

HOUSING SLOWDOWN

SINKING IN

by David A. Penn

Nashville economic activity slowed to a crawl during the third quarter, with several important indicators turning negative for the first time in several years. Nonfarm employment, a broad measure of payroll growth, failed for the first time since 2003 to post a quarterly gain (Table 1). Manufacturing employment is down from the second quarter, retail and wholesale trade are virtually unchanged, and stalwart educational and health services experienced a modest job loss (Table 3). Taxable sales are down slightly from the previous quarter, and total employment is unchanged. The number of permits issued for single-family home construction continues to drop, but due to a large increase in multi-family permits, total housing construction is down just 2.6 percent from the second quarter (Figure 1).

Nonfarm employment growth for the Nashville metro area fell behind other major metropolitan areas that are

viewed as Nashville's competitors. Employment also fell in Louisville in the third quarter, but competitor metro areas experienced net job gains (Table 2).

Both the Chattanooga and Clarksville metro areas are experiencing large declines in housing construction, although nonfarm employment growth remains respectable (Table 5). Taxable sales are flat to down, but the unemployment rate is steady.

The economic landscape this quarter has been filled by news of the subprime mortgage crisis. The research firm Global Insight recently estimated the impact of the mortgage crisis on U.S. metropolitan areas. According to the report, the effect of the mortgage credit curtailment is manifested primarily in two ways: sharply curtailed new residential investment (housing construction) and reduced household wealth due to decreased home equity. Either effect has a depressing impact on local jobs, income, and tax revenue. Fewer houses under construction mean fewer construction jobs plus indirect effects on retail, wholesale, and manufacturing suppliers for the construction industry. One less new home generates a ripple effect in the local

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Table 1. Economic Indicators for Middle Tennessee

Series (seasonally adjusted)	Geographical Area	2006Q3	2006Q4	2007Q1	2007Q2	2007Q3	% Change 07Q2-07Q3	% Change 06Q3-07Q3
LABOR FORCE AND EMPLOYMENT								
Midstate Total Employment	Midstate**	1,117,841	1,126,067	1,135,313	1,140,902	1,141,422	0.0%	2.1%
Midstate Labor Force	Midstate	1,176,018	1,180,186	1,189,124	1,191,301	1,191,284	0.0%	1.3%
Midstate Unemployed	Midstate	58,177	54,119	53,811	50,399	49,862	-1.1%	-14.3%
Midstate Unemployment Rate	Midstate	4.9%	4.6%	4.5%	4.2%	4.2%		
Nashville MSA Nonfarm Employment	Nashville MSA*	753,084	755,451	759,344	761,445	760,534	-0.1%	1.0%
Average Hours Worked per Week in Manufacturing	Nashville MSA	40.0	40.2	40.1	40.1	40.0	-0.1%	0.0%
Initial Claims for Unemployment Compensation	Midstate	42,775	41,006	42,233	38,085	37,416	-1.8%	-12.5%
HOUSING CONSTRUCTION								
New Residential Permits	Nashville MSA							
Single-Family		3,194	3,272	3,131	3,036	2,650	-12.7%	-17.0%
Multi-Family		644	335	413	284	584	105.6%	-9.3%
Total		3,838	3,607	3,543	3,320	3,234	-2.6%	-15.7%
Value of New Residential Units (million \$)	Nashville MSA							
Single-Family		523	537	537	540	491	-9.0%	-6.0%
Multi-Family		56	26	32	23	55	138.8%	-3.0%
Total		579	562	570	563	546	-3.0%	-5.7%
TOURISM								
Total Air Passengers, Nashville International Airport	Davidson Co.	2,444,600	2,576,247	2,430,861	2,439,985	2,496,395	2.3%	2.1%
TAXABLE SALES (estimates, million \$)								
Nashville MSA	Nashville MSA	7,199	7,310	7,509	7,468	7,461	-0.1%	3.6%
In-State Sales Only		6,096	6,236	6,398	6,324	6,308	-0.2%	3.5%
Midstate	Midstate	9,758	9,907	10,170	10,146	10,099	-0.5%	3.5%
In-State Sales Only		8,264	8,456	8,657	8,591	8,540	-0.6%	3.3%

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.

HOUSING SLOWDOWN

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economy beyond the cost of building the home, affecting building supply retailers and wholesalers, developers, building material manufacturers, and furniture, appliance, and home furnishings retailers.

Between 2001 and 2005, home values rose rapidly in the U.S., creating new wealth for homeowners. Taking out home equity loans or establishing equity lines of credit, U.S. householders tapped upward of \$1 trillion of increased value in their homes during this period, with much of the proceeds used for spending on goods and services. How important was the wealth effect on household spending during the housing boom? We can approximate the effect by comparing income growth (minus the wealth effect) with the growth of consumer spending during this period.

Declining housing construction and house price deflation will, all else being equal, cause total spending to fall in the Nashville area—but how much? The Global Insight study measures the effect on metropolitan areas across the country in terms of lost Gross Metropolitan Product (GMP). GMP is the metropolitan area measure of net output, much as GDP measures the value of final goods and services produced during a given period for the U.S. economy.

Global Insight estimates a loss of 0.6 percent of GMP growth for the Nashville metropolitan area, amounting to \$901.6 billion in output reduction from 3.2 percent growth that would otherwise have occurred. This estimate is

Table 2. Quarterly Growth of Nonfarm Employment for Selected Metropolitan Areas (seasonally adjusted)

Metropolitan Area	06Q3–06Q4	06Q4–07Q1	07Q1–07Q2	07Q2–07Q3
Atlanta–Sandy Springs–Marietta, GA	0.5%	0.5%	0.4%	0.8%
Birmingham–Hoover, AL	0.2%	0.3%	0.3%	0.2%
Charlotte–Gastonia–Concord, NC–SC	0.7%	1.1%	0.3%	0.5%
Indianapolis, IN	0.4%	0.3%	0.4%	0.4%
Louisville, KY–IN	0.2%	0.9%	0.1%	-0.1%
Memphis, TN–MS–AR	0.5%	0.5%	0.0%	0.3%
Nashville–Davidson–Murfreesboro, TN	0.3%	0.5%	0.3%	-0.1%

Source: Bureau of Labor Statistics, CES series

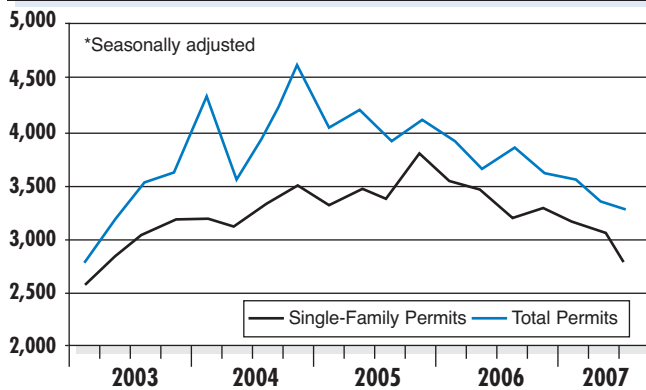
doubtful for two reasons. First, the Atlanta MSA also shows a -0.6 percent decline in GMP, producing a reduction of \$954.0 billion in output. But isn't the Atlanta economy considerably larger than the Nashville economy? According to the U.S. Bureau of Economic Analysis (BEA, www.bea.gov), Atlanta's GDP is 3.5 times that of Nashville, and Atlanta's total personal income is 3.3 times larger. So one would reasonably conclude that a 0.6 percent loss of GMP for both metro areas should be at least three times larger for Atlanta than for Nashville.

Second, the extent of the wealth effect depends on two factors: (1) the sensitivity of household spending to a change in household wealth and (2) how much household wealth is likely to change due to falling property values during the coming year. According to the Global Insight

Table 3. Nashville-Davidson-Murfreesboro MSA Nonfarm Employment (seasonally adjusted in thousands)

Sector	2006Q2	2006Q3	2006Q4	2007Q1	2007Q2	2007Q3	% Change 07Q2-07Q3	% Change 06Q3-07Q3
Total Nonfarm	750.5	753.1	755.5	759.3	761.3	760.5	-0.1%	1.0%
Total Private	652.6	654.9	657.1	660.3	661.8	661.4	0.0%	1.0%
Natural Resources, Mining, and Construction	38.9	39.2	40.0	41.8	41.6	41.8	0.3%	6.5%
Manufacturing	84.1	84.6	84.2	83.8	82.8	82.3	-0.6%	-2.7%
Durable Goods	57.7	58.1	57.9	57.5	56.9	56.8	-0.1%	-2.3%
Computer and Electronic Products	4.3	4.2	4.1	4.3	4.2	4.2	-0.9%	0.9%
Electrical Equipment, Appliances, and Components	7.4	7.6	7.7	7.5	7.7	8.0	3.6%	4.6%
Transportation Equipment	19.9	20.2	20.1	19.6	19.4	19.0	-1.8%	-5.6%
Nondurable Goods	26.4	26.5	26.3	26.2	25.9	25.5	-1.5%	-3.7%
Wholesale Trade	36.7	37.0	37.0	37.3	37.3	37.3	0.0%	1.0%
Retail Trade	86.6	86.4	86.1	86.7	87.1	87.2	0.1%	1.0%
Transportation and Utilities	31.4	31.2	31.4	31.9	31.9	31.6	-1.0%	1.4%
Information	19.7	19.7	19.8	19.8	19.8	19.6	-1.0%	-0.5%
Financial Activities	46.0	46.1	46.1	46.1	46.2	46.5	0.7%	0.8%
Finance and Insurance	35.1	35.2	35.2	35.2	35.2	35.3	0.3%	0.4%
Real Estate and Rental and Leasing	10.9	10.9	10.9	10.9	10.9	11.2	2.0%	2.1%
Professional and Business Services	98.0	99.1	99.9	99.4	99.5	99.7	0.1%	0.5%
Professional, Scientific, and Technical Services	36.2	36.5	37.0	37.5	37.7	38.2	1.4%	4.7%
Management of Companies and Enterprises	7.6	7.6	7.7	7.6	7.8	7.5	-3.1%	-1.3%
Admin., Support, Waste Management, Remediation Services	54.2	55.2	55.0	54.2	54.0	54.2	0.4%	-1.9%
Educational and Health Services	103.8	104.3	104.9	105.4	105.5	105.0	-0.4%	0.7%
Educational Services	22.8	22.8	23.1	23.2	23.3	23.1	-0.7%	1.3%
Health Care and Social Assistance	81.0	81.4	81.7	82.2	82.2	81.9	-0.4%	0.6%
Hospitals	27.8	27.7	27.8	27.8	28.0	27.8	-0.9%	0.3%
Leisure and Hospitality	76.8	76.5	76.8	77.6	78.1	78.6	0.6%	2.8%
Arts, Entertainment, and Recreation	9.9	10.0	9.9	10.1	10.1	10.0	-0.6%	-0.2%
Accommodation and Food Services	66.9	66.5	67.0	67.5	68.1	68.6	0.7%	3.2%
Accommodation	12.2	12.1	12.0	12.3	12.6	12.4	-1.3%	2.5%
Food Services and Drinking Places	54.6	54.4	55.0	55.1	55.5	56.3	1.5%	3.4%
Other Services	30.4	30.7	30.9	31.1	31.5	31.6	0.1%	2.7%
Government	97.7	98.4	98.2	99.2	99.4	99.2	-0.1%	0.9%

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



study, property values for homeowners are expected to fall a total of \$1.2 trillion during 2008 for the U.S. Indeed, property values are beginning to fall, as measured by the Office of Federal Housing Enterprise Oversight's index of same-home sales prices: average property values for the U.S. market dropped 1.5 percent in the third quarter from the second quarter, the first quarterly decline since 1994. However, the fall in home values is concentrated in just a few states including Arizona, California, Florida, Nevada, Michigan, Ohio, Massachusetts, Rhode Island, and Minnesota. All other states continue to experience rising home values due to varying reasons such as population growth

Figure 2. Trend Sales and Actual Sales for Tennessee (Adjusted)

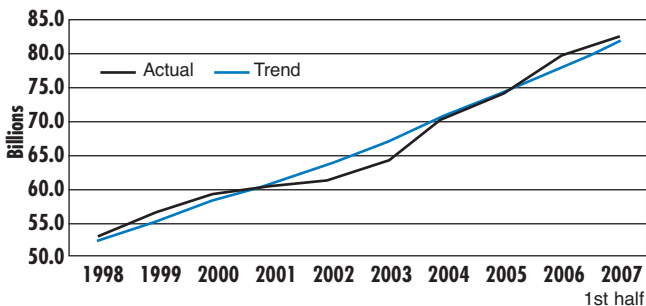


Table 4. Residential Real Estate in the Nashville MSA, 3rd Quarter

	2006	2007	Percent Change 2006-2007
Inventory	11,676	15,181	30.0%
Median Price	\$181,067	\$187,303	3.4%
Closings	3,017	2,463	-18.4%
Days on Market	57	65	14.6%

Source: Greater Nashville Association of Realtors

(Utah), the rising price of oil and minerals (Texas, Oklahoma, Montana, Wyoming), or long-term population shifts to the South. Declining housing wealth will be focused in those states already experiencing falling housing prices. Tennessee is not one of these states.

One would expect household spending to rise more quickly than disposable personal income when the wealth effect is strong. Unfortunately, the ratio of spending to income could rise for other reasons, such as rising consumer confidence. But as a first approximation, the ratio of spending to income is at least consistent with the wealth effect.

The measure of income we use, estimated by the BEA, does not count income from capital gains or income generated by accessing home equity. So spending from home equity will show up in the spending but not the income figures. Thus, the ratio of spending to income gives us a rough approximation of the wealth effect.

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Figure 3. Residential Inventory and Closings, Nashville Area

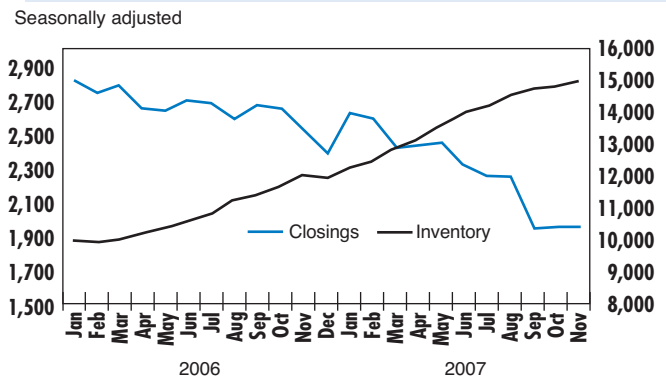


Table 5. Economic Indicators for Chattanooga MSA and Clarksville MSA

Series (seasonally adjusted)	2006Q1	2006Q2	2006Q3	2006Q4	2006Q1	2007Q2	2007Q3	% Change 07Q2-07Q3	% Change 06Q3-07Q3
CHATTANOOGA MSA									
Nonfarm Employment (thousand)	242.4	245.3	247.0	246.8	248.8	247.7	248.3	0.3%	0.5%
Unemployment Rate	4.5	4.6	4.3	4.1	4.1	3.8	3.8	0.0%	-13.4%
Taxable Sales (million \$)	1,608.7	1,621.6	1,649.7	1,637.1	1,669.5	1,683.3	1,687.8	0.3%	2.3%
Permit-Authorized Housing Construction									
Total	769	687	736	635	560	576	480	-16.6%	-34.7%
Single-Family	716	643	578	621	516	513	418	-18.5%	-27.6%
CLARKSVILLE MSA									
Nonfarm Employment (thousand)	81.9	83.0	83.0	83.0	83.2	83.8	84.6	1.0%	1.9%
Unemployment Rate	5.6	5.9	5.4	5.0	5.4	4.9	5.0	2.2%	-6.5%
Taxable Sales (million \$)	513.7	543.2	570.1	589.6	600.1	597.1	593.7	-0.6%	4.1%
Permit-Authorized Housing Construction									
Total	490	620	1,123	783	732	533	347	-35.0%	-69.1%
Single-Family	401	474	536	573	438	408	279	-31.6%	-47.9%

Business and Economic Research Center

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

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Figure 2 shows adjusted retail sales for Tennessee along with the 10-year trend.¹ We assume the 10-year trend is indicative of the relationship between disposable income and retail sales in the long-run: retail sales can deviate from the long-term trend, but only for one or two years at a time. A movement of actual sales above the trend will have to be “paid back” sometime in the future. Adjusted taxable sales were roughly 2.2 percent above trend for 2006, suggesting a combination of the wealth effect and increased consumer confidence. Data for the first half of 2007 show sales slowing considerably relative to personal income, with sales just 3.3 percent higher from the first half of 2006 compared with personal income growth of 5 percent. Thus, household spending is moving back toward the long-term trend.

The question now is what happens in the second half of 2007. Most likely, actual sales will dip below trend in the second half. Just how much at this point is unclear, but third-quarter sales from retail establishments currently are just 2.2 percent higher for Tennessee over the year, compared with 3.9 percent growth for the second quarter.

In the Nashville area for the third quarter, residential home sales are down 18 percent and inventories are 30 percent higher than one year ago (Table 4). Rapidly rising inventories are a strong sign that supply exceeds demand

in this market. Accordingly, home prices are beginning to moderate with the median price up just 3.4 percent over the year. Some price moderation in this situation is helpful, in that lower prices encourage buyers and discourage sellers, bringing supply and demand closer to a balance.

More recent evidence for October and November suggests that price moderation may be working: after adjusting for typical seasonal fluctuations, the growth of inventories has slowed considerably and sales have stopped falling. Inventory for November is just 218 homes higher than September, and sales have stabilized, at least temporarily (Figure 3). It is too early to tell whether inventories have peaked, although the data are encouraging. ■

1. Taxable sales are adjusted by subtracting sales tax collections for building materials to measure consumer, not construction, spending.

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Online: www.mtsu.edu/~berc
Phone: 615-898-2610
E-mail: kkulp@mtsu.edu
Director: David A. Penn
Associate BERC Director: Murat Arik
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Publications Editor/Designer: Sally Ham Govan