

THIRD QUARTER

GOOD BUSINESS, SLOW JOB GROWTH

by David A. Penn

Businesses are doing just fine, according to the midstate indicators for the third quarter, but this has not produced much of a rise in employment, as evidenced by the tepid pace of job creation. A review of tax collection data from the Tennessee Department of Revenue shows that tax collections from Tennessee businesses for July through October are substantially higher compared with a year earlier. The franchise tax (on net business earnings) is up 37 percent from the same period last year, and excise tax collections (based on net worth) are 20 percent higher. Higher collections for these taxes indicate growing net income and higher private-sector net worth. And, as discussed below, business-to-business sales tax collections are 14 percent higher than a year ago.

Good news for businesses has not translated into many additional jobs over the year: Nashville MSA nonfarm employment rose just 11,100 jobs, a lukewarm gain of 1.6 percent from a year earlier. Nonfarm employment growth was up a stronger 1.8 percent in the previous quarter. Thus, a cooling labor market has cooled some more.

Professional and business services, retail trade, and the leisure and hospitality industry produced nearly 75 percent of the new jobs during the third quarter.

Manufacturing employment is slipping this year, down about 980 jobs from the first quarter (seasonally adjusted). It is interesting that nondurables held steady, and transportation equipment manufacturing posted a modest gain. Computer and electronic products lost jobs this year as did electrical equipment and appliance manufacturing.

One would expect weak job growth to translate into slow payroll growth, which in turn results in slower retail sales growth. Contrary to expectations, Nashville MSA taxable sales are up a robust 9.8 percent over the year following a healthy 7.0 percent gain in the second quarter.

Although we don't know which retailing sectors are up or down for the Nashville MSA, we do have this information for Tennessee. Table 2 shows year-over-year taxable sales growth for the state by major category for the third quarter. The Tennessee state sales tax applies broadly, including much more than items sold at retail. The application of the sales tax to a broad array of goods and services is an important strength of Tennessee's system of tax revenues since it provides greatly needed diversity of revenue sources.

The sales tax and use tax¹ are collected from many businesses in the services sector and other nonretail businesses in addition to retailing. Remarkably, four in 10 dollars collected in the third quarter were from service and other nonretail businesses. For the third quarter, the retail portion of sales tax collections rose 5.4 percent while collections from services businesses increased 6.0 percent and collections from other nonretail businesses were up a whopping 14.4 percent. These nonretail sectors include wholesale trade, construction, and manufacturing (Table 2).

The strength of tax collections from services and nonretail businesses compared with retail businesses might be explained by two factors: (1) greater travel and tourism in the Nashville area and (2) an increase in the volume of business-to-business trade. When travel and tourism activity picks up, sales tax collections from hotels and motels increase. More evidence of growing tourism and travel activity is shown by higher airline passenger traffic (Table 3), higher hotel tax revenue, and steadily rising room occu-

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

Sector	2004	2005	Change	% Change
Total Nonfarm	715.1	726.1	11.0	1.5%
Total Private	619.8	630.4	10.5	1.7%
Natural Resources, Mining, and Construction	34.2	34.9	0.7	1.9%
Manufacturing	84.3	83.9	-0.4	-0.5%
Durable Goods	57.8	57.4	-0.4	-0.6%
Computer and Electronic Products	4.8	4.7	-0.1	-2.0%
Electrical Equip., Appliance, Components	7.0	7.2	0.2	3.0%
Transportation Equipment	19.3	19.8	0.5	2.6%
Nondurable Goods	26.5	26.4	-0.1	-0.2%
Wholesale Trade	34.4	34.6	0.2	0.6%
Retail Trade	83.0	85.6	2.5	3.1%
Transportation and Utilities	28.0	28.4	0.4	1.3%
Information	19.2	19.1	-0.1	-0.6%
Financial Activities	44.1	44.5	0.4	0.8%
Professional and Business Services	92.0	96.4	4.4	4.8%
Educational and Health Services	98.5	99.4	1.0	1.0%
Educational Services	20.9	21.0	0.1	0.5%
Health Care and Social Assistance	77.5	78.4	0.8	1.1%
Leisure and Hospitality	72.6	73.8	1.2	1.7%
Arts, Entertainment, and Recreation	9.7	10.2	0.5	5.0%
Accommodation and Food Services	62.9	63.7	0.7	1.2%
Other Services	29.4	29.7	0.3	1.1%
Government	95.2	95.6	0.4	0.5%
State Government	28.2	28.4	0.2	0.6%
Local Government	55.4	55.6	0.2	0.3%

Source: Bureau of Labor Statistics

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pancy rates. As for business-to-business sales, the strong increase in manufacturing, construction, business services, transportation, communication, and wholesaling is indicative of growing business revenues and profits.

Relatively strong payroll growth is also boosting retail sales for Tennessee. In the second quarter of 2005, total wages paid to Tennessee workers were 6.7 percent higher than a year ago following a 7.0 percent first-quarter rise and a 7.3 percent rise in the fourth quarter of 2004. Tennessee has not experienced payroll growth rates in consecutive quarters like this since 1998. Although comparable figures are not available for the Nashville MSA, one would expect its growth rates to equal if not exceed the statewide figures.

While payroll growth is relatively strong this year, nonfarm employment growth is not. What explains this divergence? One possibility is that employment growth is underestimated. When we compare the monthly Current Employment Survey (CES) data with the Quarterly Census of Employment and Wages (QCEW) for the first quarter of 2005, we find substantial differences. The CES figures are based on a monthly sample of employers; these figures lag about two months. The QCEW consists of employment and payroll figures from all employers who pay unemployment insurance (UI) for their workers. The QCEW numbers lag behind about six months. Once a year, the CES survey figures are adjusted using the QCEW data as the benchmark. Between benchmark dates, the two employment series can

Table 2. % Change State Taxable Sales 3rd Quarter 04-05

A. For Selected Services and Other Nonretail Business Categories		B. By Category	
Sector	% Change	Category	% Change
Hotels and lodging places	8.2%	Building materials	9.0%
Business services	5.9%	General merchandise	4.6%
Miscellaneous repair services	6.6%	Food stores	4.2%
Total services	6.0%	Auto dealers, service stations	3.1%
Construction	11.7%	Apparel and accessory stores	5.3%
Manufacturing	13.4%	Furniture & home furnishings	11.4%
Transportation	22.1%	Eating and drinking places	5.3%
Communications	11.1%	Miscellaneous retail stores	11.8%
Wholesale trade	21.0%	Service sector businesses	6.0%
Finance, insurance, real estate	33.1%	Nonretail businesses	14.4%
Total other nonretail	14.4%	Total	7.6%

diverge. In the first quarter of 2005, employment growth as measured by the QCEW series greatly exceeds that of the CES survey figures (Table 4). The CES estimates for the Nashville MSA show nonfarm employment 2.1 percent higher in the first quarter of 2005, but the QCEW figures show a much higher gain of 3.1 percent. Comparable data for Tennessee show a similar mismatch between CES and QCEW data. Based on this information, we anticipate upward revisions in CES employment data during the annual benchmarking period later this winter.

Turning to housing construction, seasonally adjusted permits issued for single-family home construction in the midstate fell in the third quarter by 3.3 percent from the second quarter, reflecting a softening in demand for new

Table 3. Economic Indicators for Middle Tennessee

Series (seasonally adjusted)	Geographical Area	2004Q3	2004Q4	2005Q1	2005Q2	2005Q3	% Change 05Q2-05Q3	% Change 04Q3-05Q3
Nashville MSA Leading Index	Nashville MSA*	118.7	119.9	117.7	119.0	119.8	0.7%	1.0%
Nashville MSA Coincident Index	Nashville MSA	113.3	114.1	114.9	115.1	115.6	0.5%	2.1%
LABOR FORCE AND EMPLOYMENT								
Midstate Total Employment	Midstate**	1,074,569	1,072,823	1,064,242	1,061,149	1,071,708	1.0%	-0.3%
Midstate Labor Force	Midstate	1,128,696	1,126,550	1,123,511	1,123,860	1,127,216	0.3%	-0.1%
Midstate Unemployed	Midstate	54,126	53,727	59,269	62,711	55,508	-11.5%	2.6%
Midstate Unemployment Rate	Midstate	4.8%	4.8%	5.3%	5.6%	4.9%	-11.7%	2.7%
Nashville MSA Nonfarm Employment	Nashville MSA	715,073	718,406	721,891	723,262	726,099	0.4%	1.5%
Average Hours Worked per Week in Manufacturing	Nashville MSA	40.1	40.4	39.5	39.4	40.1	2.0%	0.1%
Counties with Increased Employment (percent)	Midstate	53.7%	26.8%	4.9%	29.3%	73.2%	—	—
Counties with Increased Unemployment (percent)	Midstate	63.4%	41.5%	95.1%	85.4%	17.1%	—	—
Counties with Increased Labor Force (percent)	Midstate	51.2%	19.5%	26.8%	61.0%	68.3%	—	—
Initial Claims for Unemployment Compensation	Midstate	34,491	39,121	41,293	40,184	44,153	9.9%	28.0%
HOUSING CONSTRUCTION								
New Residential Permits	Midstate							
Single-family		4,620	4,647	4,452	4,739	4,584	-3.3%	-0.8%
Total		5,488	5,973	5,451	5,602	5,510	-1.6%	0.4%
Value of New Residential Units (million \$)	Midstate							
Single-family		636.4	623.7	615.6	707.6	678.0	-4.2%	6.5%
Total		695.7	703.0	679.1	753.5	738.4	-2.0%	6.1%
TOURISM								
Hotel Tax Revenue (million \$)	Davidson Co.	5.01	5.03	5.07	5.30	5.31	0.2%	6.0%
Total Air Passengers, Nashville International Airport	Davidson Co.	2,168,676	2,203,549	2,222,976	2,278,974	2,373,299	4.1%	9.4%
TAXABLE SALES (estimates)								
Nashville MSA (million \$)	Nashville MSA	6,147	6,295	6,484	6,589	6,749	2.4%	9.8%
Midstate (million \$)	Midstate	8,434	8,609	8,842	8,961	9,176	2.4%	8.8%

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.

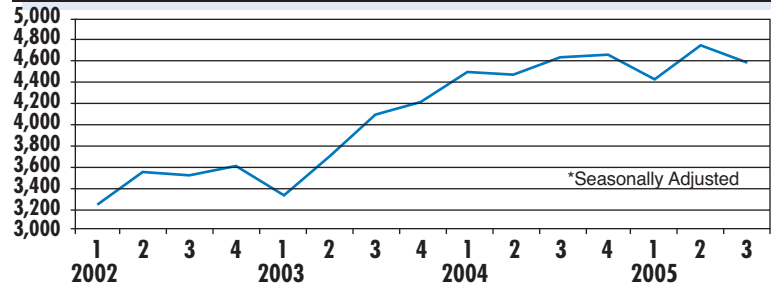
Table 4. Comparing CES* and QCEW Data for Tennessee and Nashville MSA**

Area	2004 (thousands)	2005 (thousands)	% Change
Tennessee			
CES	2,661.6	2,692.5	1.2%
QCEW	2,596.8	2,645.7	1.9%
Nashville MSA			
CES	700.9	715.3	2.1%
QCEW	698.0	719.8	3.1%

*Current Employment Survey. **Quarterly Census of Employment and Wages. Source: Bureau of Labor Statistics.

homes (Figure 1). From the third quarter of 2004, single-family permits are down 0.8 percent while total permits (single-family plus multifamily) are virtually unchanged. Softening demand for new homes can be caused by a variety of factors: falling consumer confidence, higher borrowing costs, higher construction and real estate prices, or all of the above. Judging from national household surveys, consumer confidence has taken a beating during the past few months. Householders can't help but react negatively to the steady stream of bad news: the devastating impacts of hurricanes, inadequate government responses at all levels to the aftermath of storms, the war in Iraq, and indictments of politicians in Congress and the executive branch. Meanwhile, the cost of housing is on the rise in the Nashville area. Median sales prices for new and pre-owned homes in the Nashville area are up 13.8 percent from 2004 according to the Greater Nashville Association of Realtors. Stronger sales prices plus rising land and construction costs push housing prices higher. The weaker single-family home construction figures coincide with a substantial rise in the per unit cost of new single-family homes (about 7 percent per year over the past two years), probably pricing some households out of the new home market.

Figure 1. Single-Family Building Permits, Nashville MSA



Coincident and Leading Indicators

The BERC Nashville MSA Coincident Index (CI) climbed to 115.6 in the third quarter, up a modest 0.5 percent from the second and 2.1 percent from a year ago (Table 3). Virtually all the increase occurred in August with gains evident for both real taxable sales and nonfarm employment (Table 5). So far in 2005, the CI has gained strength in just three months: January, June, and August. The time trend for the CI since 2000 is presented in Figure 2.

The leading index (LI) is composed of four indicators: initial claims for unemployment insurance, real value of housing construction, real orders for manufactured goods, and average weekly hours worked in manufacturing establishments. Average weekly hours are a recent addition to our leading index. The leading index rose 1.0 percent from a year ago, buoyed by increasing hours worked in manufacturing and greater new orders for consumer goods nationally. July was the weakest month in the third quarter, with inflation-adjusted housing construction falling to \$172 million and initial unemployment claims climbing to 13,700 compared with 12,900 in June. Real housing construction bounced back in August and fell again in Sep-

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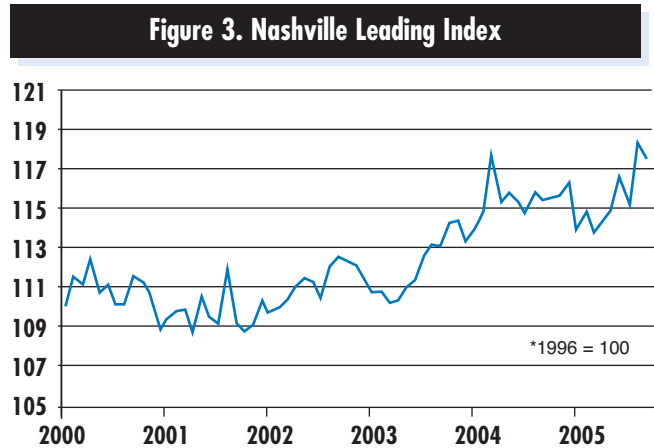
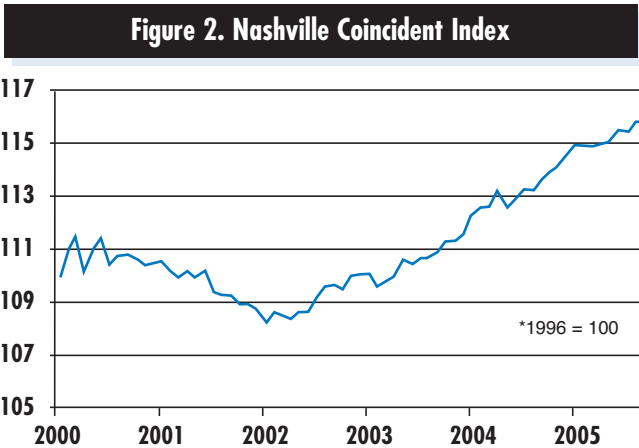
Table 5. Data and Net Contributions for Components of the Nashville Coincident and Leading Indexes

Component (seasonally adjusted)	April	May	June	July	August	September
Coincident Index Component Data						
Taxable Sales (million 2000 dol.)	1,938.0	1,948.0	1,990.4	1,963.2	1,995.8	1,980.4
Nonfarm Employment (thousands)	723.1	722.9	723.9	725.6	726.1	726.6
COINCIDENT INDEX (1996 = 100)	114.9	115.0	115.4	115.5	115.8	115.7
Percent Change from Prior Month	0.04	0.04	0.38	0.04	0.26	-0.04
Coincident Index Net Contributions						
Taxable Sales	-0.03	0.06	0.26	-0.17	0.20	-0.09
Nonfarm Employment	0.07	-0.02	0.12	0.21	0.06	0.06
Leading Index Component Data						
Initial Unemployment Claims	13,210	13,985	12,989	13,774	15,380	15,000
Value of Total Building Permits (million 2000 dol.)	192.7	204.0	249.5	171.6	229.4	217.6
Manufacturers' New Orders, Consumer Goods, U.S. (million 2000 dol.)	133,457.2	135,359.5	135,145.5	135,263.5	137,766.5	134,836.7
Manufacturing Average Weekly Hours	39.2	39.3	39.8	39.5	40.2	40.3
LEADING INDEX (1996 = 100)	117.6	118.5	120.8	118.0	121.3	120.2
Percent Change from Prior Month	0.61	0.85	1.87	-2.25	2.72	-0.88
Leading Index Net Contributions						
Initial Unemployment Claims	0.41	-0.23	0.28	-0.21	-0.42	0.09
Value of Total Building Permits	0.24	0.30	1.01	-1.72	1.44	-0.24
Manufacturers' New Orders, Consumer Goods, U.S.	-0.46	0.64	-0.07	0.04	0.80	-0.84
Manufacturing Average Weekly Hours	0.42	0.14	0.65	-0.36	0.90	0.12

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tember. The trend for the LI since 2000 (Figure 3) shows considerable volatility. ■

1. The use tax is collected on purchases of items out-of-state for use in Tennessee, including equipment and supplies.

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