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FOURTH QUARTER

GAINING STRENGTH

by David A. Penn

On balance, the midstate economy gained strength during the fourth quarter of 2004. Improving indicators include nonfarm employment, taxable sales, air passenger travel, and multifamily housing construction. Weakening indicators include single-family housing construction, unemployment, and initial claims for unemployment insurance.

Nonfarm employment will be discussed later in this report when we take up the latest data revisions. Taxable sales for the fourth quarter rose 5.7 percent for the Nashville metropolitan statistical area (MSA) and 5.8 percent for the 42 midstate counties. A good Christmas season resulted in a favorable sales report, although some counties show more Christmas cheer than others. The big winners in the Nashville area are Rutherford and Williamson counties, accounting for nearly half the increase in sales in the midstate from December 2003 to December of 2004. Sales growth figures for the counties in the Nashville MSA are presented in Figure 1. Cheatham and Sumner show very strong Christmas season increases, with moderate gains in Robertson and Davidson. Dickson and Wilson counties experienced much more modest increases.

Taxable sales from the third to fourth quarter of 2004 rose 2.2 percent in the Nashville MSA and 1.7 percent for the midstate counties. On an annualized basis the gains are much more impressive, with taxable sales for the Nashville MSA up 8.9 percent and sales in the midstate counties 6.8 percent higher than the previous quarter.

As predicted last quarter in *Midstate Economic Indicators (MEI)*, single-family housing construction slowed in the fourth quarter: permit-authorized construction for single-family units fell 1.2 percent, and the total value of single-family units dropped 2.7 percent from the third quarter, both figures adjusted for seasonal variation.

Multifamily home construction shot up in the fourth quarter, however, with the number of multifamily permits rising to 1,315 compared with just 847 in the third quarter.

Anecdotal evidence suggests that an important factor explaining the attractiveness of new homes in Rutherford, Wilson, and other suburban counties is lower prices compared with Davidson County. However, recent evidence suggests that builders in Rutherford and Wilson counties are building more expensive homes; average values of

Figure 1
Percent Increase in State Sales Tax Collections, December 2003-2004

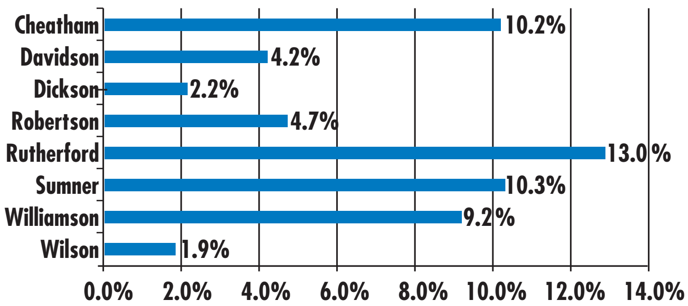
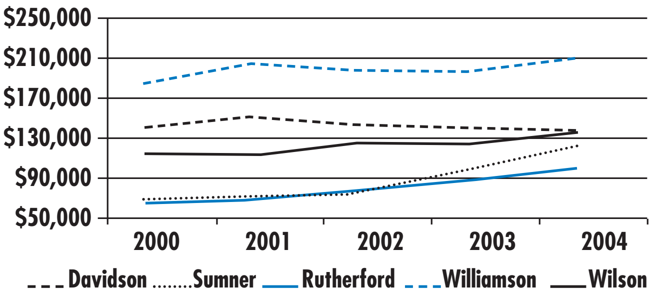


Figure 2
Average Value of Single-Family Permits, 2000-2004



building permits for homes in these suburban areas are increasing more rapidly than in Davidson County (Figure 2). At the same time, builders in Davidson County are building less expensive homes. By 2004, average permit values in Davidson and Wilson counties had converged, and Sumner was just 10 percent lower than Davidson. Rutherford County's average permit value grew faster than Davidson's but is still substantially smaller at 77 percent of the Davidson average.

These figures should be considered suggestive but not conclusive, since the value of permits includes the value of the structure only; the value of the land is not included in the figures. So, if land prices in Davidson are growing faster than in the other counties, the effect of converging permit values may not show as strongly in the actual sales

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prices of the homes. More work is needed to investigate the trend of average land prices for single-family homes.

The midstate unemployment rate rose slightly from 4.8 percent in the third quarter to 4.9 percent in the fourth quarter (Table 1). Total employment and the labor force show virtually no change from the third quarter, while the number of unemployed increased slightly. Figures for total employment, labor force, and unemployment in this issue of *MEI* reflect a new estimation method recently implemented by the Tennessee Department of Labor (DOL) and the U.S. Bureau of Labor Statistics. According to the DOL, the new method includes several enhancements: improved adjustment of place-of-work to place-of-residence, better estimates of new entrants and reentrants to the labor force, and incorporation of Census 2000 information on population and commuting. These improvements should result in smaller revisions and adjustments as new data are released. For our purposes, the new estimating process results in smaller figures for total employment and a somewhat larger figure for unemployed. As a result of the new estimation methods, the midstate unemployment rate is approximately four-tenths of a percentage point higher than previously reported.

As for the national economy, preliminary estimates for gross domestic product show growth at 3.8 percent for the fourth quarter of 2004, down slightly from 4.0 percent in the third quarter. Consumption spending rose 4.2 percent

Table 2
Initial and Revised Nonfarm Employment Growth for the Nashville-Davidson-Murfreesboro MSA

Industry	% Change Initial	% Change Revised	Job Change (1,000s) Initial	Job Change (1,000s) Revised
Total Nonfarm	1.2%	2.2%	8.1	15.3
Total Private	0.9%	2.3%	5.3	14.0
Construction and Mining	2.4%	-0.2%	0.8	-0.1
Manufacturing	1.3%	2.4%	1.0	2.0
Durable Goods	1.7%	2.8%	0.9	1.6
Nondurable Goods	0.4%	1.5%	0.1	0.4
Wholesale Trade	0.5%	-0.9%	0.2	-0.3
Retail Trade	0.2%	3.7%	0.2	3.0
Transportation and Utilities	2.9%	2.4%	0.8	0.6
Information	-5.4%	-3.5%	-1.1	-0.7
Financial Activities	2.2%	-1.0%	1.0	-0.4
Professional and Business Services	-2.7%	8.3%	-2.3	7.0
Educational Services	0.2%	5.6%	0.0	1.1
Health Care and Social Assistance	3.6%	2.9%	2.7	2.1
Leisure and Hospitality	2.5%	0.5%	1.8	0.3
Government	3.2%	1.4%	2.9	1.3
State and Local	3.5%	1.5%	2.8	1.2

and investment spending increased a strong 13.4 percent from the previous quarter on an annualized basis. Virtually all the increase in investment spending can be attributed to an 18 percent increase in equipment and software spending. By comparison, investment spending for new residential structures increased just 2.1 percent. Spending by government increased 1.2 percent, and exports rose 2.4 per-

Table 1. Economic Indicators for Middle Tennessee

Series (seasonally adjusted)	Geographical Area	2003Q4	2004Q1	2004Q2	2004Q3	2004Q4	% Change 04Q3-04Q4	% Change 03Q4-04Q4
EMPLOYMENT								
Midstate Total Employment	Midstate	1,056,722	1,057,078	1,059,969	1,062,530	1,062,717	0.0%	0.6%
Midstate Labor Force	Midstate	1,116,105	1,114,851	1,117,166	1,116,575	1,116,933	0.0%	0.1%
Midstate Unemployed	Midstate	59,383	57,773	57,197	54,045	54,215	0.3%	-8.7%
Midstate Unemployment Rate	Midstate	5.3%	5.2%	5.1%	4.8%	4.9%	0.3%	-8.8%
Average Hours Worked per Week in Manufacturing	Nashville MSA**	39.7	39.7	39.7	39.6	40.2	1.5%	1.3%
Counties with Increased Employment (percent)	Midstate	73.2%	85.4%	65.9%	61.0%	68.3%	12.0%	-6.7%
Counties with Increased Unemployment (percent)	Midstate	36.6%	2.4%	31.7%	46.3%	63.4%	36.8%	73.3%
INITIAL CLAIMS AND BANKRUPTCY								
Initial Claims for Unemployment Compensation	Midstate	28,085	28,477	28,316	25,969	42,023	61.8%	49.6%
Bankruptcy Case Filings	Midstate	4,010	3,850	3,949	4,234	NA	—	—
HOUSING CONSTRUCTION								
New Residential Permits	Midstate							
Single Family		4,213	4,445	4,448	4,695	4,637	-1.2%	10.1%
Multifamily		1,131	1,440	491	847	1,315	55.3%	16.3%
Total		5,344	5,885	4,939	5,542	5,952	7.4%	11.4%
Value of New Residential Units (million $)	Midstate	1,130.7	1,440.1	491.0	846.9	1,315.2	55.3%	16.3%
Single Family		591.2	640.5	593.4	648.3	630.7	-2.7%	6.7%
Multifamily		52.7	63.3	34.2	62.1	80.8	30.2%	53.3%
Total		643.9	703.9	627.6	710.4	711.5	0.2%	10.5%
MarketGraphics: Single-Family Construction	6 NMSA Counties***	3,260	3,460	3,288	3,275	3,625	10.7%	11.2%
TOURISM								
Hotel Tax Revenue (million $)	Davidson County	4.82	4.74	5.08	5.01	5.03	0.3%	4.3%
Total Air Passengers, Nashville International Airport	Davidson County	2,003,852	2,059,510	2,192,441	2,171,751	2,196,069	1.1%	9.6%
TAXABLE SALES (estimates)								
Nashville MSA (million $)	Nashville MSA	5,829	5,997	6,019	6,031	6,191	2.2%	5.7%
Midstate (million $)	Midstate	8,112	8,379	8,393	8,442	8,581	1.7%	5.8%

Notes: Seasonal adjustment with X11. *Midstate is a 41-county area. **Nashville MSA includes 8 counties. *** NMSA is Nashville MSA. *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; MarketGraphics, Brentwood cent. Unfortunately, imports increased a whopping 11.4 percent, thus dragging down an otherwise relatively strong GDP growth report. The surge in imports shaved 1.67 percentage points off the GDP growth rate.

Growth of nonfarm employment in the national economy slowed during the second half of 2004, averaging 162,000 monthly net new jobs July to December compared with 204,000 for the period January to June. Employment growth for January and February 2005 averaged 197,000 per month, about in line with the first half of 2004.

The Federal Reserve continues to ratchet up the Federal Funds rate, with more increases likely to occur in the future. The most apt interpretation of the Fed rate increases is an automotive analogy; the Fed is easing off the accelerator, moving monetary growth to a more neutral stance. The gradual Fed funds rate increases can be interpreted as the Fed's attempt to stay in line with commercial short-term rates that are rising on their own. However, the Fed will act much more aggressively in raising rates if it becomes worried about inflation and inflationary expectations.

Nonfarm employment revisions

The U.S. Bureau of Labor Statistics (BLS) along with the Tennessee Department of Labor (DOL) released revised nonfarm employment figures recently. The revised figures show substantially more employment growth in the Nashville MSA for 2004 than was indicated in the monthly employment reports (Table 2).

Since these monthly employment by industry figures are our only means of measuring economic activity by industry month by month, it is important to understand the significance of the revision. The monthly figures on employment by industry released by the DOL are survey data collected from a random sample of employers in the metro counties. The employers may be either private or public but must have a payroll. Self-employed persons, unpaid family members, and agricultural workers are not included in the survey. The sample of employers is chosen from those who must pay unemployment insurance tax: about 97 percent of nonfarm payroll employers. In 2003, the sample included 160,000 employers at 400,000 individual worksites nationally.

The sample data are used to estimate a month-to-month percent change for employment by industry. The percent change for the current month is then applied to the employment figure from the previous month for the industry, resulting in estimated employment for the current month.

As with all such recurring surveys, the sample may eventually stray from the population, causing the monthly employment estimates derived from the sample to either underestimate or overestimate true employment patterns. To correct for this possibility, the agencies adjust the monthly series annually to match the overall population of employers; this is termed "benchmarking." Once each year, the monthly figures are adjusted to account for changes in the "true" population of employers, with the "true" population measured by a separate employment series called the Quarterly Census of Wages and Employment (QCEW), a quarterly census of reports from all employers subject to payroll tax.

Table 3
Employment and Total Wages for Counties Added to the Nashville-Davidson-Murfreesboro MSA

Area	Payroll Employment 2004Q2	Annualized Total Wages ($1,000)
Previous Definition		
Cheatham	7,723	237,798
Davidson	426,491	16,013,752
Dickson	14,534	410,256
Robertson	17,114	473,448
Rutherford	89,262	3,154,027
Sumner	38,766	1,164,696
Williamson	69,227	2,604,097
Wilson	30,641	978,026
Counties Added		
Cannon	1,956	47,442
Hickman	3,165	75,916
Macon	4,407	103,612
Smith	5,393	154,346
Trousdale	1,477	38,027

The benchmarked figures for the previous year typically are released in March. This year the March figures show two effects: (1) the addition of five counties to the Nashville MSA in line with the new MSA definitions announced by the Census Bureau two years ago and (2) benchmarking of the 2004 monthly figures. Adding five counties to the MSA has a relatively modest impact; nonfarm employment rises by 2.4 percent and total payroll by 1.7 percent (Table 3). The additional five counties together add about as much employment and payroll as the smallest county (Dickson) under the previous definition.

The effects of the benchmarking are dramatic: the initial monthly reports for 2004 showed tepid year-over-year nonfarm employment growth during the year, with growth diminishing from March to December. Average nonfarm employment for 2004 was just 1.2 percent higher than 2003 according to the initial monthly figures. The revised

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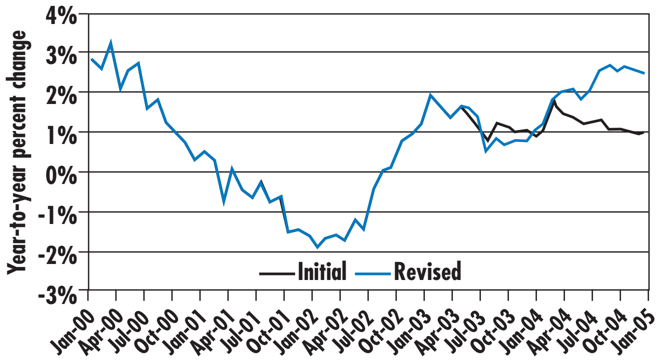
Figure 3
Nashville-Davidson-Murfreesboro MSA Payroll Employment Growth



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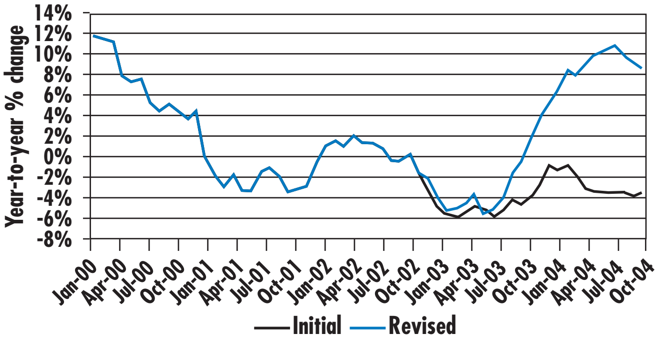
benchmarked figures tell a much different story: instead of slower growth after March, the revised figures show accelerated growth, with the average for 2004 rising by 2.2 percent from 2003 (Figure 3). Thus, instead of rising a modest 8,500 jobs, Nashville MSA employment actually increased by 15,300 jobs, nearly double the initial figure.

More telling is the effect of the benchmarking on employment by sector. Total private sector employment growth is revised from a 0.9 percent gain (+5,300 jobs) to a much larger 2.3 percent increase (+14,000 jobs). Manufacturing employment growth is revised up by more than a full percentage point, gaining a revised 2,000 jobs instead of the initial estimate of 1,000 jobs. Retail trade experienced a much larger revision, from +200 jobs initially to +3,000 jobs benchmarked. The information sector shows job losses but less than initially estimated, and the health care and social assistance sector shows little change. The largest revision occurred in the professional and business services sector, which had been experiencing declining employment growth during much of 2004. Instead of losing 2,300 jobs in 2004 (-2.3 percent growth), the revision shows that this sector actually gained 7,000 jobs (+8.3 percent growth), a net change of more than 9,000 jobs in just one sector (Figure 4). ■

Figure 4
Nashville-Davidson-Murfreesboro MSA
Professional and Business Services Employment Growth



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