Economic Uncertainty: Is it weighing on economic growth or is it just another excuse?

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March 1, 2013

As we enter the fourth year of the economic recovery, many people are wondering why the economy continues to grow so slowly. A popular answer is that current conditions represent the new economic normal. Others blame the policies of the current administration. But, another answer that has been suggested is the uncertainty in the economy is at an all-time high.

As an economist, I am very reluctant to adopt the popular idea that current conditions represent the new economic norm. In economics, the phrase “history repeats itself” is very true and if you review the history of past economic recessions we always experience a period of faster than trend economic growth during which unemployment returns to full employment levels.

In our review of the economy at Southern Company, we have noted two factors that seem to explain why the economic recovery (especially in the Southeast) has been slower than normal. The first factor is the housing market. For decades, our economy in the Southeast has been built on the migration of families, retirees, and firms from the Northeast and Midwest. This trend created a large demand for new housing that created year over year gains in new customers at Southern Company as far back as our historical records go in the 1960’s. The collapse of the financial markets and ensuing economic recession significantly slowed the train of migration to the Southeast. This change in migration trends has resulted in new housing construction dropping to a crawl and removed a major engine of economic growth both regionally and nationally. In 2011, Southern Company added no residential customers for the first time in 50 years. This lack of housing market growth is a huge drag on the economy and explains why our economic recovery has been so slow. On a good note, our customer data for 2012 shows we added about 23,000 customers (40% of normal) and indications for 2013 suggest that the housing market will continue to recover and support economic growth.

The other factor hindering economic growth is uncertainty. Anecdotally, over the past couple of years many of our customers have expressed anxiety about the level of uncertainty they were facing in the marketplace, but we did not have a good tool to quantitatively understand the uncertainty our customers were experiencing. Recently, several economists; Baker, Bloom, and Davis (www.policyuncertainty.com) have quantified the level of Economic Policy Uncertainty faced by decision makers. They created an Index of Economic Policy Uncertainty (for details go to their website) that indicates we are all facing an unusually high level of uncertainty due to the increase in short-term tax fixes, fiscal cliffs, and stalemates in Washington. Uncertainty is a real factor that is hindering our economic recovery.

So as business leaders, what do we do with all of this data? At Southern Company, this information has increased our focus on scenario planning and contingency planning. While scenario planning is a good exercise even in normal economic times, the uncertainty of the current economic environment requires this level of increased rigor in our business planning practices. Hopefully, with good planning and reduced economic uncertainty, the historical patterns of economic recovery will reassert themselves, but in the meantime spend a little time plumbing the depths of the uncertainties facing your business. The results will be useful.