remain fairly rapid because of the favorable age distribution of the population. Labor force growth should slow some because fewer people tend to seek employment when the unemployment rate is rising, but that is a very uncertain outlook.

In-migration has continued since the last recession but, through 1978, had not regained the 1973-74 pace in Florida or Georgia. The inflow of people to Alabama and Tennessee picked up smartly, while Mississippi and Louisiana continued to experience net outflows.

In-migration depends heavily on economic conditions in the rest of the country. If the northern economy is in recession, many people will find it difficult to sell their homes and, therefore, will not move. That phenomenon had a dramatic impact on the Southeast during 1974-75.

One final cyclical factor we need to consider is consumer attitudes and finances. Although we have not seen a regional survey of consumer attitudes, it is probable that southeastern consumers are concerned about the same things which affect the national sample. Consumers, according to many surveys, are in a volatile mood. The buy-in-advance psychology and the use of credit seem to have taken a stronger-than-ever hold on consumers in the South and the rest of the nation.

Consumer debt has grown in the Southeast at a pace somewhat slower than in 1978 but still much faster than income. By September, we estimated consumer instalment debt to be 16 percent of personal income, just slightly higher than nationally. Although there are reports of increased traffic at credit counseling centers and a rise in individual bankruptcies, the American Bankers Association survey of consumer instalment debt delinquency rates in the Southeast indicates that while rates are high by historical standards, as of September 1979, they were at or below September 1978 levels. Indications are that home buyers are being very careful to keep their house payments in order. Economists, including the present writer, have for some months been concerned about the tendency of households—both nationally and in the Southeast—to reduce their liquid assets to the current levels—this, despite an increase in the number of two-income families. One would have expected some increase in the savings rate by this time, but as of third quarter 1979, that had not happened. Evidently, consumer response to expected inflation is a much more powerful force than economists have thought.

It seems inevitable that at some point, a cutback in consumer spending will occur. Real measured personal income lost ground throughout 1979. Real after-tax weekly earnings of production workers were down over 4 percent through the year. This brings us to a disturbing question. How reliable an indicator are measured income and earnings? The level of retail activity belies the reported figures. It suggests increasing activity in the "underground economy" (gambling, bartering, and other unreported income). The same is true for employment data.

Noncyclical Factors. As we mentioned earlier, there are at any time certain random or noncyclical events which, when superimposed on the normal business cycle, can either exacerbate or moderate cyclical swings. In the Southeast, there are several such items. First, the energy

situation continues to be a strong positive factor in Louisiana with its petroleum and gas resources, and to the Southeast in general because of its climate. Second, there is an increasing tendency for the forestry-related industries to move away from the Northwest to the Southeast, where growing conditions, topography, and transportation facilities make the Southeast a less costly area for producers. Third, foreign investment from Europe, Latin America, Japan, and Canada has given the Southeast an edge over the rest of the country. Fourth, several major building projects are underway in the region. In Georgia, the King's Bay Naval Base will take several years to build. In Florida and Louisiana, huge theme park projects will provide many jobs for years. The Alabama and Mississippi coasts will generate jobs as rebuilding from hurricane damage continues. The proposed step-up in defense spending will benefit the southeastern states, which have disproportionately high shares of income related to military operations. All of these plus many others too numerous to mention should soften the recession in the Southeast.

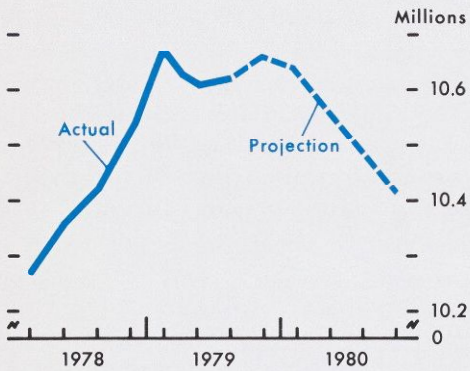
The outlook for the Southeast is that a recession will get underway in earnest in second quarter 1980. The depth and duration of that recession will depend on the experience of the nation as a whole. If the recession is moderate nationally (as most forecasters predict), the Southeast will likely fare better than the nation. If the recession is severe nationally, the Southeast's experience could be equally severe. The reason is that, while the industry mixes in the Southeast and U. S. are different, they contain offsetting differences. The greater share of durable goods employment nationally is balanced by a larger share of construction and textile and apparel employment in the Southeast. Overbuilding and the large in-migration streams, which were reduced to a trickle in 1974, put the Southeast's construction sector in dire straits in 1974-75. This time, serious overbuilding seems to have been prevented as builders and their lenders have been much more cautious. Florida has not experienced the huge population inflows of 1972-73, so a slowing of the inflow due to a recession and weak housing markets elsewhere will not have the same devastating effect this time. Tennessee and Alabama could be slightly harder hit in this regard because their population inflows are larger than in 1973. All told, construction is in for some weakening, probably less than in 1974-75.

Durables manufacturing will be off, especially in transportation equipment and construction-related industries. Auto and truck assemblies are already well below year-earlier rates. Lumber and steel fabricators dependent on construction will be hurt. Furniture and carpet producers will also feel the effects of reduced housing starts. In apparel and textile production, typical recessionary cutbacks in employment and income reductions should be expected. The reductions could be worse than the average postwar downturn, but we cannot now foresee things getting as bad as in 1974-75. However, an acceleration of inflation from recent rates could put a 1974-75 type recession in the realm of possibility.

Judging from previous experience with recessions, government and service sector employment is likely to fare moderately well. Some trade, as well as transportation jobs, could be lost. These should be offset by growth in state and local government employment and other services.

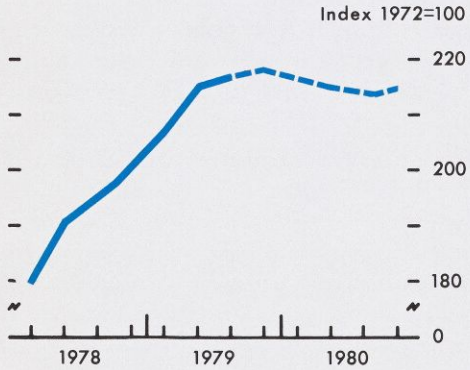
key economic variables

2. NONFARM EMPLOYMENT



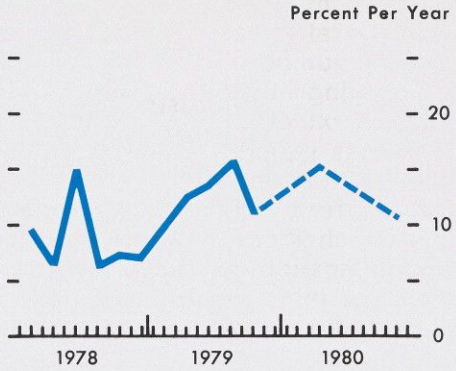
Will stagnate and drop after recent gains.

3. RETAIL SALES



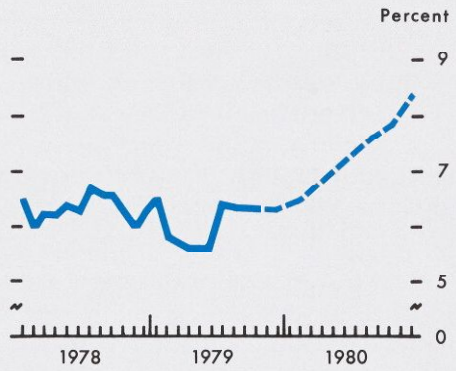
In real terms, drop could be sharper.

4. CONSUMER PRICE INFLATION



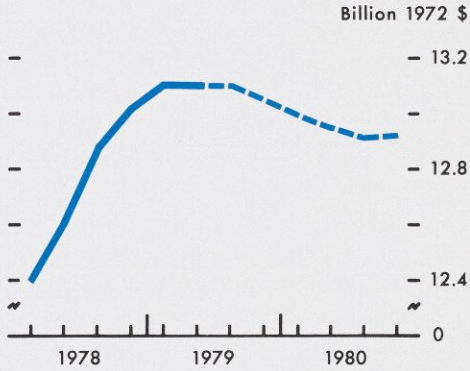
Could slow in second half.

5. UNEMPLOYMENT RATE



Will likely start rise by end of first quarter.

6. REAL PERSONAL INCOME



Will probably fall slightly.

For the banking industry, the outlook is for a slow year. All types of loan demand should be down, and while some declines in the cost of funds may occur, profits will be adversely affected. There are no strong indications at this time of severe liquidity problems such as occurred in 1974; however, with weak deposit growth, which developed in late 1979, and the possibility of one final surge in business loan demand as inventories mount, we could see liquidity problems at some institutions. Savings and loan associations have experienced large increases in the costs of funds and are caught in a profit squeeze which will likely continue.

In Charts 2-6, we show several key economic variables which the Federal Reserve Bank of Atlanta watches in order to gauge the Southeast's economic condition. The charts contain data from 1978 and 1979 for reference and the author's forecast for 1980, shown by the dotted portion of the line. All of the results assume a moderate national downturn.

Southeastern employment (Chart 2), which has shown remarkable gains in recent years, is likely to stagnate early in 1980 and drop slightly for a quarter or two before returning to positive growth in late 1980 or early 1981. Manufacturing payroll income will probably drop quite sharply in early 1980 and continue down for the entire year, with perhaps some recovery late in the year. Retail sales (Chart 3) may turn down markedly in real terms (or in unit sales) if not in dollar value. Auto sales should continue weak, particularly the larger models, as gasoline prices rise and threats of shortages once again scare away potential buyers.

Apparel sales, which have been unimpressive, are also likely to decline. Less active use of consumer credit will negatively affect sales of big-ticket items, such as appliances, furniture, and boats. Some small recovery in retail sales could begin in late 1980. That will, of course, depend partly on the inflation rate and the relative restraint of monetary policy.

The inflation outlook (Chart 4) is nothing if not gloomy. With another round of oil price increases, record prices for many other commodities, more liberal wage guidelines for 1980, and the accompanying rise in unit labor costs, overall inflation as measured by the GNP deflator might be even worse in 1980 than in 1979. Consumer prices will probably be growing at extraordinarily high rates early in 1980 but could slow in the second half to a rate below double-digit levels.

Unemployment (Chart 5) will most likely begin to increase in most District states early in 1980, conceivably to the 8- to 9-percent range by the end of 1980. This assumes that the labor force will grow at 2 percent and that 300,000 jobs will be lost in manufacturing and construction. That compares favorably to the 460,000 lost in 1974-75. Again, we point out that if inflation proves to be more resistant than we think to the monetary and fiscal policy now in place, the peak in the unemployment rate could come later and be higher.

Real income (Chart 6), which declined 3 percent during the 1974-75 recession, will probably fall about 2 percent from peak to trough.

1979 was not a particularly good year for economic forecasters, and the world situation in 1980 is even more volatile than last year. If history is any guide, 1980 probably holds at least some surprises for the Southeast and the rest of the nation. ER