

Economic Update

THE SOUTH FINANCIAL GROUP

Summer 2004

The Division of Research, Moore School of Business, University of South Carolina
(<http://research.moore.sc.edu>)
Donald L. Schunk

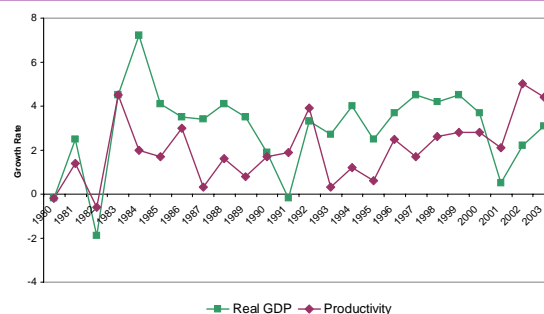


The U.S. and South Atlantic economies have clearly embarked on a solid economic expansion. The jobless phase of the recovery has ended as the nation and the region have been posting strong rates of new job creation, particularly since the summer of 2003. The current economic growth is broad-based with gains being fueled by consumer spending, business investment, and exports. Although a surge in federal defense spending early in 2003 is rippling through the economy and helping to boost growth, the current economic expansion is primarily due to growth in the private sector. Because households and businesses are driving the recent growth of the economy, the young economic expansion should be sustainable.

The metropolitan areas served by The South Financial Group across Florida, North Carolina, and South Carolina—many of which managed to do very well throughout the national recession and sluggish recovery—are expected to continue to attract new residents and businesses. As is consistently the case, these local markets saw rapid gains in population, incomes, and construction activity generally beyond national and regional averages. This *Economic Update* provides some details on the recent performance of these local economies, but begins with an overview of the recent trends and forecasts for the U.S. and South Atlantic economies.

It took the United States less than 2 quarters to recover from the recession.

Figure 1. U.S. Real GDP and Productivity Growth

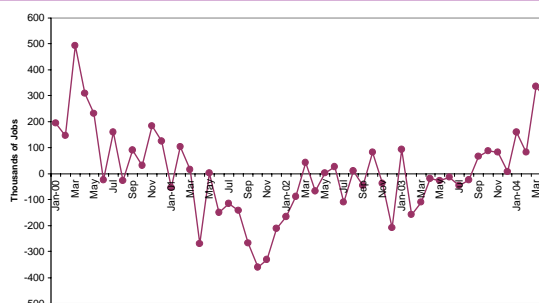


Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Moore School of Business.

The U.S. Expansion Solidifies

There is little room for debate on the strength of the current economic expansion. Following the recession that ended in the third quarter of 2001, the U.S. economy has grown nearly 9 percent as measured by real gross domestic product (GDP). It took the U.S. less than 2 quarters to recover from the recession. That is, by the first quarter of 2002, real GDP had already surpassed its previous peak set during the fourth quarter of 2000. Between the

Figure 2. U.S. Change in Payroll Employment



Source: Bureau of Labor Statistics, and Moore School of Business.

first quarter of 2003 and the first quarter of 2004, real GDP grew by 4.9 percent. This was the fastest year-over-year rate of growth since the fourth quarter of 1984.

The knock on the recovery, of course, has been the lack of jobs to accompany this rapid growth. The statistics provide a fairly clear explanation. Between 2001 and 2003, total productivity, or output per worker hour, in the U.S. grew by 9.6 percent—the fastest two-year period of growth since 1949 and 1950. Well, if output per worker is outpacing total production, it makes sense that the economy would have been shedding jobs.

However, businesses can only rely on productivity gains for so long in the face of rising demand. The strong growth in real GDP, and sustained growth in manufacturing production in particular, has given way to a reversal of the negative employment trends that previously characterized the jobless recovery. The U.S. lost a total of 2.7 million jobs between March 2001 and August 2003 for a decline of nearly 2.1 percent. However, since August 2003, the national economy has posted a net employment gain of more than 1.1 million jobs (through April 2004). This job creation has brought the unemployment rate down from a high of 6.3 percent in June 2003 to stand at 5.6 percent in April.

The current forecast for the national economy shows several more quarters of above average real GDP growth, before growth begins to moderate toward the end of 2004 and into 2005. Overall, real GDP is expected to advance roughly 4.5 percent for all of 2004 with growth slowing to about 4.0 percent in 2005. In part, the expected slower growth will be due to Federal Reserve interest rate hikes. Interest rate increases are now widely anticipated beginning this summer. The federal funds rate target—at 1.0 percent as of May—is expected to rise to about 2.0 percent by the end of the year. Fed-engineered increases in short-term rates will boost long-term rates to some degree; however, longer-term rates have already surged in advance of rising short-term rates. For example, the 10-year Treasury rate rose from 3.75 percent during late March to about 4.8 percent after the release of the April employment numbers in early May.

Slower growth can also be partly caused by the sharp run up in energy prices. With gasoline prices at record high levels, spending on other items could well be affected. However, for gas prices to cause a dramatic reversal in the economy, they would likely have to continue to rise sharply and remain high for a considerable time, both of which appear unlikely given that there are already indications that oil output may get a boost before too long. Remember, oil exporting countries have an incentive to keep oil prices from rising too much, for they do not want to trigger a global economic slowdown and an ensuing drop in oil demand.

A Turnaround for the Entire South Atlantic Region

The South Atlantic Region, including Florida, North Carolina, and South Carolina, is currently seeing its economy expand at a faster pace than the U.S. In terms of total employment, the region has seen positive and rising rates of job growth since the fall of 2002. The latest available figures from April 2004 show that regional employment increased 1.8 percent from its level one year ago. For the U.S., employment over the same period grew by 0.8 percent.

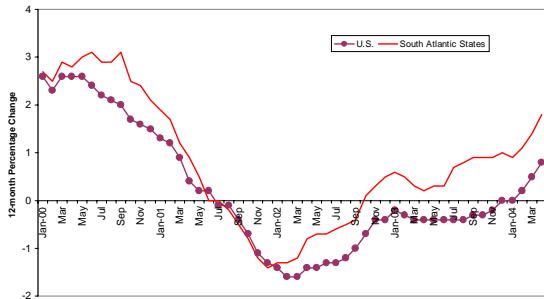
A similar strength for the regional economy was already evident in the last edition of this *Economic Update* in the spring of 2003. At that time, however, the region's growth was primarily due to the strength of Florida's labor markets. This time around, all three states are posting positive employment growth that currently is outpacing the national average.

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The major difference for the Carolinas in recent months has been the improvement in the manufacturing sector. Since the summer of 2003, manufacturing production nationwide has seen resurgence. For example, the Federal Reserve's industrial production index has risen nearly 5 percent since last June. These increases in output have



Figure 3. U.S. and Regional Employment Growth



Source: Bureau of Labor Statistics, and Moore School of Business.

finally started to translate into some manufacturing employment gains.

The U.S. manufacturing sector began posting net job losses in August 2000 as capital investment began to dry up. Between August 2000 and January 2004, the manufacturing sector saw an average net loss of nearly 72 thousand jobs each month. After 42 consecutive months of declines, U.S. manufacturers posted three straight monthly gains from February to April 2004, adding a total of 37 thousand net new jobs since January. This has been translating into stability and even slight gains in manufacturing employment in the Carolinas.

Even though industrial employment makes up a smaller share of the economy in the Carolinas than it did in the past, swings in manufacturing employment continue to be important in determining the overall direction of employment in the area. Further stability in industrial employment will help the overall trends because these states can generally expect to continue to see strong job growth in fields including health care, financial services, leisure and hospitality, and professional and business services.

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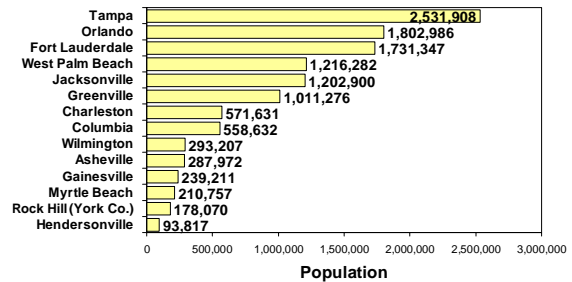
Local Market Population and Economic Growth

At a more local level, the markets served by The South Financial Group throughout the South Atlantic Region continue to post solid population gains. These markets are attractive destinations for new businesses and new residents in part because of their natural amenities and also because of their generally strong economies. To be sure, these areas felt the effects of the national recession to varying degrees. Yet, even areas that have been slower to recover—such as Columbia and Greenville, South Carolina—are still seeing population increases that are helping boost the trade and service sectors of those cities.

Overall, the markets of The South Financial Group have seen total population increase by 5.9 percent between 2000 and 2003. The fastest



Figure 4. Local Market Population, 2003



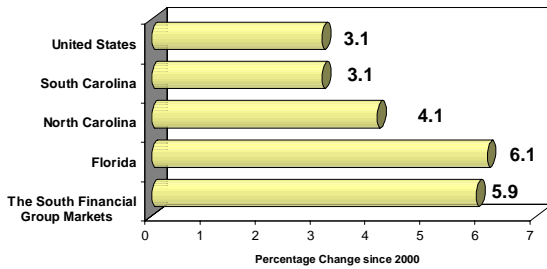
Source: Census Bureau, Moore School of Business.

growth has been in the Florida markets of Orlando (8.9%), West Palm Beach (7.1%), Jacksonville (6.8%) and Fort Lauderdale (6.1%), along with York County in the Charlotte area at 7.5 percent. The coastal Carolinas also have seen very rapid growth since 2000, including 6.4 percent growth in both Myrtle Beach and Wilmington, and a 3.9 percent increase in Charleston. Many of these markets have seen population growth more than double the 3.1 percent pace set by the United States since 2000.

It is noteworthy that many of these fast growing markets are already large areas. When looking at population growth across the country,



Figure 5. Local Market Population Growth, 2000-2003



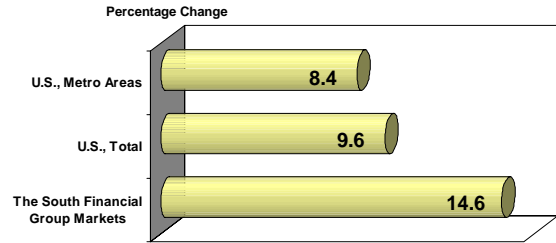
Source: Census Bureau, Moore School of Business.

many of the fastest growing areas are relatively small and as they start to attract new residents it is relatively easy to see high growth rates. However, the fast growing Florida markets in particular, are large population centers that continue to grow. For example, the second largest market served by The South Financial Group is Orlando with a 2003 population of 1.8 million. The Orlando area's population has grown by nearly 150 thousand just since 2000—a very rapid rate of growth for a relatively large area.

Strong income growth is accompanying the rapid population gains in these local markets. Overall, total personal income in all of the local markets expanded 7.1 percent between 2000 and 2002. The fastest growth in both total income and per capita income occurred in Charleston, South Carolina. Other areas posting particularly large income gains in this period were Orlando, Fort



Figure 7. Residential Construction Growth, 2002 - 2003



Source: Census Bureau, Moore School of Business.

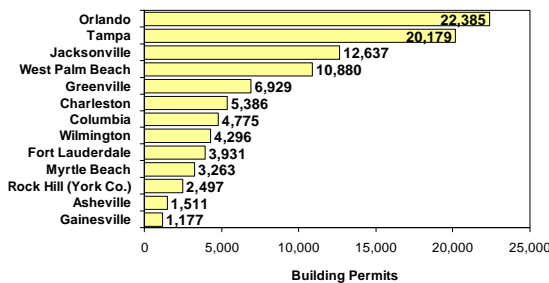
Lauderdale, and Wilmington.

Another important indicator at the local level is new home construction. Gains in housing activity correlate with both population and economic growth, and the local markets turned in another very strong residential construction performance in 2003. In total, the local markets saw single family building permits increase 14.6 percent in 2003 compared with an 8.4 percent advance for all metropolitan areas nationwide. The fastest growth was seen in

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Figure 6. Single Family Building Permits Issued, 2003



Source: Census Bureau, Moore School of Business.

Myrtle Beach, Orlando, West Palm Beach and Wilmington. All together, nearly 100 thousand single family permits were issued in the local markets during 2003. Business construction activity also improved in many of the markets in 2003, with the fastest growth in terms of the value of business construction occurring in Columbia, Myrtle Beach, Jacksonville and Greenville.

Overall, the virtuous cycle of population growth and economic growth shows no sign of stopping in these local markets. Further, the improved national economy will only work to further strengthen conditions of the metropolitan areas across the South Atlantic Region.