The economic recovery continues to take hold in Alabama. While jobs, income, and state revenues are trending upward, various economic and geopolitical factors introduce uncertainties that will affect business decisions. The third quarter BLCI barometer asks Alabama business leaders to choose the one factor out of a list of five that will most influence their decisions for the remainder of 2004.

Interest rates are foremost on the minds of 42.2 percent of survey respondents. Forecasters generally expect rates to rise gradually until year-end. Inflationary pressures bring the risk of more rapid increases, however. About 70 percent of panelists in finance, insurance, and real estate; 59 percent in health care and social services; and half of construction panelists are most concerned about the course of interest rates.

High fuel prices are the most significant concern of 20.8 percent of the state’s business leaders. The intertwining of world events and energy prices coupled with their effect on inflation and consumer spending makes this an important factor in the continuing state and national recoveries. About 40 percent of Alabama manufacturing and retail trade respondents and 30 percent of wholesale trade participants say fuel prices are their most important concern. World events could have the strongest influence on the business decisions of 15 percent of BLCI panelists, while 13.4 percent say the upcoming elections will most affect their decisions. And stock market performance, a factor influenced by the other four factors, is of primary importance to 8.6 percent of those completing the third quarter survey.

The confidence of Alabama business leaders continued the upward trend that began a year ago. An improved outlook for the state’s economy combined with more solid hiring plans to raise the third quarter index to 69. This represents a gain of two points over the 67 reported in the last two quarters. A year ago, the BLCI registered 61.

Five of six indicators that comprise the index rose in the third quarter. While the share of panelists expecting sales to increase dropped slightly, more that 79 percent anticipate improvements in sales and in the national economy this quarter. Forecasts for the Alabama economy and for industry hiring are close to 10 percentage points above last quarter. And the percentage of survey participants expecting profits in their industry to rise during the quarter is at a record 69.8 percent. Capital spending should also gain momentum. The state’s burgeoning auto industry will be a major contributor to economic growth, with Hyundai test production underway and Hyundai, Mercedes, and Honda suppliers bringing new plants and expansions online.
The National Economy

BLCI panelists are confident that the U.S. economy will continue to strengthen in the third quarter of 2004, with 79.9 percent forecasting an acceleration in growth. This is up slightly from 78.3 percent last quarter and compares to 71.5 percent a year ago. While a strong start in the second quarter was softened by a slowdown in consumer spending and weaker job growth in June, the economy is expected to resume a faster pace of growth in the third quarter. Stabilizing fuel prices, strong consumer confidence, continued job gains, and robust business investment in equipment and software are among the factors favoring this forecast, while inflation remains a concern. Seven percent of Alabama business leaders think growth in the national economy could slow during the quarter.

The Alabama Economy

Alabama business leaders are upbeat about prospects for the state’s economy in the third quarter. The 74.3 percent of panelists expecting improvement is substantially above last quarter’s 64.9 percent and contrasts with 50.7 percent a year ago. Over the last four quarters, the gap between expectations for the national and state economies has steadily narrowed from a deficit of 27 percentage points to less than 6. Alabama is participating in the U.S. recovery, adding 18,700 jobs between January and May 2004. An 8.6 percent rise in state tax revenues for the first eight months of FY 2004 compared to the same period in FY 2003 has helped ease the budget pressures the state faced a year ago when the governor’s tax and accountability plan was defeated.

Interest Rates

The Federal Open Market Committee (FOMC) raised the federal funds rate a quarter of a point to 1.25 percent on June 30, after leaving the rate at 1.0 percent for a year. Seeing upside and downside risks to both sustainable growth and inflation as “roughly equal,” the committee indicated that rate hikes could proceed at a “measured” pace. Weaker employment numbers in June give credence to this approach. Eighty percent of BLCl panelists anticipate further moderate increases in interest rates during the third quarter, while 16.3 percent think rates will hold at current levels. The FOMC meets on August 10 and September 21.
**Industry Sales**

Alabama business leaders continue to be most positive about prospects for sales, with 79.4 percent predicting sales increases in their industry during the third quarter. Just 5.3 percent see a possible downside to sales—the lowest since the BLCI’s inception in 2002. Consumer spending growth is expected to rebound from a dip in the second quarter as energy prices stabilize and job gains continue. With the residential housing market still strong and non-residential construction beginning to pick up, 88 percent of panelists in finance, insurance, and real estate (FIRE) and 81.6 percent in construction anticipate stronger sales. Forecasts are also above average in wholesale trade and in transportation, information, and public utilities (TIPU). Survey participants in health care and social services are least optimistic, with just 59.3 percent expecting sales gains and about 11 percent forecasting a decline.

**Industry Profits**

Corporate profits should continue to build during the third quarter of 2004. In the most optimistic forecast yet, 69.8 percent of Alabama business leaders foresee profits in their industry increasing (including 10.1 percent expecting a strong increase), while a record low 8.2 percent think profits could decline during the quarter. Productivity increases, weak wage gains, and strengthening demand have been contributing to near-record profit levels thus far in 2004. Expectations are particularly high in FIRE, where 79.4 percent of panelists anticipate third quarter profit growth, and in TIPU, with 76.9 percent forecasting gains. The third quarter profit outlook is weakest in health care and social services, where just 51.8 percent expect an increase and 18.5 percent a decrease. Almost 14 percent of panelists in manufacturing and in professional, scientific, and technical services think third quarter profits could weaken, while 65.2 and 62.5 percent, respectively, anticipate higher profits.

**Industry Hiring**

The job creation component of the current economic expansion should continue to strengthen in Alabama during the third quarter. A healthy 59.5 percent of business leaders expect their industry to add jobs during the quarter, over 10 percentage points above the second quarter reading. And 6.8 percent of panelists think the job growth will be strong. Only 3.5 percent expect their industry to shed jobs—a contrast to third quarter 2003 when 11 percent anticipated a decline in hiring and just 33.6 percent expected to add jobs. Expectations for job creation are highest in construction, with 68.4 percent forecasting increases; followed by FIRE at 66.3 percent and professional, scientific, and technical services where 65 percent foresee job gains.

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Manufacturing should be back on the growth track in Alabama with 59.1 percent of industry panelists anticipating increased hiring in the third quarter, up from 45.4 percent last quarter. Most panelists in health care and social services and in retail trade expect no change in hiring.

**Industry Capital Expenditures**

Capital spending should continue to gain momentum as 62.7 percent of Alabama business leaders anticipate increased investment in their industry during third quarter 2004. This is up from 59.8 percent last quarter and compares to 46.5 percent a year ago. Expiration of the bonus depreciation tax bills at the end of 2004 gives firms an incentive to accelerate purchases of software and equipment, while global competition pressures them to make capital investments to enhance productivity. Prospects for stepped up investment are strongest in retail trade, with 78.6 percent of industry panelists forecasting increases and in TIPU and FIRE, where about 72 percent anticipate higher spending. And no panelists in these three industry groups see any downside to capital spending this quarter. Given recent capital investment by Alabama manufacturers, particularly in the automotive sector, prospects for capital spending growth in the industry are expected to slow, with 57.6 percent forecasting an increase compared to 60.6 percent last quarter.

**BLCI Panelists**

Participation in the BLCI survey continues to grow, with over 500 Alabama panelists completing the third quarter BLCI survey online during June. Respondents reported their views on the probable course of the national and Alabama economies as well as sales, profits, hiring, and capital expenditures in their industry. Business leaders responding to the survey represent small, midsize, and large companies in Alabama’s 11 metropolitan areas and over 40 nonmetro communities across the state. On the third quarter survey, 38.1 percent of participating firms reported annual sales under $5 million, while 34 percent had sales in the $5 to $50 million range, and 23 percent tallied sales of over $50 million. Grouped by number of employees, one third of third quarter panelists were from firms with fewer than 20 employees, while 29.6 percent employed 20 to 99, and 37.2 percent had at least 100 employees.