

THIRD QUARTER 2006

SLOW GROWTH, MIXED SIGNALS

by David A. Penn

Economic indicators for the Nashville metropolitan area are mixed for the third quarter, continuing a trend of slower growth beginning with the first quarter. Economic signals are mixed because some indicators have weakened from the second quarter (taxable sales and housing construction), some are stronger (nonfarm employment and labor force), and others are unchanged (leading and coincident indexes). Slower growth for the Nashville

economy can be attributed to slower national economic growth and slower local housing construction.

However, there are bright spots for the Nashville MSA. Travel and tourism, for example, continue to show considerable strength over the past year. Since the third quarter of 2005, employment in lodging and food services has grown 4.4 percent, airline passenger traffic is up 9.7 percent, and hotel tax collections for Davidson County gained 11.8 percent, all strong indications of a booming travel industry.

Construction and manufacturing employment are unchanged in the third quarter following significant first quarter increases (Table 2). Given the decline in housing construction nationally and slower manufacturing growth,

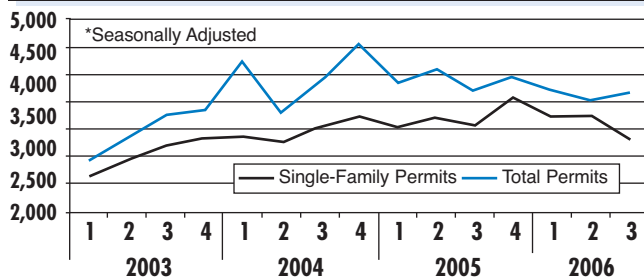
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Table 1. Economic Indicators for Middle Tennessee

| Series (seasonally adjusted) | Geographical Area | 2005Q3 | 2005Q4 | 2006Q1 | 2006Q2 | 2006Q3 | % Change 06Q2-06Q3 | % Change 05Q3-06Q3 |
|---|-------------------|-----------|-----------|-----------|-----------|-----------|--------------------|--------------------|
| Nashville MSA Leading Index | Nashville MSA* | 113.0 | 113.9 | 113.0 | 113.7 | 113.7 | 0.0% | 0.6% |
| Nashville MSA Coincident Index | Nashville MSA | 117.0 | 118.1 | 118.9 | 119.6 | 119.6 | 0.0% | 2.3% |
| LABOR FORCE AND EMPLOYMENT | | | | | | | | |
| Midstate Total Employment | Midstate** | 1,081,988 | 1,087,508 | 1,088,692 | 1,103,820 | 1,112,762 | 0.8% | 2.8% |
| Midstate Labor Force | Midstate | 1,138,300 | 1,144,990 | 1,146,578 | 1,164,219 | 1,177,618 | 1.2% | 3.5% |
| Midstate Unemployed | Midstate | 56,595 | 57,852 | 57,146 | 60,538 | 64,788 | 7.0% | 14.5% |
| Midstate Unemployment Rate | Midstate | 5.0% | 5.1% | 5.0% | 5.2% | 5.5% | 5.8% | 10.7% |
| Nashville MSA Nonfarm Employment | Nashville MSA | 735,727 | 742,677 | 746,440 | 750,167 | 754,146 | 0.5% | 2.5% |
| Average Hours Worked per Week in Manufacturing | Nashville MSA | 39.8 | 39.7 | 39.2 | 39.6 | 40.2 | 1.7% | 1.1% |
| Countries with Increased Employment (percent) | Midstate | 61.0% | 53.7% | 70.7% | 85.4% | 75.6% | | |
| Countries with Increased Unemployment (percent) | Midstate | 29.3% | 56.1% | 34.1% | 75.6% | 73.2% | | |
| Countries with Increased Labor Force (percent) | Midstate | 63.4% | 56.1% | 58.5% | 82.9% | 80.5% | | |
| Initial Claims for Unemployment Compensation | Midstate | 42,934 | 36,580 | 34,324 | 38,958 | 43,905 | 12.7% | 2.3% |
| HOUSING CONSTRUCTION | | | | | | | | |
| New Residential Permits | Nashville MSA | | | | | | | |
| Single-Family | | 3,369 | 3,779 | 3,505 | 3,477 | 3,142 | -9.6% | -6.7% |
| Total | | 3,898 | 4,100 | 3,883 | 3,749 | 3,842 | 2.5% | -1.4% |
| Value of New Residential Units (million \$) | Nashville MSA | | | | | | | |
| Single-Family | | 550.2 | 608.3 | 557.6 | 588.9 | 520.1 | -11.7% | -5.5% |
| Total | | 596.2 | 624.5 | 584.9 | 605.0 | 586.4 | -3.1% | -1.7% |
| TOURISM | | | | | | | | |
| Hotel Tax Revenue (million \$) | Davidson Co. | 5.32 | 5.65 | 5.93 | 5.88 | 5.95 | 1.2% | 12.0% |
| Total Air Passengers, Nashville International Airport | Davidson Co. | 2,214,149 | 2,256,335 | 2,352,920 | 2,301,050 | 2,444,583 | 6.2% | 10.4% |
| TAXABLE SALES (estimates) | | | | | | | | |
| Nashville MSA (million \$) | Nashville MSA | 6,751 | 6,894 | 6,970 | 7,195 | 7,050 | -2.0% | 4.4% |
| In-State Sales Only | | 5,747 | 5,859 | 5,925 | 6,128 | 6,083 | -0.7% | 5.8% |
| Midstate (million \$) | Midstate | 9,172 | 9,349 | 9,481 | 9,733 | 9,555 | -1.8% | 4.2% |
| In-State Sales Only | | 7,801 | 7,944 | 8,054 | 8,304 | 8,238 | -0.8% | 5.6% |

Notes: Seasonal adjustment with X11. *Nashville MSA includes 13 counties. **Midstate is a 41-county area. Sources: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Bureau of the Census; Davidson County Clerk's office; Metropolitan Nashville Airport Authority; U.S. Bankruptcy Court, Middle Tennessee District.

Figure 1. Building Permits Issued for Housing, Nashville MSA*



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no change is a relatively good outcome for the Nashville metro area.

Although the results are mixed, housing construction shows definite signs of slowing during the third quarter. Single-family permits for new housing dropped 9.6 percent from the second quarter after seasonal adjustments. Over the year, single-family permits are 6.7 percent lower, the largest decline since the fourth quarter of 2000, when permits were 18 percent lower from a year earlier. On the other hand, multifamily permits are strong with 700 new permits during the third quarter, the highest level since the second quarter of 2005. The net effect of rising multifamily and falling single-family activity is a modest 1.4 percent decline over the year in the total number of units (Figure 1). Much more detail and analysis regarding the housing market in middle Tennessee will be provided in a special issue of *Midstate Economic Indicators* early in 2007.

With no net employment growth in construction and manufacturing (the goods-producing sectors), nearly all the net employment gain in the third quarter occurred in the private services-providing industries. As mentioned earlier, leisure and hospitality are growing (Table 2), and employment growth in educational services, retail trade, and professional and business services also is strong.

More evidence of slower overall economic activity can be found in sales tax collections for the Nashville metro area and the larger 41-county midstate area. In-state taxable collections are down 0.7 percent from the second quarter for the Nashville MSA and 0.8 percent lower for the broader 41-county midstate area.

Although the Nashville economy is slowing, we may gain some comfort by comparing it to nearby metropolitan areas (Table 3). The comparison shows that other metropolitan areas are experiencing much weaker employment conditions. As Table 3 shows, Nashville's employment is growing 0.5 percent per quarter this year, annualized at 2.0 percent. By contrast, the rate of growth in most other nearby metropolitan areas has declined substantially; quarterly employment growth in Atlanta and Birmingham has dropped from 0.5 to 0.6 percent earlier this year to just 0.2 percent in the third quarter. And nonfarm employment growth for Memphis, Indianapolis, and Louisville has dropped to just 0.1 percent. With the exception of Charlotte, all these metropolitan areas are experiencing much slower growth compared with earlier in the year.

We should also compare Nashville's economic performance with that of the state. Tennessee's nonfarm employment rose a modest 1.2 percent over the year, a relatively anemic growth rate compared with Nashville's 2.5 percent increase. Tennessee nonfarm employment is virtually unchanged from the second quarter of 2006

Table 2. Nashville-Davidson-Murfreesboro MSA Nonfarm Employment (seasonally adjusted in thousands)

| Sector | 2005Q2 | 2005Q3 | 2005Q4 | 2006Q1 | 2006Q2 | 2006Q3 | % Change 06Q2-06Q3 | % Change 05Q3-06Q3 |
|---|--------------|--------------|--------------|--------------|--------------|--------------|-----------------------|-----------------------|
| Total Nonfarm | 732.0 | 735.7 | 742.7 | 746.4 | 750.2 | 754.1 | 0.5% | 2.5% |
| Total Private | 636.0 | 639.3 | 645.5 | 649.1 | 652.4 | 656.0 | 0.5% | 2.6% |
| Natural Resources, Mining, and Construction | 35.7 | 35.9 | 36.2 | 36.7 | 37.0 | 37.0 | 0.0% | 3.1% |
| Manufacturing | 84.4 | 84.2 | 84.5 | 84.9 | 84.4 | 84.4 | 0.0% | 0.2% |
| Durable Goods | 57.8 | 57.5 | 57.6 | 57.8 | 57.7 | 57.5 | -0.3% | 0.1% |
| Computer and Electronic Products | 4.6 | 4.6 | 4.8 | 4.7 | 4.7 | 4.6 | -0.6% | 0.0% |
| Electrical Equipment, Appliances, and Components | 7.5 | 7.3 | 7.4 | 7.5 | 7.4 | 7.2 | -3.1% | -1.2% |
| Transportation Equipment | 19.6 | 19.3 | 19.5 | 19.7 | 19.7 | 19.4 | -1.6% | 0.6% |
| Nondurable Goods | 26.6 | 26.8 | 27.0 | 27.0 | 26.7 | 26.9 | 0.6% | 0.4% |
| Wholesale Trade | 36.0 | 36.2 | 36.2 | 36.9 | 37.1 | 37.1 | 0.2% | 2.5% |
| Retail Trade | 85.3 | 86.1 | 86.9 | 87.5 | 88.6 | 89.4 | 0.9% | 3.8% |
| Transportation and Utilities | 28.2 | 28.3 | 28.5 | 28.1 | 28.0 | 28.1 | 0.4% | -0.7% |
| Information | 19.6 | 19.8 | 19.9 | 20.1 | 20.1 | 20.3 | 0.8% | 2.6% |
| Financial Activities | 45.2 | 45.5 | 45.8 | 45.9 | 46.2 | 46.5 | 0.5% | 2.3% |
| Professional and Business Services | 95.6 | 96.2 | 98.6 | 98.7 | 99.4 | 100.2 | 0.8% | 4.1% |
| Educational and Health Services | 101.4 | 101.9 | 102.8 | 103.4 | 104.2 | 104.7 | 0.4% | 2.7% |
| Educational Services | 22.0 | 22.2 | 22.5 | 22.5 | 22.7 | 22.9 | 0.8% | 3.3% |
| Health Care and Social Assistance | 79.4 | 79.7 | 80.3 | 80.9 | 81.5 | 81.8 | 0.3% | 2.5% |
| Leisure and Hospitality | 74.7 | 75.2 | 76.0 | 77.2 | 77.6 | 78.5 | 1.2% | 4.4% |
| Arts, Entertainment, and Recreation | 9.5 | 9.5 | 9.4 | 9.4 | 9.6 | 9.9 | 3.2% | 4.7% |
| Accommodation and food Services | 65.2 | 65.8 | 66.5 | 67.8 | 68.0 | 68.7 | 1.0% | 4.4% |
| Other Services | 29.8 | 30.0 | 29.8 | 29.8 | 29.8 | 29.8 | 0.3% | -0.7% |
| Government | 95.9 | 96.4 | 97.1 | 97.5 | 97.8 | 98.1 | 0.4% | 1.8% |

Table 3. Quarterly Growth of Nonfarm Employment for Selected Metropolitan Areas (seasonally adjusted)

| Metropolitan Area | 05Q3-05Q4 | 05Q4-06Q1 | 06Q1-06Q2 | 06Q2-06Q3 |
|---|-----------|-----------|-----------|-----------|
| Atlanta–Sandy Springs–Marietta, Georgia | 0.8% | 0.7% | 0.6% | 0.2% |
| Birmingham–Hoover, Alabama | 0.3% | 0.5% | 0.2% | 0.2% |
| Charlotte–Gastonia–Concord, North Carolina–South Carolina | 0.5% | 1.0% | 0.0% | 0.7% |
| Indianapolis, Indiana | -0.5% | 0.6% | -0.4% | 0.1% |
| Louisville, Kentucky–Indiana | 0.3% | 0.4% | 0.2% | 0.1% |
| Memphis, Tennessee–Mississippi–Arkansas | 0.8% | 0.3% | 0.0% | 0.1% |
| Nashville–Davidson–Murfreesboro, Tennessee | 0.9% | 0.5% | 0.5% | 0.5% |

Source: Bureau of Labor Statistics, CES series

(after seasonal adjustment); compare this with Nashville's 0.5 percent rise from the second quarter. The loss of 5,000 manufacturing jobs over the year for Tennessee is the most important factor explaining low employment growth. In fairness, however, the over-the-year comparison paints an overly negative picture because the bulk of the manufacturing job losses occurred early on, between September and December 2005, with little change since then. Manufacturing employment actually has changed very little since December, averaging about 404,000 through September. The point is that Tennessee manufacturing employment appears to be stabilizing, but this will not show in the over-the-year comparison until employment figures for December 2006 are released next year.

Clarksville MSA and Chattanooga MSA

Growth slowed for the Chattanooga metropolitan area; nonfarm employment rose just 0.1 percent from the second quarter (Table 4) and only 1.2 percent over the year. Slower job growth has resulted in diminished household spending as evidenced by the 0.5 percent drop in taxable sales from last quarter. Single-family housing construction fell by 8.2 percent in the third quarter, following the national trend of a softening housing market. Seasonally adjusted single-family permits fell to 582, the lowest figure dating back to the first quarter of 2003. At the same time, however, the number of permits for multifamily units rose considerably, reaching 163 units in the third quarter (shown as the difference between total units

and single-family units in Table 4). The third-quarter multifamily unit figure is the highest for Chattanooga since the first quarter of 2001.

For the Clarksville MSA, employment indicators are inconclusive in the third quarter, with nonfarm employment down slightly but the unemployment rate stronger, falling to 5.7 percent from 6.1 percent. It is interesting to note that both single-family and multifamily housing construction are very strong in the third quarter, bucking both national and midstate trends. The strong housing construction activity helped to boost taxable sales to \$558 million in the third quarter, a very large quarterly increase of 3.0 percent.

Nashville MSA Coincident and Leading Indicators

Both the coincident and leading indexes are unchanged in the third quarter, reflecting the mixed positive and negative economic news. As for the coincident index (CI), the two indicators constituting the index moved in opposite directions in the third quarter, with a modest decline for inflation-adjusted taxable sales offset by a rise in nonfarm employment. Consequently, the coincident index remains constant at 119.6 for the third quarter (Figure 2). The CI provides a composite measure of current conditions for the Nashville MSA economy.

The leading index is also unchanged in the third quarter at 113.7 (Figure 3). The flat leading index reflects

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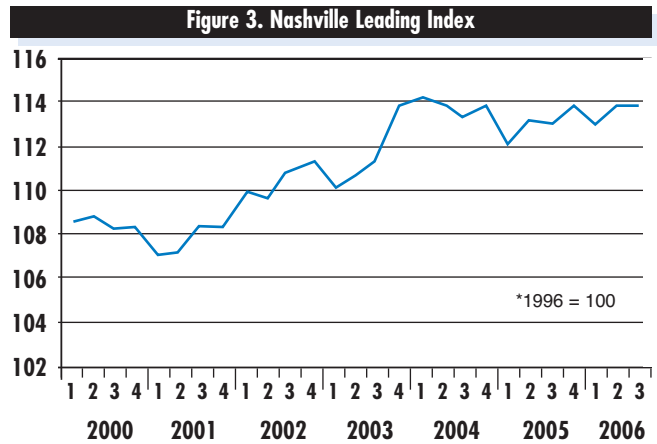
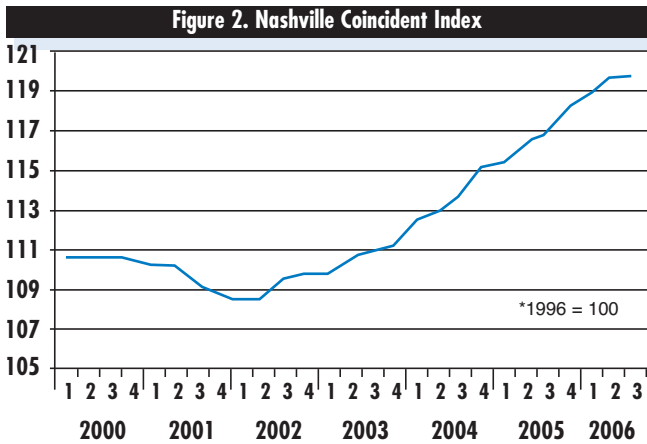
Table 4. Economic Indicators for Chattanooga MSA and Clarksville MSA

| Series (seasonally adjusted) | 2005Q1 | 2005Q2 | 2005Q3 | 2005Q4 | 2006Q1 | 2006Q2 | 2006Q3 | % Change 06Q2-06Q3 | % Change 05Q3-06Q3 |
|--|---------|---------|---------|---------|---------|---------|---------|-----------------------|-----------------------|
| CHATTANOOGA MSA | | | | | | | | | |
| Nonfarm Employment (thousand) | 239.3 | 240.8 | 241.2 | 241.5 | 243.1 | 244.0 | 244.1 | 0.1% | 1.2% |
| Unemployment Rate | 5.0 | 4.9 | 4.7 | 4.7 | 4.5 | 4.7 | 4.5 | -3.0% | -4.3% |
| Taxable Sales (million \$) | 1,541.5 | 1,533.7 | 1,577.0 | 1,567.1 | 1,612.0 | 1,620.8 | 1,612.0 | -0.5% | 2.2% |
| Permit-Authorized Housing Construction | | | | | | | | | |
| Total | 720 | 723 | 810 | 763 | 739 | 694 | 744 | 7.3% | -8.1% |
| Single-Family | 704 | 645 | 716 | 748 | 712 | 634 | 582 | -8.2% | -18.7% |
| CLARKSVILLE MSA | | | | | | | | | |
| Nonfarm Employment (thousand) | 81.5 | 82.0 | 82.8 | 83.6 | 83.9 | 82.8 | 82.5 | -0.3% | -0.3% |
| Unemployment Rate | 5.8 | 6.0 | 5.7 | 6.3 | 5.7 | 6.1 | 5.7 | -6.7% | 0.9% |
| Taxable Sales (million \$) | 527.2 | 521.2 | 544.0 | 536.4 | 515.5 | 541.7 | 558.0 | 3.0% | 2.6% |
| Permit-Authorized Housing Construction | | | | | | | | | |
| Total | 582 | 774 | 881 | 415 | 482 | 632 | 1,258 | 99.2% | 42.8% |
| Single-Family | 499 | 519 | 491 | 362 | 387 | 482 | 548 | 13.6% | 11.6% |

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the offsetting effects of rising initial claims for unemployment insurance (negative effect) and the modest rise in average weekly hours worked in manufacturing establishments (positive effect). The third component of the index, inflation-adjusted permits for housing construction, is unchanged in the third quarter. ■

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