Alabama business executives were seeing positive indications that a broad-based recovery was taking hold when they registered their opinions about the third quarter outlook in early June. This confidence faded on the fourth quarter survey, completed in the first half of September, amid signs that the economy is losing momentum. The Alabama Business Confidence Index (ABCI) fell 3.7 points to 47.9, retrenching after six consecutive quarters of improvement. This decline in business optimism will likely constrain job creation and capital spending for the remainder of 2010.

Businesses are less optimistic about every component of the index. The national economic outlook took the biggest tumble, falling 8.2 points to 42.1. Panelists expect Alabama’s economic performance to be flat. Sales is the only positive industry index at 51.6, down 4.3 points from the third quarter, but still indicating modest growth. Industry profits and capital spending are both likely to be lower this quarter. Prospects for job gains in the state weakened, with over half of firms expecting to maintain current employment levels, a fifth increasing hiring, and around 27 percent cutting back.

Alabama’s small businesses are mildly optimistic about fourth quarter prospects, a sign that firms with fewer than 20 employees could emerge as key players in the recovery. ABCI indexes forecast expansion for businesses in other services (except healthcare) and in finance, insurance, and real estate. Construction, trade, and healthcare could contract in the fourth quarter, while the recovery in manufacturing will slow.

### Fourth Quarter 2010 Outlook

<table>
<thead>
<tr>
<th>ABCI</th>
<th>Change from Q3</th>
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</thead>
<tbody>
<tr>
<td>Albania</td>
<td>47.9</td>
</tr>
<tr>
<td>National Economy</td>
<td>42.1</td>
</tr>
<tr>
<td>Alabama Economy</td>
<td>50.0</td>
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<tr>
<td>Industry Sales</td>
<td>51.6</td>
</tr>
<tr>
<td>Industry Profits</td>
<td>48.4</td>
</tr>
<tr>
<td>Industry Hiring</td>
<td>47.8</td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td>47.7</td>
</tr>
</tbody>
</table>

Index above 50 indicates expansion. Index below 50 indicates contraction.

**Concerns about U.S. Economy Weigh Heavily**

Optimism about the outlook for the national economy fell sharply on the fourth quarter survey. Close to half of panelists expect the general business environment to be negatively impacted by U.S. economic performance in the final quarter of 2010, while just 21.5 percent anticipate a positive effect. At 42.1, the national outlook component of the ABCI is now below the reading of 45.1 seen when the economy was coming out of recession in the third quarter of 2009. And the 8.2 point drop in the U.S. outlook from the third to the fourth quarter is almost as bad as the 8.6 point decline as the economy fell into recession in the fourth quarter of 2007. Given the past success of Alabama business executives in forecasting the direction of the national economy, this quarter’s result raises concern that the U.S. economy could dip back into recession or at least will lose momentum this quarter.
Alabama’s Economy Relatively Stable Positive and negative developments in the state’s economy are likely to counterbalance each other during the fourth quarter of 2010. Business executives are equally divided between an improving Alabama outlook and a worsening one, with about 28 percent on each side and over 44 percent anticipating no change. The state economy index is neutral at 50—much better than the national outlook. Still, the index is down 2.6 points from the third quarter.

Unemployment is improving and total employment is rising at the same time that the state’s civilian labor force is growing, which is a good sign. But nonagricultural jobs, which had begun to increase in the spring, slipped throughout the summer. And reduced tax collections are affecting state government spending for education and other services; tax collections were down 3.1 percent for the first 11 months of the current fiscal year.

Sales Growing at a Slower Pace Alabama business executives overall are mildly optimistic about prospects for sales in their industry during the fourth quarter. Confidence slipped 4.3 points, however, with the fourth quarter sales index coming in at 51.6. Thirty-seven percent of panelists expect sales to increase this quarter, down from almost 44 percent on the third quarter survey. The differential between positive and negative expectations is about 8 percentage points versus over 24 last quarter. Weak consumer spending was among the top two concerns for U.S. CFOs on the recent Duke University/CFO Magazine Business Outlook Survey and the recent 2.3 point drop in the Reuters/University of Michigan’s Index of Consumer Sentiment supports this concern.

Sales outlooks across the state differ widely by industry sector. Respondents in finance, insurance, and real estate (FIRE) are the most optimistic, with a sales index of 58.2. Businesses in services except healthcare also forecast moderate sales gains, although healthcare expectations are flat. While manufacturers are slightly negative on fourth quarter sales prospects, the trade and construction sectors posted sales indexes in the mid-40s.

Profit Outlook Weaker in Most Industries Firms are generally less optimistic about profit growth in fourth quarter 2010. The profits index slipped to 48.4, back below the neutral point of 50 after two quarters slightly above. But the drop of 2.1 points from the third quarter reading was the smallest of the six indicators used in calculating the ABCI. While profits have not been the problem for many businesses, as they’ve curtailed hiring and capital investment until the economy is on more solid ground, competitive price pressures are always a worry.

Profit expectations vary considerably by industry group. The prolonged downturn in residential and commercial construction continues to erode profits, as indicated by a fourth quarter index of 37.5 and over half of panelists in construction forecasting a decline. Profits could also decrease at wholesale and retail firms. Manufacturing and professional, scientific, and technical services expect to maintain third quarter profit levels. Business executives in FIRE and in other services are optimistic that their industries’ profits will rise in the fourth quarter.
Job Creation Expected to Slow  Sentiment about job prospects declined on the fourth quarter ABCI survey, echoing concerns about the strength and sustainability of the current economic recovery. After crossing the 50 mark in the third quarter, the component index fell 2.6 points to 47.8—close to where it stood when the state was still creating jobs in the first quarter of 2008 and well above the lows of around 31 in the depths of the recession during the first half of 2009. Following steady gains through May, nonfarm employment declined modestly this summer and recent indicators do not provide much encouragement for hiring.

Some companies appear to be scaling back from their third quarter hiring plans—27.4 percent of panelists expect hiring to decrease in the fourth quarter, up from 18.2 percent last quarter. The differential has shifted from a positive 5.6 points in the third quarter to a negative 7.0 points this quarter. The best areas for job seekers are likely to be FIRE, other services except healthcare, and professional, scientific, and technical services. Job prospects look particularly poor in wholesale trade, construction, and healthcare.

Index Rises in Mobile, Falls Elsewhere  Business confidence declined statewide and for three of the four metros tracked by the fourth quarter ABCI survey. All were dragged down by a sharp decline in the U.S. economic outlook, which fell more than 8 points. Recalling that the survey asks about expectations compared to the prior quarter, it is not surprising that sentiment rose a point to 51.1 in Mobile—with the capping of the damaged oil well in the Gulf, the area can quantify and begin to recover from the oil spill impacts.

Confidence fell a modest 2.5 points to a state-average 47.9 in the Birmingham-Hoover metro amid signs that job losses are abating. ABCI Montgomery declined 3.2 points to 48.3 as auto manufacturing and healthcare lent stability to employment. Huntsville panelists are feeling much less optimistic, with a steep decline in the index to 45.6 suggesting that the strong forward momentum in the area’s economy will slow in the fourth quarter.

Uncertainty and Weak Recovery Constraining Investment  The capital expenditures component index registered 47.7, 2.4 points below its reading of 50.1 last quarter, but well above the low point of 29.2 in the first quarter of 2009. While firms are spending to fulfill replacement needs for business equipment and software, they are reluctant to make investments in structures until the economic recovery gains traction. The depressed mood of most Alabama panelists in the construction sector (where the fourth quarter ABCI is 41.7) indicates that business construction is not yet expected to rebound across the state.

Twenty-three percent of executives completing the fourth quarter ABCI survey see their industry increasing capital spending compared to 28.9 percent forecasting a decrease. The 4.8 percent share expecting a strong decrease is the highest negative among the four industry indicators for the 13th consecutive quarter. Businesses in FIRE and other services are most likely to increase investment this quarter, while manufacturing and professional, scientific, and technical firms could see a modest decline. However, investment by companies in trade, healthcare, and construction is likely to fall sharply.
Midsize Firms Most Worried about Prospects

Fourth quarter ABCI panelists are from every metro area and a number of nonmetro counties across Alabama. They work in almost every industry sector and represent a wide range of businesses in terms of size, measured both by number of employees and annual sales. By employment size, 29.0 percent of respondents are from firms with fewer than 20 employees, 30.5 percent work at businesses with between 20 and 99 workers, and 40.5 percent are with companies employing 100 or more.

As a group, small businesses are the most optimistic looking ahead to the fourth quarter. The ABCI moved up 0.3 points to 50.3, indicating the beginning of a modest recovery. Concern about the U.S. economy dragged down sentiment for every firm size. But small businesses were upbeat about the performance of Alabama’s economy this quarter. Expectations of improved sales and profits contribute to this outlook. Hiring should be neutral, with 60 percent holding the status quo and the remainder about evenly divided, while capital investment will weaken.

Confidence among firms with 20 to 99 employees fell sharply, dropping 6.4 points to 45.5. Midsize businesses are particularly pessimistic about the course of the national economy in the fourth quarter, but they also do not expect to get a boost from the state’s economic performance. All four industry indicators dropped from positive into negative territory. Sales expectations fell 8.2 points to 48.2, with almost 38 percent of panelists forecasting weaker sales. Over 41 percent of respondents think profits will be lower and 28 percent expect profits to rise. Hiring will be flat, with 59.8 percent forecasting no change.

The ABCI for companies with at least 100 employees matches the state total at 47.9, down 4.7 points from a more robust 52.6 in the third quarter. Confidence in the U.S. economy dropped over 10 points this quarter, while Alabama’s business environment will be relatively neutral. Sales could increase modestly for larger firms and capital spending is expected to be down just slightly. As a group, the state’s larger companies are not likely to generate new jobs—about 35 percent of respondents forecast a decrease in hiring versus 24 percent anticipating an increase.