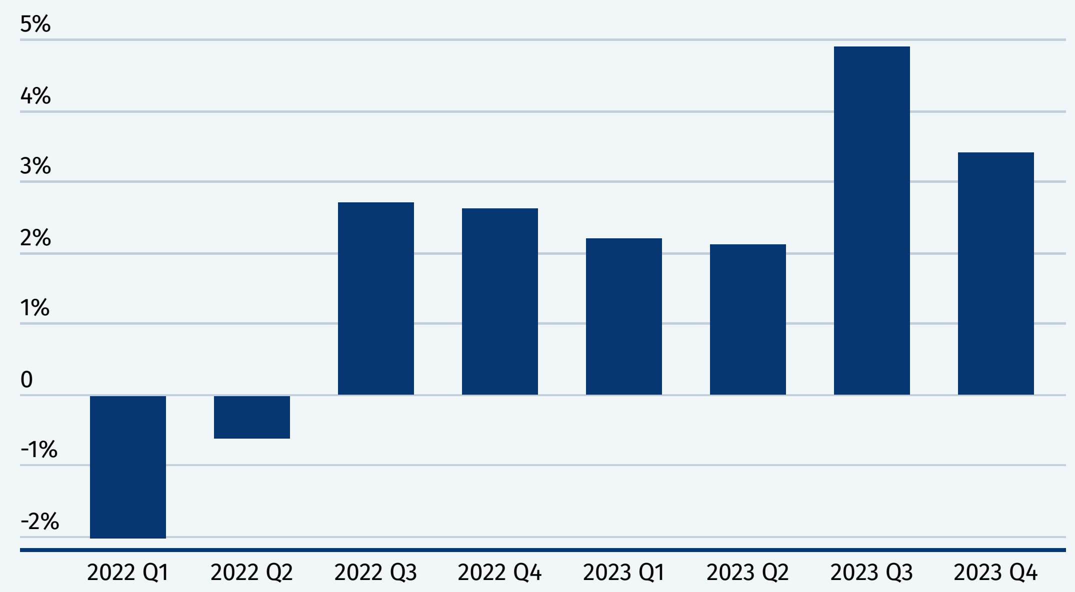
Appalachian Highlands Economic Update

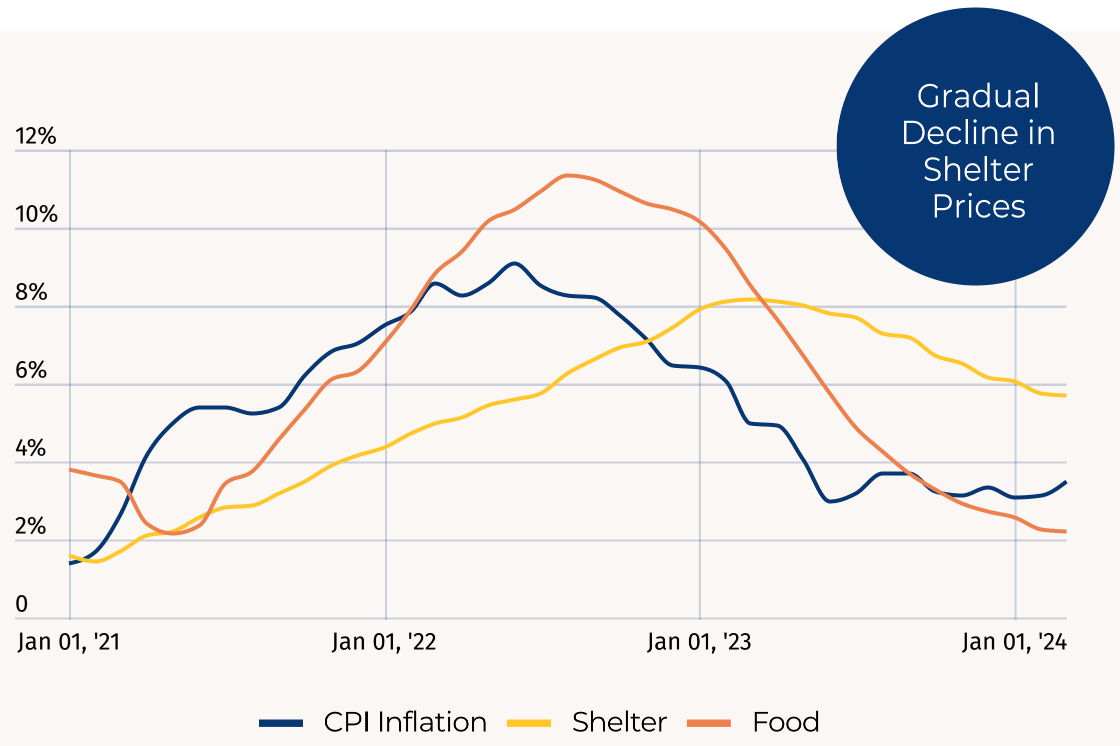
Macroeconomics

Dr. Aryaman Bhatnagar, Ph.D. Assistant Professor of Economics



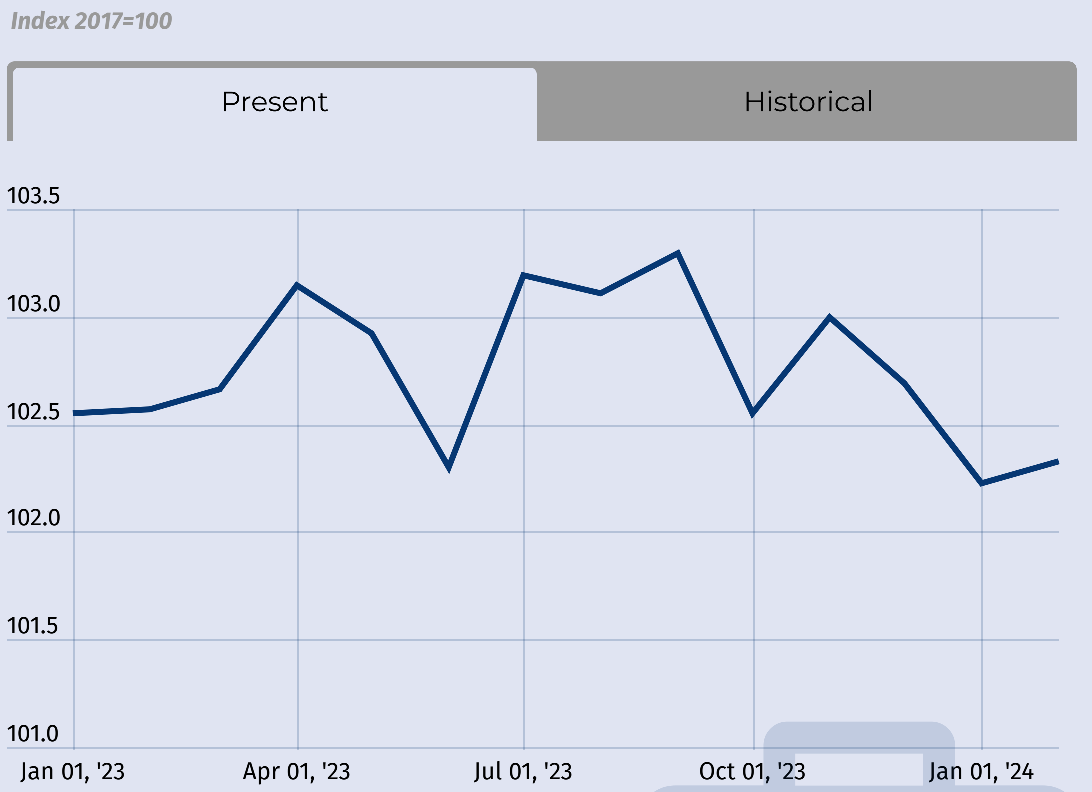
GDP Growth Rate

The U.S. economy grew at a brisk rate of 3.4% in the fourth quarter of 2023. The overall growth rate for 2023 is estimated to be 2.5%, which is higher than the 1.9% increase in 2022 and comfortably outside the recessionary zone. The growth was once again driven by strong consumer spending, especially in sectors such as food services and health care. In addition to this, exports led by financial services grew by a robust 6.3%. Government spending also continued to be a major contributor to economic growth, as has been the case since the pandemic.



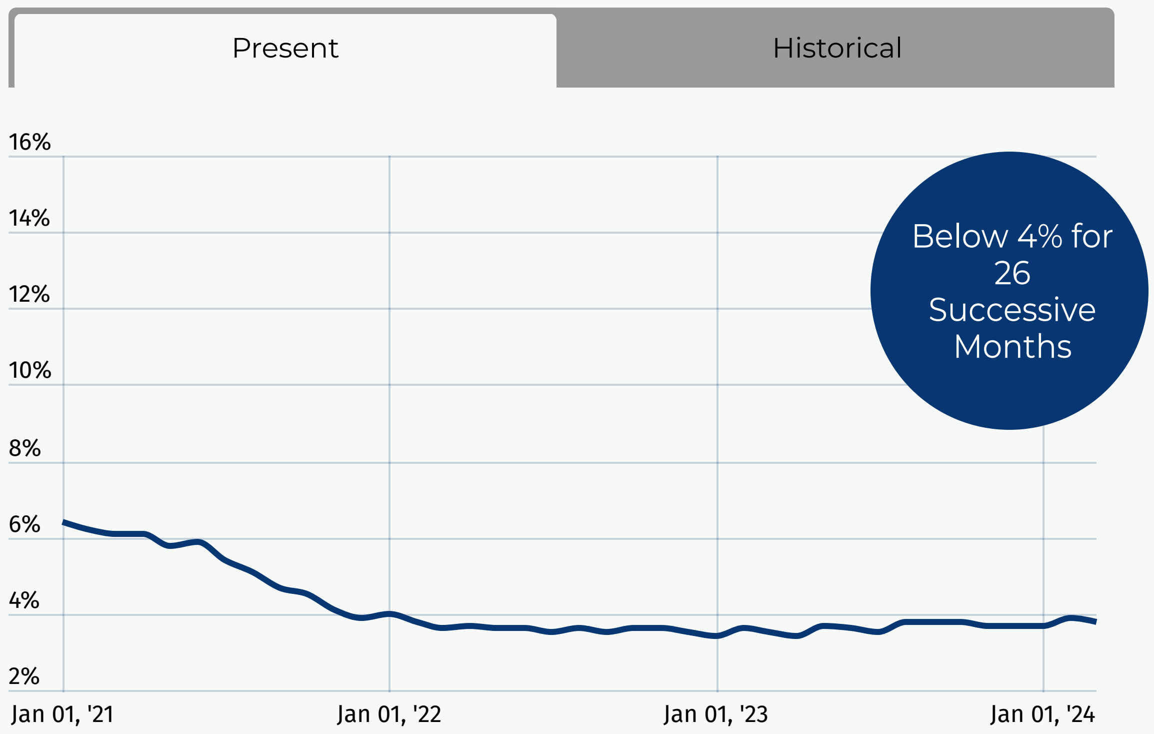
Inflation

CPI inflation grew by 3.5% on a year-on-year basis in March 2024. After a sustained decline since June 2022, inflation seems to have stabilized around the 3% mark and could pose a concern for The Fed. The decline in inflation over the last year has been led by a decrease in food and shelter prices. While food prices have come down sharply, shelter prices have seen a more gradual decline and remain elevated.



Industrial Production

Industrial production grew by 0.1% in February, following a 0.5% decline in January. Amongst the three major categories, manufacturing and mining grew by 0.8 and 2.2 percent respectively. Utilities on the other hand fell substantially by 7.5 % due to a warmer than usual February. Within manufacturing, motor vehicle output rebounded by 1.8% in February after a 3.8% decline in the preceding month.



Unemployment Rate

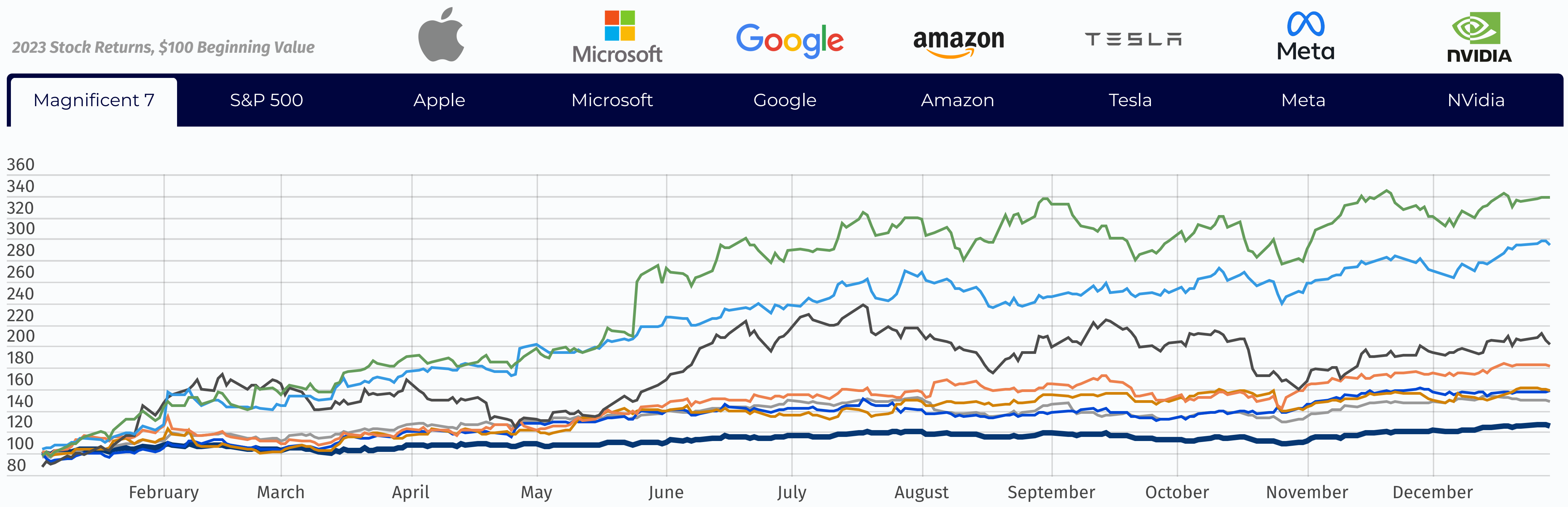
Unemployment rate remained stable at 3.8% for the month of March, once again highlighting the tightness of the labor markets. The unemployment rate has now remained below 4% for 26 successive months. This is the longest stretch since the late 1960s. Sectors such as health services, government, and construction saw a substantial increase in employment. Average weekly earnings also grew by 4.1% in March, ensuring that real wage growth remains strongly positive.

Summary

Overall, the US economy has expanded at a solid pace. Going forward, the economy is expected to continue growing albeit at a slightly lower rate compared to the previous quarter. The Atlanta Fed for instance pegs the expected growth in the first quarter of 2024 to be close to 2.5%, while the St. Louis Fed expects a 2.8% increase. However, key challenges still persist for the economy and could pose a risk. Chief among them are unsustainable debt levels, diminishing household savings, stubborn inflation, and prolonged conflicts in Ukraine and the Middle East.

Financial Markets

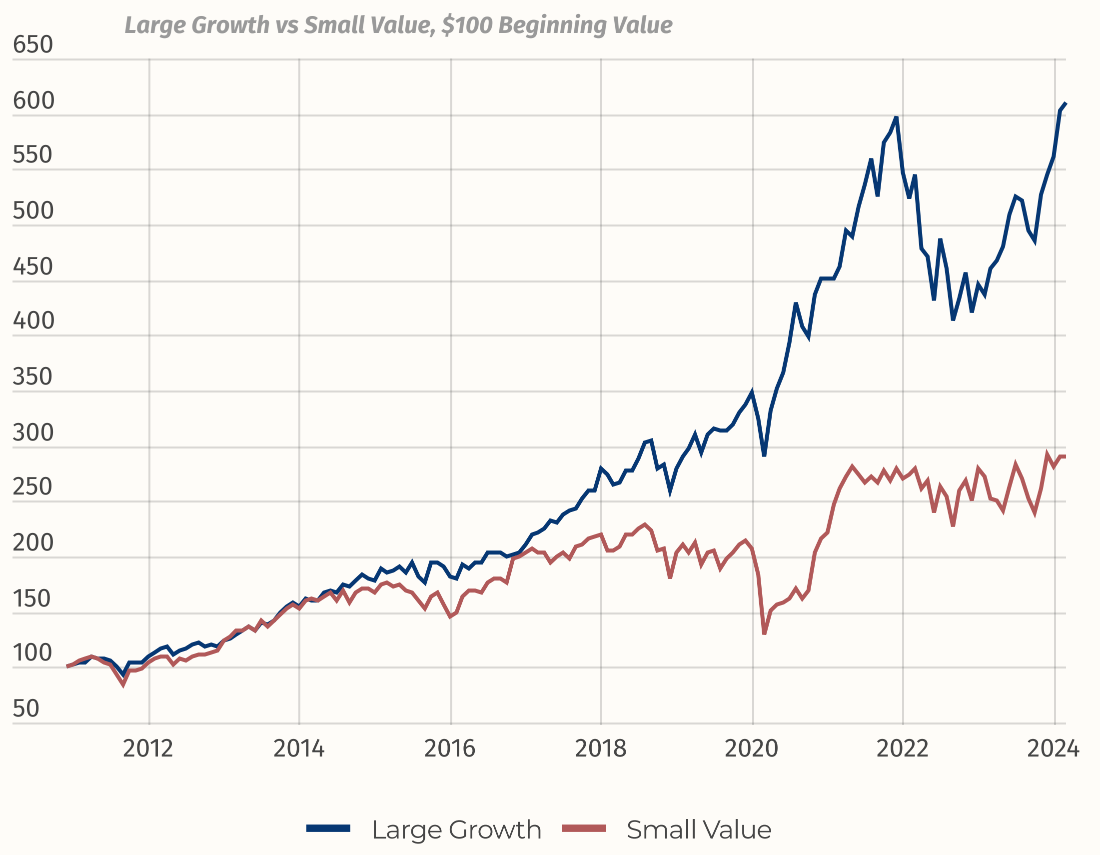
William J. Trainor Jr. Ph.D. CFA Director, Center for the Study of Finance



The Magnificent Seven

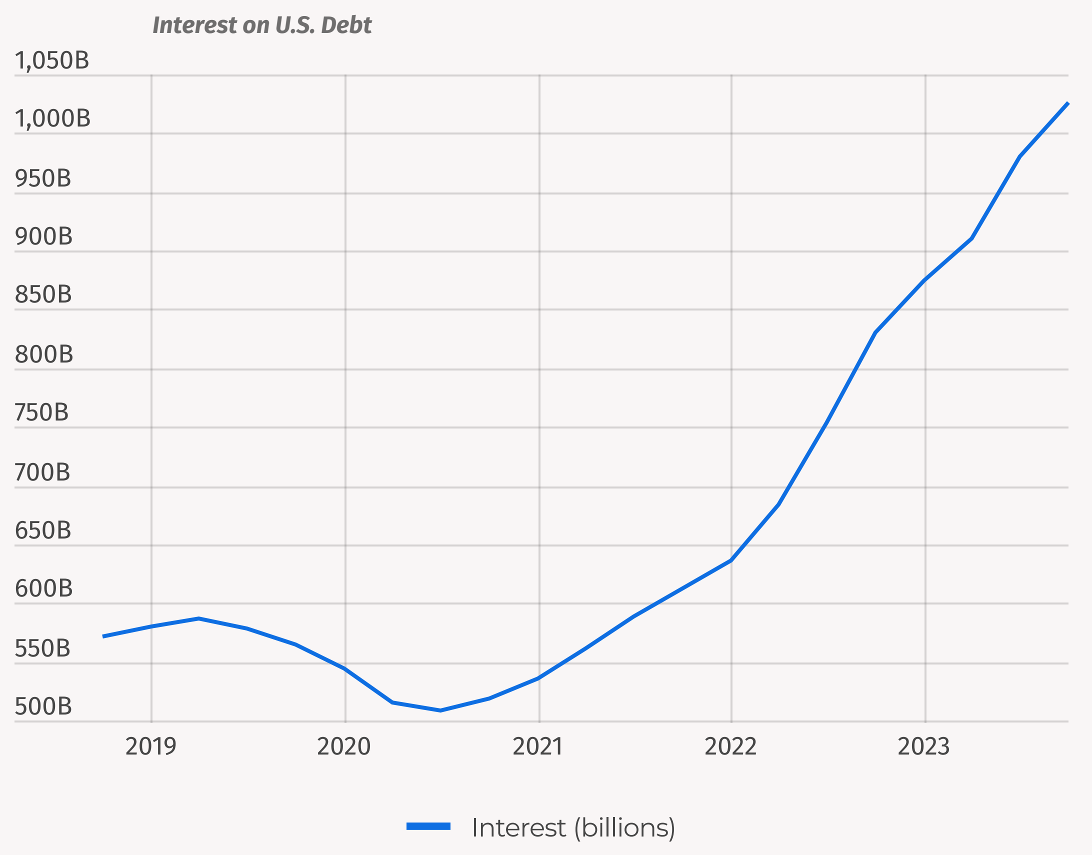
This is not about the 1960 Western which if missed, you can still enjoy. The new "Magnificent Seven" are Microsoft, Amazon, Nvidia, Meta (Facebook), Apple, Alphabet (Google), and Tesla which had an average return of 110% in 2023. These seven stocks accounted for approximately 70% of the S&P's 500 2023 return which was 25%.

Unlike the movie, this is unlikely to be repeated as the magnificent seven appears to be down to three so far in 2024, Meta, Microsoft, and Nvidia. The latter continues to soar due to the excitement in AI, and it helps Nvidia (now the third largest company with a $2 trillion market cap) sells billions of dollars in AI chips to Meta and Microsoft among others.



Growth vs Value

Large growth continues to outperform small value stocks. Historically, this order is reversed but for the past 10+ years, large growth has been the place to be and early 2024 is no exception although that is starting to change as the market is showing more breadth than it did in 2023. As always, diversification is key.



Interest Rates, Inflation, and Earnings

A major headwind for the economy and the stock market is interest on the national debt which now exceeds $1 trillion and accounts for 35% of all tax receipts. With more than 30% of the U.S. debt coming due this year that will need to be refinanced at higher rates, both the interest burden and upward push on interest rates will become increasingly problematic.

Summary

The market averages 10% a year, but it is rarely average as returns between 8% and 12% only occur about 5% of the time. The S&P 500 is already up over 8% in the first two months of 2024. It is not unreasonable to assume this trend continues, albeit unlikely at the same pace. On the positive front, earnings are projected to increase 11% in 2024 and 14% in 2025, inflation seems to have moderated (down to 3.1%), interest rate declines are more likely than increases, and the economy appears to be robust with a 3.3% growth rate. However, the middle east and Ukraine remain hotspots and interest on the U.S. debt now exceeds $1 trillion which is 35% of tax revenue. As always, the only safe prediction is the market will be volatile.

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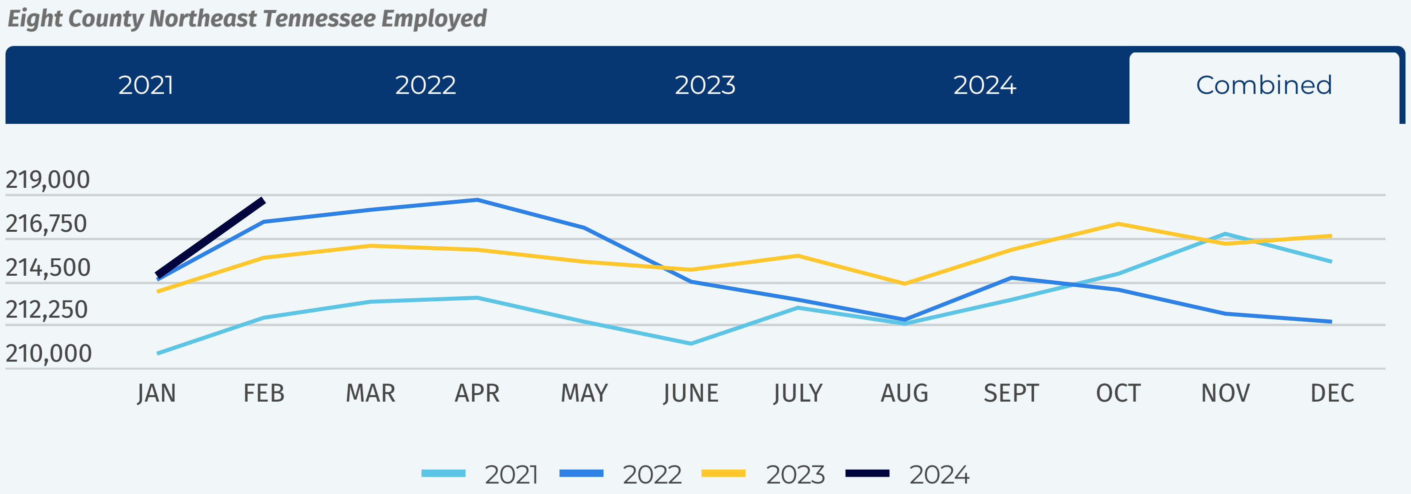
MACROECONOMICS | FINANCIAL MARKETS | LABOR & EMPLOYMENT | HOUSING

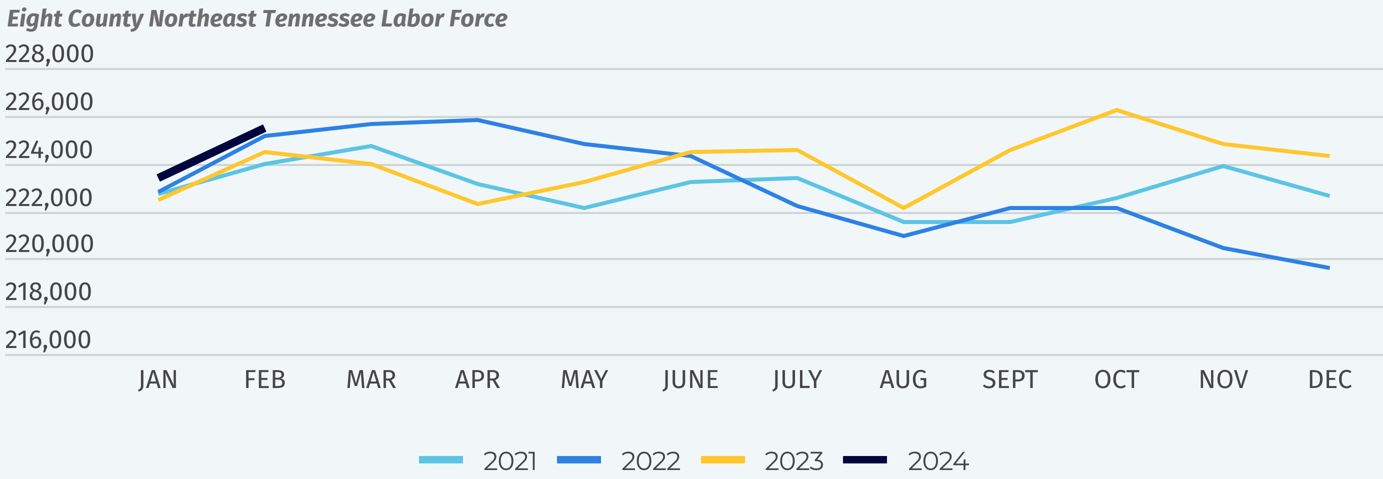
Labor & Unemployment

Dr. Jon L. Smith Ph.D. Director, Bureau for Business & Economic Research

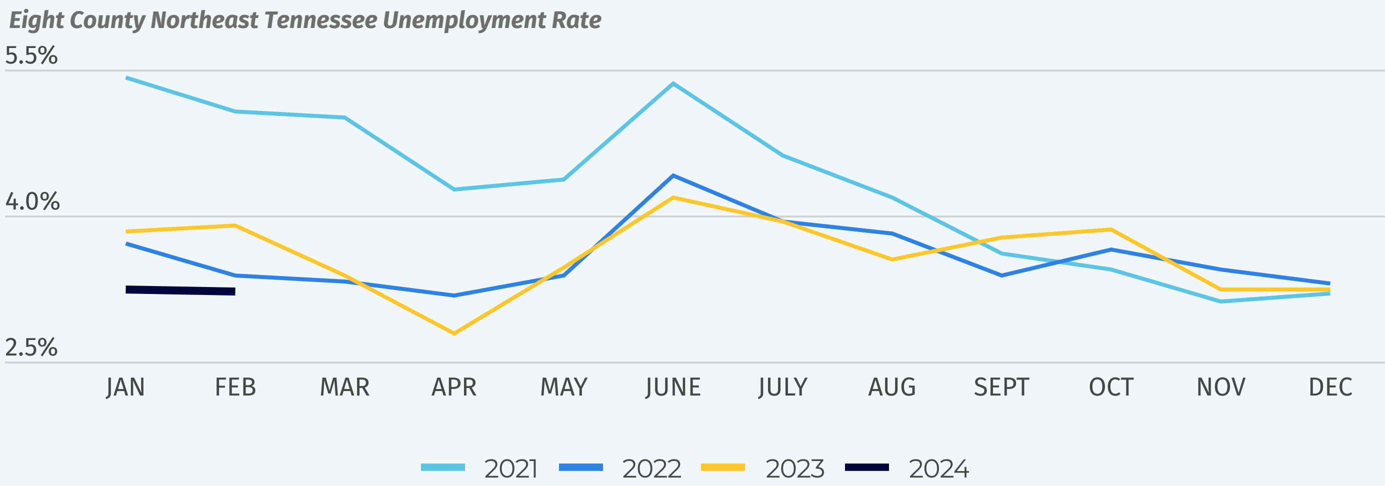


Employment & Labor Force

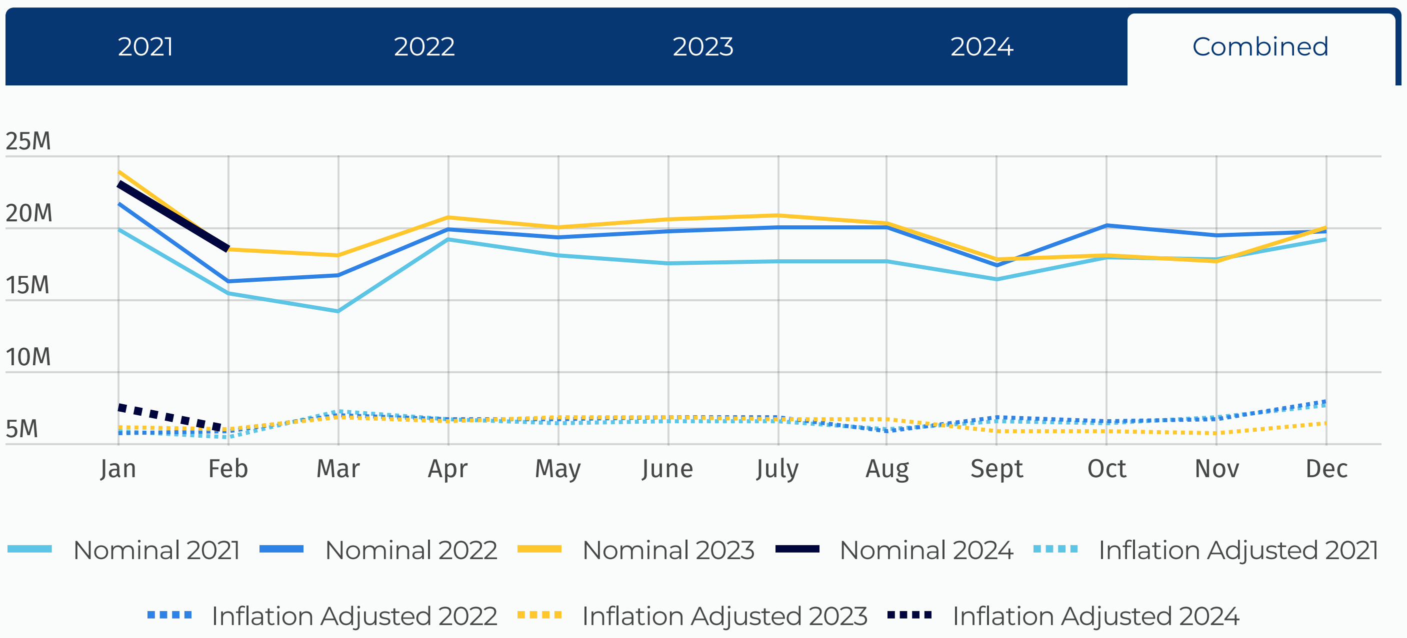
Employment levels within the eight-county region continue to be stable with a slight increase in the overall trend. February's seasonally unadjusted employment numbers showed a year-over-year increase from 215,735 to 218,668, an increase of 1.36%.



The regional labor force also showed a modest year over year increase growing from 224,496 in February of 2023 to 225,505 in February of 2024, an increase of only 0.45%.



However, the average unemployment rates for the counties within the region have shown a decrease from 3.9% in February of 2023 to 3.21% in February of 2024.



Sales Tax

Year-over-year nominal and inflation adjusted or "real dollar" local sales tax collections for the eight county region continue to show disappointing year-over-year decreases. Total nominal local sales tax collections for July through February of fiscal year 2024 were 1.8% lower than for the same period for fiscal year 2023. Inflation adjusted collections showed an even greater decrease, 5.0%.

Summary

The labor market for the eight county region of Northeast Tennessee continues to exhibit stability with neither sharp increases or decreases. The long-term trends in employment growth and labor force numbers have shown stability with slight increases over the past year.

The pernicious effect of continued inflation is however somewhat alarming. Inflation rates continue to be above the Federal Reserve Board's target rate of 2%. The effect of continued increases in nominal prices and decreases in real income has had an impact on the state's economy. State sales and use taxes for the current fiscal year are 1.68% below collections for the same period last year. Franchise and excise tax collections are down 10.34% and privilege taxes are 13.54% below last years collections at this point.

Our forecast model for local sales taxes suggests that nominal dollar local sales tax collections for this fiscal year will be around 1.9% below those for last year and real dollar collections will be approximately 5% below those of the previous fiscal year. This suggests that regional counties will be hard pressed to continue to provide the same level of services as in previous years without increases in revenues.

Appalachian Highlands Economic Update

Housing Market

Joseph Newhard, Ph.D. Associate Professor of Economics

As of February, the median listing price of a home stands at $357,450 in the Johnson City MSA and $300,000 in the Kingsport-Bristol MSA, their lowest values since June 2022 and December 2022, respectively, and down 10.5% and 7% year-over-year. They are also down 17% and 13% from their peaks, but compared to February 2017, they are still up by 88.5% and 98%, respectively. Inventories remain low: 325 in the Johnson City MSA and 511 in the Kingsport-Bristol MSA for February, standing at 36% and 32% of their respective levels in February 2017. High demand and low supply have reduced median days on the market from 95 in February 2017 to 67 in February 2024 for the Johnson City MSA and from 119 to 72 in the Kingsport-Bristol MSA.

Decomposing home listing and sold prices by city reveals significant variation within the MSAs and high volatility from month to month. In February, the median sold price was $405,250 in Jonesborough; $317,500 in Abingdon; $299,000 in Johnson City; $295,000 in Gray; $291,750 in Blountville; $273,000 in Elizabethton; $209,750 in Bluff City; $208,000 in Kingsport; $205,000 in Erwin; $200,000 in Bristol, TN; $190,000 in Bristol, VA; and $190,000 in Gate City; Nationwide, the median listing price is at $415,500 in February and the median sales price for new homes is $400,500, down 19.4% from its October 2022 peak of $496,800, nearly putting new homes in bear market territory.

Despite relatively high mortgage rates, demand for housing remains strong due to ongoing population growth. For example, the Census Bureau estimates that the population of Washington Country, TN grew by 10.7% from 2010 to 2022, increasing from 122,979 to 136,172 while the housing stock increased 8.3% from 57,358 to 62,120 units. The population of Sullivan County, TN increased 2.5% from 156,823 to 160,820 while the housing stock increased 3.3% from 73,809 to 76,230 units. In contrast, the populations of Scott, VA and Washington, VA counties saw slight declines in this period. Officials in Kingsport, Johnson City, and Jonesborough forecast continued population growth, but the recent erosion of housing affordability relative to the United States at large may deter some in-migration and provoke out-migration for some current residents.

High prices are incentivizing local developers to build thousands of single family homes, townhomes, and apartments. D.R. Horton lists 12 residential communities in the region offering hundreds of new houses and townhomes for as low as $224,000. Orth Construction is building 10 communities along the I-26 corridor including 72 houses in Jonesborough, 24 in Elizabethton, and 36 in Erwin in the $300,000 to $500,000 range. In the face of low vacancy rates, developers are also adding hundreds of apartment units to the area, including 288 units under construction on W. Oakland Ave. in Johnson City and 300 units proposed nearby on Knob Creek Rd. Brickyard Village in Kingsport is under construction and will bring 464 residential units, including 83 houses. The 494 unit Keebler Annexation in Gray and the 700 multifamily unit Burlington Park Redevelopment are currently under review by Johnson City officials. Altogether, thousands of housing units are under construction or were recently completed in the region with more in the works.

Local officials are approving most rezoning requests and development proposals, including for dense housing. According to WJHL, in Johnson City, single family home permits peaked at 214 in 2022 before decreasing to 196 in 2023 while the average value of these permits rose 16% from $290,000 to $338,000. In Kingsport, the count fell from 296 to 269 while rising in value by 36% from $241,000 to $328,000. Despite these modest declines in permit counts, they are still up significantly over previous years. However, rising permit values indicate a trend for homebuilders away from starter homes and towards more expensive models far beyond what local working class incomes can support, with one local developer saying, “We basically decided the new starter home’s going to be an apartment.”

To an extent, ongoing construction is merely replacing already existing homes that have been lost to the short-term rental market, with over 1000 Airbnb listings in the region including about 280 in the Kingsport area and 350 in the Johnson City area. More than half these are single-family homes, and up to 90% of listings are houses, condos, or townhouses combined, so for some local families, homes they would have purchased to live in are disappearing and being replaced with newly built rental units. The homeownership rate of 49.7% in Johnson City, which is already significantly below the national rate of 65.7%, is likely to fall further due to the high ratio of rental unit construction, a poverty rate that is twice the national average, ongoing flipping and investor activity, and the rapid growth of the short-term rental market.