Tennessee: Slower Growth Ahead

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Manufacturing, trade, and perhaps construction should buttress Tennessee's anticipated 1985 growth. Further stimulation may be provided by public works spending, tourism, and agriculture.

Tennessee's economic performance in 1985 should resemble the anticipated U.S. pattern of respectable but slower growth. The state's economy is similar to the nation's except that manufacturing is relatively more important, accounting for over one-fourth of Tennessee's employment compared with just over one-fifth nationally. In addition, production of interest-sensitive consumer durable goods and certain nondurable products especially vulnerable to foreign competition comprises a larger share of Tennessee's manufacturing sector than the nation's. Consequently, developments that affect manufacturing industries will play a greater role in determining the near-term future of Tennessee's economy.

Most sectors of Tennessee's economy probably will experience moderate growth in 1985. Manufacturing should continue to expand somewhat through most of the year because of macroeconomic strengths expected from consumer spending, business investment, and, at least early in the year, residential construction. As a result, continuing advances are likely in the state's personal income, and retail sales should continue to grow, albeit at a slower pace than in 1984. State and local governments are financially sound and have contracted so sharply in recent years that some expansion seems inevitable. The primary effect of such a trend would be to boost personal income, especially that of teachers and public works construction. These three sectors—manufacturing, trade, and government—account for two-thirds of the state's employment, and so their expected growth should spur healthy economic expansion across the state.

Tennessee's construction, agriculture, and tourism industries face encouraging prospects for 1985. Multifamily and commercial construction seems likely to maintain considerable momentum in Tennessee for at least another year. Continuing economic growth augurs increased deposits and loans for the state's financial institutions. Tennessee farmers have been less troubled financially than many of their southeastern peers. Although reductions in prices received for farm products make it unlikely that profitability gains will equal those achieved in 1984, the state's agricultural sector probably will prosper again this year. Finally, tourism also may strengthen as ongoing advances in personal income and the satisfaction of pent-up demand for some items leave more room in consumer budgets for discretionary purchases such as travel and entertainment. However, each of these sectors is small and their joint effect will be less than that of manufacturing.

The chief danger on Tennessee's economic horizon pertains to interest rates. If the federal

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budget deficit begins to exert renewed upward pressure on rates, the adverse impact will be felt severely in Tennessee, whose manufacturing sector is heavily oriented toward the consumer and producer durables that thrive on expanding housing and auto industries. Much of the earlier surge in housing was occasioned by demand deferred during two proximate recessions and an extended period of high nominal interest rates. Since such demand may be nearly exhausted, a return to the levels attained earlier in the recovery is unlikely even though some resurgence is probable. Moreover, residual demand will remain quite sensitive to changes in credit costs. The bleak outlook for international trade also will be troublesome to Tennessee since one-tenth of its manufacturing jobs are export-related, an even larger share are in industries vulnerable to import competition, and the overall portion of export-related jobs in Tennessee is greater than in the nation.

These projections have different implications for each of the state's three major geographic divisions. West Tennesseeans and east Tennessee tobacco growers will be particularly affected by agricultural developments, especially movements in the exchange value of the dollar and their attendant effects on farm exports. Conditions in the international sector as well as interest rate movements will be most significant for middle and east Tennessee because manufacturing is concentrated in these areas. Middle Tennessee should have the best year since its diversified economy will benefit most from expected strength in consumer spending, agriculture, and services. Middle Tennessee also will benefit disproportionately from in-state capital investment: almost three-fifths of the new jobs and almost half the dollar value of investment plans announced in the first nine months of 1984 were in middle Tennessee.

Labor Market Conditions

Labor markets improved substantially in 1984 although the pace slackened in the second half. Nonfarm employment grew at an annual rate in excess of 5 percent for the first eight months and stood at 1.8 million in November, a record level. Tennessee's jobless rate fell from almost 13 percent in the spring of 1983 to 8.4 percent in March 1984. Since then, however, employment growth has slowed while labor force growth accelerated. Tennessee's jobless rate stood at 8.7 percent in November, by which time the national unemployment rate had fallen to 7.2 percent (Chart 1).

Unemployment dropped by the largest margin in Tennessee's major cities—Chattanooga, Knoxville, Memphis, and Nashville; the decline was smaller in the Tri-Cities (Johnson City-Kingsport-Bristol) and in nonmetropolitan areas (see Table 1). More than one-fifth of the work force in seven of Tennessee's 95 counties was unemployed in

Table 1. Tennessee Labor Markets, November 1984

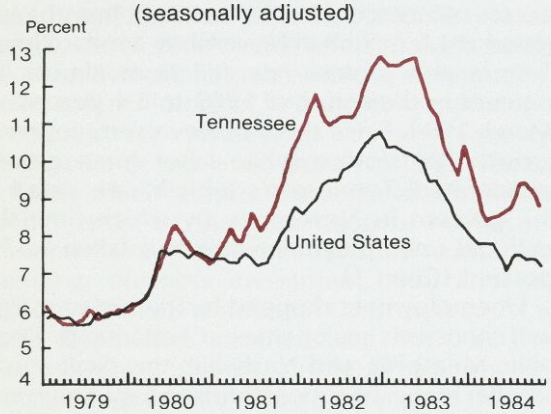
	Nonfarm Employment	Labor Force	Unemployment	Unemployment Rate
	(in thousands)	(in thousands)	(in thousands)	(in percent)
Tennessee	1,822.9	2,258.1	185.6	8.2
Percent Change*	3.3	2.8	−7.6	
Chattanooga	173.0	202.5	14.4	7.1
Percent Change*	3.2	2.8	−14.8	
Knoxville	203.9	232.6	17.1	7.4
Percent Change*	−0.7	0.4	−13.6	
Memphis	364.0	417.6	27.9	6.7
Percent Change*	2.0	−4.0	−22.5	
Nashville	402.0	477.8	22.7	4.8
Percent Change*	4.1	5.1	−21.2	
Tri-Cities	154.2	214.5	16.4	7.6
Percent Change*	3.5	5.6	−3.2	

*Relative to November 1983.

Source: Tennessee Department of Employment Security, *Tennessee Labor Market Report* (November 1984); data are preliminary and not seasonally adjusted.

November. Employment growth held up best in Nashville and Chattanooga as the year progressed. Nashville's diversified economy accounts for its healthy labor market conditions. For Chattanooga, which had yet to return to its previous peak of nonfarm jobs, gains in 1984 reflect a belated recovery from a sharply reduced level of activity.

Chart 1. Unemployment Rate, Tennessee and United States (seasonally adjusted)



Source: U. S. Department of Labor, Bureau of Labor Statistics, and Tennessee Department of Employment Security; Tennessee rates seasonally adjusted by Federal Reserve Bank of Atlanta.

One-fourth to one-third of the employment in east Tennessee's three major cities is in manufacturing, and labor market conditions largely reflect the strengths and weaknesses of particular industries concentrated in each. For example, textiles and apparel, which comprise almost one-third of Knoxville's industrial jobs, have been affected adversely by foreign competition.

In Memphis job growth was slow during 1984 and as of November had not regained its earlier peak. Indeed, according to a separate employment survey that canvasses households and includes the self-employed as well as those working for establishments, employment declined in Memphis in 10 of the first 11 months of last year. Memphis' weaker performance bespeaks the agricultural orientation of its many transportation and distribution businesses and the troubled condition of farming nationally.

Manufacturing created the largest number of new jobs in the state in 1984 (Chart 2), and even in relative terms it outdistanced most other major sectors. Twenty-eight percent of all new employment through the first 11 months was in factories, slightly more than manufacturing's portion of total jobs. Services, transportation, and construction also contributed a disproportionate share of new jobs. Government and finance, in

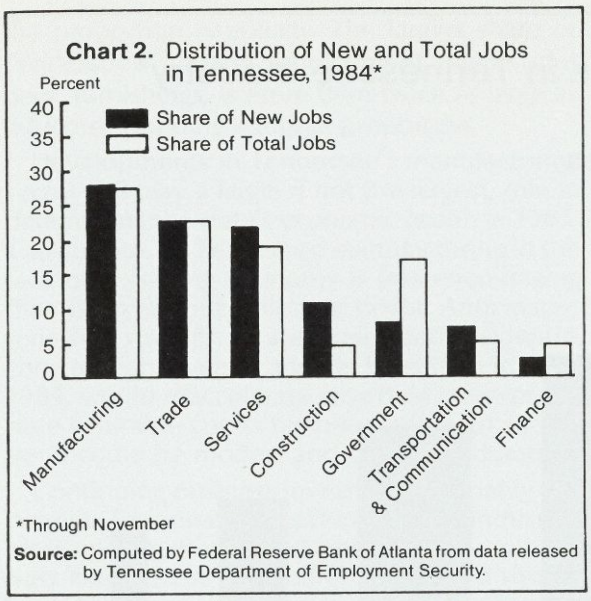


Chart 2. Distribution of New and Total Jobs in Tennessee, 1984*

*Through November

Source: Computed by Federal Reserve Bank of Atlanta from data released by Tennessee Department of Employment Security.

contrast, accounted for a much smaller employment boost than their share of total employment.

Conditions are ripe for improved labor markets in 1985, even though job growth and unemployment rate declines probably will take place much more slowly than in the first half of 1984. Producers were able to trim inventories when consumer spending decelerated in 1984, and inventory-to-sales ratios remain low by historical standards. Hence, layoffs are unlikely, and still-expanding industries and services should create new jobs.

Industrial Activity

Manufacturing employment growth in Tennessee outpaced the nation's in the first quarter of 1984 but slowed more sharply than elsewhere in the second and third quarters. The durable goods sector's employment grew in the double-digit range for the first seven months. Boosted by the first-quarter strength of residential construction, Tennessee industries associated with building materials, home furnishings, and appliances posted especially good job gains. Through November, employment in stone, clay, and glass manufacturing was up 11 percent from the year-earlier period (Chart 3).

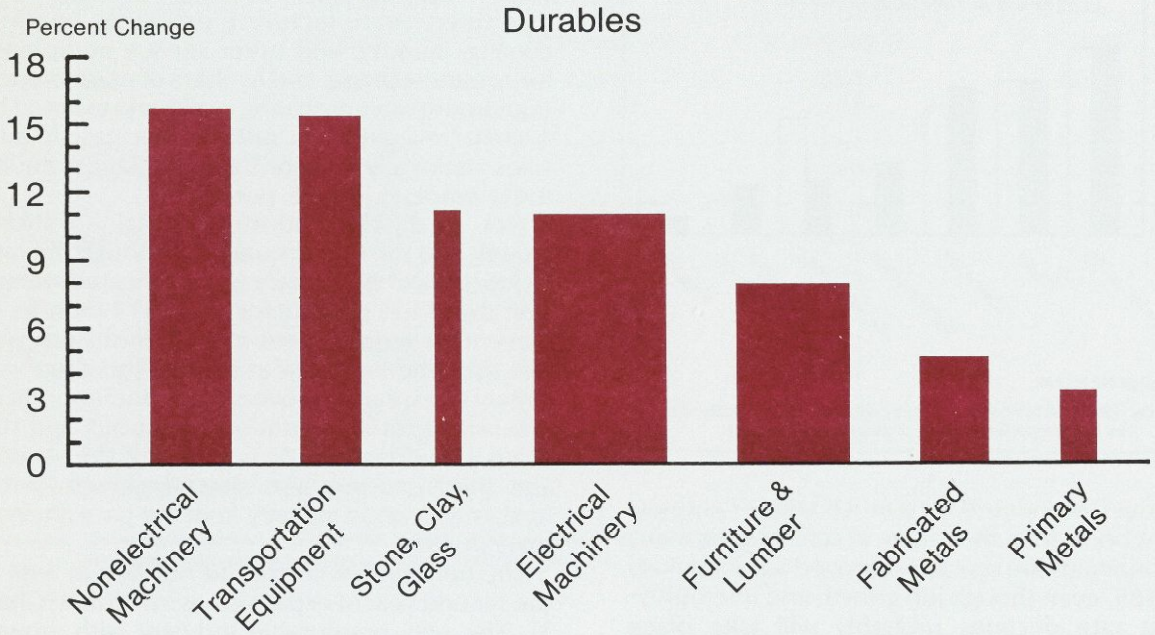
Increases of equal or greater magnitude in machinery employment were attributable to the strong nationwide growth in business fixed investment and the boom in housing construction. One of machinery production's largest components in Tennessee is household appliances. Its share of electrical and electronic equipment manufacturing is four times as large as in the nation. The other large component of Tennessee's machinery manufacturing produces heating, cooling, laundry, and other service equipment for commercial use, and its share of nonelectrical equipment manufacturing is overrepresented by a similar margin.[1] The sustained increase in auto sales nationally boosted transportation equipment employment 15 percent.

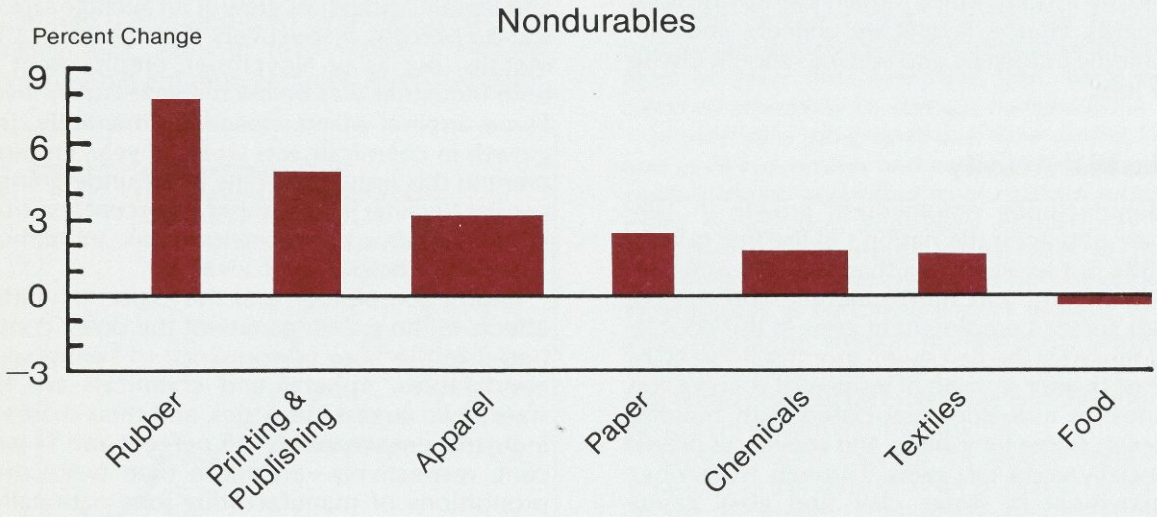
Not all durable industries sustained strong growth into the fourth quarter. Although the rate of job growth in primary and fabricated metals averaged 3 to 5 percent for the first 11 months, in November employment in both industries was less than the level a year earlier. This drop was largely a response to oversupply and imports of low-priced foreign aluminum. Imports and the sharp slowdown in housing during the second and third quarters also slowed growth in the lumber and wood industry from the pace attained early in 1984.

The nondurable sector did not fare as well in the second year of expansion as in the first (Chart 3). The only nondurable industry with growth comparable to most durable industries was rubber, which was spurred by strong auto sales through most of 1984. Employment in the textile and apparel industries grew at an average rate of 2 and 3 percent, respectively, through the first 11 months, but as of November, employment in both industries was below the year-earlier level. Some apparel plants closed permanently. Job growth in chemicals was weak all year. Employment in this industry seems to be undergoing a secular decline; jobs number 6 percent less than in the previous pre-recession peak and almost 15 percent below 1969 levels.

Import competition and the export-inhibiting effects of the exchange rate of the dollar contributed to the poor performance of Tennessee's nondurables. Apparel and chemicals are the state's two largest industries, and their shares of industrial employment—13 percent and 11 percent, respectively—are more than twice their proportions of manufacturing jobs nationally.[2] Moreover, large components of these two industries are concentrated in products especially vulnerable to competition from lower-cost foreign producers. One-third of the jobs in Tennessee's chemical industry involve production of synthetic fibers used to make textiles, which is three times

Chart 3. Employment Changes in Tennessee Industry*





* 1984 v. 1983, average through November. Bar widths denote relative size of industry.

Source: Computed by Federal Reserve Bank of Atlanta from data released by Tennessee Department of Employment Security.

the proportion nationally. The largest share of Tennessee's apparel employment, men's and boys' furnishings, is more than twice as large as the corresponding national proportion.

Developments in Tennessee's manufacturing sector will play a large, if not the largest, role in determining the state's economic health in 1985. The outlook for Tennessee manufacturing in the face of a slowing economy is less encouraging than last year but still fairly bright. Anticipated renewed strength in auto sales and residential construction, even at a lower level than in early 1984, would reaccelerate growth in many of the state's durable goods factories, although such a trend could be modest and of limited duration.

Continuing business investment probably will benefit Tennessee's machinery and industrial inorganic chemical producers. Moreover, business fixed investment within Tennessee should contribute to continuing expansion. The announcements of capital expansion plans and intended new investment in manufacturing during the first 11 months of 1984 promise over 17,000 new manufacturing jobs, 8 percent more than the number generated by investments announced in the 1983 period.[3] For example, Nissan's $85 million project to add car assembly to its Smyrna truck plant should boost the state's transportation equipment industry when production begins in 1985, and ultimately increase the company's local work force by 50 percent.

Despite worldwide competition, major Tennessee manufacturers are reaffirming their faith in the future of Tennessee's favorable economic environment by expanding into new product lines or retooling existing facilities. In Kingsport, for instance, Tennessee Eastman is adding a production unit for hydroquinone, a product used in film manufacturing. Operations are scheduled to begin by 1986. This Kodak division just completed a major capital investment in Tennessee to produce feedstock chemicals from coal for the first time on a commercial basis.

A growing world economy in 1985 could increase the state's bulk chemical exports moderately. A decline in the value of the dollar would bring some improvement, but the outlook is dim for a substantial gain in manufacturing exports or for a decline in imports. Even if exchange rates become more favorable to the United States, there is usually a lag of six months or so before demand rises substantially.

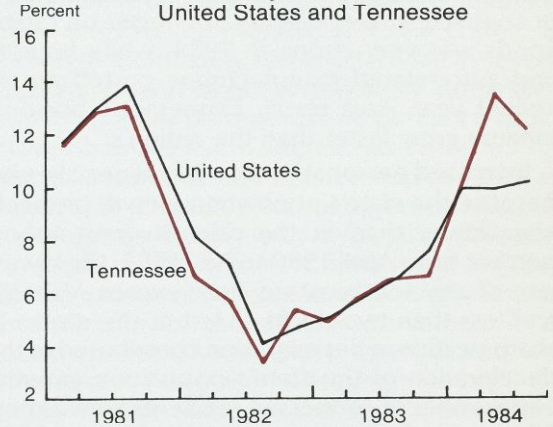
The discouraging international prospects may prove especially burdensome to Tennessee. Although the 10 percent share of manufacturing jobs attributable to exports is less than the nation's 13 percent, more Tennessee industries are vulnerable to foreign competition and 5.3 percent of total employment is export-related compared with 4.7 percent nationally.[4] One source of national strength that will be relatively limited in Tennessee is defense. From 1981 to 1983, Tennessee producers won less than 1 percent of all military contracts, a much smaller share in dollar value than any other southeastern state.[5]

Personal Income and Consumer Spending

Fast personal income growth in Tennessee during the last two years contributed to unusually robust consumer spending that boosted the state's second most important economic sector, trade. Tennessee's personal income grew at an annual rate of 12 percent in the third quarter compared with about 10 percent nationally (Chart 4).

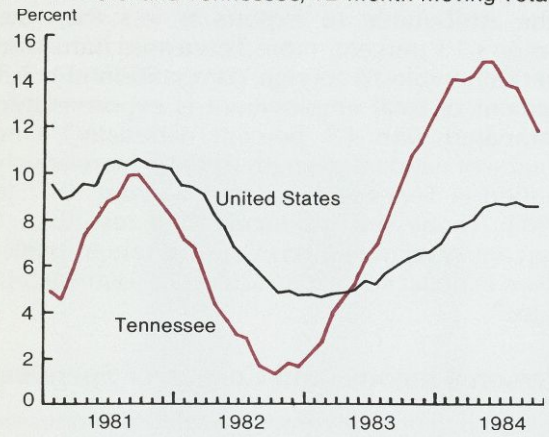
Retail trade activity on a per capita basis was even more impressive in relation to other southeastern states and the nation in 1984, reversing the state's performance in 1981 and 1982 (Chart 5). Through October 1984, the pace of Tennessee sales growth was well ahead of the rate nationally. Not surprisingly, furniture and home appliances

Chart 4. Annual Percent Change in Quarterly Personal Income, United States and Tennessee



Source: Calculated by Federal Reserve Bank of Atlanta from data in U. S. Department of Commerce, Bureau of Economic Analysis, *Quarterly Personal Income*, various issues.

Chart 5. Annual Percent Change in Retail Trade, U.S. and Tennessee, 12-Month Moving Total



Source: U.S. Department of Commerce, Bureau of the Census, *Monthly Retail Trade*, various issues.

posted the strongest sales gains during the first 11 months, but automobiles and building materials also advanced dramatically.[6] Reflecting this growth in consumer spending, trade employment expanded more rapidly than in 1983 (4 to 5 percent versus 2 percent) despite a contraction in wholesale trade jobs.

The rate of expansions and contractions in personal income, like that of unemployment, is greater in Tennessee than in the nation because of the state's heavier reliance on manufacturing. The most striking differences have occurred when Tennessee's cyclically sensitive durable manufactured goods industries were expanding or contracting. Spending by businesses on capital goods was very strong in 1984, while housing and auto-related manufacturers posted an excellent year. As a result, Tennessee's personal income grew faster than the nation's.

Increased personal income was especially vital because the state's population growth probably was slower than in the past. It grew only 2 percent from April 1980 to July 1983, the lowest rate of any southeastern state except Alabama and less than two-thirds as fast as the nation. A sharp decline in net migration contributed to the deceleration of the state's population growth.[7] The number of Tennessee residents grew almost 50 percent faster than nationally in the 1970s, although growth was concentrated in the state's middle and eastern urban and suburban areas.

Without the prop of population growth, prospects for income and spending gains in 1985 will depend largely on the national and international economic outlook and concomitant demand for Tennessee goods and services. If the national economy settles into a moderate, sustainable growth path this year as expected, Tennesseans can anticipate continued healthy income and spending growth, albeit at a less robust pace than in 1984. Ongoing gains in income and consumer spending should buoy the state's economy in general, and its financial, public, and service sectors in particular, by generating increased loans, deposits, tax revenues, and demand for personal and business services.

Public Sector

Tennessee's state government has been financially sound for several years, ending each of the last three fiscal years with a budget surplus. A one-cent increase in the state's sales tax and the broadening of its base swelled coffers last year. A $51 million surplus, the equivalent of 2 percent of expenditures, is projected for fiscal 1985.[8] The higher sales tax and an anticipated fiscal 1984 surplus have revived state and local government job growth. Government employment climbed about 2 percent through the first 11 months of 1984, reversing a downward trend during the previous three years. Nonetheless, the number of public sector workers still was below the peak attained in 1980. The per capita ratio of full-time equivalent state and local government workers is 9 percent lower than three years earlier and 2 percent below the national average.[9] Of the six southeastern states, only Florida has proportionately fewer state and local government workers than Tennessee.

It is likely that employment and spending in Tennessee's public sector, especially at the state and local levels, will increase in 1985. The fiscal 1985 state budget represents a nominal increase of 16 percent. Substantial job increases also may occur at the local level, where the decline has been greatest. A recent state emphasis on education also should stimulate local government employment. In fiscal 1984, the Tennessee legislature appropriated $1 billion over the next three years to improve the state's educational system. Much of the increased funding will improve financial incentives for teachers. Thus, this government stimulus should be felt mainly on personal incomes and concomitantly on consumer spending.

Table 2. Tennessee Construction, 1984 vs. 1983

	Single-Family Permits January-November			Multifamily Permits January-November			Value of Nonresidential Construction* January-November		
	1983	1984	Percent Change	1983	1984	Percent Change	1983	1984	Percent Change
Tennessee	13,059	12,622	–3.4	15,239	21,304	39.8	1,053.3	1,300.8	23.5
Chattanooga	1,016	1,128	11.0	795	585	–26.4	70.5	119.1	68.9
Knoxville	1,442	1,262	–12.5	660	601	–8.9	166.3	151.8	–8.7
Memphis	3,786	3,903	3.1	1,223	4,197	243.2	255.7	325.6	27.3
Nashville	3,866	3,894	0.7	6,854	12,754	86.1	349.6	468.7	34.1

*Millions of dollars.

Source: Computed by Federal Reserve Bank of Atlanta from data in U.S. Department of Commerce, Bureau of the Census, *Housing Units Authorized by Building Permits and Public Contracts* (C-40), and F.W. Dodge, *Dodge Construction Potentials*.

The recent end of a freeze on hiring further suggests that increased state spending will stimulate employment and income. However, improved productivity afforded by office automation as well as efficiencies achieved during an extended austerity period make it unlikely that government employment, which consists largely of white-collar workers, will rebound quickly to its previous peaks as a result of revenue and budget increases. Thus, government employment should grow only modestly, as should the attendant consequences of that job expansion on the rest of the state's economy.

Federal job growth averaged 4 percent during the first 11 months but seems unlikely to be a source of growth in Tennessee in 1985. The TVA, which employs one-third of Tennessee's federal workers, will increase its budget only modestly. Yet, at least until the start of the next federal fiscal period in October, neither should federal government employment shrink, as in the past, since most of the substantial cutbacks and layoffs the TVA began several years ago have been completed. Thereafter, proposed federal budget cuts could necessitate further paring of the TVA's staff.

Construction

After three years of sharp declines, Tennessee's construction industry improved considerably last year. The growth rate of construction employment averaged around 16 percent in the first half. Although the pace slowed toward the end of the year, construction accounted for more than one in 10 new jobs through the first 11 months, over twice the industry's share of jobs overall (Chart 2). Multifamily and nonresidential building sustained construction activity and employment after higher interest rates dampened single-family home building.

Single-family building permits soared in the first quarter but then began to decline, on a seasonally adjusted basis. Through November, single-family building permits declined 3 percent from the first 11 months of 1983 (Table 2). Although multifamily construction fell in several months, growth rates tended to be quite high, and multifamily permits rose 40 percent through November. The rise in interest rates early in 1984 made apartments and condominiums more attractive or affordable for many buyers. Duplex townhouses were an especially popular alternative to single-family homes. Chattanooga enjoyed the largest rate of increase in single-family houses, an indication of the sharp improvement in its labor markets. Multifamily construction was strongest in Nashville, reflecting that city's disproportionate share of the state's population growth, particularly of newcomers.

Nonresidential construction increased substantially statewide. Industrial construction in

Tennessee experienced strong and fairly steady growth. As a result of sharply increased manufacturing and consumer spending, many businesses required additional warehouse space to store inventory; others responded to the invigorated economy and tax incentives by investing in plant expansions. Office construction, which accounts for a larger share of nonresidential building, also rose considerably.

The strength of building in Nashville and Memphis helped to pull up the statewide average as fewer new projects were undertaken in Knoxville than in the first 11 months of 1983. Strong gains in manufacturing absorbed a 9 percent increase in Nashville's industrial space, and the occupancy rate rose from 77 to 84 percent.[10] However, absorption of the large volume of new office space has been slower, causing a drop in occupancy to 84 percent. Two years ago, only 5 percent of Nashville's office space was vacant.[11]

Total residential construction should increase, at least early this year, as a result of lower interest rates, which have reduced builders' costs and drawn customers back into the market. Construction of moderately priced single-family homes should be stimulated by the flow of $150 million in housing funds at 11 5/8 percent from a bond offering by the Tennessee Housing Development Authority. Applicants, who may earn no more than $30,000 a year, must apply the funds to single-family residences in the $40,000 range. Despite the bonds, single-family buildings are expected to grow more slowly than multifamily dwellings. Much of the deferred demand for single-family homes already has been met, and Tennessee has been experiencing modest population growth compared with the 1970s. Without the catalyst of population growth, especially by in-migrants, the demand for single-family homes at this mature stage of the business cycle is unlikely to equal that attained earlier in the expansion.

Growth in nonresidential construction probably will continue at a strong pace in 1985 because of corporate relocations. Memphis' central business district should increase its office space by one-third over the next few years, and Nashville has a large number of new office projects on the drawing boards. High vacancy rates may be a harbinger of a mild deceleration by the end of 1985. Commercial construction often is driven more by the availability of financing than by the market, and there is no reason to expect that institutional sources, which provide much of the capital for office construction, will stop funding prospective builders since offices remain a profitable long-term investment.

Government expenditures could stimulate construction, especially in the nonbuilding category. The state government's emphasis on improving water quality should spur construction of new sewage systems, and some bridge construction is contemplated. Expected growth in construction is likely to stimulate certain building-related industries, especially stone, clay, glass, lumber, and fabricated metals. However, considering the moderate growth anticipated and construction's relatively small share of the state economy, this industry's gains are unlikely to propel other economic sectors significantly.

Finance

Tennessee bank deposits showed moderate to strong growth throughout 1984. As of December, commercial bank deposits were 10 percent ahead of the year-earlier level of $22 billion.[12] Tennessee's deposit growth was only slightly less brisk than the nation's. Time deposits grew rapidly, in contrast to 1983, when rising rates led savers to favor money-market deposit accounts. After growing only modestly in the second half of 1983, loans closed by Tennessee banks increased sharply in 1984, standing 19 percent above the year-earlier level in September.[13] The statewide loan-to-asset ratios rose from 49 to 56 percent, reflecting the rapid growth in lending by Tennessee banks. In November, mortgage commitments by Tennessee thrift institutions were over 65 percent ahead of the comparable 1983 level.[14]

The strongest employment growth in several years in the state's financial services industry is further evidence of its underlying strengths. These measures point to Tennessee's energetic growth in personal income and industrial production in 1984. The healthy gains posted by all these financial services industry indicators is especially noteworthy in view of Tennessee's two-year spate of bank failures. Of more than 70 failures nationwide, 11 were in Tennessee, primarily in the central and eastern portions of the state.

The outlook for Tennessee's financial sector in 1985 hinges largely on the state's economic health. It is not likely on its own to contribute significantly to growth in other sectors. Since statewide economic prospects are for respectable

advances, the financial services industry probably will experience continuing expansion. Healthy deposit growth should persist into 1985, given the anticipated increases in personal income. Loan volume and mortgage commitments also should strengthen as long as interest rates remain in their present range.

No simple explanation exists for the large number of bank failures in 1984. Deregulation of the banking industry will make exit, by failure or merger, generally more common than in recent decades, but that does not account for the fact that Tennessee has had far more failures than other states with similar economic structures. Thus, it is difficult to forecast whether 1985 will bring more failures.

It is likely, though, that competitive pressures on Tennessee banks will intensify in the next few years. Passage of regional interstate banking laws by several nearby states will increase demands on the Tennessee legislature to do the same. The Tennessee Bankers Association has endorsed the governor's legislative proposal to allow statewide branching as well as reciprocal interstate banking with a number of regional states. The strong performance by the state's financial services industry last year suggests that the economic impact of any future failures will not be substantial. The main adverse effect of a smaller bank failure, aside from the loss to its stockholders, is the disruption of established relationships between loan officers and the businesses they have served, and this disruption is mitigated when a failure is resolved through acquisition rather than liquidation.

Services

Tennessee's service sector, like those of other states in the Southeast, has resumed steady growth after slowing during the 1981-82 recession. Miscellaneous services contributed more than one-fifth of the new jobs added to Tennessee's economy last year (Chart 2). Health services compose the largest component of this sector in Tennessee, accounting for slightly over a third of service employees. Another third work in hotels or provide business and personal services.

Tourism is an important service industry in Tennessee, accounting in 1983 for $3 billion in expenditures, 4 percent of all payroll employment, and over $150 million in state and local tax revenues.[15] Tennessee's state and national parks rank in the top 10 nationally in the number of visitors. Tourism is important not only in terms of size but also in its "export" quality, since two-thirds of all tourist revenues derive from out-of-state visitors. By bringing revenues to Tennessee from elsewhere, tourism fuels the local economy to supplement gains from population growth and increased personal income. In this respect, tourist-related services are more like manufactured goods, reaching a market far beyond the state's borders; markets of many services are limited to the needs of local consumers and businesses.

Tourist industry conditions in Tennessee were mixed in 1984, although somewhat better than in 1983. In the earlier year most indicators registered declines relative to 1982 levels, which were boosted by the World's Fair in Knoxville. Air travel increased substantially in most Tennessee cities, but declined in Memphis, by far the busiest airport. Judging by visitor center registrations, the level of auto travelers to the state dropped 12 percent through the first 11 months.[16] Most attractions had only slightly higher attendance than the previous year.

Hotels and motels enjoyed the strongest surge as lodgings tax receipts jumped 35 percent, a sharp rise even factoring out the sales tax increase.[17] Moreover, occupancies were up 8 percent through October.[18] This growth was primarily the result of a higher volume of business and convention visitors, who form a larger share of hotel guests than do vacation travelers. Competition from the Olympics, purchases of durable goods deferred for years because of recessions and high interest rates, and the strong dollar that reduced the cost of foreign travel for many Americans all helped tarnish the performance of vacation travel in 1984. In addition, Louisiana's World Fair in New Orleans failed to give Tennessee tourism the expected boost in bus tours; many travelers with intermediate stops in the state cancelled when the fair's shaky financial situation was published.

The outlook for Tennessee's tourist industry in 1985 hinges largely on macroeconomic factors, which appear more positive than negative. Tourism should benefit from anticipated increases in personal income and consumer spending. Indeed, vacation travel might increase considerably if consumers' pent-up demand for housing has been largely met, leaving more in household budgets for discretionary goods and services such as travel. The absence of major competing events also bodes well for 1985 tourism.

On the other hand, if the value of the dollar remains high, more Americans likely will travel abroad, possibly diminishing domestic travel.

The dollar's effects on foreign travel to the United States will have little impact on Tennessee, though, since foreign travelers typically compose only a small portion of the state's visitors.

Local factors will influence the performance of Tennessee tourism this year. A 27 percent increase in the state Tourism Department's budget should improve that agency's ability to market Tennessee's tourist industry. New attractions and convention facilities scheduled to open this year in Nashville, Chattanooga, and Memphis will enhance those cities' appeal as tourist and convention destinations. If tourism grows as expected, it will benefit the retail and public sectors by boosting merchandise and restaurant sales and generating tax revenues beyond those expected from in-state growth in personal income and spending.

The outlook for other major service industries should track in-state economic developments because their demand derives primarily from local markets. Since the statewide outlook is positive, services should continue to expand at a healthy pace. One service that might grow more slowly than in the past is health care. Many southeastern hospitals have excess capacity relative to local markets, and new federal and private-sector efforts to control costs already have led some to furlough employees.

Agriculture

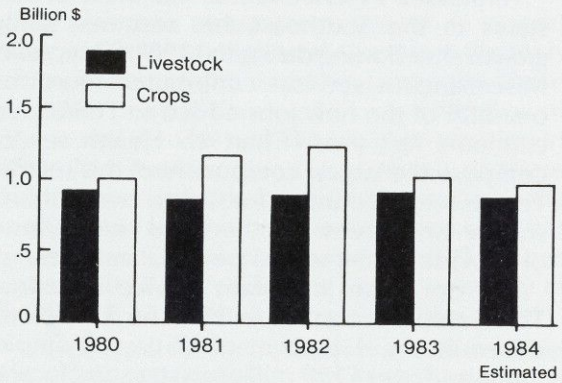
Tennessee has more farms (95,000) than any other state in the region, ranging from one- and two-acre burley tobacco farms in the mountains of east Tennessee to expansive cotton and soybean fields in the west. Although an estimated 80 percent of these are in small holdings that jointly produce less than 40 percent of the state's farm cash receipts,[19] such farms constitute an important auxiliary source of employment and income, especially in east Tennessee. Total revenue from farming varies from year to year but has approached $2.5 billion. Approximately 40 percent of that revenue typically is earned by the livestock sector, while nearly 60 percent is derived from crop sales.

Tennessee's farmers have remained in the best overall financial condition of all southeastern farmers, although poor weather in 1983 increased the financial plight of some. Last year appears to have been favorable, though, and the farm sector may be improving its financial health, even though Tennessee's agricultural sector is too small to be a significant driving force in the state's economy. If the state's farmers can avoid severe setbacks in 1985, most should remain in better financial shape than those elsewhere in the region. Improved profits are likely for corn, dairy, and pork farmers in 1985. However, the most important crops, soybeans and tobacco, as well as other crops and livestock are unlikely to repeat last year's strong performance.

Tennessee crop farmers experienced a relatively good year in 1984, as yields of every major commodity exceeded both the previous five-year average and the yield in 1983, when weather played havoc with productivity. Total revenue fell (Chart 6) as a result of lower prices and reduced acreage, but prices did not drop as low as in 1982. Tobacco, corn, soybeans, and cotton were especially profitable. With the exception of tobacco, these crops are grown largely in west Tennessee, whose economic conditions consequently were better than in recent years.

Yields of soybeans, the most important Tennessee crop with respect to share of cash receipts, returned to normal in 1984 from severely reduced 1983 levels; 1985 should reflect a general downward trend in soybean prices. Given large production nationwide, there is little indication soybean prices will strengthen substantially this year. Hence, the state's soybean farmers may find 1985 a more difficult year in which to profit.

Chart 6. Tennessee Cash Receipts from Farm Marketings (Crops, Livestock, and Products)



Source: U.S. Department of Agriculture, *Agricultural Statistics 1983*; 1984 figures estimated by Federal Reserve Bank of Atlanta.

Tobacco, a traditional mainstay of middle and east Tennessee agriculture and the state's second-ranking cash crop, produced a near-record yield in 1984, exceeding 1983 performance by one-third. Because of good quality, prices were also favorable, generating profits for Tennessee's 50,000 tobacco growers. Still, slack demand may cause a quarter of the crop to be purchased by the U.S. Burley Stabilization Corporation. Uncertainty concerning the value of the dollar clouds the outlook for tobacco growers this year since foreign markets constitute a large share of consumption.

Tennessee's farmers earn approximately 15 percent of their total revenue from the production of cotton, wheat, and corn. Despite probable further price declines in 1985, corn farmers still may be able to turn a profit provided the weather is favorable. Prospects for cotton farmers this year are dim. Supplies substantially exceed demand, causing prices to remain low. In addition, Tennessee cotton yields often fall below yields in other southeastern states, making it more difficult to profit from the crop. Wheat prices were mediocre in 1984 and are unlikely to improve in 1985, and so wheat farmers cannot expect substantial profits.

Despite marked increases in pork revenue, declining dairy and beef production led to an overall reduction in 1984 cash receipts from livestock (Chart 6). The dairy industry, concentrated in south central Tennessee, cut production approximately 10 percent as a result of government incentives to reduce output and the closing of unprofitable operations. Many in the industry have been experiencing financial difficulties in recent years as a consequence of high costs and poor returns. Because of substantial production cutbacks in the Southeast, consumer milk prices edged upward last fall. The current outlook for the dairy industry is improved over 1984, since lower feed costs and higher revenues should increase profits for most dairy producers.

Cattle production, concentrated in central Tennessee, fell roughly 5 percent in 1984 in response to mediocre prices. Reduced supplies of pork and beef may cause prices to edge upward slowly, but beef industry profits are likely to remain low in 1985. Declining feed costs and higher hog prices should give pork farmers a better return than in 1984, when profits were squeezed, but the impact will be minor since pork is the smallest of the three major livestock components.

Mining

Coal production in Tennessee rose 16 percent through November 1984 from the same period in 1983.[20] Much of the increased coal mining activity resulted from fears of a strike and heightened demand from electrical utilities. The number of kilowatt hours used in Tennessee rose 9 percent through the first three quarters of 1984 compared with a 7 percent increase nationwide. In 1983, total electrical power usage rose only 2 percent all year. The largest increases last year derived from residential and industrial use, which moved upward in the double-digit range in most months.[21] However, the growth rate of electrical power use slowed progressively in 1984.

Tennessee coal producers have been handicapped by regulatory inertia in taking advantage of recent stronger demand. Supervision of surface mines was returned to the states in 1982, but because the state government has lacked sufficient staff and other resources to assume the responsibilities formerly performed by the federal Office of Surface Mining, permits issued to Tennessee producers have been delayed.

The improved coal production of early 1984 is unlikely to continue in view of slumping world energy prices, which encourage the substitution of better quality energy sources for high-sulphur Tennessee coal. Opening of the Tennessee-Tombigbee Waterway probably will have only a limited initial impact on coal exports from Tennessee because nearby coal-producing states such as Alabama have a comparative advantage. In the longer term, Chattanooga's expansion of port facilities related to the Tenn-Tom promises to boost that city's employment and its share of exports upon the project's completion in 1986.

Local utilities will continue to be the main buyers of Tennessee coal, and demand is unlikely to increase from 1984, owing to the expected slowing of economic growth. However, energy no longer stimulates Tennessee's economy as it did when the TVA's hydroelectric-based power system's low rates attracted energy-intensive industries. Once the TVA reached the limits of local hydroelectric capacity and shifted toward greater reliance on coal and nuclear power, it lost much of its rate advantage. The state has a much smaller comparative advantage with respect to coal, and the cost of building nuclear power plants has risen dramatically since the early 1970s.

Summary

In conclusion, 1985 promises to be a year of respectable economic growth in Tennessee as in the nation. The factors contributing to the state's economic expansion are largely macroeconomic. Expected nationwide growth in consumer spending and business fixed investment should stimulate demand for Tennessee's important durable manufacturing industries and thereby fuel gains in employment and personal income. Lower interest rates should revive single-family building, at least early in the year, as well as reaccelerate growth in the production of building materials, furniture, and home appliances. Thus, the strongest sectors in Tennessee in 1985 probably will be manufacturing, trade, and perhaps construction, with the first two contributing most to the state's continuing expansion.

State and local governments may provide modest growth independent of national economic developments. Finance, services such as tourism, and agriculture probably will register a good year in 1985, but these sectors are too small to generate much statewide growth. Moreover, to a large extent the performance of finance and many services mirrors rather than drives changes in other economic sectors.

The weakest areas in Tennessee's economy probably will be import-sensitive nondurables, such as textiles, apparel, and chemicals, and divisions of manufacturing, trade, and agriculture that depend heavily on exports. Construction and related durable manufacturing also will suffer if interest rates rise substantially.

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NOTES

[1]Computed by Federal Reserve Bank of Atlanta from data in U. S. Department of Commerce, Bureau of the Census, *County Business Patterns*, 1981, Tennessee (January 1983) and United States (July 1983), Table 1-B.

[2]Ibid.

[3]Tennessee Department of Economic Development.

[4]U. S. Department of Commerce, Bureau of the Census, Origin of Exports of Manufactured Products," *1981 Annual Survey of Manufactures* (January 1982), pp. 14, 16.

[5]U. S. Department of Defense, Directorate for Information, Operations and Reports, *Prime Contract Awards by Region and State*, Fiscal Years 1981, 1982, and 1983, Table I-1.

[6]Tennessee Department of Revenue, *Monthly Statement of Revenue Collections*, January through November issues, 1983 and 1984; taxable sales in each of these categories grew by more than one-third, but some of that growth reflects a one-cent sales tax hike.

[7]U. S. Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-25, No. 944, (January 1984), p. 2; *The Number News*, April 1984.

[8]National Governors Association and National Association of State Budget Officers, *Fiscal Survey of the States*, Tables A-1, A-2, June 1984.

[9]U. S. Department of Commerce, Bureau of the Census, *Public Employment*, 1976-1983, GE80, No. 1.

[10]Aladdin Resources, Inc.

[11]Coldwell Banker, *Office Building Real Estate Data* (September 30, 1984), p. 11.

[12]Federal Reserve Board, *Report of Transaction Accounts, Other Deposits, and Vault Cash* (FR 2900).

[13]Federal Reserve Board, *Report of Condition*, June 30, 1983 and 1984; December 31, 1983 and 1984.

[14]Federal Home Loan Bank Board.

[15]*Economic Impact of Travel on Tennessee Counties, 1983* (Washington, D. C.: U. S. Travel Data Center, July 1984), pp. 9, 32, 41.

[16]Tennessee Department of Tourist Development.

[17]Tennessee Department of Revenue.

[18]*Trends in the Hotel Industry* (Memphis, Tenn.: Pannell, Kerr, & Forster, November 1984), p. 2.

[19]George Smith, *Tennessee's Agriculture* (Knoxville: University of Tennessee Institute for Agriculture, 1984), p. 4

[20]U. S. Department of Energy, Energy Information Administration, *Weekly Coal Production*, DOE 1 EIA-0218 (84/50).

[21]U. S. Department of Energy, Electrical Power Division, Energy Information Administration.