U.S. FORECAST

Current Economic Conditions

The national economy closed 1996 with calendar-year growth in inflation-adjusted gross domestic product (GDP) of 2.4 percent. Employment showed healthy growth, climbing 2.0 percent on the heels of 2.7 percent growth in 1995. Manufacturing employment sagged 1.0 percent in 1996 following two years of sustained growth. Employment in nondurable goods manufacturing, which has been the Achilles’ heel of the Tennessee economy, slipped 2.7 percent for the national economy in 1996. Consumer and investment spending both supported the rise in economic activity, growing 2.5 percent and 7.4 percent, respectively. Government spending and the nation’s international sector each served to reduce the pace of national growth.

The first quarter of 1997 produced an unprecedented spike in economic activity, as shown in Figure 1. Inflation-adjusted GDP jumped up at a 5.6 percent seasonally adjusted annual rate (SAAR), and employment rose 2.5 percent. Rapid growth helped push the unemployment rate down from 5.4 percent in January to 4.8 percent in May. The surge in growth is not expected to continue through 1997, nor into 1998. Second quarter projections and preliminary data point to a less vigorous economy.

First quarter growth was buoyed by an 11.9 percent (SAAR) inflation-adjusted increase in investment spending. Investment...
in equipment enjoyed the strongest growth, followed by structures. Residential housing was up 5.5 percent. Inflation-adjusted consumer spending also was up sharply in the first quarter, rising 6.4 percent (SAAR). Growth in government spending was negative in the first quarter, while the trade deficit widened, aggravated by a strong dollar in international currency markets.

**Forecast Summary**

The general economic climate in the U.S. for the remainder of 1997 and 1998 will be characterized by a sustained slowdown in economic growth. A serious weakening of the economy is not anticipated, and risk of recession remains low. The slower pace of economic growth will be encouraged by the quarter point increase in the Federal Funds rate in March. Further rate increases can be expected if any signs of inflation surface, which would place an additional drag on the economy’s growth potential. Inflation fears stem from the tight national labor market (and a rising employment cost index) as well as high capacity utilization in the manufacturing sector. Fortunately, inflation has remained in check, with the consumer price index rising 2.9 percent in 1996. The outlook for 1997 calls for 2.6 percent growth, with the same expected for 1998. The primary policy objective of the Federal Reserve is to achieve price stability with inflation-adjusted growth in GDP slightly above 2.0 percent.

Inflation-adjusted gross domestic product is projected to rise 3.5 percent in 1997, versus 2.4 percent growth in 1996. Growth will decelerate to 1.9 percent in 1998. There appears to be little upside potential for the national economy in the near term, as shown in Figure 2. Job growth will slow for the remainder of 1997, closing out the year at 2.1 percent, and recording 1.5 percent growth in 1998. Fortunately, the rate of job erosion in the nation’s nondurable goods manufacturing sector will slow from 2.7 percent in 1996 to 0.7 percent in 1997. Weak but positive growth in employment in nondurable goods manufacturing is expected in 1998. Slower growth in transportation, communication and public utilities; wholesale trade; and finance, insurance and real estate will serve to lower overall employment growth through the near term forecast horizon.

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The international sector will aggravate the broader slowdown in economic activity through 1997. Reasonably strong domestic income and job growth will support imports, while the strong dollar and weak growth among many of our trading partners will retard the performance of exports. Nonresidential fixed investment will grow 7.9 percent in 1997, followed by 3.7 percent growth in 1996, with most growth in equipment rather than structures. Housing
investment will slow, with ripple effects across the construction, building material, furniture and appliance sectors.

The nations’ consumer sector, which represents about two-thirds of spending on final goods and services, will show strong growth of 3.5 percent in calendar year 1997, buoyed by 6.4 percent growth in the first quarter of 1997. But spending growth will wane for the remainder of 1997, and growth in 1998 is expected to be 2.3 percent. Slower spending will occur because of slower job and income growth and slower growth in consumer installment credit.

U.S. Forecast at a Glance

- Inflation-adjusted gross domestic product will increase 3.5 percent in 1997 and 1.9 percent in 1998.
- Growth in the broad components of GDP--consumer spending, investment and net exports--will show deceleration through 1997 and into 1998. There is little upside potential for the national economy in the near term. At the same time, the risk of recession remains slim.
- Job growth will slow through 1997 resulting in calendar year growth of 2.1 percent, slowing to 1.5 percent in 1998. Job losses in the nation’s durable goods manufacturing sector will slow, and positive job growth is projected by 1998.
- Inflation is expected to remain under control at both the consumer and producer levels. The consumer price index will rise 2.6 percent in both 1997 and 1998.
- Any hints of accelerating inflation will be met by rate increases on the part of the Federal Reserve. The general atmosphere should be one of relative price and interest rate stability.

The prime interest rate will average 8.8 percent in 1997 and 8.9 percent in 1998.

### Good News, Bad News for State Economy

**TENNESSEE FORECAST**

**Current Economic Conditions**

The good news coming from the Tennessee economy is that the economic expansion that started in the early 1990s continues to this day. The bad news is that the state economy has slowed appreciably in recent quarters. Rather than finding itself leading the Southeast and broader U.S. in economic growth, by many accounts the state is now a laggard. There are two compelling signs--growth in Tennessee per capita personal income ranked 47th across all states in 1996, and the Tennessee unemployment rate (5 percent) found itself above its national counterpart (4.9 percent) in April (see Figure 3).

![Tennessee and U.S. Unemployment Rates](image)
There is no single explanation for the sharp deceleration in state economic growth. Instead, a number of factors have together conspired to force the state onto a slower growth trajectory. Notable has been the rather dramatic loss of jobs in the state’s nondurable goods manufacturing sector, attributable in part to import competition and high cotton prices. In 1996 job losses totaled 15,000, or 6 percent of all jobs in the nondurable goods sector. (Had these losses been averted and had nondurable goods manufacturing simply sustained the employment levels of 1995, overall state job growth would have come in at 2.1 percent in 1996, rather than the actual 1.5 percent rate of growth.) Jobs in leather were down 24.2 percent, jobs in apparel dipped 17.7 percent and jobs in textiles slipped 7.3 percent in 1996 alone. Employment in durable goods manufacturing, which enjoyed 4.5 percent growth in 1994, was up only 2.2 percent in 1995, but slipped 0.5 percent in 1996. This means an important engine of quality job creation for the state was effectively put in reverse. More generally, it would appear that Tennessee has simply reached its full employment potential during the current economic expansion. A good indicator is growth in the civilian labor force, which was up 6.5 percent in 1994, but grew only 1.6 percent in 1995 and 1996.

The slowdown in the labor market is not confined to manufacturing. Trade and services, which account for nearly one-half of all state jobs, each experienced sharp deceleration in employment growth in 1996. Trade employment, which advanced 4.2 percent in 1995, was up only 1.8 percent in 1996. The first quarter of 1997 showed little change, with growth of 1.8 percent (SAAR). Services employment grew only 2.9 percent in 1996, on the heels of a strong 5.7 percent growth in 1995. The first quarter of 1997 shows growth in services slipping further to 2.1 percent (SAAR). Finally, growth in construction employment was cut in half in 1996, signaling a slowdown in new residential and business fixed investment in the state.

Slower job growth has rippled across other dimensions of the state economy. Nominal personal income growth slowed to 4.7 percent in 1996, following near 7 percent growth in the previous two years. All broad components of personal income have suffered. The first quarter of 1997 provides little encouragement for the near term, with personal income up only 1.1 percent (SAAR). (Year-over-year growth is more encouraging at 5.1 percent.)

It would appear that Tennessee has simply reached its full employment potential during the current economic expansion.

Taxable sales have softened in the face of the slower economy wide growth. Following 9.5 percent and 7.9 percent growth in 1994 and 1995, respectively, taxable sales were up only 4.8 percent in 1996. First quarter data for 1997 shows a jump of 10.2 percent (SAAR), although this is unsustainable in light of other economic conditions and trends.

Forecast Summary

The Quarterly Tennessee Econometric Model projects a continuation of the current pattern of slow growth through 1998. Neither a sharp deceleration nor a sharp acceleration in growth is expected in the near term. Employment growth is projected to deteriorate slightly in 1997 to 1.3 percent from the sluggish 1.5 percent pace of 1996. While the rate of job decay in manufacturing is expected to slow, most other sectors of the state economy will experience slower rates of growth, as shown in Figure 4. Growth in
trade and services will be similar to the pattern of 1996. But transportation, communication and public utilities (TCPU); fire, insurance and real estate (FIRE); and construction will slow further. Growth is expected to accelerate somewhat in 1998, with employment expanding by 1.8 percent, clearly not an economic boom. The state seasonally adjusted unemployment rate will hold its own, just above 5 percent.

Nominal personal income is forecast to grow 4.6 percent in 1997, with 5.4 percent growth in 1998. Tennessee will lag the U.S. in personal income growth in 1997, but is expected to return to its leadership role with a relatively stronger growth rate (albeit slim) in 1998.

Slower statewide economic growth will hinder the growth of taxable sales. Modest improvement is expected for 1997 (5.3 percent) and 1998 (5.6 percent). Fiscal year 1997/98 is projected to show 5.0 percent growth in taxable sales.

**Tennessee Forecast at a Glance**

- The state economy will continue to grow at a slow pace through 1998.
- Nonagricultural jobs will advance 1.3 percent in 1997 and 1.8 percent in 1998.
- The rate of job loss in manufacturing (especially nondurable goods manufacturing) will slow. Net losses of 1.4 percent and 1.1 percent are projected in 1997 and 1998, with contraction in the nondurable goods sector more than offsetting modest expansion in the durable goods sector.
- The Tennessee unemployment rate, which moved above the national unemployment rate in April, will average 5.1 percent in both 1997 and 1998. Expected increases in the national unemployment rate should return Tennessee to its leadership role by the close of 1997.
- Nominal personal income will experience sluggish 4.6 percent growth in 1997, improving to 5.2 percent in 1998.
- Taxable sales are projected to climb 5.3 percent and 5.6 percent in 1997 and 1998, respectively. Fiscal year 1997/98 will show 5.0 percent growth.