U.S. ECONOMY TO CONTINUE EXPANSION THROUGH 1999

U.S. FORECAST

Current Economic Conditions

The U.S. economy is showing some signs of decelerating economic growth. Inflation-adjusted gross domestic product (GDP) advanced at a healthy 3.8 percent clip in 1997. Fourth quarter year-over-year growth came in at 3.7 percent and slowed further to 3.3 percent growth in the first quarter of 1998. This downward trend is somewhat more pronounced when GDP is examined on a quarter-to-quarter basis using seasonally-adjusted annual rates of growth (SAARs). At the same time, one can hardly say the national economy is cooling off. Growth in excess of 3 percent is itself a remarkable achievement, but is viewed by most economists as unsustainable over the longer term due to labor force constraints, the potential for escalating inflation and other factors.

While this strong growth in GDP is remarkable, so is the pattern of inflation at both the consumer and producer levels. Inflation hawks have been sounding the alarm of potentially escalating inflation for several years as they have watched the economy grow and grow. Instead, the consumer inflation rate has been steady in the 2.5 percent range and producer prices have in recent quarters actually fallen. In fact, the expectation is that producer prices for finished goods will show a 1.3 percent decline in 1998. This is unlikely to deter the inflation hawks in light of OPEC’s decision to curtail oil production, slowing productivity growth and rising wage pressures in the nation’s labor markets. Inflation will rise, but any acceleration will be modest over the near term.

Perhaps the most significant story is the continued currency and economic turmoil in Southeast Asia. Indonesia, Thailand, Korea, the Philippines, Malaysia and Japan are all mired in a complicated web of currency volatility and broader economic weakness. Fortunately, most believe the worst part of the crisis is now behind these economies. The overall impact on the global economy is expected to be quite modest, since these countries comprise a relatively small share of total economic activity. Similarly, the expectation is for only a modest reduction in growth for the U.S. through the remainder of 1998 and into 1999. This tempering of economic growth will help ease inflationary pressures.

Strong economic growth has continued to fuel the nation’s engine of job creation. Establishment employment was up 3.0 percent in 1997:4, yielding 2.3 percent growth for 1997 as a whole. The first quarter of 1998 showed job growth accelerating to 3.5 percent. Expect job growth to slow throughout the remainder of the year. The strong economy has
been instrumental in pushing down the nation’s unemployment rate from 5.4 percent in 1996 to 4.9 percent in 1997. April’s job release shows an astonishingly low national unemployment rate of 4.3 percent, the lowest rate recorded since 1970.

Inflation-adjusted investment continues to enjoy exceptionally strong gains. The nation’s housing market has sustained its strength, benefitting from relatively low interest rates, strong consumer sentiment, strong job growth and good gains in personal income. Growth in housing has in turn buoyed the construction, building material and home furnishing sectors. Non-residential fixed investment jumped 14.6 percent and 19.2 percent in 1997:2 and 1997:3, respectively. A surprising contraction took place in the fourth quarter of 1997, but investment rebounded to double-digit growth in 1998:1. The rapid growth in nonresidential fixed investment has important direct effects on the economy through the production of new equipment and structures, but also has important impacts through expanding the nation’s productive capacity, boosting productivity and easing inflationary pressures.

The current economic expansion and run-up in the stock market, coupled with a degree of fiscal restraint in Washington, have been instrumental in reducing the nation’s deficit. Between February of 1997 and 1998, federal government receipts produced a $12.6 billion surplus; in the prior twelve-month period there was a $116.5 billion deficit. As shown in Figure 1, the deficit now appears to be dead and Congress will be spending more of its time wrangling over what to do with emerging budget surpluses. If the economy remains strong and fiscal restraint continues, the debt-to-GDP ratio in 2003 will match its value in 1981, the year in which deficits began to explode.

**U.S. Forecast Summary**

At the risk of repetition, expectations are for slower national economic growth over the short-term forecast horizon. Analysts have anticipated a more tame economy on many occasions, only to see the national economy continue its rapid ascent, highlighting the peculiar nature of the current economic expansion. Inflation-adjusted GDP is projected to rise a modest 2.2 percent in 1998:2, while growth for 1998 should come in at 2.9 percent, slipping to 2.3 percent growth in 1999. Nominal GDP will accelerate slightly as a result of higher inflation. The implicit deflator for GDP will rise 1.7 percent in 1998 and 2.6 percent in 1999. Inflation-adjusted per capita personal income will be up 3.2 percent in 1998 and 1.9 percent in 1999. The Federal Funds rate and the prime interest rate are each expected to rise by 1999, but by only about one-half of a percentage point. If the economy should show stronger economic growth or if inflation should accelerate sharply, expect higher rates as a result of Federal Reserve intervention.

The nation’s trade deficit will continue to grow for the foreseeable future. The current situation is aggravated by the dollar’s significant appreciation in international currency markets, as shown in Figure 2. But the dollar’s strength will begin to wane in 1998, and by 1999 expectations are that the dollar will show some depreciation. Nonetheless, dollar depreciation will be insufficient to stave off further growth in the trade deficit.

U.S. job growth will ebb in light of tight labor markets and slower overall economic growth. U.S. nonagricultural job growth will tend to decelerate

![U.S. Federal Surplus, Unified Budget Basis](image-url)
through the short-term forecast horizon. For 1998 as a whole, job growth is projected at 2.3 percent, falling to 1.2 percent growth in the following year. Employment in manufacturing is expected to fall 0.3 percent in 1998, with a 2.5 percent decline anticipated in 1999. More slack in the nation’s labor markets will translate into a rising unemployment rate. The unemployment rate for 1998 is projected at 4.7 percent, rising to 5.1 percent in 1999.

Inflation-adjusted consumer spending, the economy’s workhorse, jumped 5.3 percent (SAAR) in 1998:1. Growth in consumer spending will slow to 3.4 percent for 1998 and to 2.5 percent in 1999. Nonresidential fixed investment growth will move into the single-digit range and stay there throughout the short-term forecast window. Growth in 1998 is projected to be 8.9 percent and growth in 1999 is projected at 6.3 percent.

U.S. Forecast at a Glance

The U.S. economy is expected to continue to expand through 1999. Most measures of economic growth will begin to slow. Inflation will rise slightly, raising the chances of Federal Reserve intervention. The Fed must walk a fine line to avoid an interest rate hike that might cause more rapid economic deceleration.

Inflation-adjusted GDP will rise 2.9 percent in 1998 and 2.3 percent in 1999. Nominal GDP growth will be somewhat stronger, reflecting higher inflation.

Nonagricultural jobs are expected to grow at a 2.3 percent pace in 1998 and a 1.2 percent pace in 1999. Growth in 1999 will be the slowest since 1993.

The implicit deflator for GDP will rise 1.7 percent in 1998, increasing a further 2.6 percent in 1999. No sharp increase in the price level is likely in the near term.

Higher inflation and chances of a rate increase from the Fed will lead to modestly higher interest rates into 1999. The prime interest rate, which averaged 8.4 percent in 1997, will average 8.5 percent in 1998, increasing to 8.9 percent the following year.

Tennessee Economy Remains Strong and Stable

TENNESSEE FORECAST

Current Economic Conditions

Tennessee’s nonagricultural job growth for 1997 was a healthy 2.0 percent, significantly better than the 1.4 percent job gain registered in 1996. At the same time, Tennessee’s growth lagged the nation. Job growth for the national economy was 2.3 percent in 1997. While the state’s overall job picture remains strong, not all sectors of the economy have shown expansion. Manufacturing employment continues to contract, though the 0.4 percent loss in jobs in 1997
was a sharp improvement over the 3.7 percent drop in jobs that took place in 1996. As has been the case over the longer term, durable goods manufacturing has fared considerably better than nondurable goods manufacturing. The durable goods sector witnessed job losses of 1.1 percent in 1996, but enjoyed 1.0 percent growth in 1997. Despite net growth in durable goods employment in 1997, the furniture and fixtures, stone clay and glass, fabricated metals, electrical machinery and miscellaneous sectors all shed jobs. The nondurable goods sector has seen the rate of job decay slow. Following a 6.7 percent plummet in 1996, job losses in 1997 came in at only 2.2 percent. The first quarter of 1998 showed further improvement as the pace of job decline was 0.7 percent (SAAR). Nonetheless, jobs in leather were down 13.9 percent, jobs in apparel were down 8.8 percent and jobs in textiles were down 4.8 percent in 1998. As shown in Figure 3, these sectors have been subject to long-term job erosion.

Job growth in construction has slowed appreciably from the torrid pace of 1994 and 1995. Following a 3.9 percent advance in 1996, job growth slowed further to 3.1 percent in 1997. Growth for the first quarter of 1998 suggests additional deceleration, with job gains of only 0.7 percent (SAAR). While the construction jobs are themselves important, so is the investment they represent in new housing, plant and equipment; the broader consequences for the building material and home furnishing sectors; and the one-time boost to state/local sales tax coffers.

Trade and services, which together account for about 50 percent of all jobs in the state, continue to fare well. Following weak growth of 1.5 percent in 1996, the trade sector was up 2.4 percent in 1997. Jobs in services were up 3.8 percent in 1997, on the heels of 3.3 percent growth in 1996. Job growth in finance, insurance and real estate (FIRE) and transportation, communication and public utilities (TCPU) actually accelerated in 1996 and sustained growth in excess of 3 percent in 1997.

It is quite surprising that strong job growth in 1997 coincided with a 1.3 percent decline in the civilian labor force. The number of employed people also contracted in 1997, down 1.6 percent. Unemployed persons were up 3.3 percent for the year. These factors together produced an unemployment rate of 5.4 percent for the year as a whole. In 1998:1 the unemployment rate had fallen to 4.5 percent.

Taxable sales have yet to show signs of a slowdown. In fact, after slowing to 4.7 percent growth in 1996, sales growth advanced to 8.8 percent in 1997. Sales growth is expected to slow and come more in line with personal income growth in the near term. Nominal personal income was up 5.7 percent in 1997, slightly behind the 5.8 percent pace set by the national economy in the same year. Tennessee per capita personal income grew 4.4 percent in 1997, trailing the nation’s 4.9 percent growth rate. Wage and salary income was up 6.4 percent for the year, driven by reasonably strong job gains.

Tennessee Forecast Summary

The Quarterly Tennessee Econometric Model foresees a continuation of moderately strong economic growth for the state’s economy, with growth decelerating only slightly through 1999. Nominal personal income in Tennessee is projected to rise at a 5.6 percent pace in both 1998 and 1999. Inflation-adjusted personal income will show slower growth, advancing 3.9 percent in 1998 and 2.6 percent in 1999. Tennessee’s growth is expected to lag the nation through 1999, but only by a slim margin.

The Tennessee unemployment rate, which averaged 5.4 percent in 1997, will inch forward from current levels, reaching 5.2 percent by 1998:4. The unemployment rate is expected to hold its own in the 5.2 percent range through 1999. Accompanying a slowly rising unemployment rate will be a largely stable pace of job creation. Following 2.0 percent job growth in 1997, expect job gains of 2.2 percent and 2.1 percent in 1998 and 1999, respectively. The jobs picture by broad sector is summarized in Figure 4. The state’s manufacturing sector will lose jobs in both 1998 and 1999. Job gains of 1.0 percent and 0.9 percent are
expected in durable goods manufacturing in 1998 and 1999, respectively. Transportation equipment employment will rise 2.2 percent and nonelectrical machinery jobs will expand 2.3 percent. Jobs in nondurable goods manufacturing will slip by 2.4 percent in 1998 and by 2.0 percent in 1999. Jobs in textiles, apparel and leather will be especially hard hit. On the brighter side, jobs in services will grow by 3.5 percent and 3.4 percent in each of the next two years. Growth in wholesale and retail trade will come in at 2.8 percent and 2.9 percent, respectively, for 1998 and 1999.

Nominal taxable sales are projected to grow 4.6 percent in 1998 and 4.6 percent in 1999. On a fiscal year basis, sales are anticipated to rise 4.5 percent in fiscal 1998/99.

Tennessee Forecast at a Glance

- Nonagricultural job growth will show sustained strength, progressing 2.2 percent in 1998. The state will continue to lose jobs in the manufacturing sector, with nondurable goods manufacturing bearing the brunt of the loss.
- The Tennessee unemployment rate will average 4.9 percent in 1998 and 5.2 percent in 1999, slightly higher than the national rate of unemployment.
- Nominal taxable sales are expected to increase by 4.6 percent in calendar year 1998 and 4.5 percent for fiscal year 1998/99.

Figure 3

Tennessee Nondurable Mfg Employment

Figure 4

Tennessee Nonag Employment by Sector