Washington Economy Watch

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The Stephen S. Fuller Institute
for Research on the Washington Region's Economic Future
Schar School of Policy and Government
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The Washington Economy Watch is a monthly report issued by The Stephen S. Fuller Institute that is intended to inform its readers regarding the current and near-term performance of the Washington region's economy. The Leading and Coincident Indices were first reported in February 1991 and have been calculated each month since that first release and reflect an underlying data base that dates from 1978 covering five complete business cycles in addition to the current cycle that began in 2009.

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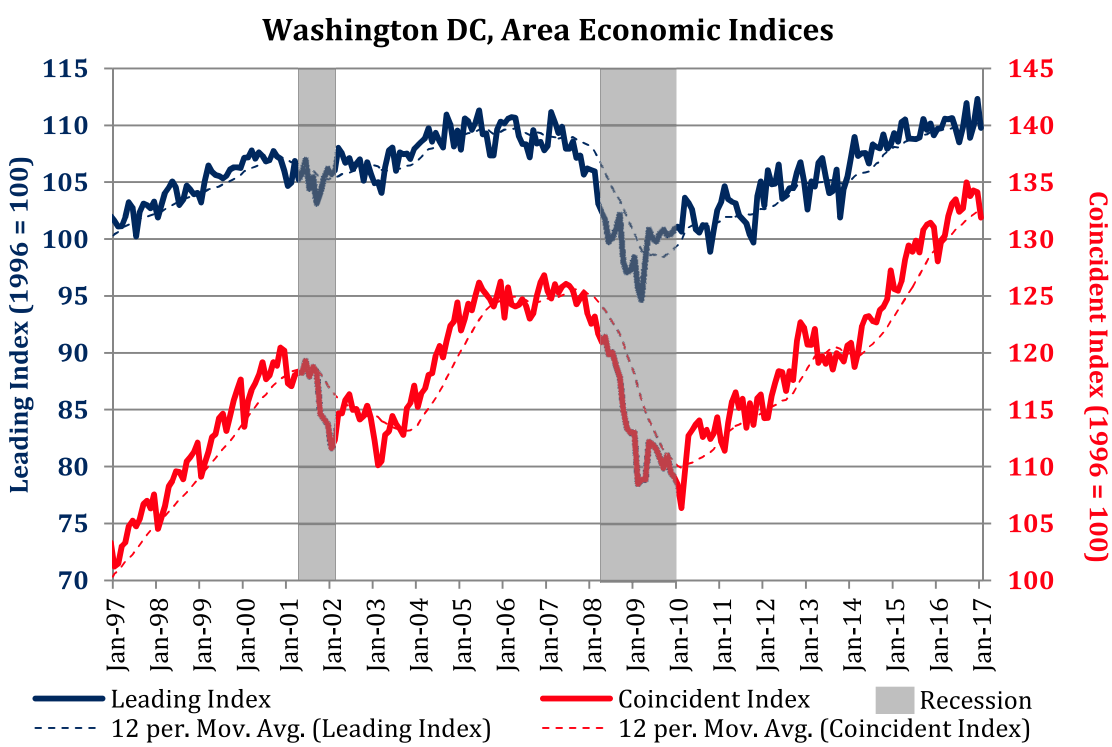
The Washington Region's Economy Starts Year Well Off Its 2016 Peak

Both the Washington Leading and Coincident Indices experienced a sharp decline in January after registering a year-long gain in 2016. While some of this softness in can be explained by seasonal factors, some indicators may be reflecting a more fundamental shift in the economy's performance. Just released jobs data for 2016 show job growth to have been weaker than previously reported, with total gains of 55,600 jobs, far fewer than the BLS's initial estimates of 72,400 jobs. This downward adjustment is consistent with the flattening of the Leading Index over the second half of 2016 that is pointing to a continuation of this growth trajectory into 2017. However, President Trump's proposed FY 2018 budget, released on March 16th, if adopted, could undermine the economy's current performance trends.



Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, decreased for a second month in January from the previous month down 1.7 percent from December's value. This is the third month-to-month decline in the Index over the past four months. Still, even with its slowing at the end of the year, the Coincident Index was 3.0 percent higher than its January 2016 level, extending this positive monthly over-the-year trend to 34 consecutive months dating back to March 2014. This unbroken string of monthly over-the-year gains in the Coincident Index tracks the Washington region's recovery from the year-long impacts of The Sequester. In January, all of the Index's four components were greater than in January 2016.

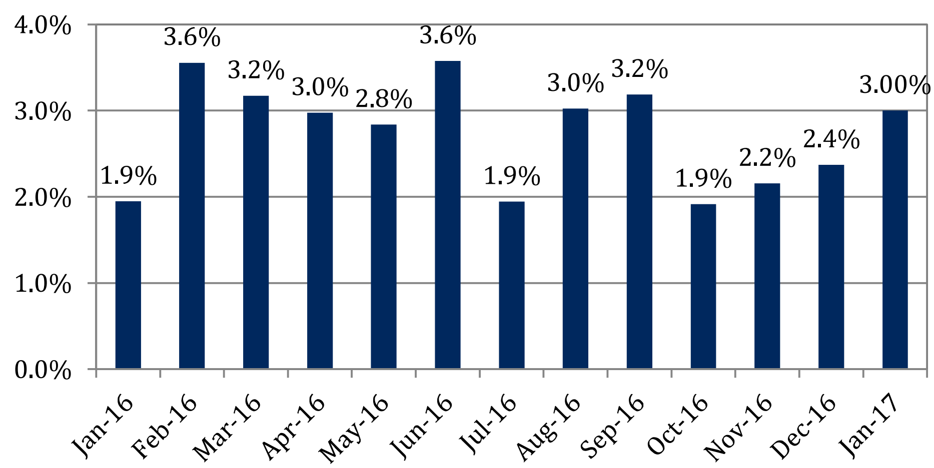
- *Wage and salary employment* growth in the Washington region increased 1.7% between January 2016 and January 2017 although January's total was down from December;

- *Consumer confidence (in the present)* started the year up sharply increasing on a monthly over-the-year basis; it was also up 6.9% from December;

- *Non-durable goods retail sales* outperformed same-month sales continuing its upward trend on both a monthly over-the-year and month-to-month basis; and,

- *Domestic passenger volume at Reagan National and Dulles Airports* was stronger in January 2017 than in January 2016 but was lower than in December 2016.

Washington Coincident Index, Monthly Over-the-Year Changes



Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy six to eight months in advance, was basically unchanged in January, increasingly just 0.04 percent from January 2016 and declined 2.3 percent from December 2016. The trajectory of the Leading Index flattened over the second half of 2016; this leveling off points to the region's economy continuing to grow generally at last year's rate. January's month-to-month performance in 2017 differed from its month-to-month performance in January 2016. In 2016, all four of the Index's components improved from their respective values in December 2015, while all of the January 2017 indicators declined from December 2016. This performance reversal might be associated with the disruption of Inauguration week. In January, two of the Index's four components were positive compared to January 2016 but all four were lower than in December.

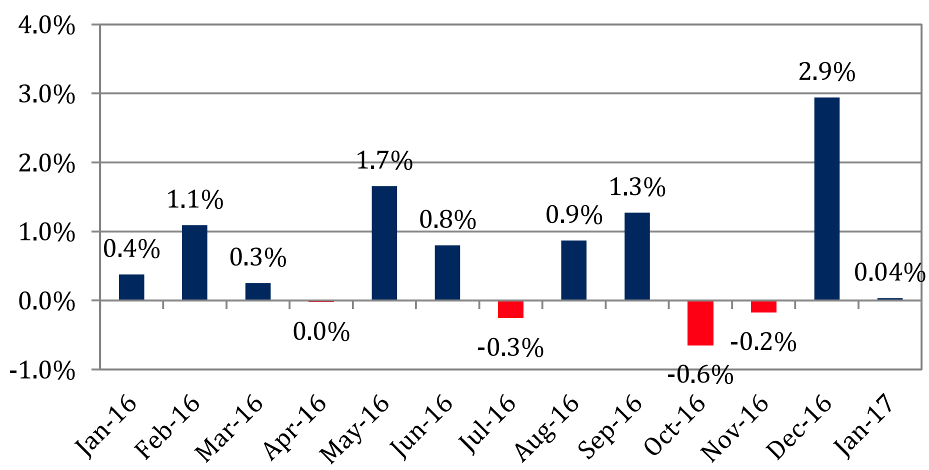
- *Durable goods retail sales* increased in January gaining 7.0% from January 2016 extending this strong performance from last year; and,

- *Consumer expectations (consumer confidence six months hence)* continued its upward trend with a solid gain in January; while,

- *Total residential building permits* retreated in January following a strong gain in December; and,

- *Initial claims for unemployment insurance* increased (worsened) for a third consecutive month, reversing what had been a long-term downward trend and a tightening of the labor market.

Washington Leading Index, Monthly Over-the-Year Changes



Source: The Stephen S. Fuller Institute at the Schar School, GMU

January's data provide the first glimpse into 2017 following 34 months of recovery since March 2014 and a negative year (GRP declined 0.5% in 2013) due to federal spending reductions associated with the Sequester. The Leading Index flattened out during the Sequester and rebounded strongly until mid-2016 since which time it has become more volatile (larger monthly swings) but on average tracing a flatter trajectory into 2017. Still, the Coincident Index has tracked higher through the end of 2016 although it pulled back in January as is common due to seasonal factors that this year may have been altered further by the once-every-four-years Inauguration. Going forward, we now know the Washington area economy is not as strong as had been previously assumed based on revised estimates by BLS for 2016 that showed job growth considerably lower than previous reported. With the Trump Administration generating continuing uncertainty concerning the federal budget and other policies potentially impacting the Washington region's economy, it is likely that the economic trends projected today may be significantly different by the end of the year and beyond.

Current Performance

Washington region's economy registered solid gains during 2016 but starts the year in a weaker position than had been initially reported. The Coincident Index was higher each month in 2016 than in the same month in 2015. In January 2017, the Coincident Index exceeded its same-month 2016 level by 3.0 percent. There can be little argument that the region's economy has bounced back from the losses it experienced during the Sequester. It added 57,700 new jobs in 2015 after generating only 18,600 new jobs in 2014. In 2016, revised BLS data show the region added 55,600 net new jobs. While this is a substantial gain, it was far less than the 72,400 jobs that had been estimated over the course of the year by BLS.

These revisions underscore the economy's current condition and the structural changes that are currently underway. The downward revisions to the region's 2016 jobs affected the retail trade sector this most; initial estimated had it adding 8,700 jobs but only 600 new jobs in the final revision. Professional and business services, the region's largest sector, did add 17,000 new jobs, in 2016, but this reflected a downward revision of 3,200 jobs. Government, federal and state and local, had a combined downward revision of 5,400 jobs from an initial combined estimate of 9,400 jobs, a reduction of 57 percent.

Overall, the region's job gains in 2016 were revised downward by 16,800 jobs; this is the largest annual job revision that we can identify. The changing nature of work may be responsible for BLS's over-estimate; that is, more jobs are part-time, there is a growing percentage of self-employment, and there is a growing informality to employment making it more difficult to estimate.

The gains in the region's employment base further reduced unemployment. While January ordinarily has higher unemployment than in December for seasonal reasons, the unemployment rate in January (3.9%) was down from a year ago (4.2%). One ominous sign in recent months that needs to be monitored is an upward trend in initial claims for unemployment insurance; that is, in newly unemployed persons, in the District of Columbia. As a component of the Leading Index, a rise in initial claims usually points to a pull back in the private sector, possibly some re-positioning or right-sizing in the face of growing uncertainty. Or, possible it is in response to expansion that was too aggressive. However, in January some of this increase can be attributed to "federal-related" claims; that is federal contract workers losing their jobs with the hiring freeze and change in Administrations. Initial claims improved (decreased) each month during the first seven months of 2016 through July and now have increased (worsened) in four of the last six months and for three consecutive months.

Near-Term Outlook

The Leading Index has plateaued, is tracking a relatively flat trajectory, and registered no real gain in January. The Washington region's economy did not grow as much as had been initially estimated in 2016 although this was not a poor performance; it just was not a record performance. In fact, the economy in 2016 underperformed 2015, as measured by job growth. And the mix of jobs continues to favor local-serving (rather than export-based jobs serving national and global markets) and more moderate wages (not high-value added) than the region needs to replace lower levels of federal spending.

This is not a new trend—it dates back to 2010—but a trend that could become a great challenge if the Trump Administration's *America First Blueprint*, its proposed FY 2018 budget released on March 16th, is adopted. This budget proposed has been shown to have the potential to reduce federal employment in the Washington region by as much as 24,600 jobs, lower the federal payroll by $2.7 billion, and reduce federal procurement spending in the region by as much as $1.2 billion. Such a reduction in federal procurement spending would generate losses of 10,000 to 12,000 professional and business service jobs, as was experienced in even larger numbers during the Sequester.

The outlook for 2017 appears similar to what was achieved in 2016 in the absence of this proposed Trump budget for FY 2018. The current forecast is for slightly stronger growth in gross regional product (total output) with slightly less job growth than in 2016. While the region's economy may not be as resilient and as well positioned to absorb federal spending reductions as it could have been, or was thought to be, the Washington region's economy has shown a relatively steady and continuing month-after-month improvement since the dark days of the Sequester. All indicators reflected in the Leading and Coincident Indices are much improved going into 2017 than they were going into 2016 or 2015.

The question that remains unanswered is what will drive the region's economic growth in the absence of growth in federal spending? In light of the Trump budget proposal, the question might better be rephrased to what will compensate for federal spending reductions in the Washington region's economy that could total $5 billion in the coming fiscal year and what sources of growth could support the economy's continued expansion beyond offsetting these losses? The answer is not clear. What is clear is that the region's non-federally dependent business base is not sufficiently large or sufficiently expansive to replace these reductions in federal spending as quickly as these reductions can be implemented. As a result of the longer period required for the Washington region's economy to adjust to a disruption in federal spending, it is likely that the region's gross regional product would contract and job growth slow or even decline, impacts similar to those experienced during the Sequester, with these negative consequences extending beyond the period of the federal spending reductions. The magnitudes of these impacts and options for reducing their negative effects will be topics that the Fuller Institute will explore in coming publications available on its website.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Jan-17 Prelim.	Dec-16 Final	Jan-16 Final	Dec-16 to Jan-17	Jan-16 to Jan-17
Washington Area Business Cycle Indicators					
Coincident Index (1996 = 100)	131.9	134.1	128.0	-1.69%	3.00%
Leading Index (1996 = 100)	109.8	112.3	109.7	-2.29%	0.04%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,217.4	3,269.8	3,162.6	-1.60%	1.73%
Consumer Confidence (South Atlantic)[a]	137.1	128.2	106.5	6.94%	28.73%
Domestic Airport Passengers ('000)[b]	2,015.9	2,222.9	1,995.6	-9.31%	1.02%
Nondurable Goods Retail Sales ($000,000)[c]	3,078.7	3,047.2	3,005.5	1.03%	2.44%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	1,557.0	1,766.0	1,818.0	-11.83%	-14.36%
Consumer Expectations (South Atlantic)[a]	110.0	111.9	94.4	-1.70%	16.53%
Initial Unemployment Claims[b]	2,031.9	1,457.1	1,312.6	39.45%	54.80%
Durable Goods Retail Sales ($000,000)[c]	3,487.1	3,630.3	3,259.3	-3.94%	6.99%
Wahington Area Labor Force[a]					
Total Labor Force ('000)	3,341.6	3,347.5	3,293.0	-0.18%	1.47%
Employed Labor Force ('000)	3,212.1	3,232.1	3,156.0	-0.62%	1.78%
Unemployed Labor Force ('000)	129.5	115.3	137.0	12.28%	-5.50%
Unemployment Rate	3.9%	3.4%	4.2%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,217.4	3,269.8	3,162.6	-1.60%	1.73%
Construction ('000)	152.6	153.4	151.3	-0.52%	0.86%
Manufacturing ('000)	53.2	54.1	52.9	-1.66%	0.57%
Transportation & Public Utilities ('000)	64.6	68.9	63.3	-6.24%	2.05%
Wholesale & Retail Trade ('000)	339.8	351.1	337.1	-3.22%	0.80%
Services ('000)	1,911.0	1,934.8	1,871.4	-1.23%	2.12%
Total Government ('000)	696.2	707.5	686.6	-1.60%	1.40%
Federal Government ('000)	370.0	369.8	365.5	0.05%	1.23%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars