

The 2010 Georgia Economic Outlook: Atlanta EOL Version
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If you attended one of the speeches that I made last year, you heard me predict an economic recovery beginning in the 3rd Q. I hope you made plans to take advantage of it. I said that the recession would last 18 months and it looks like the recession's trough was approximately June 2009. That is 18 months from its beginning in December 2007.

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Today, the big question is will the recovery continue, **or** will it fall apart?

The news and the statistics you hear every day seem confusing. Although GDP grew by 5.7% in the 4th Q and by 2.2% in the 3rd Q, we don't feel like we are in a recovery. In fact, we **still** feel **dreadful**.

- Employment is declining.
- Non-residential property markets are plunging.
- Consumer spending is restrained.

- On top of all that—the banking system is not completely fixed. Too many banks are still holding onto assets that are **clearly** distressed.

Despite this list of concerns—a list I could easily make longer—my forecast **is for the recovery to be sustained.**

U.S. GDP will expand by 2.3% in 2010. That's the good news. The bad news is that rate of growth is well below the long-term trend rate of about 3%.

A slow rebound after a deep recession is unusual. Typically, there is a lot of pent-up demand due to postponed purchases and excessive inventory liquidation. For example, it took GDP only 3 Qs to fully recover after the severe 1973 recession and after the deep 1981-82 recession.

But, this upturn will be different. Credit is still unusually tight, non residential property markets are still under extreme duress, and the decline in households' net worth was truly unprecedented. For example, between 2007 and the 1st Q of 2009, U. S. households lost \$14 trillion—that represents 22% of the net worth that they accumulated over their **entire lifetimes**.

So, even though the economy has already bottomed out and the recovery will be sustained, this will be the most subdued recovery in consumer spending since WWII. I predict it will take about 6 quarters for US GDP to surpass its previous peak—that will be late 2010.

It will take at least 4 years —that is sometime in 2014 — before the labor market replaces the nearly 8.5 million jobs lost. Only then, will the U.S. economy be fully healed.

How will GA fare in 2010?

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Our recovery will be slow and bumpy but it will be sustained. I forecast state GDP to increase by 1.6%. That is a lot better than the 4.2% decline I estimate for 2009 but below my overall prediction for the U.S.

Now, let's consider why GA's economy will lag the nation as a whole.

Our state will continue to suffer from its heavy exposure to the real estate downturn, which was the epicenter of this recession.

GA's economy is geared towards new residential and nonresidential development. Thus, going into this recession, GA had

- an outsized construction industry,
- a huge supply bubble of residential and nonresidential properties, and
- a swollen pipeline of properties at various stages of development.

GA also had a very high concentration of manufacturing industries closely allied to construction such as lumber and wood products, building materials, and floor coverings. Plus, GA's over dependence on development meant that the financial crisis did much more damage to GA's banks than to the nation's financial sector.

The period of heavy job losses is over, although some job losses will persist into early 2010. GA will end up losing about 350K jobs. That's 8.4% of statewide employment and more than twice as many jobs as we lost in the previous recession.

Let me put it another way—at the dawn of the millennium, GA had 3.9M jobs. A decade later we have 3.8M jobs. This is a lost decade for GA.

In comparison, the nation will lose 6.2% of its jobs. So, -8.4% for GA versus -6.2% for the U.S. GA lost a higher percentage of jobs for the same reasons that our recovery will be slower—the state's exposure to housing, commercial real estate, and related industries.

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GA's job growth will finally turn positive in the spring of 2010, but initially growth will be too anemic to keep pace with people entering the job market.

GA's unemployment rate will continue to rise, topping out just shy of 11% in mid-2010. Remember 2007? It was only 4½% then.

If you need a job **today**, where should you look?

- Staffing and temp agencies,
- health care,
- defense and **the federal government**.

There will be more job opportunities by mid-2010:

- transportation & logistics,
- education,
- retail,
- and hospitality will be adding to their staffs.

And by late 2010, the financial sector will be on the upswing.

Job creation will begin to accelerate in 2011 when construction begins to recover and as we stop losing jobs in state and local government.

My prediction that GA will have a sustained recovery rests on a few likely developments.

1st and most essentially, credit markets must continue to thaw.

2nd, sales of both new and existing homes will increase in 2010. 3rd, business spending for new equipment will expand. 4th, Federal fiscal policy will continue to provide a powerful economic stimulus. 5th, net hiring will resume in the 2nd Q.

Although many forces will power GDP growth in 2010, there also will be 3 powerful headwinds: (1) Spending on nonresidential construction will **decrease sharply**. (2) Spending by state and many local governments will continue to decline and (3) even as credit improves, it will not loosen dramatically.

Although the recovery will be sustained, you need to plan for GA's economy to underperform the national economy until real estate and construction stabilizes, sometime in 2011. Initially, opportunities to take advantage of the economic recovery may be stronger outside of GA than inside GA.

What about consumers? You hear almost every day that consumer spending is weak and you may wonder how we can recover without it. The truth is that we can't.

I expect consumer spending to increase by 1.5% in 2010. Improving consumer fundamentals in the coming year should pave the way for the more robust spending in 2011 and 2012.

Let's consider why I expect consumers to behave this way. As the recession deepened and job losses mounted, households had to shift their priorities from spending to saving. The savings rate has already risen from only 1.2% in the first Q of 2008 to 4.6% and will continue to rise through 2010. While increased saving is a headwind for the recovery—the adjustment is already 3/4 complete.

At this juncture, job creation – and the income growth that accompanies it – is absolutely vital to the outlook for both consumer spending and the GA economy. My forecast anticipates that the job machine will shift gears from reverse to forward in the 2nd Q of 2010. Job growth should be **just adequate** to sustain the expansion.

With recent losses in household wealth and a greater focus on savings, increases in disposable personal income must account for virtually the entire projected rise in Georgians' spending. The **upturn** in both the **number of jobs** and the **number of hours worked** per job are two factors that support this income growth.

While consumer spending will only rise slowly, business spending, will increase sharply, and will be a powerful driver of GA's recovery.

The growth in business spending for equipment and software reflects strengthening cash flow and higher corporate profits. Also, corporate discipline with respect to capital outlays over the course of the 2001-2009 was excellent.

Credit will remain tight, but, lending standards will not get any tighter. Also, for many companies cash flows will be adequate relative to needs for investment, lessening the impact of tight credit.

Business spending for transportation equipment will increase the fastest; **but only because** the starting point is so depressed. Spending for computers, software, and communications equipment also will increase robustly. Less positively, low rates of capacity utilization will be a powerful headwind for business spending for industrial equipment.

On the international front, both imports and exports are expected to rise sharply, but imports will rise much faster than exports, widening the trade gap. Net exports will subtract from U.S. GDP growth. **But—the impact of the upturn in international trade flows will be very positive for GA’s economy.**

Higher foreign trade flows, whether imports or exports, favor GA’s logistics-centered economy, **especially** GA’s ports. As businesses add to inventories, imports of raw materials and finished goods will rise quickly.

One plus for GA's economy is that **the recession has done nothing to reduce GA's attractiveness as a cost effective place to do business.** And, in 2010, reducing costs will continue to be a high business priority.

Atlanta is the least costly, large U.S. metropolitan area in which to do business (KPMG). GA is well positioned to compete nationally for corporate HQs, high tech industries, expansions, and relocations. Deep pools of talent and expansive transportation and logistic infrastructure make Georgia is an ideal place to establish national or regional HQs.

We do have two significant negatives: traffic congestion and potential water shortages.

Many of the large relocation and expansion projects announced by the Georgia Department of Economic Development will provide a tailwind to GA's economy. For example, in 2009, the Georgia Department of Economic Development announced 327 economic development projects. This is actually an **increase** from 2008. Even a

small increase is remarkable give the dire state of the economy in FY09.

The Georgia Department of Economic Development continues to land major projects, including the relocation of First Data Corporation's global HQs to Atlanta (1,000 jobs).

The state has yet to feel the full economic impact of some projects announced in FY2008. For example, the new \$1.2B Kia assembly plant began production in November with about 1,000 workers. It will be up and running all of 2010, and eventually will employ about 2,500 workers. And, each direct job at the Kia plant will support 4.5 additional jobs outside the plant.

Over the next year or two, GA also stands to realize a major economic boost from the last round of base realignments and closings, or BRAC. GA has already taken its economic hit from base closings in Athens and Atlanta, but has yet to reap the lion's share of the gains from realignments and expansions.

Fort Benning, in Columbus, emerged as the largest BRAC winner with an expected gain of more than 11K civilian and military jobs at the base itself. Most those new jobs will be created in 2010 and 2011. The bottom line is that the defense industry will sustain and strongly reinforce GA's economic recovery.

There is more good news, GA's severe housing bust has run its course. The housing downturn ended in the 2nd Q of 2009. For the single-family and the multi-family housing subsectors, the peak-to-trough plunge in housing starts was 86%. The free fall, which began in the first Q of 2006, lasted for 13 dismal Qs.

Looking forward, the number of single-family home permits authorized for new construction should increase by over 33% in 2010. That's a very large percentage gain, but don't get too excited—even a one third increase in the number of new home permits pales in comparison to the 81,000 unit plunge in activity that occurred since building permits were at their peak.

Still, the projected upturn in single-family homebuilding is one of the main distinctions between GA's economic outlook for 2010 and the economy's recent performance.

The gradual upturn in home sales has caused existing home prices to stabilize at depressed levels. The 3rd Q 2009 data shows that the sharp depreciation of U.S. home values is over through most of the nation, with home prices actually rising by a statistically insignificant 0.2 percent compared to the 2nd quarter. It is clear that dramatic home price declines have become rare.

In 2010, you can expect home price **appreciation** in some markets. That should prompt potential homebuyers who have been waiting on the sidelines for even lower prices to take the plunge into home ownership. For the first time since 2005, the housing market will push GA's economy forward rather than backward.

One important reason why housing activity will improve is that substantial price declines have made homes more much affordable.

GA never developed a home price bubble during the housing boom, but the combination of too much supply and plunging demand caused the price of existing single-family homes to drop by 12% (bottom was in the 2nd quarter-2009).

Consequently, right now, overvaluation is basically nonexistent in GA. In fact, GA's homes are significantly undervalued, which means that home price appreciation could be significant once the inventory of unsold homes normalizes. For example, in the 3rd Q of 2009, existing home prices in Atlanta were 15% lower than their expected value. That means many homes might appreciate significantly faster than inflation. That should happen once job growth resumes, and credit is more widely available.

Unfortunately, while housing recovers, GA's nonresidential real estate markets will get **much, much** worse in 2010.

The abundance of empty space, weak demand for new space, plummeting non-residential prices, and extremely tight credit are huge problems. High and rising delinquency rates on commercial real estate loans will stymie conventional lending.

The bottom line is that non-residential is so bad that it overwhelms the small positives in home construction. Consequently, only in 2011, will GA's overall construction industry begin to make significant positive contributions to the growth of the state's GDP. And, until that happens, GA's economic recovery will continue to proceed more slowly than the nation's.

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Even though the economic recovery will be bumpy, growth in terms of output is back. And, by spring, the recovery in output will be accompanied by a small recovery in jobs. **The bottom line is that the economic recovery that began in the 3rd Q will be sustained.**

So, this is the time to go out and execute your plans to expand profits, increase your net worth, start a business, or look for a job.

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I hope my forecast will be helpful to you.