

Situation Mixed for Midstate This Fall

David Penn, BERC Director

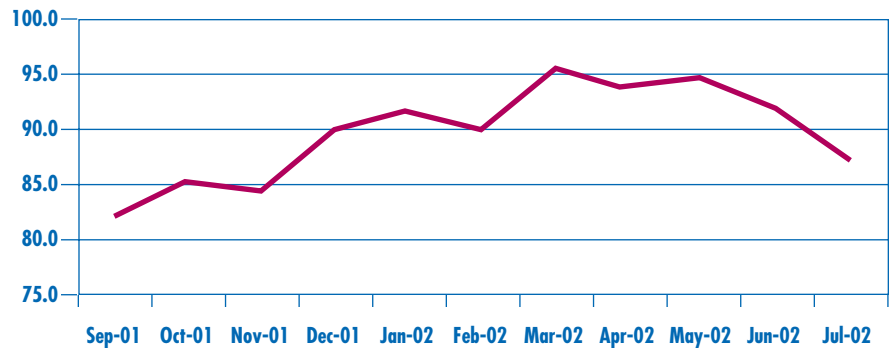
With the change of seasons came new hope of rekindling the fires of the national economy. As it turned out, the national economy cooled during the second quarter. Inflation-adjusted gross domestic product rose a very modest 1.1 percent from the first quarter, reflecting moderately higher consumer spending for services but weakness in consumer durables, investment, net trade, and government spending. Seasonally adjusted payroll employment posted a small gain in June after falling every month since March 2001.

Spending by households provided a much-needed boost during the second quarter. Retail and food services spending rose 1.06 percent from the first quarter and gained 3.3 percent from the second quarter of 2001. Sales strengthened during the summer months: advance figures for July show a 1.2 percent increase from June led by very strong sales in the motor vehicle sector (up 4.2 percent) spurred by special low-interest and no-interest financing programs offered by auto manufacturers.

Consumer confidence, as measured by the University of Michigan Consumer Sentiment Index, rose 1.2 percent from the first quarter. However, figures for June and July are down, creating considerable concern about the strength of consumer spending in coming weeks (Figure 1).

The current economic situation is mixed for middle Tennessee. Payroll employment in the Nashville MSA increased 900 net jobs from the first quarter (seasonally adjusted), a gain of just 0.1 percent (Table 1). Job growth in manufacturing was flat but favorable by comparison with job losses that continue in the U.S. manufacturing sector. Transportation, communication, and utilities posted robust job gains, as did wholesale trade, while modest job gains occurred in retail trade and government. Services employment fell by 800 jobs.

Figure 1. University of Michigan Consumer Sentiment Index



After gaining ground in the first quarter, average hours worked per week in manufacturing dropped, as did average hourly pay. Hours worked per week is an important indicator of future hiring plans, since employers are likely to lengthen the workweek before they increase hiring. Look for average hours worked to increase as a sign of future employment gains in the manufacturing sector.

Initial monthly claims for unemployment insurance in the 41-county midstate area have fluctuated since the beginning of the recession, ranging from a peak of nearly 50,000 in the fourth quarter of 2001 to a low of 37,000 in the second quarter of 2002. Seasonally adjusted claims shot up 20 percent in the second quarter, suggesting lingering pain from the national recession.

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Spending by households provided a much-needed boost during the second quarter.

Table 1. Nashville MSA Payroll Employment (thousands, seasonally adjusted)

Sector	2002Q1	2002Q2	% Change
Total	685.5	686.4	0.1%
Construction and Mining	33.4	33.0	-1.2%
Manufacturing	90.5	90.7	0.2%
Durable Goods	55.7	55.8	0.3%
Nondurables	34.9	34.9	0.0%
Finance, Insurance, and Real Estate (FIRE)	41.9	42.0	0.1%
Transportation, Communications, and Utilities	38.7	39.2	1.2%
Wholesale Trade	37.9	38.4	1.5%
Retail Trade	127.9	128.1	0.2%
Services	228.4	227.6	-0.4%
Government	87.1	87.2	0.1%

Sources: U.S. Bureau of Labor Statistics; MTSU

Table 2. Economic Indicators for Middle Tennessee

Series (adjusted for seasonality and inflation)	Geographical Area	2001Q4	2002Q1	2002Q2	Percentage Change from 2002Q1-2002Q2
Midstate Leading Index	Midstate (41 Counties)	104.7	106.5	104.8	-1.6%
EMPLOYMENT					
Midstate Number of Employed Persons	Midstate (41 Counties)	1,035,558	1,051,952	1,058,717	0.6%
Midstate Unemployment Rate	Midstate (41 Counties)	4.6%	5.2%	4.7%	-9.7%
Average Hours Worked per Week in Manufacturing	Nashville MSA (8 Counties)	38.5	39.2	38.7	-1.1%
Average Pay per Hour in Manufacturing (\$ per hour)	Nashville MSA (8 Counties)	14.54	15.07	14.93	-0.9%
INITIAL CLAIMS AND BANKRUPTCY					
Initial Claims for Unemployment Compensation	Midstate (41 Counties)	49,971	37,031	44,455	20.0%
Bankruptcy Case Filings	Midstate (41 Counties)	3,946	3,856	3,653	-5.3%
HOUSING CONSTRUCTION					
New Residential Units (permits)	Midstate (41 Counties)	3,287	3,854	3,781	-1.9%
Value of New Residential Units (million \$)	Midstate (41 Counties)	377.4	428.9	437.8	2.1%
AUTOMOBILE PRODUCTION					
Autos Assembled in United States	United States	2,896,919	3,041,658	3,093,714	1.7%
Autos Assembled in Midstate	Midstate (41 Counties)	156,814	189,661	201,785	6.4%
Units Sold: Autos Assembled in Midstate	United States	179,606	156,987	163,470	4.1%
TOURISM					
Hotel Revenue (million \$)	Davidson County	92.5	91.8	92.7	0.9%
Total Air Passengers, Nashville International Airport	Davidson County	1,947,588	1,966,069	1,995,453	1.5%

Notes: Seasonal adjustment with X11-ARIMA.

Sources: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Bureau of the Census; U.S. Bureau of Economic Analysis; Tennessee Department of Labor and Workforce Development; Davidson County Clerk's office; Metropolitan Nashville Airport Authority; Nashville Electric Service; *Automotive Weekly*; *economagic.com*; U.S. Bankruptcy Court, Middle Tennessee District; BellSouth

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Unemployment data are a lagging indicator of economic activity. Some employers who struggled through the worst part of the recession last year in anticipation of a robust recovery are finding their hopes frustrated by the failure of revenue to recover. Layoffs are the result in some companies even as overall

economic conditions improve. Some employers, such as Consolidated Freightways, declare bankruptcy.

In the midstate area, total bankruptcy filings fell by 5.3 percent in the second quarter to 3,653. The trend in bankruptcy filings is down after peaking at 3,946 in the fourth quarter of 2001.

Indicators for housing construction and tourism in the midstate area are mixed. The number of residential permits for new housing construction fell slightly in the second quarter even as the total value of the permits rose. The total number of airline passengers at Nashville International Airport increased a bit, and hotel revenue for Davidson County was flat.

Consumer confidence in middle Tennessee took a decidedly negative turn in August according to the Office of Consumer Research at MTSU. Professor Tim Graeff reported that the Middle Tennessee Consumer Confidence Index plunged from 325.8 in April to 269.4 in August, suggesting that consumers will likely cut spending on big-ticket items. Expectations for the future also dropped, but not as much. Even though middle Tennessee consumers are more pessimistic, consumer confidence still compares very favorably with similar measures for the U.S. economy.

Looking forward, indications for the next quarter are no better than flat activity for the local economy. After rising in the first quarter, the Midstate Leading Index fell by 1.6 percent in the second quarter, a cause for concern as we proceed into the second half of the year. Employment gains in a few sectors will probably be nearly offset by job losses in other sectors as the local economy continues to sort itself out. ■

About the Consumer Confidence Index

The Consumer Confidence Index represents the sum of the Present Situation, Future Expectations, and Purchasing Indexes. It is derived from an MTSU Office of Consumer Research survey in which telephone interviews are given to 452 randomly selected adults from Davidson, Rutherford, and Williamson counties. There is 95 percent confidence that the survey error is ± 4.6 percent. For more information, contact the office's director, Dr. Timothy Graeff, 898-5124.

Table 3. Consumer Confidence Index

	February 2002	April 2002	August 2002
Consumer Confidence Index	328.2	325.8	269.4
Present Situation Index ¹	46.8	53.3	29.1
Future Expectations Index ²	138.7	117.6	102.1
Purchasing Index ³	142.7	154.9	138.2

Source: MTSU Office of Consumer Research (898-5124)

¹ Based on four questions regarding the current outlook of national and local business conditions, the availability of jobs in middle Tennessee, and survey participants' financial situation

² Based on four questions regarding future expectations for national and local business conditions, the availability of jobs in middle Tennessee, and survey participants' financial situation

³ Based on three questions regarding the current outlook for purchasing major household items, houses, and automobiles

Banking in Tennessee

Branch Growth Surged in 2001

Albert E. DePrince, Jr., Professor of Economics and Finance, MTSU; Thomas H. Strickland, Professor of Finance, MTSU

Local banking markets are approaching the third birthday of the passage of the Financial Modernization Act in November 1999, on the heels of the 1997 implementation of the Interstate Banking and Branch Efficiency Act (IBBEA) of 1994.

The 1994 act led to widespread mergers with attendant closure and/or sale of redundant branches. Additionally, the 1990s was a decade of strong cost controls reflected in the closing, downsizing, and outright sale of branches.

Forces are also pushing in the opposite direction. The FMA's provision of the ability to offer more products through branches might encourage expansion of branch systems, and branches are now viewed as an important element in a multichannel service delivery system. Banks have begun to upgrade branches with large-scale technology spending to meet demand, recognizing that the branch is an important vehicle for building relationships with customers and developing brand identity.

This is the third annual report assessing the impact of these developments on shifts in branches and concentration in local banking markets between 1991 and 2001. Branch and deposit data include commercial banks, thrifts, and credit unions. Banking offices include the main and branch offices of each of these institutions in the local market. Branch data are annual from June 30 of each year, with June 2001 the latest available.

Branch Growth in 2001

Statewide, 2001 saw an explosive growth in branches—a net of 226 opened during the year ending in June 2001, the largest yearly increase since 228 new branches in 1990. During the intervening years (1991-2000), there was an average net addition of only 14 branches a year, with most additions in the latter years.

Fast growth in 2001 also occurred in the 41 middle Tennessee counties (97 branches added), and the 10-county area including and around Nashville (70 added). Rutherford County added 15, Williamson County 26, and Wilson County eight.

Ten Years in Perspective

In the longer term, population will be the single most important variable determining a county's number of branches. Over the 10-year period, branches increased marginally faster than population, which led to a decrease in the population-to-branch ratio between 1991 and 2001. This reversed the trend for rolling 10-year

horizons in the last few reports. Results for 2001 versus earlier reports suggest branches are added discreetly and only after a critical business mass is reached. "Clumpiness" appears in the time line of branch growth in local markets.

The model, also used in the last two annual reports, relates the number of branches in a county to its population after controlling for the county's income distribution and points to one branch for every 2,816 people, on average, statewide in 2001. A decade earlier, this population-to-branch ratio, controlled for income distribution, was 3,077. The decline means that, on average, branches increased faster than population across the state from 1991 to 2001.

The fall in the population-to-branch ratio in the 2001 data appears inconsistent with the belief that cost rationalization dominated banking decisions during the 1990s. However, a long list of forces pushed in the opposite direction, and results for 2001 suggest these competing forces overpowered cost rationalization as the new millennium began.

Branches and Economic Growth

Next, the link between branch and population growth was examined by developing a model linking the 10-year change in number of branches to the 10-year change in population in each county. The model showed that, on average, each increase of 2,041 people is associated with one additional branch. The model generates a predicted growth in branches over the 10-year period based on the county's actual population growth. Most counties' actual branch growth was close to the prediction, but three large outliers were noted among the 95 counties.

Two are local. Davidson County added only seven branches between 1991 and 2001 versus the model's estimated 28. Davidson's slow branch growth has served to move the county's branches into alignment with its population, as the county was heavily over-banked relative to population in 1991 according to the model.

Rutherford County added 15 branches over the 10 years versus the estimated 30. The model has consistently suggested that Rutherford is "under-banked" and suggests the gap may have widened during the last 10 years.

Yet no visible shortage of banking services appears in Rutherford County. Some suggest that Rutherford is demographically relatively young, thanks to its fast population growth, and has not yet attracted the businesses its population could support. As it does, the related demand for financial services will lead to additional branches.

Banks rely on detailed branch profitability models to determine when and where to build new branches. If those models have not produced more branches in the county, it may be true that business opportunities have not grown in tandem with the fast population growth.

Shelby County is the third outlier. In the three

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Over the 10-year period, branches increased marginally faster than population, decreasing the population-to-branch ratio.

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**Strong growth
provides business
opportunities and
newly chartered banks
as well as incentive
for outside institutions
to move into an area.**

Banking continued from inside

years that this report has been compiled, Shelby has been one of the state's most seriously under-banked counties based on results from the model. Shelby's 64-branch gain during the 10-year period far exceeded the gain (34) predicted by the county's population growth; by 2001, the gap between branches and population, adjusted for income distribution, had narrowed considerably.

Banking Concentration

Merger effects of the 1994 IBBEA were dramatic. In 1991, there were 11,927 insured commercial banks nationwide. That number dropped 32 percent to 8,080 in 2001. The decline was not as severe for Tennessee; there were 250 banks in 1991 and 189 in 2001, a drop of 24 percent.

To assess effects of bank consolidation on concentration in Tennessee, a conventional measure of concentration—the Herfindahl-Hirschman Index (HHI)—was calculated for each county for 1991 and 2001. There seems to have been a slight decrease in concentration during the 10 years ending in 2001, opposite of the pattern the IBBEA was expected to unleash.

The average HHI for the 95 counties fell from 3,363 to 3,178 between 1991 and 2001. The HHI increased in 40 of the state's 95 counties, falling

in 53 counties over the same period. While more counties experienced a relative reduction in concentration more than an increase, extreme movements were evident in both directions. Of the 40 counties posting increases, 12 (roughly 30 percent) showed increases of 20 percent or more in their concentration ratios. Of the 53 counties whose HHI fell, 17 (roughly 32 percent) posted declines of 20 percent or more.

What accounts for the seemingly mild effect of bank mergers on concentration rates?

Economic growth brings with it *de novo* entry. Strong growth provides business opportunities and newly chartered banks as well as incentive for outside institutions to move into an area.

Another factor is an already high level of concentration in many counties. The Justice Department and Federal Reserve use an HHI of 1,800 as the point at which anti-competitive concerns of a merger must be considered. In 2001, 73 of the state's counties had HHI in excess of 1,800, down marginally from 1991's 80. These high concentrations obviously limit within-county consolidation.

Community banks in counties with high HHIs should, however, note that they are not immune to forays by larger banking institutions. High concentration ratios do not rule out the acquisition of a local bank by a larger, out-of-county bank, but only mean within-county mergers may be problematic. ■