**Business Leaders Temper Expectations** The third quarter 2005 Alabama Business Leaders Confidence Index (BLCI) declined 1.8 points to 59.7. Although the index has dropped over the last four quarters, the third quarter reading clearly indicates moderate expansion. Weaker outlooks for the national economy and for industry sales, profits, and capital expenditures pulled down the overall index. The success of Alabama’s economic development initiatives and consequent job creation boosted the third quarter state and industry hiring outlooks.

Panelists in the construction industry; transportation, information, and public utilities (TIPU); and in other services had the most positive outlooks for the third quarter. Index values in professional, scientific, and technical services and in the healthcare industry were about five points below the overall BLCI score of 59.7.

**Optimism about National Economy Slips** Alabama business leaders expect the pace of growth in the national economy to slow in the third quarter of 2005. This index component fell four points to 58.3 for the weakest outlook in over two years. Just 45.8 percent of BLCI panelists expect U.S. economic growth to accelerate during the quarter, and 16.3 percent anticipate a downturn. Uncertainties including the effect of high energy prices on consumer spending for other goods and services, the influence of a stronger dollar and weak overseas economic growth on U.S. exports, and the sustainability of the current housing market may be influencing expectations. While revised first quarter 2005 GDP growth came in at 3.8 percent, a sharp inventory correction in the second quarter likely dropped GDP gains to around 3.1 percent.

**Forecast for Alabama Economy Upbeat** Panelists are more optimistic about third quarter prospects for the state’s economy than they are for the nation as a whole. The third quarter component index value of 62.6 represents the first time in 15 quarters of survey history that expectations for the Alabama economy are above those for the United States and is the highest of the six BLCI components this quarter. Almost 53 percent forecast an increase in the pace of economic growth in the state, while just 6.6 percent feel that Alabama’s economy may slow. Recent positive indicators including higher tax receipts, job gains, new industry announcements, low unemployment, and signs that more people are moving into the state all support expectations for an improving economy.
Alabama Should Continue to Add Jobs  The state's hiring plans index value of 58.0 indicates that job growth will continue at a moderate pace in the summer quarter. While just over half of Alabama business leaders completing the survey expect no change in jobs in their industry, the 38.4 percent anticipating increased hiring is above the 11.0 percent forecasting a decline in jobs. A robust 5.3 percent are expecting a strong increase in hiring this quarter. Alabama added 29,000 jobs between January and May 2005, including 9,200 jobs in the leisure and hospitality industry and 4,300 in manufacturing. Unemployment fell to 3.9 percent in May, well below the U.S. rate of 5.1 percent. Panelists expect third quarter job gains to be strongest in the construction industry and in services. The pace of manufacturing job growth is expected to slow.

Profit Gains to Slow Slightly  Expectations for increased profits dropped modestly with the index component slipping from 60.7 in the second quarter of 2005 to 59.4 in the third quarter. Higher oil prices coupled with difficulty passing costs on to customers are squeezing profit margins in many industries. Rising interest rates and a stronger U.S. dollar are also having an impact. Just 51.2 percent of panelists expect profits in their industry to rise in the third quarter, down from 54.6 percent in the second quarter for the weakest profit forecast in two years. Profit growth should be strongest in construction, retail trade, and other services and well below average in the healthcare industry.

Outlook for Sales Growth Moderates  Although the third quarter sales index of 61.8 indicates continued gains in industry sales, it is down from last quarter’s 65.6. And the 59.3 percent of panelists expecting sales in their industry to rise is the lowest in two years. High oil prices compounded by rising interest rates and the lack of any new federal stimulus could constrain consumer spending, while economic weakness overseas and a stronger dollar place a drag on exports. Still, the University of Michigan’s Consumer Sentiment Index came in at a six-month high in June. Over 73 percent of BLCI participants in the transportation, information, and public utilities industries anticipate stronger sales in the third quarter. Expectations among firms in retail and wholesale trade are also above average.

Capital Spending Backs Off from 2004 Pace  After a particularly strong year in 2004, expectations for capital spending have slowed in 2005. The third quarter capital expenditure index of 58.1 is down from 59.8 in the second quarter, with 41.8 percent of panelists expecting business investment to increase compared to 45.9 percent last quarter. A payback for the 2004 investment boost that came from bonus depreciation may help account for weaker business investment in the first half of 2005, but available cash and a rebound in nonresidential construction could boost investment for the remainder of the year. Only 12.4 percent of panelists expect capital spending to decline this quarter. Capital expenditure expectations are weak among firms in professional, scientific, and technical services and in wholesale trade, but well above average in the healthcare and other services industries.
Alabama Businesses Cope with High Energy Costs  This quarter’s topical questions explore business cost concerns with an emphasis on the impact of energy costs. When asked to identify their top three cost concerns for the remainder of this year, 73 percent of Alabama business leaders selected healthcare benefits. The first quarter 2005 BLCI survey found that 83 percent of Alabama firms are paying at least part of the increased cost of health insurance. According to Mercer’s National Survey of Employer-Sponsored Health Plans, costs to employers rose an average of 7.5 percent in 2004, with an increase between 6.6 and 10 percent anticipated for 2005. While down from the recent peak of 14.7 percent in 2002, these increases represent a significant challenge for businesses.

Energy prices are a key concern for 54.5 percent of Alabama BLCI panelists. A number of factors, including rapidly rising global demand and threats from weather, terrorism, and labor strife in key oil producing regions have combined to push oil prices up by about 55 percent over the past year. Concerns extend to other forms of energy including natural gas, where demand for natural gas-fired electricity generation has kept prices up. Higher energy costs affect businesses in virtually every industry in a myriad of ways including travel and transportation costs, shipping and delivery expenses, raw material prices, workplace energy costs, and the ability of consumers to purchase the goods and services they sell.

Employee wages and salaries were selected as a significant cost concern by 46.3 percent of third quarter respondents. With high healthcare and energy expenses, businesses may feel that they have little leeway to give employee wage and salary increases. Although job gains have been steady over the past year, wage increases have been modest. Between June 2004 and June 2005, average hourly earnings rose 2.7 percent nationwide. But with indications that productivity growth is slowing and with unemployment falling, higher wage and salary gains may be on the horizon.

What are the top three cost concerns in your business for the remainder of 2005?

<table>
<thead>
<tr>
<th>Cost Concern</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare benefits</td>
<td>73.0%</td>
</tr>
<tr>
<td>Energy prices</td>
<td>54.5%</td>
</tr>
<tr>
<td>Employee wages and salaries</td>
<td>46.3%</td>
</tr>
<tr>
<td>Rising interest rates</td>
<td>34.1%</td>
</tr>
<tr>
<td>Inability to raise prices</td>
<td>32.8%</td>
</tr>
<tr>
<td>Commodity prices (non-energy)</td>
<td>26.2%</td>
</tr>
<tr>
<td>Weak U.S. dollar</td>
<td>10.7%</td>
</tr>
<tr>
<td>Non-healthcare benefits</td>
<td>7.9%</td>
</tr>
<tr>
<td>Other</td>
<td>6.4%</td>
</tr>
</tbody>
</table>

How is your business dealing with high energy costs?

- Absorb Most of Cost: 64.6%
- Share Equally with Customers: 12.8%
- Pass on to Customers: 15.9%
- Neutralize through Efficiencies: 4.4%
- Other: 2.3%

While 51.8 percent of third quarter panelists report that rising energy costs over the past year have had a minimal impact on their business, a sizeable 45.6 percent feel that their business has been negatively impacted. The inability to pass along costs means that higher energy prices are directly affecting the bottom line for many firms, draining resources that could otherwise be used for capital investment and business expansion. And the impact of energy costs on customers of businesses across the spectrum of industries raises concerns about the ability of firms to grow or even maintain sales. A prolonged period of high energy prices will increasingly affect the consumer’s ability to purchase other goods and services.

Impact of rising energy costs

- Negative: 45.6%
- Minimal: 51.8%
- Positive: 2.6%
While the price of West Texas Intermediate (WTI) crude oil was close to $52 per barrel in late May, prices averaged $56 per barrel in June 2005. The U.S. Energy Information Administration now expects crude oil prices to average $59 per barrel in the third quarter of 2005 and remain above $55 per barrel throughout 2005. Responding to the BLCI survey during June, 25.9 percent of Alabama panelists felt oil would likely end the year in the $50 to $54 range. Most panelists (69.5 percent) placed bets on year-end WTI crude oil in the range of $45 to $59 per barrel. However, the fragility of the oil situation was emphasized in early July when early-season tropical storm and hurricane activity disrupted some oil production and refining in the Gulf of Mexico, temporarily pushing prices above $61 per barrel. Despite high oil prices, U.S. gasoline consumption has continued to rise. Aging refineries, a lack of oilfield development, and a dearth of petroleum engineers make it difficult for the United States to expand production.

Metro Indices Reflect Diverse Economies At 60.3, third quarter sentiment in the Birmingham metro area was just above the statewide index of 59.7. Birmingham area panelists in construction and other services were most upbeat about the outlook. Mobile, with a recent boost from the announcement of a new EADS manufacturing facility, was particularly positive about the Alabama economy and registered an index of 61.5. Facing prospects of job losses at Maxwell-Gunter Air Force Base and related IT support firms, Montgomery respondents’ less optimistic view of the national economy and industry sales, profits, and hiring pushed their index down to 55.9. And above average expectations for industry sales and profits boosted the Huntsville MSA index to 64.7.

A Look into the BLCI Almost 400 Alabama business leaders completed the third quarter survey. And well over half took the time to provide their comments on the energy situation in their industry. Many thanks to all of our panel members for making this survey a useful and reliable indicator. Please join us in September for our Fourth Quarter 2005 survey at www.blci.com/alabama.

Analysis provided by Carolyn Trent, Socioeconomic Analyst, Center for Business and Economic Research, The University of Alabama.

For more details on the Alabama Business Leaders Confidence Index, visit www.blci.com/alabama.
For more details on the Center for Business and Economic Research, visit cber.cba.ua.edu.