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
George Mason University

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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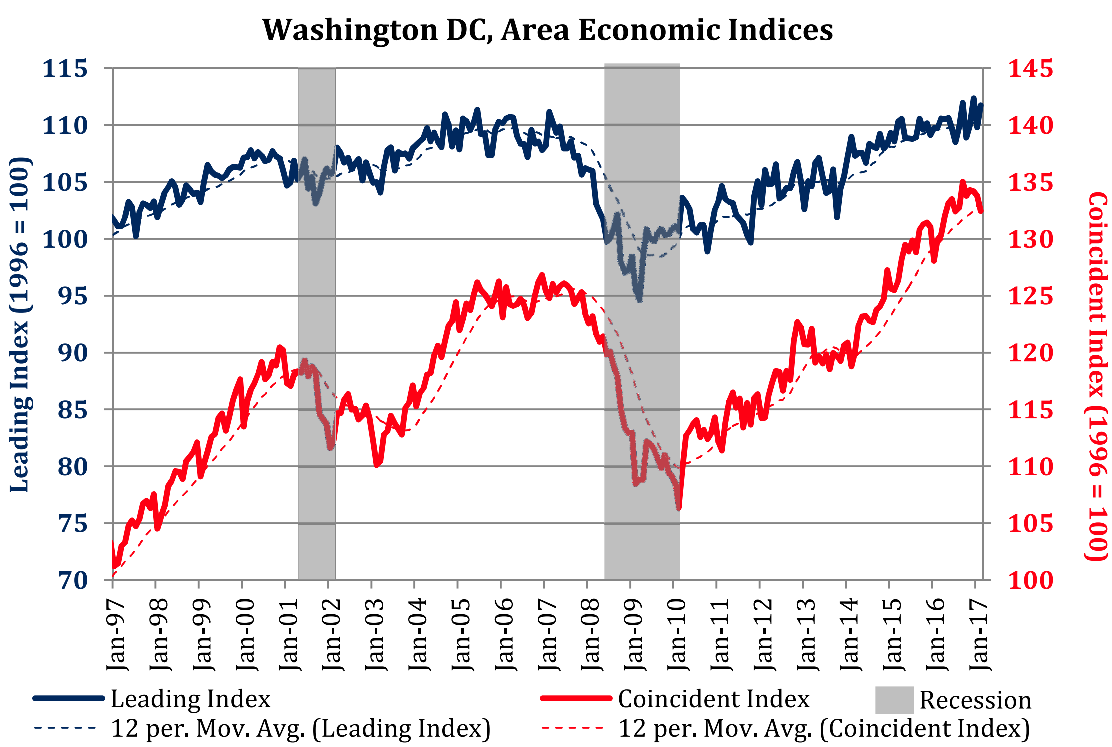
The Washington Region's Economy Expands in February, Outlook Remains Positive

Both the Washington Leading and Coincident Indices continued to trend higher in February compared to February 2016 although several component indicators fell below their January readings reflecting seasonal patterns. The region's economy added 62,400 net new jobs between February 2016 and February 2017 and consumer confidence remained strong pointing to solid gains in consumer spending and a positive housing market during the spring season. The Leading Index regained strength in February following a flat performance in January. However, one month does not make a trend and February's performance might reflect unsustainable optimism associated with proposed pro-business federal policy changes being advanced by the Trump administration.



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 in February from January; on a month-to-month basis, the Index has declined in four of the last five months. While the Index slowed over the second half of 2016, its monthly over-the-year values continued to increase and, in February 2017, the Coincident Index was 1.94 percent higher than in February 2016. This increase extended the Index's positive monthly over-the-year trend to 35 consecutive months starting in April 2014. For the six months previous to April 2014, the Index had experienced five negative months during the peak impact of the Sequester.

In February, two of the Coincident Index's four components were greater than in February 2016 and two components decreased.

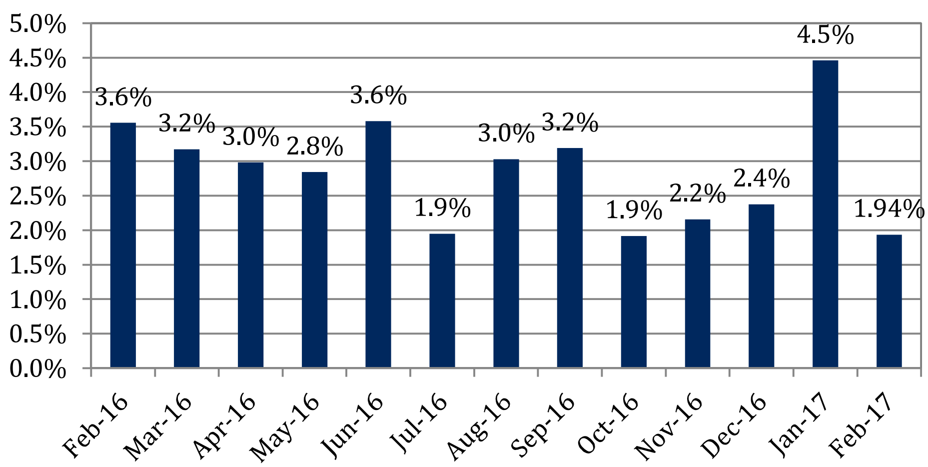
- *Wage and salary employment* growth in the Washington region increased 2.0% between February 2016 and February 2017; and,

- *Consumer confidence (in the present)* recorded a third consecutive double-digit monthly over-the-year gain in February, increasing 30.1% from February 2016; while,

- *Non-durable goods retail sales* declined for the first time in more than a year on a same-month basis; this decrease was small and may be explained by February 2016 being Leap Year and having an extra business day; and,

- *Domestic passenger volume at Reagan National and Dulles Airports* was lower in February compared to February 2016 following three consecutive monthly over-the-year gains.

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, registered a strong gain in February, increasingly 1.84 percent from February 2016, after being flat in January. The trajectory of the Leading Index had become more variable over the second half of 2016 (down in July, October and November; up in August, September and December) but ended the year sharply higher. Revised year-end data now show the Leading Index to have had its strongest performance for all of 2016 in December (up 2.95%) followed now by a second strong performance in February.

The Index's recent performance may be pointing to a new acceleration in the region's economic performance in the coming months although this cannot be assured from only two strong monthly gains. In February, three of the Index's four components contributed to its monthly over-the-year increase.

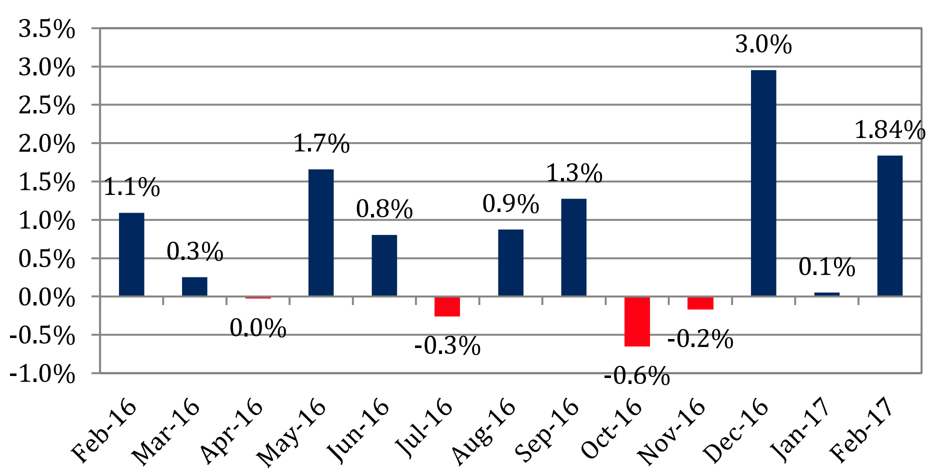
- *Durable goods retail sales* increased in February gaining 1.7% from February 2016 continuing its positive trend from 2016 when it increased every month;

- *Consumer expectations (consumer confidence six months hence)* extended its upward trend for a fifth month registering its largest ever gain of 32.6% in February; and,

- *Total residential building permits* increased in February following a decrease in January continuing its inconsistent pattern from 2016; while,

- *Initial claims for unemployment insurance* increased (worsened) for a fourth 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

February's performances of the Coincident and Leading Indices show the performance patterns established in the almost three years continuing into 2017. The Coincident Index has increased (on a monthly over-the-year basis) every month starting in April 2014. This trend now extends 35 months through February 2017 with the Index gaining 10.3 percent over this period. During this three-year period, the region's economy has generated more than 170,000 net new jobs and unemployment has declined from 5.4 percent (February 2014) to its present level of 3.9 percent. While the upward trajectory of the Leading Index has not been as consistent as the Coincident Index's, it has gained 2.5 percent since February 2014. However, its pace of growth over the last twelve months (up 1.84%) has slowed and may be forecasting moderation in the region's economic growth path by the fourth quarter of 2017.

Current Performance

The Washington Region added 62,400 net new jobs between February 2016 and February 2017. To date in 2017, job growth is running ahead of revised estimates for 2016 (55,600 jobs). The unemployment rate has held steady at 3.9 percent in 2017 but is expected to decline further over the year. That is the good news.

The composition of the new jobs being generated in the Washington region continues to reflect a less-than-favorable pattern. The professional and business service sector remains the largest employer in the region, with 742,100 jobs (22.9% of all jobs) and continues to grow adding 19,600 new jobs between February 2016 and 2017 and accounting for 31.4% of new jobs. In comparison, the jobs generated by two other major sectors, education and health services (the second largest sector) and leisure and hospitality services (the fifth largest sector), totaled 27,800 during this period and accounted for 44.6 percent of all new jobs. Combined, these two sectors have 764,400 jobs and account for 23.6 percent of the region's total employment base.

These three sectors, with a total of 1.5 million jobs account for 46.5 percent of the region's total jobs but accounted for 76.0 percent of all of the region's net new jobs generated between February 2016 and February 2017. While this job generation imbalance—the three sectors accounting for 46.5 percent of the region's total jobs base generated 76.0 percent of all new jobs—represents a structural weakness in the region's economy, these three sectors also reflect widely different salary profiles that magnifies the consequences of this structural imbalance. The jobs in professional and business services have an average annual salary roughly twice the average of the education and health services and leisure and hospitality services sectors combined.

The federal government sector is the region's third largest with 367,200 jobs. Like the professional and business service sector (this is where most federal contractor jobs are enumerated), the federal government sector has an average annual salary roughly twice the value of the average annual salary in education and health services and leisure and hospitality services combined. However, the federal government sector has been shrinking, having lost almost 13,000 jobs since 2010 and, while it added jobs in 2016, it appears on course to lose jobs in 2017. Federal contractor jobs could also be impacted by budget reductions in the next fiscal year and beyond.

So, while job growth remains strong in number, the mix of these jobs is not supporting the magnitude of economic growth that it has in the past due to their lower wage profile and concomitant lower value added per job to the region's economy (gross regional product). This reduction in the economy's ability to generate output value reduces its ability to compensate for a sudden shift in federal policy that would decrease federal jobs in the region and/or cutback federal procurement spending. This vulnerability has impacted the Washington region in the past, most recently during the Sequester, but efforts to diversify the region's economy to reduce its vulnerability to potential shifts in federal spending have not yet achieved that goal.

Near-Term Outlook

The Leading Index attempts to chart the future path of the Washington region's economy six to eight months in advance. It builds this forecast on the performance of indicators that historically anticipate the economy's real-time performance. However, the Leading Index cannot anticipate sudden or one-time externalities that have no precedents. In the absence of (1) any clarification of the Trump administration's personnel policies (the freeze has been lifted but plans for job reductions are being required of all agencies) and (2) the final budget outline for FY 2018, the Washington region's economy is positioned for a continuation of moderate growth in 2017 with the likelihood that the region's rate of economic growth will accelerate in 2018 but will still slightly underperform the performance of the national economy.

Job growth in 2017 and 2018 is projected to slow from its 2015 peak. This slower job growth projection is predicated on a continuing decline in federal jobs reflecting a tightening of the budget (this trend was already in place and does not reflect additional reductions resulting from policy changes of the Trump administration) and the region's slower than national growth rates in its non-federally dependent, export-based (non-local serving), high-value added advanced industrial clusters, a pattern dating from March 2014.

Forecasts have been developed that incorporate the economic impacts of congressionally imposed budget reductions and spending shifts and agency cutbacks impacting federal employment and procurement in the Washington region and elsewhere in the U.S. With the Washington region accounting for 18 percent of the federal workforce and 20 percent of federal procurement it would be unreasonable to expect that it could avoid the negative consequences of major inter-agency shifts or reductions in federal spending. These forecasts are presented in a report released on April 11th by the Stephen S. Fuller Institute entitled *The Washington Region's Jobs Forecast: 2017-2021* and is available at http://sfullerinstitute.gmu.edu/2017/04/12/jobs-forecast/.

The region's economic vulnerability to significant federal spending reductions is clear. The current baseline forecasts projects the addition of 172,200 net new jobs over the next five years. Under the worst-case scenario—the Trump Budget Blueprint—this total would be only 117,300 or one-third less. Federal jobs losses are projected to total 16,500 in the baseline forecast. Under the Trump Budget Blueprint, federal job losses are projected to be more than doubt that level totaling 36,500 jobs.

The impact of this job forecast on the Washington region's economic vitality is best measured in the value of the region's gross regional product, the value of the goods and services the region's economy produces in a year. The baseline line forecast for the 2017-2021 period has the region's economy maintaining an annual real growth rate of 2.0% or better over this period, peaking in 2018 at 2.6%. In comparison, under the Trump Budget Blueprint, these growth rates would average 1.8% through 2020 before rising to 2.2% in 2021 (cutbacks in the Trump Budget Blueprint are front loaded).

The Fuller Institute's baseline forecast provides the near-term reference points for the Washington region's economy. These reflect the performance history of the region's economy as tracked by the Leading Index over five business cycles dating back to 1978. Given the current conditions and recent patterns of performance, the Washington region's economy appears well positioned for continued moderate growth that will accelerate into 2018 before slowing with the national economy towards the end of the decade. Any changes to this projected growth path in 2017 or 2018 would likely result from an externality, most likely a major shift in federal budget policy impacting federal jobs and procurement spending. These could abruptly alter the Washington region's current growth trajectory. The Stephen S, Fuller Institute will continue to monitor these possibilities and will report out as new information becomes available with postings on its website.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Feb-17 Prelim.	Jan-17 Final	Feb-16 Final	Jan-17 to Feb-17	Feb-16 to Feb-17
Washington Area Business Cycle Indicators					
Coincident Index (1996 = 100)	132.4	133.8	129.9	-1.00%	1.94%
Leading Index (1996 = 100)	111.7	109.8	109.7	1.79%	1.84%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,236.5	3,218.2	3,174.1	0.57%	1.97%
Consumer Confidence (South Atlantic)[a]	149.2	137.1	114.7	8.83%	30.08%
Domestic Airport Passengers ('000)[b]	1,951.0	2,262.6	2,027.7	-13.77%	-3.78%
Nondurable Goods Retail Sales ($000,000)[c]	3,074.5	3,078.7	3,114.5	-0.14%	-1.28%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	1,441.0	1,557.0	1,238.0	-7.45%	16.40%
Consumer Expectations (South Atlantic)[a]	114.7	110.0	86.5	4.27%	32.60%
Initial Unemployment Claims[b]	1,608.1	2,031.9	1,319.7	-20.86%	21.86%
Durable Goods Retail Sales ($000,000)[c]	3,537.0	3,488.3	3,476.4	1.40%	1.74%
Wahington Area Labor Force[a]					
Total Labor Force ('000)	3,361.8	3,341.6	3,294.6	0.60%	2.04%
Employed Labor Force ('000)	3,231.6	3,212.4	3,158.4	0.60%	2.32%
Unemployed Labor Force ('000)	130.2	129.2	136.2	0.77%	-4.42%
Unemployment Rate	3.9%	3.9%	4.1%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,236.5	3,218.2	3,174.1	0.57%	1.97%
Construction ('000)	150.9	152.4	150.1	-0.98%	0.53%
Manufacturing ('000)	52.8	52.6	53.0	0.38%	-0.38%
Transportation & Public Utilities ('000)	63.3	64.2	63.0	-1.40%	0.48%
Wholesale & Retail Trade ('000)	338.1	340.6	332.8	-0.73%	1.59%
Services ('000)	1,929.4	1,910.9	1,881.0	0.97%	2.57%
Total Government ('000)	702.0	697.5	694.2	0.65%	1.12%
Federal Government ('000)	367.2	369.9	365.3	-0.73%	0.52%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars