The diverse local economies that make up The South Financial Group’s markets across the South Atlantic region have weathered the U.S. recession well. The strongest evidence of this comes from a look at the performance of the housing sector during 2001 in the cities of Jacksonville, Orlando, and Tampa Bay in Florida; Wilmington in North Carolina; and Charleston, Columbia, Greenville, and Myrtle Beach in South Carolina. Thanks to the confluence of positive economic and demographic trends in these markets, the housing sector outperformed the national and state averages.

This Economic Update provides a closer look at the region’s residential construction trends along with a focus on The South Financial Group’s newest market, Tampa Bay. First, however, is an overview of the current U.S. economic outlook.

The U.S. Economic Outlook

The U.S. economic recession that officially began in March 2001 is over. Indications of recovery have been coming at an increasing rate since the first of the year. The U.S. housing sector has remained strong, manufacturing has turned around, and labor markets have begun to stabilize. Meanwhile, despite rising energy prices for several months, there is virtually no inflationary pressure in the U.S. economy. In a rare moment of clarity, the ever-obfuscating Alan Greenspan recently stated that the U.S. economy is “experiencing significant expansion.”

After the business investment boom of the late 1990s, U.S. producers were faced with high inventories and excess capacity as the economy began to cool in late 2000. Throughout 2001, firms underwent a massive inventory correction. The inventory drawdown paved the way for the production rebound that has been evident during the first months of 2002. The Federal Reserve’s industrial production index has risen each month this year. The lack of inventory coupled with stable demand for manufactured goods, has resulted in this increase in production.

The rate of capacity utilization at U.S. firms has also been rising. However, this capacity utilization rate is still relatively low, that is, firms are still operating with excess capacity. Because of this, substantial gains in new business investment are unlikely in the immediate future. However, toward the end of 2002 and into 2003, firms should once again be approaching full capacity, and business spending should pick up.

Resiliency is a prominent feature of the U.S. economy. This has been demonstrated by the tremendous strength of the housing sector since the recession began. This resiliency has also been shown by the apparent rapid recovery from the terrorist attacks on the U.S. Since September 11, stock markets have posted substantial gains, consumer confidence has improved, and jobless claims have returned to more average levels.

Figure 1. Industrial Production and Capacity Utilization

Source: Federal Reserve
One result of the overall heightened tension in the Middle East has been rising energy prices during 2002. While higher gasoline prices could limit the strength of the economic recovery, they should not prevent it. Though energy prices have risen, the core rate of inflation remains low. This lack of inflationary pressure means that the Federal Reserve should be able to allow the economic expansion to become firmly rooted before raising interest rates to head off price pressure.

The Fed is unlikely to enact any change to monetary policy before late summer. Consistent with current expectations in the futures markets, the Fed’s target for the federal funds rate will probably climb from 1.75 percent currently to 3 percent by the end of the year. With the overall strength and speed of the recovery in doubt, the Fed will probably target short-term rates at roughly 3 percent to 3.5 percent over the next two years. This would be similar to the Fed’s strategy coming out of the recession of the early 1990s.

The housing sector, though remarkably strong across the U.S. in 2001, was even more impressive in the South Atlantic states.

The economies of Florida, North Carolina, and South Carolina are poised to reap the benefits of the improving national economy, though for different reasons. The downturn in the Carolinas was driven by the manufacturing recession. Manufacturing remains an important source of employment in the Carolinas. The loss of industrial jobs in the Carolinas then spread to the service and retail trade sectors. The turnaround in manufacturing will spark job gains and economic growth in the Carolinas throughout the year. Florida’s rebound will be dictated more by the return of tourists this year. Indications are that tourism activity in Florida and the Carolinas is returning to normal levels or better.

Even though they suffered through the recession of last year, the South Atlantic States enjoyed several bright spots. Florida and the Carolinas posted above average population growth in 2001. The U.S. population rose 0.9 percent in 2001. Meanwhile, Florida’s population swelled by 2.1 percent. This was the fourth fastest growth in the country, behind just Nevada, Arizona, and Colorado. North and South Carolina posted the 10th and 19th fastest growth rates in the nation at 1.3 percent and 1.0 percent respectively.

The South Atlantic States

The housing sector, though remarkably strong across the U.S. in 2001, was even more impressive in the South Atlantic states. Single family building permits rose a remarkable 7.9 percent in 2001 compared with a 1.9 percent gain for the entire U.S. This housing boom has occurred despite rising unemployment.

Why has the housing sector remained so vibrant? Nationally, there are two primary reasons. First, mortgage rates have been favorable, hovering around 7 percent since early 2001.
Second, even though unemployment has trended upward, it remains at a very low level. In March, the U.S. jobless rate stood at 5.7 percent. If economists could have known five years ago that the unemployment rate in early 2002 would be under 6 percent, they would generally have assumed that the economy was performing quite well.

The superior performance in the South Atlantic states, and in The South Financial Group’s markets in particular, is due to the fact that low mortgage and unemployment rates were combined with above average population growth.

### Housing Boom in the Local Markets

Driven by rapid population growth and strong and diverse economies, the local markets served by The South Financial Group have witnessed a greater residential construction boom than either the U.S. or the states as a whole across the region. This is the case whether looking at longer term trends or the performance during the recession of 2001. Now, a booming housing sector does not by itself translate into continued strength. However, in the case of the local markets in Florida and the Carolinas, economic and population growth is expected to remain above average for the coming years. Therefore, the positive housing trends of recent years are expected to continue into the future.

To gauge the performance of the housing sector in these local markets, the number of building permits and the total dollar value of residential construction can be compared with the U.S. and relevant state averages. Between 1995 and 2001, the annual number of single family building permits in the U.S. increased by 22.5 percent, and the number of multi-family permits rose by 16.2 percent. For the three-state region, single and multi-family permits advanced by 35.9 percent and 27.6 percent over the same period. Meanwhile, The South Financial Group’s local markets experienced a 45.7 percent increase in single family permits and a 47.6 percent surge in multi-family permits.

Because of the population and economic gains that have contributed to this record of home construction, many of these areas are faced with concerns over how to handle this tremendous growth. It is important to note that while dealing with issues of “smart growth” can be difficult, it is actually a great problem to be faced with. These cities are asking themselves, “How can we better prepare for the strong growth we expect in the future?” Many areas across the country would love to have these kinds of concerns as opposed to dealing with a declining population base and stagnant economies.

These markets have also posted tremendous gains in the total dollar value of residential construction. Again, between 1995 and 2001, the annual dollar value of all residential construction in the U.S. rose by 60 percent. In the three-state
region, total value increased 75.8 percent. The South Financial Group’s markets saw residential value soar 90.4 percent. This housing boom has been experienced in each of the local markets. In terms of single family building permits, the most rapid growth since 1995 has been in Charleston, South Carolina, and in Tampa Bay, Florida.

Similar trends appear when looking at the housing sector during 2001 only. Again, despite the recession, the U.S. saw single family permits rise 1.9 percent for the year. Permits increased 7.9 percent in Florida and the Carolinas. The markets across the region posted a gain of 10.4 percent. The continuance of this housing boom during a national recession underscores the beneficial population and economic trends in The South Group’s major markets.

**Tampa Bay, Florida**

The metropolitan area of Tampa Bay-St.
Petersburg-Clearwater on Florida’s gulf coast is another example of a Florida market that has enjoyed above average population, income, and per capita income growth. Tampa Bay is expected to post particularly strong performance in terms of per capita income growth in the future. In addition to excellent growth prospects, the Tampa Bay metro area already has the highest per capita income level of any of The South Group’s markets, with Jacksonville, Florida, and Columbia, South Carolina, coming close behind.

The economic structure of Tampa Bay is similar to most of the other markets around the region. The service sector is by far the largest source of employment in Tampa Bay, accounting for over 40 percent of all jobs. Meanwhile, just over 7 percent of total employment comes from the manufacturing sector.

Tampa Bay is another example of a diverse local economy. The area’s relatively small reliance on manufacturing as a source of employment and income helps insulate it from cyclical downturns in the national economy. The recession of 2001, though much less severe than previous recessions, was similar in that the manufacturing sector bore the brunt of the job losses. However, Tampa’s reliance on non-manufacturing sectors allowed it to post a job increase of 1.9 percent between 2000 and 2001. Only in the wake of the terrorist attacks and the ensuing drop in tourism did the local economy begin to weaken. However, tourism’s return this year should bring the Tampa economy back with it.

The remarkable performance of the housing sector during 2001 is clearly evident in Tampa. The area’s 18.7 percent increase in single family permits in 2001 was second across the region only to Jacksonville. Meanwhile, Tampa posted the largest advance of total residential construction value of any of the local markets with a gain of 23.6 percent, compared with a statewide increase of 13.7 percent.

Tampa Bay, like the rest of The South Financial Group’s major markets, is reaping the benefits of the link between positive demographic and economic trends.