

FIRST QUARTER

HOUSING MARKET ADJUSTMENT?

by David A. Penn

Midstate housing construction took a break during the first quarter: seasonally adjusted single-family construction fell to 4,436 units, down 3.9 percent from the fourth quarter of 2004 and 1.2 percent lower than the previous year. Some evidence suggests that demand may have cooled; residential sales in the Nashville area are virtually the same as last year's 5,976 first-quarter single-family home sales.¹ But median prices are up and inventory is down, signs of stronger, not weaker, demand. Perhaps the best explanation is that the market has entered an adjustment period. After all, equaling the performance of last year's very strong first quarter is impressive in itself.

Other evidence shows continuing strong demand for real estate in the midstate. For example, the value of real estate transactions rose 18.5 percent year over year in the first quarter, measured by collections from the state real estate transfer tax. Compare this with a much smaller 5 percent gain for the rest of the state. The largest increases occurred in Davidson, Williamson, and Montgomery counties, accounting for about half the increase in real estate activity in the midstate. Other counties with sizable gains include Maury (6.2 percent), Rutherford (6.0 percent), and Robertson (4.9 percent).

Before construction begins on a home, land must be purchased and rezoned if necessary, infrastructure installed, and concerns of nearby neighborhoods dealt with. Actual construction occurs when these issues have been settled, materials and labor are obtained, and the weather is cooperative. If the number of new lots ready for construction does not keep pace with the demand for new homes, then housing construction activity will slow and perhaps even decline. An analysis by Edsel Charles of MarketGraphics, a Brentwood home construction data company, suggests that the number of lots being readied for construction is not enough to satisfy demand. If this is correct, then we can expect slower construction activity coupled with rising home prices and falling inventories, conditions that appear to be in place right now.

Prices of homes in the Nashville area are rising moderately, suggesting a rough balance between supply growth and demand growth. According to figures from the Office

PERHAPS THE BEST EXPLANATION IS THAT THE [HOUSING] MARKET HAS ENTERED AN ADJUSTMENT PERIOD. AFTER ALL, EQUALING THE PERFORMANCE OF LAST YEAR'S VERY STRONG FIRST QUARTER IS IMPRESSIVE IN ITSELF.

of Federal Housing Enterprise Oversight (OFHEO), Nashville MSA housing prices rose by 6.1 percent during the first quarter year over year, somewhat higher than the Tennessee average gain of 5.4 percent. Nashville's housing price gain is only about half the national increase of 12.5 percent. Not surprisingly, the largest increases occurred in the West, including California, Arizona, and Nevada. In the East, the largest housing price increases were in Washington, D.C., Florida, Virginia, and Maryland.²

continued inside

Table 1
Nashville-Davidson-Murfreesboro MSA Nonfarm
Employment First Quarter 2004 and 2005 (thousands)

Sector	2004	2005	% Change
Total Nonfarm	700.9	715.3	2.1%
Total Private	602.7	617.7	2.5%
Construction and Mining	33.1	33.3	0.5%
Manufacturing	82.1	84.6	3.0%
Durable Goods	55.9	58.2	4.1%
Computer and Electronic Products	4.8	5.0	3.5%
Electrical Equipment	6.7	7.5	11.4%
Transportation Equipment	18.1	19.6	8.5%
Nondurable Goods	26.2	26.4	0.6%
Wholesale Trade	33.9	34.1	0.6%
Retail Trade	81.4	83.7	2.9%
Transportation and Utilities	27.1	28.1	3.4%
Information	19.4	18.9	-2.7%
Financial Activities	44.1	44.1	0.2%
Professional and Business Services	86.7	93.1	7.4%
Educational and Health Services	96.7	98.2	1.6%
Educational Services	20.4	20.5	0.3%
Health Care and Social Assistance	76.3	77.8	1.9%
Leisure and Hospitality	68.3	69.7	2.0%
Arts, Entertainment, and Recreation	8.0	8.6	7.9%
Accommodation and Food Services	60.3	61.1	1.3%
Other Services	29.9	29.9	0.0%
Government	98.2	97.7	-0.5%
State Government	29.4	29.3	-0.2%
Local Government	57.4	56.8	-1.1%

Source: Bureau of Labor Statistics

FIRST QUARTER

continued from front

Bucking the national trend, manufacturing employment for the Nashville-Davidson-Murfreesboro MSA rose 3.0 percent during the first quarter year over year, much more robust than a 0.4 percent gain for Tennessee and 0.2 percent for the U.S. Virtually all the gain for Nashville can be attributed to two sectors: transportation equipment manufacturing (up 8.5 percent year over year) and electrical equipment manufacturing (up 11.4 percent). By contrast, employment growth for the transportation equipment sector nationally was just 0.6 percent, and electrical equipment manufacturing experienced an employment decline of 0.5 percent.

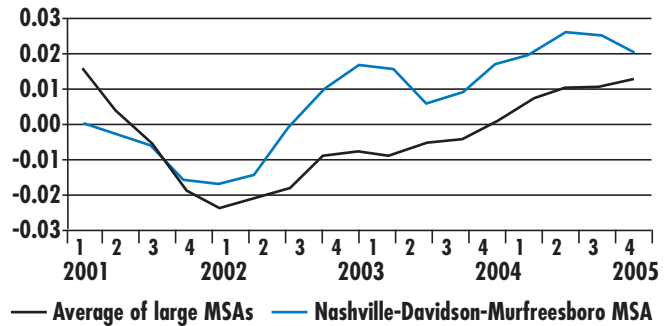
The relative success of transportation equipment manufacturing in Nashville is simple to explain: Nashville produces vehicles that consumers want to buy. Nissan products in particular are selling very well this year, especially models produced at the Smyrna production facility. According to Autodata Corp., Nissan domestic car sales for January through May rose 7.8 percent from a year ago and domestic truck sales are up 38.4 percent for the same period. Compare this with a 0.4 percent decline in domestic car sales for all models in the U.S. and a drop of 2.6 percent for U.S. domestic trucks. Strong sales for Nissan vehicles not only create more job opportunities (or at least improved job security for current employees) but also increase demand for locally produced auto parts. Increased Nissan production creates a ripple effect in the Nashville area economy, leading to more income and more parts purchased from local suppliers.

Taxable sales showed their strongest increase for several quarters, rising by a very strong 3.3 percent for the Nashville MSA and 3.0 percent for the midstate from the fourth quarter of 2004 after seasonal adjustment. The quarter-to-quarter gain was the largest rise since the third quarter of 2003, when sales rose 3.7 percent.

We don't know which categories of sales performed better than others for the Nashville area. We can, however, examine statewide figures. During the first quarter, Tennessee households spent considerably more for items related to the home, including building materials, furniture, and home furnishings. Year-to-year spending for furniture and home furnishings rose 9.8 percent, and households spent 9.5 percent more for building materials. The next highest categories of spending growth are apparel and accessory stores (up 5.6 percent), miscellaneous retail (up 5.4 percent), and eating and drinking places (up 5.1 per-

TAXABLE SALES FOR CHEATHAM COUNTY INCREASED A REMARKABLE 24.0 PERCENT FROM LAST YEAR, ATTRIBUTABLE TO THE OPENING OF A NEW WAL-MART.

Figure
Year-to-Year Growth of Total Nonfarm Employment



cent). Spending for new and used autos, repair, and parts was weak, up just 1.3 percent from last year, and spending at food stores rose just 2.8 percent.

Among the midstate counties, 16 experienced year-over-year taxable sales increases of 5 percent or more, six of them with double-digit increases (Cheatham, Humphreys, Bedford, Wilson, Rutherford, and Sumner). Taxable sales for Cheatham County increased a remarkable 24.0 percent from last year, attributable to the opening of a new Wal-Mart. Taxable sales declined year over year in 13 counties, including a 10.8 percent drop in Jackson County.

Series (seasonally adjusted)	Geographical Area
EMPLOYMENT	
Midstate Total Employment	Midstate*
Midstate Labor Force	Midstate
Midstate Unemployed	Midstate
Midstate Unemployment Rate	Midstate
Average Hours Worked per Week in Manufacturing	Nashville MSA**
Counties with Increased Employment (percent)	Midstate
Counties with Increased Unemployment (percent)	Midstate
Initial Claims for Unemployment Compensation	Midstate
HOUSING CONSTRUCTION	
New Residential Permits	Midstate
Single Family	
Multifamily	
Total	
Value of New Residential Units (million \$)	Midstate
Single Family	
Multifamily	
Total	
MarketGraphics: Single-Family Construction	6 NMSA Counties***
TOURISM	
Hotel Tax Revenue (million \$)	Davidson County
Total Air Passengers, Nashville International Airport	Davidson County
TAXABLE SALES (estimates)	
Nashville MSA (million \$)	Nashville MSA
Midstate (million \$)	Midstate

Notes: Seasonal adjustment with X11. *Midstate is a 41-county area. **Nashville MSA includes 13 counties. ** Sources: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Bureau of the Census; Davidson County

The midstate unemployment rate increased in the first quarter to 5.3 percent, equaling the figure for the second quarter of last year. Initial claims for unemployment insurance increased markedly, rising 8.1 percent in the first quarter from the previous quarter (Table 2). Rising labor market weakness is a cause for concern and deserves close monitoring during the coming months.

Compared with other large metropolitan areas, the Nashville MSA performed relatively well in terms of year-over-year nonfarm employment growth. Among the 57 metropolitan statistical areas (MSAs) with nonfarm employment of one-half million or more, the median employment growth rate was 1.5 percent compared with 2.1 percent for the Nashville MSA.

Since the end of the recession in 2002, Nashville MSA nonfarm employment has increased each quarter but not smoothly. Employment appears to grow as if climbing stairs with a short breather every fourth step or so. This ratcheting effect can be clearly seen in the figure; since mid-2002, employment has followed a cycle of increasing growth, then diminished growth, and back to increasing

EMPLOYMENT APPEARS TO GROW AS IF CLIMBING STAIRS WITH A SHORT BREATHER EVERY FOURTH STEP OR SO.

COMPARED WITH OTHER LARGE METROPOLITAN AREAS, THE NASHVILLE MSA PERFORMED RELATIVELY WELL IN TERMS OF YEAR-OVER-YEAR NONFARM EMPLOYMENT GROWTH.

growth. Employment growth increased rapidly from the first quarter of 2002 for about a year and then diminished for the next three quarters. Growth picked up again in the fourth quarter of 2003 and then diminished again. Although the general growth trend is positive, the path of growth over time is cyclical.

The figure also shows the employment growth rate for the median large MSA, those with at least 500,000 payroll jobs. Three points are of interest: (1) the Nashville MSA outperforms the median large MSA during every period since mid-2002, (2) employment growth for the median large MSA exhibits a similar ratcheting growth pattern but to a much smaller degree, and (3) the Nashville MSA and median large MSA growth rates tend to converge at the trough of the Nashville cycle.

Assuming the employment growth pattern continues for the Nashville MSA, we can reasonably expect employ-

continued on back

Table 2
Economic Indicators for Middle Tennessee

2003Q3	2003Q4	2004Q1	2004Q2	2004Q3	2004Q4	2005Q1	% Change 2004Q4 – 2005Q1	% Change 2004Q1 – 2005Q1
1,056,999	1,060,202	1,062,358	1,062,762	1,065,156	1,064,411	1,064,258	0.0%	0.2%
1,114,878	1,117,531	1,116,296	1,116,882	1,118,703	1,117,697	1,123,679	0.5%	0.7%
57,880	57,328	53,939	54,120	53,547	53,285	59,421	11.5%	10.2%
5.2%	5.1%	4.8%	4.8%	4.8%	4.8%	5.3%	10.9%	9.4%
39.7	40.4	40.8	40.5	39.8	40.3	39.4	-2.2%	-3.4%
63.4%	78.0%	51.2%	61.0%	56.1%	34.1%	61.0%	—	—
46.3%	41.5%	26.8%	48.8%	36.6%	34.1%	80.5%	—	—
33,037	28,246	28,312	28,090	26,092	31,547	34,101	8.1%	20.4%
4,115	4,188	4,491	4,443	4,674	4,616	4,436	-3.9%	-1.2%
591	1,164	1,450	491	821	1,377	1,030	-25.2%	-29.0%
4,706	5,352	5,941	4,934	5,496	5,993	5,466	-8.8%	-8.0%
591.1	1,163.6	1,450.0	490.7	821.5	1,377.4	1,029.9	-25.2%	-29.0%
532.1	589.3	648.2	592.1	643.5	628.9	618.8	-1.6%	-4.5%
42.3	50.7	66.4	35.0	60.2	79.0	65.8	-16.7%	-0.9%
574.4	640.0	714.5	627.2	703.7	707.9	684.6	-3.3%	-4.2%
3,291	3,260	3,460	3,288	3,275	3,625	3,626	0.0%	4.8%
4.74	4.82	4.72	5.08	5.01	5.03	5.03	0.0%	6.6%
2,029,543	2,009,446	2,092,101	2,191,560	2,173,662	2,201,830	2,214,536	0.6%	5.9%
5,818	5,843	5,976	6,019	6,033	6,176	6,379	3.3%	6.7%
8,101	8,130	8,353	8,384	8,452	8,600	8,856	3.0%	6.0%

MSA is Nashville MSA.
erk's office; Metropolitan Nashville Airport Authority; U.S. Bankruptcy Court, Middle Tennessee District; MarketGraphics, Brentwood, Tennessee

Business and Economic Research Center

P.O. Box 102
Middle Tennessee State University
Murfreesboro, TN 37132
615-898-2610


 **FIRST QUARTER**
continued from inside

ment growth to pick up once again during the next three or four quarters, perhaps averaging 2.5 percent or so for the remainder of 2005.

As for the national economy, real output of goods and services rose by a strong 3.5 percent during the first quarter, higher than the initial estimate but lower than the 3.8 increase recorded for the previous quarter. A gain of 5.4 percent for consumer nondurables offset the lackluster increase of 1.7 percent for consumer durable goods. Spending for housing construction and business equipment and software was strong, but the growth of imports continued to outpace export growth.

The ISM Index of strength in the manufacturing sector continues to slide, falling to 51.4 points in May, down from 56.4 in January; a score of 50.0 or more indicates expansion, while less than 50.0 suggests contraction. Although the production and export orders components of the index are strong, declining employment in the sector continues to pull the index down.

Turning to interest rates, the Federal Reserve must balance inflationary pressures on the one hand with a weakening industrial sector on the other. Future increases

**AS FOR THE NATIONAL ECONOMY, REAL
OUTPUT OF GOODS AND SERVICES ROSE
BY A STRONG 3.5 PERCENT DURING THE
FIRST QUARTER** 

in the Fed funds rate will continue to occur but perhaps not as frequently. ■

1. Greater Nashville Association of Realtors.
2. For more detail, see "U.S. House Prices Continue to Rise Rapidly," Office of Federal Housing Enterprise Oversight, June 1, 2005, www.ofheo.gov/media/pdf/1q05hpi.pdf.



MEI is published quarterly by the Business and Economic Research Center, Jennings A. Jones College of Business, Middle Tennessee State University. MTSU, a Tennessee Board of Regents University, is an equal opportunity, nonracially identifiable, educational institution that does not discriminate against individuals with disabilities.
AA306-0605

Online: www.mtsu.edu/~berc

Phone: 615-898-2610

E-mail: kkulp@mtsu.edu

Director: David A. Penn

Associate BERC Director:
Murat Arik

**Dean, Jennings A. Jones
College of Business:**
E. James Burton

Publications Editor/Designer:
Sally Ham Govan