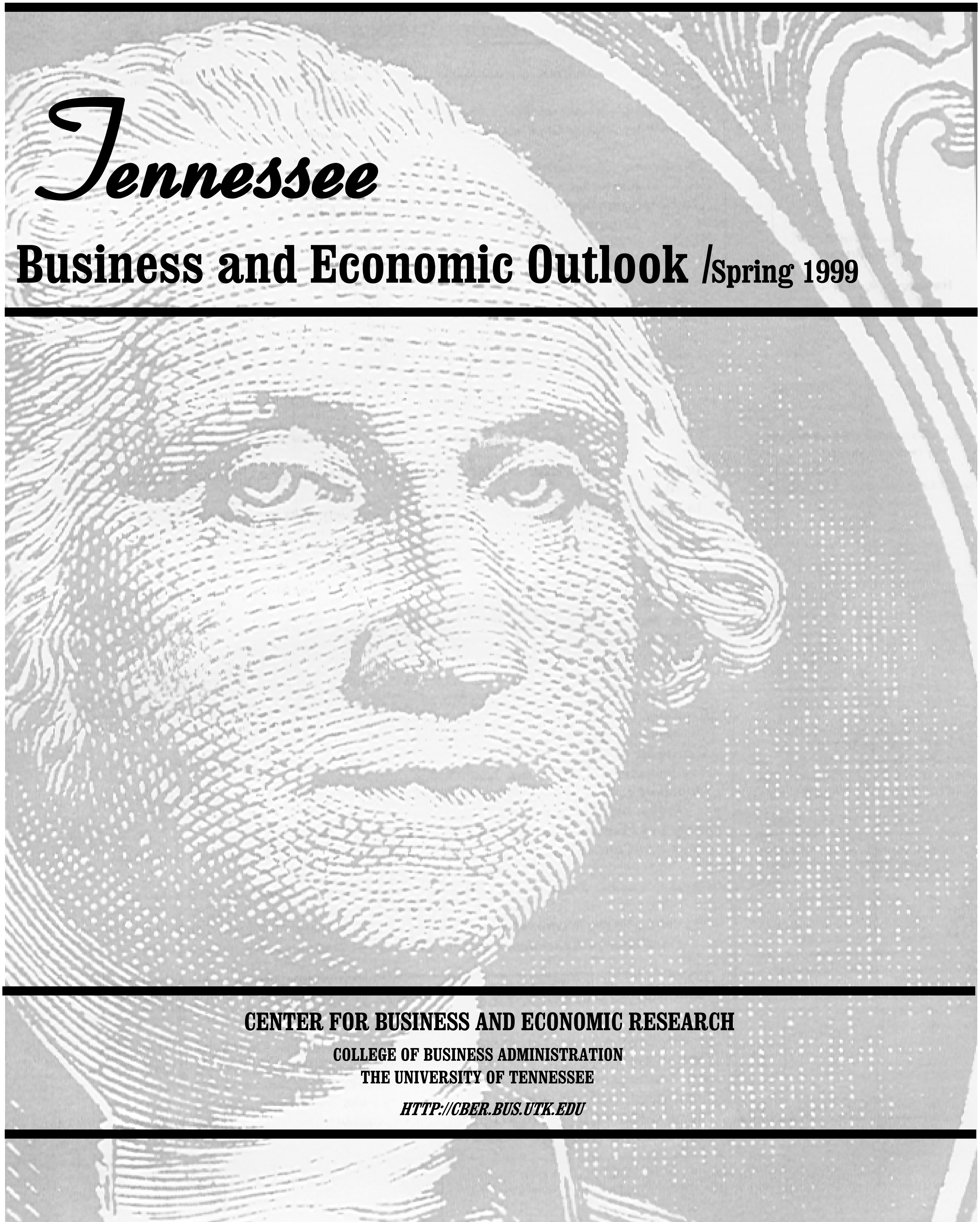

Tennessee

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CENTER FOR BUSINESS AND ECONOMIC RESEARCH

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Slowdown? What Slowdown?

U.S. FORECAST

Current Economic Conditions

Observers have anticipated a slowdown in U.S. economic activity on many occasions during the current expansion. Most recently was the appearance of a potentially crippling global financial crisis in late summer of 1998, which seemed to be the harbinger of a sharp slowdown for the national economy. But the concerted actions of the IMF, the World Bank and western central banks—as well as modest efforts on the part of the struggling economies themselves—were able to stave off crisis. Rather than slowing appreciably, the U.S. economy was able to register strong growth in 1998. Inflation-adjusted gross domestic product (GDP) closed out the year with 3.9 percent growth and the unemployment rate averaged 4.5 percent. Job growth was up a stellar 2.6 percent, well above what many analysts believe to be a sustainable and non-inflationary pace of job creation. Nonresidential fixed investment defied the skeptics, with an 11.8 percent rate of growth.

And no slowdown has emerged in 1999. In fact, concerns today relate more to sustained growth and the potential for rising inflationary pressures than any prospects for slower growth. The first quarter brought a 4.5 percent inflation-adjusted increase in GDP (seasonally-adjusted annual rate, or SAAR) and 2.3 percent employment growth (SAAR). The unemployment rate edged down to an amazingly low 4.3 percent.

Consumer spending has been key to the nation’s strong path of growth. In fact, consumers are engaged in a spending spree, as evidenced by a negative savings rate in several recent months (see Figure 1). Inflation-adjusted consumption spending was up 4.9 percent in 1998, accelerating to 6.7 percent in the first quarter of the current year. Growth for the second quarter is expected to come in at a cooler 4.0 percent. Providing the baseline strength for this growth in consumer spending has been the strong and sustained pace of job and income creation (including a 3.2 percent increase in inflation-adjusted disposable income in 1998). But this is only part of the story. Much of the driving force behind the consumer is asset appreciation, including both stocks and homes. Low interest rates, coupled with strong growth in the stock market and modest growth in home values, are the missing links to explaining recent consumer spending patterns. The Congressional Budget Office issued a report showing that over $460 billion of capital gains

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Figure 1

FIGURE UNAVAILABLE

income was realized in 1998 (about 5 percent of GDP), and the majority of this was not from homes nor securities. While much of this income is likely to be reinvested rather than spent on consumables, it illustrates the magnitude of recent wealth creation.

Continued strong economic growth caused the Federal Reserve to raise the federal funds rate by one-quarter percentage point at its most recent Open Market Committee meeting. The financial markets had been spooked by April's release of the consumer price index (CPI), which raised the year-over-year inflation rate to over 2.2 percent (see Figure 2). The inflation hawks can easily muster evidence to support their case, including the strong rates of job and income growth, declining unemployment rates and rising employment cost indices. The doves are finding it harder and harder to make their case. They would argue that April's jump in CPI was due to one-time events, including increases in gasoline, apparel and tobacco prices that are not expected to be repeated in future months. And while employment costs are rising, there are no signs of acceleration, and employment cost growth in the service sector—where there is less competition from abroad and productivity growth has been anemic—is growing slowly following a sharp jump in mid 1998.

Regardless of one's perspective, the Fed now has the flexibility to raise interest rates, unlike the situation last fall. Interest rate hikes in 1998 would have expedited capital inflows from destabilized foreign economies and would have led to further dollar appreciation. With deterioration of global economic conditions unlikely, and with incipient signs of rising inflation, the Fed may very well raise interest rates further as the year progresses.

Figure 2

FIGURE UNAVAILABLE

U.S. Forecast Summary

The U.S. economy is poised to enjoy another strong year of economic growth, marking the 8^{th} straight year of uninterrupted expansion. There is nothing apparent on the domestic nor international fronts that would derail the economy. WEFA estimated the probability of recession at 35 percent in its September 1998 update on the national economy, following financial market chaos abroad. In May and June of the current year, WEFA has held the prospect of recession at only 10 percent.

Inflation-adjusted GDP is projected to slow to 3.2 percent and 2.5 percent, respectively, in the 3^{rd} and 4^{th} quarters (SAARs). Growth for 1999 is anticipated to be 4.1 percent. The consumer price index is expected to rise slightly in 1999, up 1.7 percent versus the 1.6 percent growth recorded in 1998. The finished-goods producer price index is expected to rise 1.0 percent in 1999, following a dip of 0.9 percent in 1998. Both the employment cost index and unit labor costs are expected to ease in 1999, while output per hour will rise to 3.3 percent (versus 2.2 percent in 1998).

Employment growth is expected to slow in tandem with GDP growth. Establishment employment growth will be 1.0 percent in the 3rd quarter, slipping further to 0.6 percent growth in the 4th quarter. Calendar year 1999 will bring forth employment growth of 1.8 percent, about two-thirds of the growth in 1998. The unemployment rate is projected to fall further to 4.2 percent in 1999, then inch back up to 5.1 percent in 2000. The nation's manufacturing sector is expected to lose jobs in 1999 (1.1 percent) following weak growth in 1998 (0.3 percent). Both the durable and nondurable goods manufacturing sectors are expected to contract (1.0 percent and 1.3 percent, respectively). As would be expected, both the capacity utilization and industrial production indices are expected to fall in1999.

No significant retrenchment in consumer spending is projected, with inflation-adjusted consumer spending to come in at 4.7 percent (SAAR) in 1999. But by 2000 consumer spending will slow, due to somewhat slower economy-wide growth and modest retrenchment due to low savings rates and relatively high levels of consumer indebtedness. Consumer spending growth is anticipated to be up only 2.5 percent in 2000. Residential investment will also hold its own in 1999, with growth of 9.7 percent, down only slightly from the heated 10.4 percent pace of 1998. As with consumer spending, expect housing investment to slow as the economy enters the year 2000.

Nonresidential fixed investment growth will be nearly halved in 1999 (to 6.7 percent). The trade deficit is projected to widen, although the pace of dollar appreciation is expected to slow. The nominal current account deficit will grow to $268.7 billion in 1999.

U.S. Forecast at a Glance

- **The U.S. economy has weathered the storm of global financial chaos with little difficulty. To the surprise of many, the national economy was able to remain an *island of prosperity*. The global situation has been instrumental in putting some downward pressure on economic growth and inflationary pressures. Now that the crisis has eased, concerns are shifting to prospects for rising inflation. Economic growth has shown few signs of abating. Following 3.9 percent growth in 1998, inflation-adjusted GDP is expected to grow 4.1 percent in 1999.**

- **Growth in establishment employment will ease to 1.8 percent in 1999, following exceptional growth of 2.6 percent in 1998. Employment in manufacturing will fall 1.1 percent in 1999. The unemployment rate will move down to 4.2 percent.**

- **Consumer spending will remain critical to the sustained expansion of the economy. The current consumer spending spree will continue with a 4.7 percent increase in inflation-adjusted consumption spending in 1999—slightly lower than the 4.9 percent in 1998. Consumers will remain buoyed by job and income growth, as well as by wealth creation in the stock and housing markets. Expect a degree of consumer retrenchment in to 2000.**

- **Business fixed investment will remain reasonably strong, with growth projected at 6.7 percent for 1999. Growth in producer equipment investment will be 8.8 percent.**

- **Consumer price inflation will accelerate slightly to 1.7 percent in 1999, following 1.6 percent in 1998. The GDP deflator will show stronger growth, moving from 1.0 percent in 1998 to 1.4 percent in 1999.**

State Economy Continues to Expand

TENNESSEE FORECAST

Current Economic Conditions

The Tennessee economy continues along its path of expansion. A good indication of the strength of the economy is the statewide unemployment rate for the month of May, which came in at the unprecedented low of 3.4 percent (or 3.8 percent on a seasonally adjusted basis), following an average of 4.2 percent for 1998. The state's seasonally adjusted unemployment rate has now maintained its position below 4.5 percent since January of 1998. As shown in Figure 3, all but one of the state's metropolitan areas enjoyed unemployment rates below the state average in May. The Nashville metropolitan statistical area recorded the lowest rate of any metropolitan area of the state (2.3 percent) while the Tri-Cities registered the highest rate (4.2 percent).

The tight labor markets in Tennessee have contributed to somewhat slower rates of job creation. Following 2.1 percent nonagricultural job growth in 1998, there was actually a 0.2 percent (SAAR) contraction in jobs in the 1st quarter of 1999. Tennessee's job growth for both 1998 and the 1st quarter of the current year lagged job growth for the national economy. (Tennessee's unemployment rate in 1998 was 3 tenths of a percentage point below that of the nation, indicating a somewhat tighter labor market in the state.) The labor force grew 1.9 percent in 1998, accelerating to 2.8 percent (SAAR) in the 1st quarter of 1999.

Figure 3

FIGURE UNAVAILABLE

Job growth remains exceptionally strong in construction, with a 4.5 percent gain in 1998 and a 4.8 percent (SAAR) gain in the 1st quarter. Jobs were up sharply in 1998 in both transportation, communication and public utilities (4.8 percent) and finance, insurance and real estate (4.4 percent). The service sector, which accounts for over one in four jobs in the state, enjoyed a 3.4 percent job gain in 1998. In the 1st quarter of 1999, there were job losses in the finance, insurance and real estate, and trade sectors, and weak growth in service sector jobs. The transportation, communication and public utilities sector was able to sustain 3.8 percent (SAAR) job growth.

The manufacturing sector registered a 0.5 percent loss in jobs in 1998, translating into a loss of 2,700 positions. The rate of job decay accelerated in the 1st quarter of 1999, with a 1.9 percent (SAAR) contraction. As is often the case, there is an uneven pattern of job creation and destruction within manufacturing. The durable goods manufacturing sector witnessed a 1.0 percent gain in employment in 1998, while the nondurable goods sector saw jobs fall 2.5 percent. Within the durable goods sector in 1998, the furniture and fixtures, stone, clay and glass, electrical machinery and miscellaneous sectors all contracted, whereas other two-digit standard industrial classification components expanded. Weaknesses in nondurable goods manufacturing are more pervasive, with only four of ten sectors able to engineer job gains. Jobs in apparel were down 12.8 percent, jobs in leather were down 11.6 percent and jobs in textiles were down 4.4 percent. The 1st quarter brought about only modest improvement in the rate of job decay in these sectors. These three sectors alone are accountable for the loss of 6,100 jobs in Tennessee in 1998. Had these losses been averted in 1998, the nondurable goods sector would have eked out positive job growth for the year. When compared against 1995, there were 24,400 fewer jobs in these sectors than in 1998.

Tennessee's growth in inflation-adjusted personal income of 4.1 percent in 1998 trailed the 4.2 percent pace set by the national economy by a narrow margin. First quarter growth in Tennessee personal income was 2.0 percent (SAAR). Inflation-adjusted per capita income in Tennessee was up 3.0 percent in 1998, surpassing the growth rate of the U.S. Wage and salary income advanced 5.4 percent in 1998, proprietors income was up 3.8 percent and rent, interest and dividend income grew 1.4 percent.

Nominal taxable sales showed growth of only 0.4 percent in 1998, due largely to a terribly weak performance in the 1st quarter of the year when sales fell 14.4 percent (SAAR). Inflation-adjusted taxable sales actually slipped in 1998. Auto dealer sales led the charge in 1998 with a 6.9 percent jump, followed by eating and drinking establishment sales, which were up 4.9 percent. Purchases from manufacturers, miscellaneous durable good sales, miscellaneous nondurable good sales and transportation and communication sales, were all down for the year.

Tennessee Forecast Summary

The Quarterly Tennessee Econometric Model forecasts a continuation of relatively strong growth through 1999 and into 2000. Nominal personal income is projected to rise 5.3 percent in 1999, up slightly from the 4.9 percent pace recorded in 1998. Personal income growth is projected to slow to 5.1 percent in 2000. Tennessee's personal income growth will lag growth for the national economy in 1999 and 2000, but by a narrow margin. On a fiscal year basis, personal income will grow 5.7 percent in 1999/2000. Tennessee per capita personal income will rise 4.1 percent in 1999 versus 3.8 percent in 1998. Proprietors income is expected to enjoy 8.8 percent growth, and rent, interest and dividend income will advance 5.1 percent in 1999. Wage and salary growth will total 5.1 percent for the year, slowing to 4.9 percent growth in the following year.

Tennessee nonagricultural job growth is projected at 1.6 percent for 1999, lagging the 1.8 percent rate expected for the U.S. Construction will sustain a strong 4.1 percent growth rate for 1999, boosted by 5.8 percent and 5.4 percent (SAAR) growth in the 3rd and 4th quarters. The wholesale and retail trade sector will advance with 2.8 percent growth in 1999, while jobs in services are projected to grow 2.4 percent. The finance, insurance and real estate sector will close 1999 with 2.0 percent growth, and the transportation, communication and public utilities sector will be up 2.4 percent. Projected growth rates by sector, from the 2nd quarter of 1999 through the 2nd quarter of 2000, are shown in Figure 4.

Job losses in manufacturing are expected to accelerate to 1.6 percent in 1999, as opposed to the 0.5 percent loss experienced in 1998. Growth in the 3rd quarter is expected to be down 1.5 percent (SAAR), and in the 4th quarter down 0.5 percent (SAAR). Jobs in the durable goods sector will be up 0.2 percent in 1999, with slight improvement anticipated in 2000. The lumber

Figure 4

FIGURE UNAVAILABLE

and wood, stone, clay and glass, primary metals, nonelectrical machinery, electrical machinery and transportation equipment sectors will experience growth in 1999. The furniture and fixtures, fabricated metals, instruments and miscellaneous sectors will contract. Job losses in nondurable goods manufacturing will increase to nearly 4 percent in 1999 from the 2.5 percent rate of job decline in 1998. Only the food, petroleum refining, and rubber and plastics sectors will avoid job losses.

Unemployment will remain low and stable through the remainder of the year, producing an annual rate of unemployment of only 4.2 percent, matching the performance of the previous year and lining up with the nation's anticipated performance. Labor force growth will rise to 2.4 percent and growth in employed people will slip to 2.4 percent.

Inflation-adjusted taxable sales are expected to rebound and show growth of 4.7 percent for 1999. Nominal taxable sales are projected to grow at a 6.0 percent pace in 1999. For fiscal year 1999/2000, taxable sales are expected to be up 5.0 percent. Purchases from manufacturers, food store sales and liquor store sales will shrink, while all other sectors will show growth. Auto dealer sales will be a particular bright spot for the state, with growth of 9.4 percent expected in 1999.

Tennessee Forecast at a Glance

- ☞ **As with the nation, the Tennessee economy was able to avoid a sharp slowdown in economic activity in 1998 and early 1999. From all indications, the state economy will continue to expand at a modest pace through the short-term forecast horizon.**

- ☞ **Nominal personal income is expected to grow 5.3 percent in 1999 versus 5.7 percent growth for the U.S. Tennessee personal income will grow 5.7 percent for fiscal year 1999/2000. Nominal per capita personal income in Tennessee is projected to rise 4.1 percent in 1999 and 3.9 percent in 2000.**

- ☞ **The state's pace of job creation will slow to 1.6 percent in 1999, relative to 2.1 percent growth in 1998. Job growth in Tennessee is expected to trail the pace set by the national economy in 1999. Job losses in manufacturing will be 1.6 percent in 1999, due to slower growth in the durable goods sector and an increased rate of job loss in the nondurable goods sector.**

- ☞ **The state unemployment rate will average 4.2 percent in 1999, matching the nation's rate of unemployment for the year.**

- ☞ **Nominal taxable sales are expected to grow 6.0 percent in 1999, following lethargic growth of 0.4 percent in 1998. For fiscal year 1999/2000 taxable sales are projected to rise 5.0 percent. Inflation-adjusted taxable sales will be up 4.7 percent in 1999.**