



The Economic Forecast

Virginia, like the nation, has been experiencing unprecedented economic expansion. Virginia's high-tech sector has been a solid driver of economic growth. This sector has experienced explosive employment growth over the last four years, increasing by an average of close to 20 percent per year.

In addition, information technology professionals earn substantially higher than average wages, a significant part of which is spent in the state. This has contributed to growth in the trade and finance sectors.

Other positive trends for the Commonwealth are the development of the state's

telecommunications infrastructure and the expansion of back office and call center operations. The improved federal fiscal picture and expected increase in defense spending also bode well for Virginia.

Several factors are now contributing to a slowing of economic growth in Virginia. The consolidation in the technology industry that started this year and the major shake-out that is expected next year as technology companies run out of initial startup money should slow high-tech growth toward more moderate rates. Also, manufacturing industries such as tobacco, coal mining, textiles, and apparel may continue to shrink.

Virginia's economy often mirrors the nation's, because factors that impact U.S. trends also have an influence in the Commonwealth. If Virginia's economy continues to decline, it will be due to national economic events such as interest rate increases, the decline in equity markets, and surging fuel costs. Here is a look at U.S. economic trends:

1990s expansion is the longest in U.S. history

In February 2000, the current economic expansion became the longest in U.S. history. Furthermore, economic growth posted its largest gain for this expansion in fiscal year 2000.

Growth in U.S. Gross Domestic Product posted its strongest gain

The value of all goods and services produced within the U.S., adjusted for inflation, grew at 5.2 percent in fiscal year 2000. Growth in total personal income was 5.9 percent, while growth in wages and salaries increased by 6.7 percent.

U.S. economy expected to grow at a moderate pace

	<i>ACTUAL</i>		<i>FORECAST</i>	
	<i>1999</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>
Real GDP	4.0%	5.2%	4.4%	3.4%
Total employment*	2.4%	2.3%	1.7%	1.4%
Unemployment rate	4.4%	4.1%	4.2%	4.3%
Inflation -- CPI	1.7%	2.9%	3.0%	2.3%

*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

Productivity growth surged

Productivity is the key determinant of real incomes and consumer spending. Productivity growth in the second quarter of calendar year 2000 was the largest gain since 1983. Over the last three years, labor productivity has risen an average of 3.1 percent per year, more than double the average of the 1980s.

Consumer spending was robust

Consumer spending experienced another year of exceptional growth in fiscal year 2000, increasing by 5.6 percent. Solid consumer fundamentals, such as strong job and income growth, continuing wealth gains, and high levels of consumer confidence, formed the basis for this robust consumer spending.

Job gains exceeded the forecast

Total nonagricultural employment in the U.S. increased by 2.3 percent during fiscal year 2000, well ahead of the forecast of 1.5 percent. Growth in construction, services, and transportation, communication, and public utilities (TCPU) employment also substantially exceeded their respective forecasts.

Inflation was slightly higher than expected

The surge in energy prices drove the consumer price index (CPI) slightly ahead of forecast. The actual increase in the CPI was 2.9 percent, higher

than the forecast of a 2.5 percent increase.

The Fed stepped on the monetary brakes

From June 1999 to May 2000, the Federal Reserve Board increased the federal funds rate on six separate occasions, raising short-term interest rates by 175 basis points as economic growth, particularly in the third and fourth calendar year quarters, increased at rates the Fed deemed unsustainable.

U.S. economic growth is moderating

The Fed's aggressive interest rate hikes over the past year and the explosive increase in oil prices have and will continue to slow economic growth. Economic predictions for the next two years include:

- ▶ Real Gross Domestic Product (GDP) growth is expected to grow by 4.4 percent in fiscal year 2001, and then by 3.4 percent in fiscal year 2002.
- ▶ Job growth will moderate over the forecast horizon, with growth rates of 1.7 percent and 1.4 percent in fiscal years 2001 and 2002, respectively.
- ▶ Lower employment growth, higher energy costs, and a slowing housing market should contribute to reduced consumption growth in the future.

▶ Productivity will demonstrate its procyclical nature. When GDP growth is accelerating, as it does early in economic expansions, productivity growth increases. Similarly, when GDP growth is decelerating as it is currently, productivity gains diminish. Thus, quarter-to-quarter changes in productivity growth are closely related to changes in the economy's overall rate of growth. Should the economy maintain its more modest pace of expansion, further drops in productivity growth can be expected.

- ▶ Inflation should show a temporary increase and then fall. Sharp increases in productivity have been offsetting strong economic growth and wage pressure to alleviate any inflation threat. The impact of higher oil prices is expected to have only a temporary effect on inflation, particularly in fiscal year 2001 when the CPI is expected to increase 3.0 percent before falling to 2.3 percent in fiscal year 2002.
- ▶ With the economy noticeably slowing, the Fed is expected to maintain steady interest rates for an extended period.

Virginia's economy in fiscal year 2000 experienced solid growth

The flourishing high-tech industry continued to be the principal driver of Virginia's thriving economy in fiscal year 2000. Employment growth was broad-based, with almost all industry sectors adding jobs.

Virginia's nonagricultural employment grew by 2.7 percent, increasing by 92,300 jobs during fiscal year 2000. The Virginia economy of the new millennium is a service-based economy. One out of every two new jobs created in fiscal year 2000 was in the services sector. The dominance of the services sector reflects at least a decade-long trend. The unemployment rate fell to 2.7 percent, over a half of a percentage point lower than the

official forecast of 3.3 percent.

Here is a look at regional employment in Virginia during fiscal year 2000:

Northern Virginia

Northern Virginia, home to most of Virginia's high-tech industries, experienced the best job growth among the major metropolitan areas during fiscal year 2000. The region's employment growth of 4.2 percent generated over 44,400 jobs, accounting for 48 percent of the statewide increase. Growth in services employment continued to lead the region by creating 27,200 jobs, a robust 6.3 percent increase.

The technology sector is the real engine of job-creation, growth, and business expansion in the region. Northern Virginia has the highest concentration of high-tech com-

panies outside of Silicon Valley. It is the number one region in the U.S. for software development and also leads the nation in Internet services.

The building boom in Northern Virginia continued unabated in fiscal year 2000, with construction employment growing by a strong 7.7 percent.

Richmond/Petersburg

Job growth in the Richmond-Petersburg Metropolitan Statistical Area (MSA) slightly lagged the statewide average, growing at a 2.4 percent rate during fiscal year 2000. The region added 13,100 new jobs, which represents almost 14 percent of the statewide increase. Services growth of 2.7 percent contributed most of the gain (3,900 jobs).

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 finance, insurance, and real estate employment (FIRE) sector added 2,400 jobs.

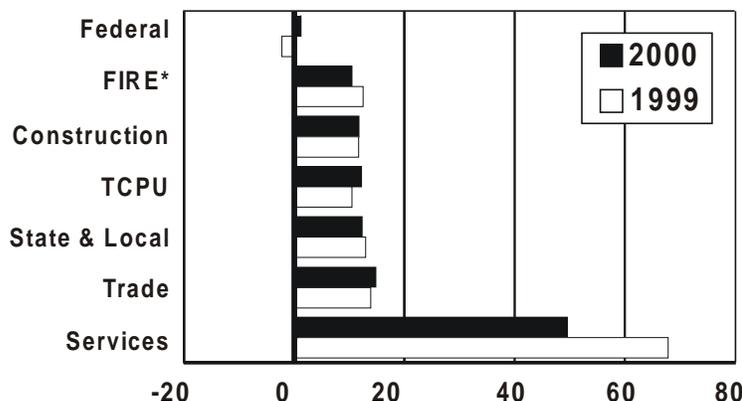
Norfolk/Newport News/Virginia Beach

Employment in the Norfolk-Newport News-Virginia Beach MSA grew by 2.0 percent. The Tidewater area added 13,500 new jobs, 15 percent of the statewide increase.

The services and transportation, communications, and public utilities (TCPU)

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

Jobs in thousands



Finance, Insurance, and Real Estate (FIRE). Transportation, Communication, and Public Utilities (TCPU). Source: Department of Taxation.

sectors led the growth with annual increases of 2.2 percent and 7.7 percent, respectively. Employment in transportation equipment increased by 900 jobs.

Balance of the state

The balance of the state lagged statewide job growth with an increase of 2.0 percent, or 21,200 jobs. This represents over 23 percent of the statewide increase. Services and trade 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 13,800 jobs.

Virginia's economy is still expected to outpace the nation's

The Virginia standard forecast expects the Commonwealth to outperform the nation in terms of job growth and wages and salary growth over the forecast horizon. However, growth will be slower than Virginia has been experiencing in recent years.

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

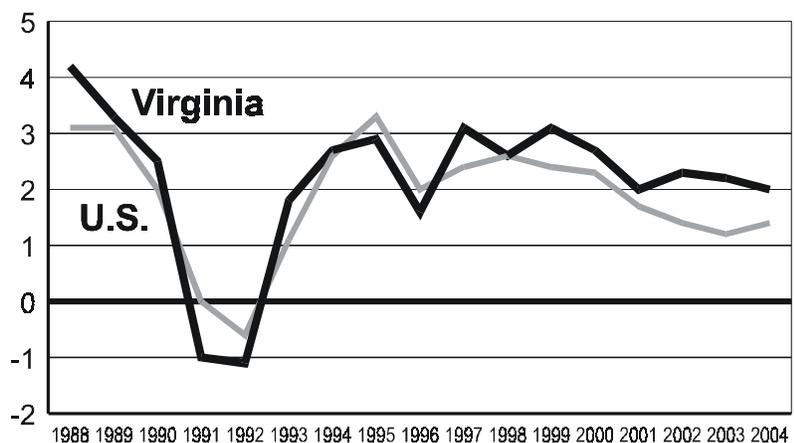
- ▶ Total personal income in Virginia is forecast to grow at 6.2 percent and 5.9 percent in fiscal years 2001 and 2002, respectively. Wages and salaries, the largest portion of personal income, is expected to in-

crease 6.8 percent in fiscal year 2001 and 6.7 percent in fiscal year 2002.

- ▶ In fiscal year 2001, Virginia is expected to add 70,900 nonagricultural jobs for growth of 2.0 percent. The service sector is expected to again lead job growth with gains of 41,300 jobs. Wholesale and retail trade is expected to add almost 12,100 jobs.
- ▶ Job growth is expected to be slightly faster in fiscal year 2002. Jobs are expected to grow by 2.3 percent.
- ▶ Services employment is forecast to grow at 3.7 percent in fiscal year 2001. In fiscal year 2002, services employment growth is expected to slow slightly to 3.6 percent.
- ▶ Construction employment is expected to experience another year of solid growth in fiscal year 2001, growing by 2.7 percent. Growth is forecast to slow in fiscal year 2002 to 2.4 percent.
- ▶ Employment in wholesale and retail trade is expected to continue the slow, steady growth seen in fiscal year 2000.
- ▶ Virginia's manufacturing sector is expected to slightly decline once again in fiscal year 2001 before rebounding in fiscal year 2002.
- ▶ The finance, insurance, and real estate employment (FIRE) sector is expected to weaken slightly over the forecast horizon with growth of 1.7 percent and 0.8 percent in fiscal

Virginia employment growth again expected to outpace the nation's

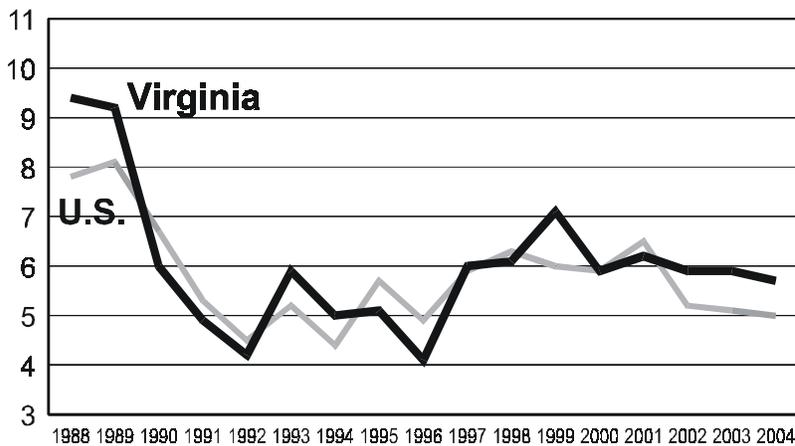
Percentage growth in nonagricultural employment



Data for 2001 through 2004 are forecasts. Source: Department of Taxation

Personal income growth in Virginia expected to slightly lag U.S. in 2001

Percentage growth in personal income



Data for 2001 through 2004 are forecasts. Source: Department of Taxation

years 2001 and 2002. This sector will continue to experience positive net growth due to the strong performance of nondepository credit institutions and insurance carriers.

- ▶ State and local government employment is expected to grow moderately at 2.4 percent in fiscal year 2001 and 1.6 percent in fiscal year 2002. Local governments are expected to add 16,000 new jobs over the next three years, providing most of the growth in this sector.

Predictions for the near future

In summary, economic growth in Virginia over the next two fiscal years is expected to moderate significantly from the expansionary pace of the last few years. Slowing growth will be due mostly to national and international economic events such as the Federal Reserve Board interest rate increases, the decline in equity markets, and surging fuel costs.

In addition, growth in the high-tech sector, one of the Virginia economy's main drivers, has begun to decelerate, and it remains to be seen what impact the NASDAQ and dot-com fallout will have on employment and income growth in this sector.