



## The economic forecast

Virginia's economy has an enormous impact on both the need for government services and the state's ability to provide them. When the economy is strong, more Virginians are working in jobs that pay higher salaries and more taxes are paid into the state treasury. A strong economy allows the state to return a portion of its tax revenues to its citizens in the form of tax relief.

Conversely, when the economy is weak, jobs are lost, more people are out of work, and tax revenue declines. At the same time, a weak economy increases the demand for government services. More people become eligible for unemployment compensation, food stamps, welfare, and other services.

Virginia's economy is well suited to outperform the nation's for many years to come. Virginia is one of the fastest growing technology states in the nation, and is expected to increasingly attract suppliers, competitors, and consultants to the state. In the manufacturing sector, high-tech production jobs in the Commonwealth will offset the losses in old-line manufacturing jobs such as apparel, textiles, met-

als, and tobacco. In addition, the federal government, which accounts for 4.6 percent of the state's employment base, is not expected to be a considerable drag on job growth, as it has been for much of the 1990s. The first real increase in defense spending in more than a decade will contribute to the Commonwealth's growth.

### 1990s expansion expected to become longest in U.S. history

The current economic expansion continued unabated in 1999. The slowdown that was expected to come from the deterioration of the worldwide economy

failed to materialize.

### Growth in Gross Domestic Product again posted a strong advance

The value of all goods and services produced within the U.S., adjusted for inflation, grew at 3.9 percent in fiscal year 1999, matching the growth rate for fiscal year 1998. Growth in total personal income was 5.0 percent, while growth in wages and salaries increased by 6.4 percent.

### The new economic paradigm: high growth, low inflation

The productivity trend is one of the most important single variables for the long-term forecast of economic growth. The ever-growing advancements in productivity have

### U.S. economic indicators point to moderate growth

	— ACTUAL —		— FORECAST —		
	1998	1999	2000	2001	2002
Real GDP	3.9%	3.9%	3.2%	2.5%	2.9%
Total employment*	2.6%	2.3%	1.5%	1.0%	1.3%
Unemployment rate	4.6%	4.4%	4.5%	4.5%	4.5%
Inflation -- CPI	1.8%	1.7%	2.5%	2.4%	2.4%

\*Total nonagricultural employment. Figures represent percent change over previous year, except unemployment rate, which is a percentage. Data based on October WEFA standard forecast. Source: Department of Taxation

allowed companies to boost production, lower costs, and pass those savings on to consumers in the form of relatively stable prices for goods and services.

It is increasingly clear that the explosive growth of the information technology industry has been instrumental to the economy's success. The advances in the information technology industry are boosting productivity for businesses, as highlighted by the tremendous growth in the Internet and e-commerce.

The Internet boosts productivity by lowering transactions costs, lowering search costs for suppliers, and providing dramatic increases in a business' presence in the marketplace. The power and continuing evolution of the Internet, made possible by the information technology industry, is enhancing productivity growth in nearly every industry.

These historic gains in worker productivity are playing a key role in moderating inflation. Consequently, we have not experienced the strong upward pressure on prices that were witnessed during the previous periods of economic expansion.

#### **Job gains exceeded the forecast**

Total nonagricultural employment in the U.S. increased by 2.3 percent during fiscal year 1999, compared with the forecast of 1.9 percent. Growth in construction, services, and finance, insurance and real

estate (FIRE) employment also substantially exceeded the forecast.

#### **Inflation reaches lowest rate of the 1990s**

Notwithstanding historically low unemployment rates and extremely tight labor markets, the consumer price index increased by only 1.7 percent, the lowest rate of this expansion.

#### **Interest rates hiked back to September 1998 rates after foreign woes dissipate**

The Federal Reserve Board, reacting to concerns about financial liquidity, made three 25 basis points cuts in interest rates at the beginning of the fiscal year. However, by November 1999, the Fed had raised rates by 75 basis points in three separate hikes, thereby taking back the three rate cuts it had made a year before.

#### **U.S. economic growth to continue at a solid pace**

**B**y February 2000, this expansion is expected to become the longest in U.S. history. The expansion has accelerated to a pace not seen since the 1960s. Furthermore, none of the imbalances that usually mark the end of a business cycle have yet appeared. Economic predictions for the next few years include:

- ▶ Real Gross Domestic Product (GDP) growth is expected to slow slightly to 3.2 percent in fiscal year

2000, then drop to 2.5 percent in fiscal year 2001 before rising in fiscal year 2002 to 2.9 percent.

- ▶ Moderating job growth over the forecast horizon with growth rates of 1.5 percent, 1.0 percent, and 1.3 percent in fiscal years 2000 through 2002, respectively. Growth is expected to slow in all the major employment sectors, with especially strong declines in construction employment.
- ▶ A slight rise in inflation is expected in fiscal years 2000 through 2002, although the increase in the Consumer Price Index is expected to remain at about 2.5 percent per year. Although largely offset by gains in worker productivity, low unemployment and rising wage gains are still likely to create some inflationary pressure. However, the forecast is for subdued inflation despite the strong-growth outlook.
- ▶ A leveling out of interest rate changes. After raising rates three times within the last six months, the Federal Reserve Board is expected to keep interest rates steady for the foreseeable future.

## Virginia's economy continued with explosive growth in 1999

Employment growth was broad-based, income growth was robust, and the housing market grew at a double-digit pace. The most important driver of the Virginia economy heading into the new millennium has become the rapidly expanding high-tech industry.

Virginia nonagricultural employment grew by 2.7 percent, increasing by 86,700 jobs during fiscal year 1999. Growth in most sectors was considerably stronger than anticipated. The only sector to experience negative growth, the manufacturing sector, actually performed better than shown due to the temporary impact of a strike at Newport News Shipbuilding. The unemployment rate fell to 2.8 percent, a half of a percentage

point lower than the official forecast of 3.3 percent.

An important result of the economy's stellar performance is the improvement in the quality of jobs being created. The strength in the services sector is a reflection of this, because high-tech employment is concentrated primarily in the services industry.

Here is a look at regional employment in Virginia during fiscal year 1999:

### Northern Virginia

Virginia's employment growth is mainly being driven by the rapidly expanding Northern Virginia economy. The region's employment growth of 3.9 percent generated over 39,700 jobs, accounting for 46 percent of the statewide increase. Growth in services employment continued to lead the region by creating 21,200 jobs, a superb 5.3 percent increase.

Employment growth in Northern Virginia is being driven by its high-tech industries, as well as business services. Northern Virginia's large and rapidly expanding business and professional services sector, which represents over 36 percent of services employment, advanced 11.0 percent.

Construction employment grew by a strong 7.0 percent, a result of the building boom in Northern Virginia.

### Richmond/Petersburg

Job growth in the Richmond-Petersburg Metropolitan Statistical Area (MSA) lagged the statewide average, growing at a 2.0 percent rate during fiscal year 1999, adding 10,400 new jobs. This represents almost 12 percent of the statewide increase. Services growth of 2.2 percent contributed most of the gain (3,100 jobs), followed by wholesale and retail trade employment (2,700 jobs) with growth of 2.2 percent.

Because of the mergers of its banks and investment firms, Richmond is no longer a major player in the finance industry. Driven by growth in nondepository institutions, however, the FIRE sector added 2,200 jobs, increasing by a robust 4.9 percent.

### Norfolk/Newport News/Virginia Beach

Employment in the Norfolk-Newport News-Virginia Beach MSA outpaced statewide job growth with an increase of 2.8 percent. The

### Strongest growth has been in services and trade sectors of the economy



\* Finance, Insurance, and Real Estate (FIRE). Source: Department of Taxation.

Tidewater area added 19,000 new jobs -- 22 percent of the statewide increase.

The services and trade sectors led the growth with annual increases of 5.1 percent and 3.0 percent, respectively. Employment in transportation equipment declined by 2,400 jobs; however, the strike at Newport News Shipbuilding was responsible for these temporary job losses. The insurance industry is showing strength in the Tidewater area, driving an increase of 4.5 percent in FIRE employment.

**Balance of the state**

The balance of the state lagged statewide job growth with an increase of 1.7 percent, or 17,500 jobs. This represents almost 20 percent of the statewide increase. Services, trade, and construction employment were responsible for the bulk of the growth in the

balance of the state. Like the other regions, the services sector produced the most new jobs in this region, increasing by 9,900 jobs.

**Virginia's job and personal income growth expected to outpace the nation's**

The Virginia standard forecast expects the Commonwealth to outperform the nation in both job and personal income growth over the forecast horizon.

Here is a look at what economists are predicting for Virginia over the next few years:

- ▶ Total personal income in Virginia is forecast to grow at 6.5 percent, 6.0 percent, and 5.7 percent in fiscal years 2000 through 2002,

respectively. Wages and salaries, the largest portion of personal income, is expected to increase 8.7 percent in fiscal year 2000, 6.9 percent in fiscal year 2001, and 6.5 percent in fiscal year 2002.

- ▶ In fiscal year 2000, Virginia is expected to add 80,300 nonagricultural jobs for growth of 2.4 percent. The service sector is expected to again lead job growth with gains of 35,200 jobs. Wholesale and retail trade is expected to add almost 20,700 jobs.
- ▶ Job growth is expected to slow in fiscal year 2001. Jobs are expected to grow by only 1.7 percent.
- ▶ Services employment is forecast to grow at 3.4 percent in fiscal year 2000, less than the fiscal year 1999 growth rate of 4.5 percent. In fiscal year 2001, services employment growth is expected to slow to 2.1 percent.
- ▶ Construction employment is expected to grow at 2.9 percent, 3.3 percent, and 2.4 percent over the biennium.
- ▶ Employment in wholesale and retail trade is expected to continue the slow, steady growth seen in fiscal year 1999.
- ▶ Virginia's manufacturing sector is expected to lose some jobs in fiscal year 2000 before rebounding in fiscal years 2001 and 2002.



Job gains in nonelectrical machinery and transportation employment account for the bulk of new jobs in this sector while the old-line industries of apparel, textiles and tobacco continue to shed jobs.

- ▶ The Finance, insurance, and real estate employment (FIRE) sector is expected to show continued job growth over the forecast horizon, adding 4,800 jobs in fiscal year 2000. This sector will continue to experience positive net growth due to the strong performance of real estate brokers, nonbank credit institutions, and insurance headquarters.
- ▶ State and local government employment is expected to grow moderately at 3.6 percent in fiscal year 2000, 2.7 percent in fiscal year 2001, and 2.7 percent in fiscal year 2002.
 

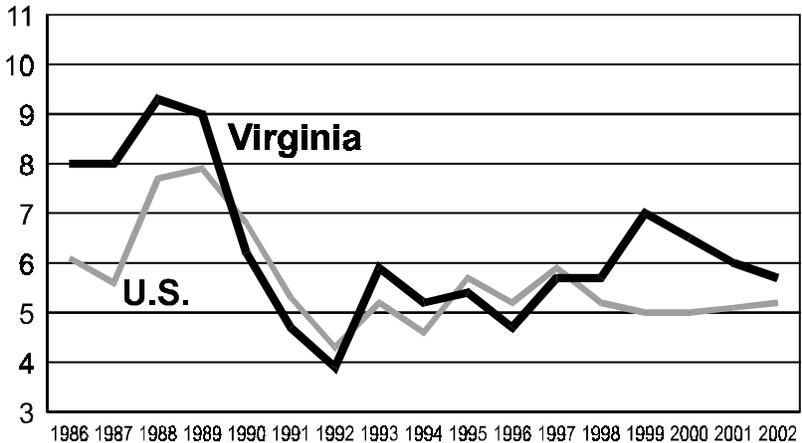
Local governments are expected to add 35,300 new jobs over the next three years, providing most of the growth in this sector.

## Summary

**I**n summary, the strong growth that the Virginia economy has had during the latter part of this expansion -- mainly driven by information technology advances -- is expected to continue as Virginia remains one of the fastest growing technology states.

### Personal income in Virginia expected to be slightly above the U.S.

*Percentage growth in personal income*



Data for 2000, 2001, and 2002 are forecasts. Source: Department of Taxation

The Virginia economy is well positioned to continue to outperform the nation in terms of job growth and personal income growth over the forecast horizon.