

The Georgia Outlook for 2017

Speech by Jeffrey M. Humphreys in Valdosta on 02/09/2017 at the Valdosta-Lowndes County Chamber of Commerce's Business Outlook Breakfast, Rainwater Conference Center. Dr. Humphreys is the Director of the Selig Center for Economic Growth, Terry College of Business, University of Georgia, www.selig.uga.edu

The 2017 outlook for Georgia's economy is very good. The pace of Georgia's GDP and personal income growth will accelerate. Jobs will be plentiful. Job growth will be very well balanced, with gains in both goods producing and service providing industries. Existing home prices will rise to all-time highs. And, once again, Georgia's economy will grow faster than the nation's economy.

Specifically, I expect Georgia's GDP to grow by 3.2 percent in 2017. That's higher than the 2.6 percent growth I estimate for 2016. It's also above the 2.5 percent growth I estimate for US GDP in 2017. Georgia's personal income will rise by 5.0 percent.

Georgia's employment will rise by 2.1 percent in 2017, which exceeds the 1.5 percent gain estimated for the US. Georgia's unemployment rate for 2017 will average 4.8 percent. That's below the full employment unemployment rate of about 5 percent. The last time we were at full employment was in 2007. The very depressed labor force participation rate will increase slightly in 2017, which will help sustain economic growth by adding to the supply of workers.

What accounts for my optimism? Many of the same forces that contributed specifically to Georgia's growth in the past two years will be even stronger in 2017. First, Georgia has even more projects in its economic development pipeline. Second, Georgia's economy will get more leverage from the housing recovery than the national economy. Third, Georgia's manufacturers will continue to do better than US manufacturers. Fourth, Georgia will see faster population growth.

I'm also optimistic because there will be less gridlock in Washington. Although we sometimes joke about it, unless you believe that the historical policies work well in an evolving global environment, then gridlock is bad rather than good for the economy. We have an opportunity to implement policies that will improve economic growth through tax reform, regulatory relief, and spending on productivity-enhancing infrastructure. If leaders get it right, the country will benefit substantially.

As always, there will be some headwinds: The strong US dollar and weak foreign economies will make it difficult for our exporters. Higher oil prices will not favor oil-consuming states like Georgia. Low productivity growth will limit increases in wages and salaries, which in turn limits growth in consumer spending. The Federal Reserve will hike policy interest rates by 75 basis points in 2017, which will increase borrowing costs on the margin. With a new administration in Washington, there will be more economic policy uncertainty. That will put some business decisions on hold. It may even delay some decisions to expand, or to hire. So, even though I expect faster economic growth for Georgia, the risk of a recession beginning sometime in 2017 will be 35%, up from only 25% in 2016.

What does this forecast mean for you? The main takeaway is that it's not too late to take advantage of Georgia's economic expansion, but it's also time to prepare for the next recession.

Part 2: Economic Development Success

The main reason why we are so optimistic for Georgia is the large number of major business relocation and expansion projects that have been announced over the last 5 years. As these projects build out over the next several years, they will expand Georgia's economic base providing a powerful tailwind to the state's economy.

When it comes to landing economic development projects our success reflects cost, logistical, and tax advantages that make us very competitive with other states. Georgia also fields a very competitive team of economic development professionals. Georgia is viewed as a place where there's a good working relationship between government and

other major players. In fact, for the fourth consecutive year, site consultants ranked Georgia as the top state in which to do business. And, that's a ranking that truly matters because those are the folks that companies hire to recommend and rank sites for relocations or expansions.

Now, let's briefly look at five business clusters where Georgia competes very effectively: (1) headquarters operations, (2) distribution and logistics, (3) "new" high-technology, (4) professional and business services, and (5) TV and movie production.

In 2017, Georgia will continue to do well when it comes to attracting corporate headquarters. Hartsfield-Jackson International Airport makes Georgia a great hub from which to serve operations in the Americas. Access to talent and the strength of Atlanta's business community are important drivers of headquarters locations. Also, according to FEMA, Atlanta has a very low risk for business disruption due to natural disasters, which is an important consideration for headquarters locations.

Many of the headquarters projects announced in recent years have been in the Atlanta area, but some headquarters are selecting sites outside of the Atlanta MSA.

Logistics and distribution is another cluster that will power Georgia's economy. A robust and well maintained infrastructure combined with cyclical increases in economic activity will ensure that Georgia continues to attract logistics and distribution companies. Recent announcements include: UPS, Tory Burch, HD Supply, and Polymer Logistics. In 2017, Georgia will benefit from many newly announced distribution centers for online as well as bricks and mortar retailers. Examples including Home Chef, Variety Wholesalers, and Amazon.

In 2017, new high tech industries ranging from healthcare IT, to Fintech, to cyber security and mobile apps will underpin Georgia's economic growth. IT companies that have announced major projects, include ADP, GE Digital, Honeywell, and NCR.

Healthcare IT is an industry that will create thousands of high-paying jobs in Georgia over the next decade. For example, in 2016, Anthem, Inc. announced that it will create about 1,800 healthcare IT jobs at a services hub in midtown Atlanta and 450 new health-IT jobs in Columbus.

Another cluster that's growing rapidly is professional and businesses services. Many of the same factors that appeal to headquarters attract providers of professional and business services. These companies locate in Georgia due to the strength of the potential client base, access to talent, and the ease of using Atlanta as a transportation and logistical hub from which to service clients located throughout the Southeast and beyond.

Because of generous economic development incentives and the attainment of critical mass, Georgia's film industry will make a substantial contribution to economic growth in 2017. Georgia's film industry ranks third in worldwide film production, behind only California and the United Kingdom. Its annual economic impact has been estimated at about \$7 billion. We are at the stage of development where new movie and TV production increasingly begets additional movie and TV production. And, as the professional, technical, and physical infrastructure to support the film industry becomes more fully developed, the economic benefits of each dollar spent on film production in Georgia will generate larger economic impacts for our state's economy.

Part 3: Manufacturing Recovery

Another reason Georgia will do well in 2017, is that Georgia's manufacturing economy continued to expand in 2015 and 2016 even as US manufacturers were cutting factory jobs. Over the last seven years, Georgia added over 45,000 manufacturing jobs. The factors that pushed US manufacturing into a jobs recession were felt in Georgia – low commodity prices, weak exports, an inventory correction, and a drop in investment spending by businesses. But, Georgia manufacturers continued to add jobs due to the

large number of major economic development project announcements. Those announcements are bolstering growth in aircraft, automobile, flooring, building materials, food processing, and chemicals manufacturing. It also helped that Georgia manufacturing was not geared towards oil or natural gas production, and was helped rather than harmed by the drop in oil and gas prices.

Going forward, Georgia will see substantial increases in advanced manufacturing activity. Recent project announcements include Jindal Films in LaGrange, Aspen Aerogels in Statesboro, and MI Metals in Millen. The Sentury Tire announcement in LaGrange illustrates Georgia's growing economic ties with China and validates the establishment of the State of Georgia's two economic development offices in China.

Part 4: Housing Recovery

Housing and real estate development will be a powerful driver of Georgia's economy in 2017. The number of single-family home starts for new construction will increase by 18%. New multi-unit homebuilding will rise by 6 percent. Existing single-family home prices will rise by 4% in Georgia in 2017.

Georgia's housing market is responding to a more favorable balance of supply and demand. Increased demand for housing will come mostly from job growth. Those new jobs, and slightly bigger paychecks – plus appreciating home values – will give more people the wherewithal, and the confidence, to buy homes.

As of mid-2016, the average price of an existing single-family home in Georgia exceeded its pre-recession peak value by 4 percent. Similarly, US home prices exceed its pre-recession peak value by 3 percent. For the state and nation as a whole, the home price recovery, on average, is complete, but home prices are still depressed in some areas of the state. For example, home prices are still 16% below their peak level in Brunswick.

Part 5: Demographics

Demographic forces are another factor behind Georgia's improving economic performance. For decades, Georgia depended on a growth model that was based on high levels of in-migration. That growth model stopped working during the Great Recession as net migration to Georgia declined due to the housing bust and heavy job losses. In 2014, geographic mobility finally increased as a result of sustained job growth and the housing recovery, and Georgia's population began to grow more quickly. In 2015-16, corporate relocations and expansions brought even more people to Georgia. The trend of higher migration to Georgia will persist in 2017.

Jobs will attract young adults who will be more mobile than they were prior to the housing bust. The nationwide recovery in home prices will give retirees the wherewithal and confidence to move to Sunbelt states such as Georgia. Georgia's population will grow at a pace that exceeds the national average in 2017 – 1.4 percent for Georgia versus 0.8 percent for the US. Population growth therefore will be a stronger driver of Georgia's GDP in 2017 than in 2008-2016.

Georgia's population will grow the fastest in the Athens, Atlanta, Augusta, Gainesville, Savannah, and Warner Robins, which boosts the prospects for homebuilders and B-to-C companies operating in those parts of our state.

Part 6: What keeps me up at night?

I expect Georgia's economy to grow, but as I mentioned at the beginning of my remarks I see a 35% risk of a recession beginning sometime in 2017. What events might trigger a recession?

The main risks are (1) a major shift in asset prices and (2) economic policy mistakes.

In terms of asset prices, I'm mostly concerned about bond prices. I have some modest concern about equities prices. I'm not at all worried about home prices. Home prices have returned to their pre-recession peak, but are still low once inflation is taken into consideration.

The bottom line is that I see bonds as substantially overvalued, stocks as modestly overvalued, and homes as undervalued.

Imbalances in the financial markets tend to adjust – typically those adjustments are gradual and don't trigger a recession, but more dramatic adjustments are possible.

The possibility of a major economic policy mistake is also a concern. A trade war is my most immediate concern. It's a mistake to believe that a more isolated economy will lead to economic prosperity. A trade war would reduce Georgia's exports, disrupt supply chains, lower productivity, and raise consumer prices. A full-blown trade war would trigger the type of recession that would be especially hard on Georgia given our large transportation and logistics industry. In Georgia, one job out of every 12 is in some way dependent on Georgia's ports, and is at risk of being lost if we pull back substantially from international trade.

My main long-term concern is whether the combination of tax reform, more spending on infrastructure, and more spending on national defense will cause the federal debt to rise substantially faster than previously projected. Increased government borrowing won't trigger a recession in 2017 or 2018. In fact, it would provide a boost to growth. But, larger budget deficits increase the risk of a future fiscal crisis.

When interest rates are low, more federal spending on infrastructure makes sense, but only when it goes to projects that increase productivity enough to more than cover the costs of financing the project. The vetting of the projects will determine the success or failure of this policy. I do strongly favor tax reform, but not at the expense of substantially higher federal budget deficits.

Part 7: Closing

I'm pleased to report that the economic outlook is good. For the 5th straight year, Georgia will outperform the nation. Our prospects for growth reflect a pipeline that's full of economic development projects, a manufacturing recovery that Georgia sustained even as US manufacturing slide back into recession, the housing recovery, and faster population growth.

Thank you for your attention!