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Coastal Empire Economic Monitor, 2nd Quarter, 2016

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Coastal Empire ECONOMIC MONITOR

SURFACE LOOKS GOOD, BUT TURBULENCE BELOW

The Savannah metro economy continued its growth phase during the second quarter of 2016. Continued gains in reported total employment, along with growth in consumer confidence, boardings at the airport, and electricity sales, kept the index moving up. However, seasonally and inflation-adjusted port activity declined, while hotel room sales and retail sales waivered somewhat.

The forecasting Coastal Empire leading economic index also gained ground, but there is also some weakness below the top line number. There is some emerging weakness in the labor market and residential housing market, but exceptionally strong increases in building permit valuation supported the forecasting index. Consumer expectations in the South Atlantic states declined modestly during the second quarter.

Based on some underlying weakness in the coincident index and below-surface turbulence in the forecasting index, economic growth is expected to weaken through the second half of 2016 and into early 2017. Expect growth to slow, as compared to the gains achieved in the first half of the year. The effects of Hurricane Matthew will further test the resiliency of the economy during the fourth quarter.

Region: Mixed Signals

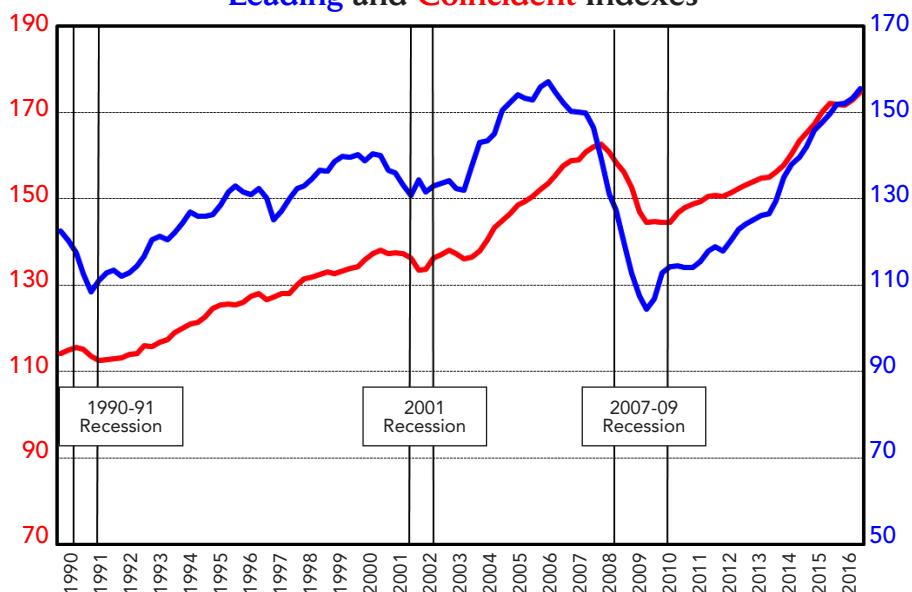
The Coastal Empire coincident economic index increased to 172.5 from 171.8 (revised) in the previous quarter. After slipping a bit during the second half of 2015, the index increased at an annualized pace of 3.3% during the opening quarter of 2016 and increased the pace of growth in the second quarter to 4.2%. However, the underlying data is sending mixed signals about the current health of the economy.

From a purely data-driven perspective, increasing total regional employment, along with increases in boardings at the airport and a rebound in consumer confidence, combined to give the index the lift it needed to offset flatness in hotel and retail sales and weaker activity at the port.

Below the surface, however, the underlying employment data tell a different story. The addition of employment in each of the major sectors (tourism, education, health care, manufacturing, etc.) does not match the total number reported for the region by the Bureau of Labor Statistics (BLS). Sector-level employment was stable from the first to second quarter at 177,000 workers, while the total reported by BLS indicates growth of approximately 1,900 jobs during the quarter, to reach 177,500. Much of the reported second quarter gain is anomalous because reported first quarter total employment was less than the total of sector-level employment.

Further, it is likely that regional manufacturing data is currently over-reported by as much as 1,000 jobs, and will be revised downward in the annual data benchmarking process conducted by the Georgia Department of Labor in the first quarter of 2017. Current employment data is gathered through a surveying process of employers and is benchmarked against employment data gathered through a census-like procedure (but reported with a delay of six to nine months). The two manufacturing employment series differed by a few hundred jobs through mid-2015, but the gap has widened to average just over 1,000 jobs in 2016 first quarter data. Second quarter data is not yet available, but there is no particular reason to think the gap will close. Takeaway: expect manufacturing employment data to be revised downward by as much as 5% from the currently reported figure of 18,100 workers.

Coastal Empire Economic Indicators
Leading and Coincident Indexes



In some respects, the modest decline in port activity and in the softness in tourism growth can be viewed as a return to normalcy following very impressive, but ultimately unsustainably fast growth in 2015. Recall that port numbers in 2015 were boosted by labor strife in West Coast ports that artificially pushed up numbers in Savannah's port facilities. Now, as West Coast ports return to more normal operations, much of the diverted cargo returned west and is now having the resultant effect of artificially reducing Savannah's port numbers. This is also compounded by modest growth in major Asian and European economies, which is marginally affecting international trade.

In the tourism sector, hotel room rentals managed 0.3% growth from the previous quarter and were 1.7% higher than year-ago levels, down from double-digit gains in 2015. Secondary indicators of tourism reflect this as well: ridership on tour buses and trolleys is 2.6% lower than previous-year data. However, auto rentals are up 2% from the previous quarter, consistent with, but not quite matching the 4% growth in airport boardings. Nonetheless, the tourism sector added 200 workers, reaching 26,900 employees. Leisure and hospitality sector employment remains the single largest concentration of workers in the region.

U.S. Economy Up Modestly

The U.S. economic growth improved somewhat during the second quarter of 2016, growing at an annualized rate of 1.4%. The growth reflected an increased pace of consumer spending (+4.3%), growth in nonresidential construction (+1%), and export growth (+1.8%). However, residential construction fell at a pace of 7.9% and government spending fell at a rate of 1.7%, dragged down by declines in state and local government spending (-2.7%). *The Wall Street Journal* consensus forecast for GDP growth in 2016 fell again and is currently 1.8% for the year, but is expected to be 2.2% in 2017.

The Federal Reserve has the perspective that the labor markets have strengthened somewhat recently, along with GDP growth, while inflationary pressure remained muted. Although the solid economic growth commonly viewed as being the catalyst for Fed rate increases has not yet materialized, the Fed is cautiously inching closer toward lifting interest rates in December. A vast majority of economists (82%) surveyed by *The Wall Street Journal* expect the next rate increase in December 2016 and to continue to rise to a little over 1% through 2017.

Forecasting Index Muddled

The Coastal Empire leading economic index increased 1.4% percent (5.8%, annualized), rising to 155.5 from 153.3 (revised) in

the previous quarter. The index was primarily lifted by residential home building permit valuation and the U.S. leading economic index. Weakness emerged in the number of residential building permits issued, consumer expectations in the South Atlantic states, and the number of new claims for unemployment insurance. The overall good forecasting signal indicated by the index should be tempered by the reality of submerged weakness in several key indicators of activity in the housing and labor market.

In the housing market, building permit issuance for single-family homes fell sharply by 10% from the first quarter and was below year-ago levels by the same amount. The seasonally adjusted number of new residential homes permitted for construction was 439, compared to 487 in the first quarter. The average valuation of building permits for single family homes remained exceptionally strong, holding at about \$250,000 for the second consecutive quarter. This is well over 20% higher than valuation data going back a few years, and is likely to decline in upcoming quarters.

In the labor market, seasonally adjusted initial claims for unemployment insurance (UI) jumped 6.7% to 812 per month from 762 (revised) claims. The number of new UI claims is 10% higher than year-ago levels. The regional unemployment rate bumped up to 5.2% (seasonally adjusted) in the first quarter, but dropped to 4.8% for the second quarter. The unemployment rate was 5.7% in the second quarter of 2015.

In summary, while both the coincident economic index and the forecasting index are displaying signs of strength at the surface level, the underlying behavior of several indicators of important components of the regional economy are soft. Manufacturing employment is likely to be revised downward. Residential building permit issuance is down, and the number of new claims for unemployment insurance is up. Less troubling is the softness in port activity and tourism that are likely returning to normalcy in a process that is artificially signaling weakness in those sectors.

Overall, there is a somewhat blurry picture in the signals transmitted by the coincident and forecasting indexes. Expectations about the regional economy's growth should be adjusted downward through late 2016 and early 2017, due to mixed signals and the anticipated lingering effects of Hurricane Matthew.

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A Note From the Director

The *Economic Monitor* is available by email and at the center's website (www.armstrong.edu/Liberal_Arts/economics). If you would like to receive the *Monitor* by email, please send a "subscribe" message to CRA@armstrong.edu.

About the Indicators

The Coastal Empire Economic Indicators are designed to provide continuously updating quarterly snapshots of the Savannah Metropolitan Statistical Area economy. The coincident index measures the current economic heartbeat of the region. The leading index is designed to provide a short-term forecast of the region's economic activity in the upcoming six to nine months.