STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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Memorandum

To: Honorable Justin Wilson, Comptroller of the Treasury
Honorable Tre Hargett, Secretary of State
Honorable David Lillard, Treasurer
Commissioner David Goetz, Commissioner of Finance & Administration

From: Keith Boring, Associate Legislative Research Analyst
Ronald H. Queen, Manager of Local Finance

Date: 3/24/2010

Re: Economic Report to the Governor

EXECUTIVE SUMMARY

The State Funding Board is charged, in *Tennessee Code Annotated* (*TCA*) § 9-4-5202, with the responsibility of commenting on the estimated rate of growth in the state's economy as presented in *An Economic Report to the Governor of Tennessee on the State's Economic Outlook: January 2010* (Economic Report).

Pursuant to *TCA* § 9-4-5201(a), "estimated rate of growth of the state's economy shall be based upon the projected change in Tennessee personal income." *TCA* § 9-4-5201(b) requires the State Funding Board to adhere to the U.S. Department of Commerce's definition of personal income: "the income received by all persons from all sources."[1] This definition includes the sum of net earnings by place of residence, rental income of persons, personal dividend income, personal interest income, and personal current transfer receipts.[2]

[1] U.S. Department of Commerce, Bureau of Economic Analysis, "Personal Income for Metropolitan Areas, 2008," Aug. 6, 2009, http://www.bea.gov/newsreleases/regional/mpi/mpi_newsrelease.htm (accessed March 16, 2010).
[2] Ibid.

The Economic Report presents the rate of growth in Tennessee's nominal personal income as follows:

Forecast Year	2010
Fiscal Year 2011	2.80%
Fiscal Year 2010	1.20%
Calendar Year 2011	3.51%
Calendar Year 2010	2.10%
Calendar Year 2009	0.24%

However, the lack of other public estimates of Tennessee's nominal personal income growth required staff to compare the Economic Report's GDP estimate with GDP estimates produced by other economic forecasters to determine the reasonableness of the estimate in the Economic Report.

Factors considered in the staff's conclusion are:

- The rate of U.S. GDP growth after this recession appears weak when compared to U.S. GDP growth after other recessions since 1980.
- Consumer spending may not significantly increase until the level of full-time employment increases.
- The natural rate of unemployment may rise due to a mismatch of workers' job skills to employers' needs, which developed during the current recession.
- Labor market weakness that will persist until at least 2012.

The staff considered the following risks to the Economic Report's forecast of U.S. GDP and state nominal personal income:

- Consumer spending weakness due to high unemployment, higher levels of savings, and low levels of consumer confidence
- Housing market weakness
- Credit markets tightening for consumers and small businesses
- Accelerated increases in the cost of energy, food, and other commodities

The Economic Report's U.S. real GDP forecast was below the forecast median of other economic forecasters used for comparison, but nevertheless, within the range of those forecasts. Considering the potential risks to the recovery and weak level of growth, this forecast does not seem extreme or excessive.

The economy will likely experience an additional year or two of sluggish economic growth. Low levels of consumer spending and tight credit markets combined with high unemployment rates may continue to negatively impact consumption-based taxes. Actual growth, therefore, may be lower than forecasters expect. Based upon this review, however, the Economic Report's forecast of 2.80 percent nominal personal income growth for fiscal year 2011, 2.10 percent for calendar year 2010, and 3.51 percent for calendar year 2011 does not appear unreasonable.

STAFF COMMENTARY

An Economic Report to the Governor of the State of Tennessee on the State's Economic Outlook: January 2010 (Economic Report) by the University of Tennessee Center for Business and Economic Research (CBER) forecasts growth of 2.1 percent in Tennessee's nominal personal income for calendar year 2010 and 3.51 percent for calendar year 2011. The forecast growth for fiscal year 2011 is 2.8 percent. The revised forecast for calendar year 2009 was 0.24 percent. At the time of publication of the Economic Report, Tennessee's nominal personal income growth rate for calendar year 2009 was not available. Exhibit 1 provides a table summarizing the 2009 and 2010 Economic Reports' forecast year estimates.

Exhibit 1: Estimated Tennessee Personal Income Growth

Forecast Year	2010	2009
Fiscal Year 2011	2.80%	NA
Fiscal Year 2010	1.20%	1.5%
Calendar Year 2011	3.51%	NA
Calendar Year 2010	2.10%	2.82%
Calendar Year 2009	0.24%	0.68%

Source: CBER, *An Economic Report to the Governor of the State of Tennessee on the State's Economic Outlook: January 2009*; CBER, *An Economic Report to the Governor of the State of Tennessee on the State's Economic Outlook: January 2010*; CBER, Report to the State Funding Board, April 30, 2009.

Exhibit 2 provides a table summarizing forecasted calendar year indicators related to growth from the Economic Report.

Exhibit 2: Economic Report Forecast Summary

Indicator	2010	2011
US Real GDP Growth	2.61%	2.66%
TN Real GDP Growth	2.44%	3.51%
US Nominal Personal Income Growth	3.83%	3.87%
TN Nominal Personal Income Growth	**2.10%**	**3.51%**
US Unemployment Rate	10.10%	9.50%
TN Unemployment Rate	10.40%	10.20%
Consumer Price Index	1.74%	2.02%
Federal Fund Rate (% per annum)	2.44%	1.70%

Source: CBER, *An Economic Report to the Governor of the State of Tennessee on the State's Economic Outlook: January 2010*, Table 2.1: Selected U.S. and Tennessee Economic Indicators, Seasonally Adjusted.

GROSS DOMESTIC PRODUCT (GDP)

The lack of other public estimates of Tennessee's nominal personal income growth required staff to compare the Economic Report's GDP estimate with GDP estimates produced by other economic forecasters to determine the Economic Report estimate's reasonableness. The Economic Report forecasts real GDP growth of 2.61 percent for calendar year 2010 and 2.66 percent for calendar year 2011.

Exhibit 3: Economic Report GDP Forecasts

Calendar Year	CBER US GDP Forecast	US GDP	Forecast Error
2011	2.66%	TN Forecast 2011	
2010	2.61%	TN Forecast 2010	
2009	-2.52%	-2.40%	-0.12%
2008	1.90%	1.10%	0.80%
2007	2.80%	2.00%	0.80%
2006	3.40%	2.80%	0.60%
2005	3.60%	2.90%	0.70%
2004	4.70%	3.60%	1.10%
2003	3.10%	2.50%	0.60%
2002	2.10%	1.60%	0.50%
2001	1.10%	0.80%	0.30%
2000	3.10%	3.70%	-0.60%
1999	2.00%	4.50%	-2.50%
1998	2.50%	4.20%	-1.70%
1997	2.10%	4.50%	-2.40%
1996	2.50%	0.037	-1.20%
High	4.70%	4.50%	1.10%
Average	2.31%	2.54%	-0.22%
Low	-2.52%	-2.40%	-2.50%

Staff compared the Economic Report's forecast to central bank and government forecasts, the January 2010 Bloomberg Economic Forecast, and the January 2010 *Wall Street Journal* Forecasting Survey. The *Wall Street Journal* conducted a survey of 56 economists for its calendar year 2010 forecasts. Bloomberg surveyed 46 economists for its calendar year 2010 and 2011 forecasts. Exhibits 4 and 5 display the results.

Exhibit 4: Central Bank & Government Forecast Comparison: 2010-2011 Real GDP Growth

Forecaster	2010	2011	Date
Congressional Budget Office	2.2	1.9	January 26, 2010
Federal Reserve Board	2.8	3.4	January 27-28, 2010
FRB Philadelphia: Survey of Professional Forecasters	3.0	2.9	February 12, 2010
Fannie Mae	3.2	3.9	February 10, 2010
Freddie Mac	3.4	3.5	February 12, 2010
International Monetary Fund	2.7	2.4	January 26, 2010
Royal Bank of Canada	2.9	3.4	February 5, 2010
High	3.40	3.90	
Median	2.90	3.40	
Low	2.20	1.90	

Exhibit 5: Comparison of Forecasters GDP Growth

Forecaster	Central Bank & Government		Bloomberg		WSJ
Calendar Year	**2010**	**2011**	**2010**	**2011**	**2010**
Forecast High	3.40%	3.90%	3.80%	4.60%	4.50%
Forecast Median	2.90%	3.40%	2.70%	2.90%	2.90%
Forecast Low	2.20%	1.90%	0.30%	1.80%	1.70%
CBER GDP Forecast	2.61%	2.66%	2.61%	2.66%	2.61%

Source: CBER, Economic Reports to the Governor 1996-2010; U.S. Bureau of Economic Analysis.

The central bank and government economists' median forecasts favor a slightly higher rate of increase in GDP for calendar years 2010 and 2011 compared to the Economic Report's forecasts. The Bloomberg and *Wall Street Journal* median forecasts are slightly higher, but very close to the Economic Report's forecasts for calendar years 2010 and 2011. Nevertheless, the Economic Report's GDP forecasts for calendar years 2010 and 2011 lie within the range of the central bank and government forecasts, the Bloomberg Economic Forecasts, and the *Wall Street Journal* Forecasting Survey. Thus, the Economic Report's U.S. GDP growth forecast does not appear unreasonable when compared to the medians and ranges of these other forecasts.

RECESSION AND RECOVERY

Recessions Since 1980

On November 28, 2008, the National Bureau of Economic Research (NBER) Business Cycle Dating Committee determined that a peak in U.S. economic activity occurred in December 2007. This peak marked the beginning of a recession.[3] Exhibit 6 compares the other four recessions since 1980 with the December 2007 recession. The recession beginning in July 1981 lasted 13 months and reached a depth of -6.4 percent quarterly GDP growth occurring in the first quarter of 1982. This recession is one of the most comparable to the December 2007 recession in length and depth of loss. However, the expansionary period beginning in the first quarter of 1983 resulted in 5.1 percent quarterly GDP growth. The following three quarters sustained a quarterly GDP growth rate of more than 8 percent. The December 2007 recession may have ended in June 2009 with a possible duration of 18 months and depth of loss reaching -6.4 percent quarterly GDP growth occurring in the first quarter of 2009. The expansionary period beginning in quarters three and four of 2009 netted 2.2 percent and 5.9 percent quarterly GDP growth, respectively. Expectations are that growth will be lower in the current expansionary period than growth experienced during recovery from prior recessions.

[3] National Bureau of Economic Research, Business Cycle Dating Committee, Determination of the December 2007 Peak in Economic Activity, Dec. 11, 2008.

Exhibit 6: Comparison of Recessions since 1980 Quarterly GDP Growth (%) with CBER Forecasts for I & II Quarter 2010

Recessions	Recession Period						Beginning of Expansionary Period			
	2008 I	2008 II	2008 III	2008 IV	2009 I	2009 II	2009 III	2009 IV	2010 I	2010 II
December 2007 - June 2009 (est.)	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	2.2	5.9	**2.25**	**2.96**
	2001 II	2001 III	2001 IV				2002 I	2002 II	2002 III	20002 IV
March 2001 - November 2001	0.6	-1.1	1.4				3.5	2.1	2	0.1
	1990 III	1990 IV	1991 I				1991 II	1991 III	1991 IV	1992 I
July 1990 - March 1991	0.0	-3.5	-1.9				2.7	1.7	1.6	4.5
	1981 IV	1982 I	1982 II	1982 III	1982 IV		1983 I	1983 II	1983 III	1984 IV
July 1981 - October 1982	-4.9	-6.4	2.2	-1.5	0.3		5.1	9.3	8.1	8.5
	1980 I	1980 II	1980 III				1980 IV	1981 I	1981 II	1981 III
January 1980 - July 1980	1.3	-7.9	-0.7				7.6	8.6	-3.2	4.9

Source: National Bureau of Economic Research and U.S. Bureau

Exhibit 7 illustrates by calendar year the impact these recessionary periods have had on U.S. real GDP, Tennessee's nominal personal income, and the statewide unemployment rate. The two recessions beginning in 1980 and 1981 occurred during times of high inflation. The recent recession differs from that period in that inflationary forces have not affected the economy.

Exhibit 7: Selected Economic Indicators for Recessions since 1980 by Calendar Year

Recession	Duration (Months)	Calendar Year	US Real GDP Growth (%)	TN Nominal Personal Income (%)	TN Unemployment Rate (%)
December 2007 – June 2009 (est.)	18 (est.)	2009	-2.4	0.24	10.5
		2008	0.4	3.73	6.7
March 2001 - November 2001	8	2001	1.1	3.75	4.7
July 1990 - March 1991	8	1991	-0.2	5.16	6.6
		1990	1.9	6.3	5.5
July 1981 - October 1982	16	1982	-1.9	6.71	11.7
		1981	2.5	11.61	9.2
January 1980 - July 1980	6	1980	-0.3	10.98	7.3

Source: National Bureau of Economic Research, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, and CBER.

Recovery and Consumer Spending

The Economic Report expects that economic recovery will take years and that "2010 will represent a moderate turnaround in the economy."[4] Additionally, the Economic Report states that "consumer spending will certainly not drive the recovery but will improve weakly in 2010."[5] Consumer spending is approximately 70 percent of real GDP.

The Federal Reserve's semiannual *Monetary Policy Report to Congress* submitted on February 24, 2010, states that "the pace of the recovery probably will be tempered by households' desire to rebuild wealth, still-tight credit conditions facing some borrowers, and, despite some tentative signs of stabilization, continued weakness in labor markets."[6] Additionally, the report includes the Federal Open Market Committee participants' projection that "the economic recovery from the recent recession was expected to be gradual."[7] The Federal Reserve's Monetary Report to Congress supports the Economic Report's assertion of a moderate turnaround in the economy. Federal Reserve Board Chairman Ben Bernanke testified before the U.S. House of Representatives Committee

[4] University of Tennessee Center for Business and Economic Research, *An Economic Report to the Governor of Tennessee on the State's Economic Outlook: January 2010*, 2010, p. 13.
[5] Ibid., p. 15.
[6] Federal Reserve, *Monetary Policy Report to Congress, Part 1*, Feb. 24, 2010, http://www.federalreserve.gov/monetarypolicy/mpr_20100224_part1.htm (accessed March 15, 2010).
[7] Federal Reserve, *Monetary Policy Report to Congress, Part 4*, February 24, 2010, www.federalreserve.gov/monetarypolicy/mpr_20100224_part4.htm#8636 (accessed March 15, 2010).

on Financial Services on February 24, 2010, that "a sustained recovery will depend on continued growth in private-sector final demand for goods and services."[8]

The U.S. Consumer Confidence Index, which measures consumer optimism on the state of the economy, fell in February 2010. Lynn Franco, Director of The Conference Board Consumer Research Center stated that "consumers' short-term outlook took a turn for the worse, with fewer consumers anticipating an improvement in business conditions and the job market over the next six months."[9]

UNEMPLOYMENT

Current Conditions and Forecasts

Tennessee unemployment has been at its highest annual level since 1982 and 1983, when the annual unemployment rate was 11.7 percent. Tennessee's unemployment rate has been greater than the national rate since the beginning of the current recession in December 2007. The latest Tennessee unemployment rate of 10.7 percent for January 2010 is higher than the January U.S. unemployment rate of 9.7 percent. The Economic Report forecasts that this trend will continue for the next two years. For 2010, the Economic Report estimates a 10.4 percent unemployment rate for Tennessee, compared to a U.S. rate of 10.1 percent. The 2011 Tennessee forecast displays 10.2 percent unemployment in Tennessee, while the U.S. estimate is 9.5 percent.[10] Exhibit 8 portrays a comparison of national and state unemployment rates from the Federal Reserve Bank of St. Louis.

The unemployment rate is a lagging economic indicator, meaning that it does not change until after a turn in the business cycle has taken place. The Economic Report does not expect state unemployment to drop below 10 percent until the first quarter of 2012.[11]

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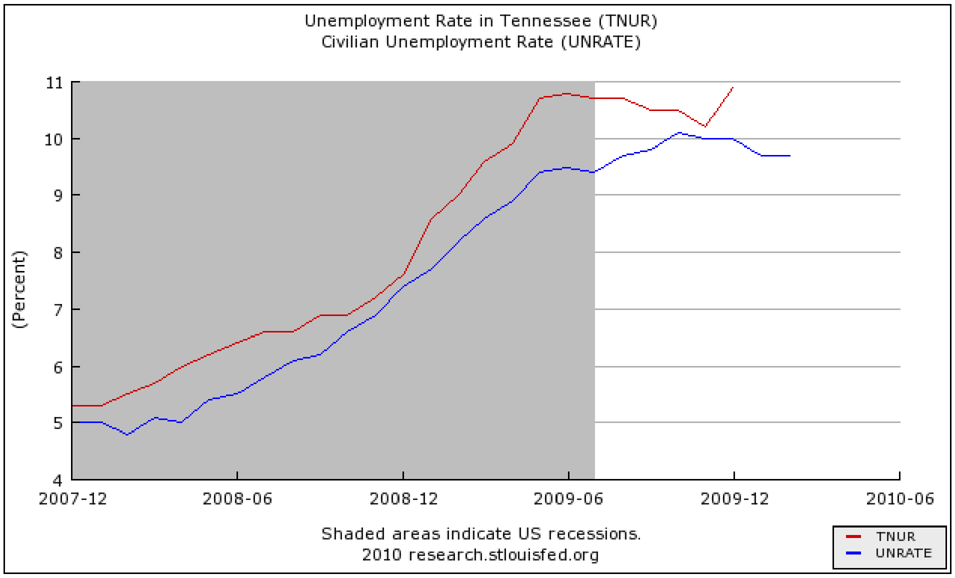
[8] Bernanke, Ben; Semiannual Monetary Report to Congress (testimony to the Committee on Financial Services, U.S. House of Representatives, February 24, 2010).

[9] The Conference Board, "The Conference Board Consumer Confidence Index Declines Sharply" Feb. 23, 2010, http://www.conference-board.org/economics/ConsumerConfidence.cfm (accessed March 16, 2010).

[10] CBER, *An Economic Report to the Governor*, 2010, p. 32.

[11] Ibid., p. 31.

Exhibit 8: Unemployment Rate Comparisons



Source: Federal Reserve Bank of St. Louis, http://www.stlouisfed.org/ (accessed March 9, 2010).

The Economic Report forecasts continued high unemployment in the short term. Like previous recessions, there will be "large numbers of structurally unemployed individuals; i.e., individuals with skills that were no longer valued in the labor market."[12] This outlook was recently echoed by Charles Evans, Chicago Federal Reserve Bank President and CEO, who commented that "it is possible that longer durations and lower labor force attachment could reflect broader structural changes in the economy, such as a mismatch between the skills of the unemployed and those demanded by employers."[13] If the structural unemployment rate increases, this could potentially lower the wage and salary portion of personal income. A decrease in personal income would also lower disposable income, affecting the level of consumer spending.

Labor Force and Utilization

The unemployment rate can be deceptive because it measures the number of people holding jobs compared to the total labor force. The labor force does not include unemployed people who are not looking for jobs. The Tennessee civilian labor force decreased in size during 2009 by 0.99 percent. Exhibit 9 shows recent estimates from the U.S. Bureau of Labor Statistics for Tennessee.

[12] CBER, *An Economic Report to the Governor*, 2010, p. 32.

[13] Charles Evans, Speech to 26th Annual NABE Economic Policy Conference, "Labor Markets and Monetary Policy," March 9, 2010, http://www.chicagofed.org/webpages/publications/speeches/2010/03_09_nabe3_speech.cfm (accessed March 15, 2010).

Exhibit 9: Annual Tennessee Employment, Unemployment, and Labor Force Information

Year	Period	Labor force	Employment	Unemployment	Unemployment Rate (%)	Labor Force Growth (%)
2001	Annual	2,863,516	2,728,523	134,993	4.7	-0.28
2002	Annual	2,867,108	2,714,992	152,116	5.3	0.13
2003	Annual	2,896,135	2,731,371	164,764	5.7	1.01
2004	Annual	2,904,355	2,746,241	158,114	5.4	0.28
2005 (D)	Annual	2,942,297	2,778,489	163,808	5.6	1.31
2006 (D)	Annual	3,008,957	2,852,764	156,193	5.2	2.27
2007 (D)	Annual	3,021,896	2,873,641	148,255	4.9	0.43
2008 (D)	Annual	3,050,310	2,846,105	204,205	6.7	0.94
2009 (D)	Annual	3,020,016	2,702,990	317,026	10.5	-0.99

Note: (D) Reflects revised population controls and model re-estimation.
Source: U.S. Bureau of Labor Statistics; accessed March 9, 2010.

In 2008, the U.S. Bureau of Labor Statistics computed annual averages for six alternative measures of labor utilization (U-1 through U-6) available for the states. (See Exhibit 10.) The U.S. Bureau of Labor Statistics provides these measures for 2005 through 2009.

The narrowest (U-1) measure gives a view of the number of people unemployed for 15 weeks or longer in Tennessee as a percentage of the civilian labor force. In 2009, 5.7 percent of the civilian labor force was unemployed 15 weeks or longer. The duration of unemployment has increased during the current recession.

The broadest (U-6) measure gives a view of the potential persons who would desire full-time employment. This measure represents the unemployed, discouraged, and workers employed part-time for economic reasons as a percentage of the civilian labor force and discouraged workers. This measure was 18.6 percent for 2009.

Although CBER projects the Tennessee civilian labor force will start growing in the second quarter of 2010, the growth rate will not be sufficient to produce a calendar-year gain in employment.[14]

[14] CBER, *An Economic Report to the Governor*, 2010, p. 32.

Exhibit 10: Alternative Measures of Labor Underutilization for Tennessee Annual Averages

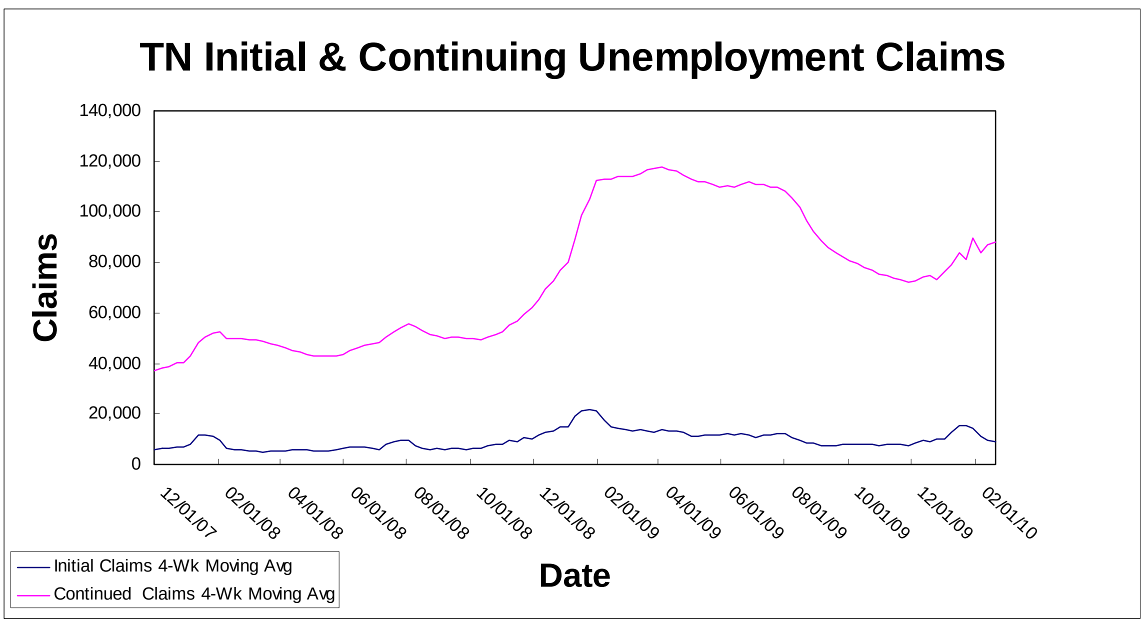
	Measure	
	U-1	U-6
2005	1.8%	9.4%
2006	1.8%	8.7%
2007	1.4%	8%
2008	2.2%	11.4%
2009	5.7%	18.6%

Source: U.S. Bureau of Labor Statistics.

Unemployment Claims

Unemployment claims remain high, but have generally trended downward since peaking in early 2009 for both initial and continuing unemployment claims in Tennessee. It should be noted, however, that claims have slightly increased in the first two months of 2010. Exhibit 11 illustrates these trends.

Exhibit 11: Tennessee 4-week Moving Average Initial and Continuing Claims December 2007 through February 20, 2010



Source: U.S. Department of Labor Employment and Training Administration.

FORECAST RISKS

Economic forecasts face risks due to uncertainty. Building econometric models requires making assumptions about the explanatory data used to predict variables. Unexpected events or changes in the relationships of underlying explanatory data may decrease a model's ability to provide useful estimates.

Conditions that may influence CBER's Tennessee forecast:

- Consumer spending weakness due to high unemployment, higher levels of savings, and low levels of consumer confidence
- Housing market weakness
- Credit markets tightening for consumers and small businesses
- Accelerated increases in the cost of energy, food, and other commodities

Housing Market

The fiscal crisis leading to this recession came from the bursting of the housing bubble and subsequent meltdown of the financial markets. According to the Federal Reserve's semiannual *Monetary Policy Report to Congress*, the housing market began to recover in the spring of 2009. Part of this recovery was due to the first-time homebuyer tax credit. Housing prices had been falling, but were more stable in the latter part of 2009 as measured by national indexes. Falling prices made houses more affordable and low mortgage rates encouraged buyers to enter the market. One drawback has been the number of foreclosed houses on the market. The Federal Reserve also reported that banks had continued to tighten lending standards for mortgages during 2009.[15]

In Tennessee, single-family home construction permits rose to 13,500 in the fourth quarter of 2009, climbing from 12,700 in the third quarter. While single-family construction has improved, "the level of activity remains substantially lower than most of 2008."[16] Multi-family construction permits remained low in both the third and fourth quarters of 2009.[17] The housing market may be weakly recovering, but it will be some time before a return to the pre-crisis levels.

Credit Market

The Federal Reserve reported that conditions in the financial markets improved in the second half of 2009 due to the actions of the Federal Reserve, U.S. Treasury, and other agencies, as well as an improved economic outlook. Credit had become available for larger firms, but small businesses faced tightened lending standards. Consumer and residential loans also faced tight standards.[18] Credit markets are still a concern, especially for small business, consumer, and residential loans. Continued tightness in these markets will slow economic growth.

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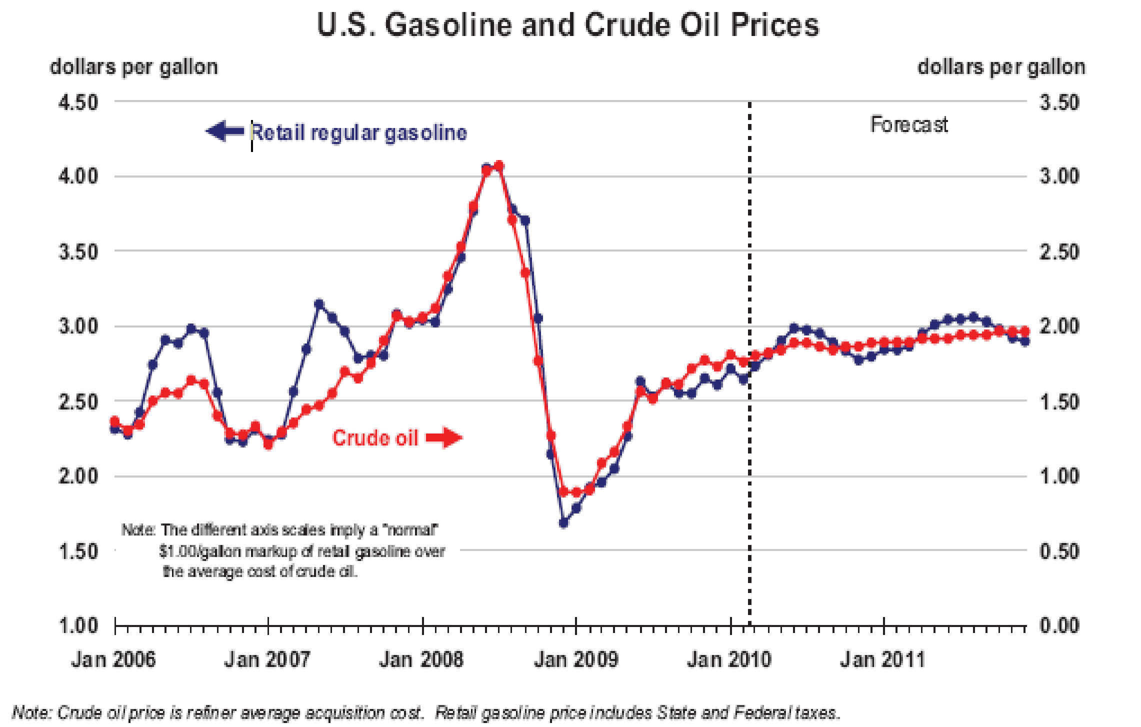
[15] Federal Reserve, *Monetary Policy Report to Congress, Part 2*, February 24, 2010, http://www.federalreserve.gov/monetarypolicy/mpr_20100224_part2.htm.
[16] Business and Economic Research Center, Middle Tennessee State University, *Tennessee Housing Market*, 2009, http://frank.mtsu.edu/~berc/pdfs/housingbrief4Q09.pdf (accessed March 16, 2010).
[17] Ibid.
[18] Ibid.

Inflation
The Economic Report forecasts inflation of 1.5 percent for 2010 after deflation of 0.3 percent for 2009.[19] The economic projections submitted by the members of the Board of Governors of the Federal Reserve and presidents of the Federal Reserve Banks anticipated that inflation would remain subdued over the 2010 through 2012 period.[20]

Commodity Prices
Oil prices dominated headlines in 2008, as prices of West Texas Intermediate (WTI) crude oil averaged $100 per barrel.[21] As in five of the last seven U.S. recessions, significant increases in the price of oil preceded the economic downturn in 2008.[22]

Exhibit 12: U.S. Gasoline and Crude Oil Prices



Source: U.S. Department of Energy, Energy Information Administration.

The Energy Information Administration (EIA) anticipates WTI prices to average above $80 per barrel in 2010.[23] As Exhibit 14 depicts, the EIA estimates the average annual regular grade retail gasoline price will increase from $2.35 in 2009 to $2.84 in 2010 and to $2.96 in 2011 because of the projected rising crude oil prices. During the 2010 summer

[19] CBER, *An Economic Report to the Governor*, 2010, p. 16.
[20] Federal Reserve Board, Minutes of the Federal Open Market Committee, January 26-27, 2010, Summary of Economic Projections, p.3, http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20100127.pdf (accessed March 15, 2010).
[21] U.S. Department of Energy, Energy Information Administration, "Short-Term Energy and Summer Fuels Outlook," March 9, 2010, p. 1, http://www.eia.doe.gov/steo (accessed March 9, 2010).
[22] Keith Sill, "The Macroeconomics of Oil Shocks," *Business Review*, Federal Reserve Bank of Philadelphia, (First Quarter, 2007), p. 1.
[23] U.S. Department of Energy, "Short-Term Energy and Summer Fuels Outlook," p. 1.

driving season, it is expected that U.S. prices will likely exceed $3 per gallon.[24] Rising oil prices could contribute to greater risks of inflation, though it should also be noted that higher demand is encouraging during economic recovery. Economies like Tennessee's, which still maintain a higher than average manufacturing workforce, are those most negatively impacted by increasing oil prices.

In 2009, U.S. liquid fuel consumption dropped for the fourth consecutive year. The EIA forecasts total U.S. liquid fuel consumption to grow by 200,000 bbl/d in 2010 and by 210,000 bbl/d in 2011. These projections are encouraging, but it should be noted that expected U.S. consumption in 2011 is 1.7 million bbl/d lower than the highest level of annual consumption reached in 2005.[25]

The U.S. Department of Agriculture forecasts that the Consumer Price Index for food will return to more moderate levels in 2010, increasing by 2.5 to 3.5 percent. This represents an increase from 2009 levels due to increased commodity and energy costs combined with stronger demand.[26]

CONCLUSION

The economy will likely experience an additional year or two of sluggish economic growth. Low levels of consumer spending and tight credit markets combined with high unemployment rates may continue to negatively impact consumption-based taxes. Actual growth, therefore, may be lower than forecasters expect. Based upon this review, however, the Economic Report's forecast of 2.80 percent nominal personal income growth for fiscal year 2011, 2.10 percent for calendar year 2010, and 3.51 percent for calendar year 2011 does not appear unreasonable.

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[24] Ibid.
[25] Ibid., p. 4.
[26] U.S. Department of Agriculture, Economic Research Service, "Food CPI and Expenditures: Analysis and Forecasts of the CPI for Food," February 25, 2010, http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/consumerpriceindex.htm (accessed March 9, 2010).