Modest Growth in U.S. Follows Quarter of Uncertainty

U.S. FORECAST

Current Economic Conditions

Following a first quarter marred with uncertainty because of inclement weather, labor strikes, and government shutdowns, the U.S. economy is poised to realize modest, stable growth for the remainder of 1996. January’s lackluster economic performance raised serious concerns about the vitality and direction of the U.S. economy, but February saw the tide shift with the creation of over 600,000 new jobs and increases in industrial production. After continued strength in February, first-quarter inflation-adjusted (real) gross domestic product (GDP) was expected to grow a seasonally adjusted (SAAR) 1.9 percent--an improvement over the meager 0.5 percent growth in 1995:4. However, most economic indicators returned to trend in March, indicating that the remainder of 1996 will be characterized by somewhat slower growth than in recent years. In spite of the slower growth rate, the nation’s risk of recession is quite slim, as the economy will be buoyed by strength in exports and business investment.

Worries over inflation have mounted due to the sustained growth in the economy and rising commodity prices. Key trouble spots include gas and grain prices. The price of petroleum products has a great effect on producer and consumer prices since petroleum products are widely used in many economic activities. Fortunately, gas prices are now in decline. The situation for grain

Figure 1

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prices continues to hinge on weather patterns throughout the Midwest and the southern grain belts. Nonetheless, consumer prices have shown little inclination to accelerate, as shown in Figure 1. Moderating economic growth should keep inflation in check over the short to mid-term.

Consumer spending was expected to rebound in the first quarter after a downturn in 1995:4. Until recently, consumer spending was the strongest contributor to economic growth. Even after a weak fourth quarter, consumer spending advanced 2.4 percent in 1995. But the first quarter of 1996 will not live up to the pace of 1995, as consumer spending is expected to expand 2.2 percent (SAAR).

In the latter part of 1994 and the early portion of 1995, business sought to bolster its strained capacity by investing heavily in durable equipment and, to a lesser extent, in new facilities. Durable equipment investment led the charge, growing in double digits three of four quarters before the investment boom began to subside in the second quarter of 1995. The year ended with 4.0 percent and 0.9 percent (SAARs) growth in durable equipment and structures, respectively. The pace of investment quickened in the first quarter of 1996. Durable investment expanded 4.3 percent, and investment in structures grew 3.9 percent.

Although down from 11.1 percent (SAAR) growth in 1995:4, export growth will still provide an important engine of growth for the U.S. economy, as with the first quarter expansion at 6.3 percent. Imports, which have grown at a conservative pace of 1.0 and 1.3 percent (SAARs) in 1994:3 and 1994:4, respectively, are expected to grow 7.0 percent (SAAR) in the first quarter. The slower growth in imports, coupled with accelerating import growth, was expected to lead to a slight increase in the trade deficit in the first quarter.

Employment expanded 2.3 percent in 1995, even after modest 1.4 percent (SAAR) growth in 1995:4. As shown in Figure 2, the nation’s pace of job creation has subsided from the heated pace of 1994. The slowdown in job creation mirrors the slowdown in GDP growth. After losing 140,000 jobs in January, nonagricultural employment rebounded in February, increasing by over 600,000 jobs. It was anticipated that the first quarter of 1996 would see employment increase by 500,000 jobs, attributable to February’s massive expansion. February’s strong growth, coupled with May’s surge in employment, allays the fear of a general economic slowdown and provides a basis for continued growth throughout the year.

Forecast Summary

The forecast for the remainder of 1996 indicates that the U.S. economy is still on the runway after the soft landing engineered by the Federal Reserve Board. Expect real GDP growth to rebound in the second quarter of 1996, showing a strong 3.0 percent (SAAR) increase. The pace of growth will slow somewhat for the rest of the year as inflation-adjusted GDP will expand 2.7 percent in 1996:3 and 2.1 percent in 1996:4 (SAARs). Overall, the U.S. economy is forecast to grow 2.1 percent in 1996, a slight improvement over the 2.0 percent growth realized in 1995.

Consumer expenditures, which account for approximately two-thirds of total spending in the national economy, should grow 1.8 percent (SAAR) in the second
quarter. Consumers will increase their consumption in the third and fourth quarters as growth jumps to 2.4 percent (SAARs) in each quarter. Growth of consumer expenditures in 1996 is expected to be 2.1 percent, slightly down from 2.4 percent growth in 1995.

The economy will continue to be stimulated by business investment throughout the remainder of 1996 as firms purchase both durable equipment and invest in structures. Equipment investment will move forward 5.4 percent (SAAR) in 1996:2 and increase further to 5.6 percent (SAARs) in the third and fourth quarters. Likewise, investment in structures is expected to push forward 3.2 percent in the second quarter and end the year with 4.3 percent expansion in 1996:4.

More good news comes on the foreign trade front, as exports are projected to grow a healthy 7.9 percent in 1996. Export growth is expected to hover in the 8 percent (SAAR) range in the second through the fourth quarters of 1996. Imports are expected to grow 7.4 percent (SAAR) in 1996:2, but growth will taper off in the remaining two quarters. Annual import growth will diminish from 8.0 percent in 1995 to 5.2 percent in 1996. Enhanced growth of exports and slower import growth has bolstered U.S. economic health and should allow the 1996 trade deficit to shrink $15.5 billion from 1995's level.

Nonagricultural employment growth for the remainder of 1996 will not surpass the 1.8 percent (SAAR) rate recorded in 1996:1. Expect employment to grow 1.4 percent (SAAR) in the second quarter and 1.5 percent (SAARs) in the third and fourth quarters. Overall job growth for 1996 will be 1.5 percent, down from 2.3 percent growth in 1995. The unemployment rate should remain at 5.6 percent until 1996:4 when it will increase to 5.7 percent.

Inflation as measured by the GDP implicit deflator is expected to subside after showing some acceleration in the first quarter of 1996. Spiking at 2.9 percent (SAAR) in 1996:1, inflation should fall to 2.0 percent in the second quarter. Inflation will creep up slightly in the latter part of the year, but not to the levels seen in the first quarter. Expect inflation to be 2.7 and 2.6 percent (SAARs) in 1996:3 and 1996:4, respectively.

Interest rates, measured by the prime lending rate, are expected to fall throughout the rest of 1996. In the first quarter, the prime lending rate stood at 8.3 percent, but a decline to 7.8 percent is expected by the fourth quarter. As inflation is not a primary concern, the Federal Reserve Board will probably not raise interest rates. Should inflation accelerate, however, expect a quick rate increase by the Fed. A cut can be expected only if there are sustained and broad-based signs of economic weakness.

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Highlights of the U.S. Forecast

- Inflation-adjusted GDP growth will surge to 3.0 percent in 1996:2 and slowly diminish for the remainder of 1996. Expect real GDP to grow 2.1 percent in 1996.
- The unemployment rate will average 5.6 percent in 1996, the same rate as 1995.
- Employment is projected to grow 1.5 percent in 1996 and 1997, a slight decrease from the 2.3 percent annual growth recorded in 1995.

- Inflation, measured by the GDP implicit price deflator, will be 2.4 percent, down 1 percentage point from 1995.
- Business fixed investment will expand 4.4 percent in 1996, led by strong expansion in durable equipment investment.

**Tennessee Continues Its Fifth Year of Economic Expansion**

**TENNESSEE FORECAST**

**Current Economic Conditions**

The Tennessee economy is now in its fifth year of sustained economic expansion. By most yardsticks of economic performance—including personal income growth, nonagricultural job growth and the level of the unemployment rate—the Tennessee economy has outstripped the performance of its national counterpart. One illustration is provided in Figure 3, which traces annual growth in U.S. and Tennessee personal income from 1991 through 1997. Despite the economy’s strong performance, the state has nonetheless experienced some growing pains, as with the loss of 4,300 jobs in the nondurable goods manufacturing sector in 1995. But while there will likely be some bumps in the road in the months and quarters to come, the Tennessee Econometric Model projects a continuation of economic growth into 1998.

Tennessee personal income closed out 1995 with growth of 6.4 percent (or 3.9 percent in inflation-adjusted 1992 dollars), surpassing the 6.1 percent pace set by the national economy. Aggregate wage and salary income climbed 5.9 percent in 1995. Following 7.4 percent (SAAR) growth in 1995:5, personal income growth in the first quarter of 1996 was estimated at 6.4 percent.

Tennessee's job picture has softened somewhat since last year, when the state economy created over 80,000 jobs. Over the longer term, nonagricultural job growth advanced 3.7 percent in 1993 and 4.1 percent in 1994, slipping to 3.3 percent in 1995. Growth in 1996:1 is estimated at 3.0...
percent (SAAR), on the heels of a 4.8 percent (SAAR) jump in 1995:4.

Job growth in the state’s manufacturing sector was lackluster in 1995, as jobs were up only 0.7 percent. This slower rate of growth is in sharp contrast to 2.7 percent and 2.0 percent job growth in 1993 and 1994, respectively. The durable goods manufacturing sector has continued to expand, with the pace of job creation at 2.8 percent in 1995 (versus 4.5 percent in 1994). Difficulties have surfaced in nondurables manufacturing, where jobs were down 1.7 percent in 1995. The textiles, apparel, tobacco, paper, chemicals and leather sectors all contracted in 1995. The situation worsened in the first quarter of 1996, as employment in nondurables slipped 5.6 percent (SAAR).

The services sector, which represents over 25 percent of the state’s nonagricultural jobs, enjoyed 5.4 percent growth in 1995. The first quarter of 1996 saw services jobs expand at only a 1.3 percent (SAAR) rate. The trade sector experienced 4.6 percent growth in 1995, slowing to 3.2 percent (SAAR) growth in 1996:1. Together the trade and services sectors created 58,500 new jobs in 1995.

As the state’s labor markets have softened, the unemployment rate has inched forward. After averaging 4.8 percent in 1994, the Tennessee unemployment rate rose to 5.2 percent in 1995. The first quarter of 1996 saw the unemployment rate rise further --to 5.2 percent. No significant improvement or deterioration in the unemployment rate is anticipated over the forecast horizon.


Forecast Summary

The slowing of economic growth that took place in 1995 will continue into 1996 and 1997. At the same time, economic growth will remain sufficiently vigorous to support job and income gains for most Tennesseans. The Tennessee Econometric model projects nominal personal income growth at 6.2 percent in 1996 and 6.0 percent in 1997. This expected growth in state personal income compares favorably to anticipated growth in personal income of 4.9 percent for the national economy in 1996 and 1997. Inflation-adjusted personal income should grow 3.7 percent and 3.4 percent in 1996 and 1997, respectively. Tennessee’s proprietor and farm income will be buoyed by rising grain prices.

Respectable job growth of 3.1 percent is expected for the state economy in 1996, with job growth slowing to 2.8 percent in 1997.

As the state’s labor markets have softened, the unemployment rate has inched forward, from 4.8 in 1994 to its present 5.2. No significant improvement or deterioration is anticipated over the forecast horizon.
Nonagricultural jobs for the national economy will expand at about half the pace set by Tennessee in 1996 and 1997. Unfortunately, continued weakness is expected in the state’s nondurable goods manufacturing sector, where nearly 9,000 jobs will be lost in 1996. In fact, as shown in Figure 4, only the food production sector will enjoy job expansion in 1996. Sharp declines of 16.9 percent and 11.3 percent are anticipated for jobs in the leather and apparel sectors in 1996. These two sectors alone will account for 7,000 lost jobs. Further job losses are expected in the nondurable goods manufacturing sector in 1997, although the rate of job loss will slow.

Other sectors of the state economy will enjoy job gains in 1996. Durable goods manufacturing employment is expected to rise 1.4 percent during 1996. Jobs in the trade sector are projected to rise 3.5 percent, while services jobs will expand 4.7 percent.

The state unemployment rate is projected to hover above 5 percent for the remainder of the short-term forecast horizon. Despite a somewhat higher unemployment rate, Tennessee will continue to compare favorably with the U.S. The unemployment rate for the national economy is expected to average 5.6 percent in 1996 and 5.9 percent in 1997.

Growth in Tennessee taxable sales is expected to slow appreciably through 1997. Expect nominal sales to advance at a 5.1 percent pace in 1996 and 1997. For fiscal year 1997, taxable sales are expected to grow 5.5 percent.

Highlights of the Tennessee Forecast

- Nonagricultural jobs will expand at a 3.1 percent pace in 1996. The nondurable goods manufacturing sector will lose nearly 9,000 jobs in 1996.
- The Tennessee unemployment rate will average 5.2 percent in 1996.
- Tennessee taxable sales will advance 5.1 percent in 1996 and 1997. Taxable sales will be up 5.5 percent for the 1997 fiscal year.

- Nominal Tennessee personal income will grow 6.2 percent in 1996. Inflation-adjusted personal income will be up 3.7 percent for the same period.