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 mid-2009.

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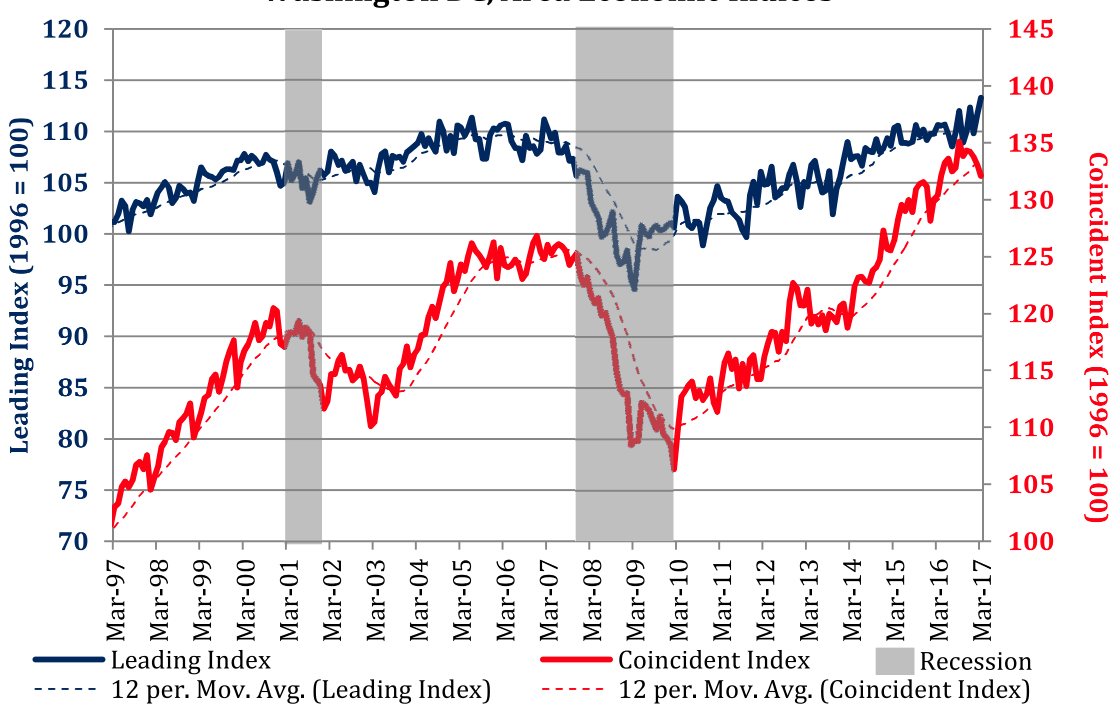
The Washington Region's Economy Slows in March While Its Outlook Strengthens

The performance of the Washington Leading and Coincident Indices in March, while both positive, began to diverge from their recent trajectories with the current economy slowing while its outlook strengthened. The region's economy job gains in March slowed from January and February but are still considered strong adding 51,900 net new jobs from March 2016. Other performance indicators registered continuing gains but these were not as strong as in recent months. Unemployment continued to decline. Offsetting this moderation in the current economic indicators were stronger gains in the economy's leading indicators. These have registered three strong monthly increases over the last four months pointing to a likely stronger economic performance for the region's economy in the third quarter.

Washington DC, Area Economic Indices



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, registered its fourth consecutive monthly decrease in March (from February); on a month-to-month basis, the Index has declined in five of the previous six months with the trend becoming increasingly negative. However, the Index has had a positive long-term trend (as measured on a monthly over-the-year basis) extending back to April 2014. While March's gain of 1.29 percent from March 2016 was its smallest increase over this three-year period, it did extend the Index's positive monthly over-the-year trend to 36 consecutive months reaffirming the regional economy's long and continuing recovery from the negative impacts of the Sequester.

In March, three of the Coincident Index's four components were greater than in March 2016 while one component decreased.

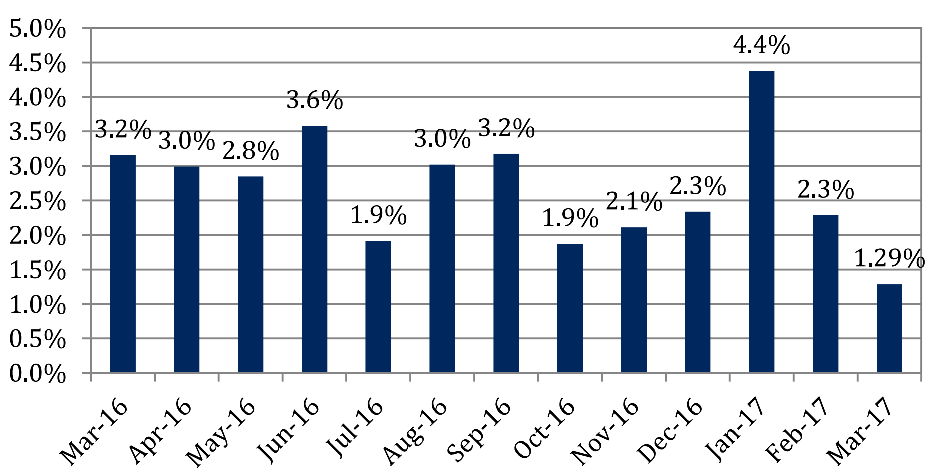
- *Wage and salary employment* growth in the Washington region increased 1.6% between March 2016 and March 2017;

- *Consumer confidence (in the present)* recorded its fourth consecutive double-digit monthly over-the-year gain in March, increasing 29.8% from March 2016; and,

- *Non-durable goods retail sales* increase 0.9% on a same-month basis recovering slight from its decline in February; while,

- *Domestic passenger volume at Reagan National and Dulles Airports* was lower in March compared to March 2016 following four 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 second consecutive strong gain in March, increasing 2.40 percent from March 2016, after registering a 1.8 percent gain in February. 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. Now, after starting the year with a tiny gain (0.05%), the Leading Index has achieved three strong increases over the past three months; monthly over-the-year gains for December, February and March are the biggest gains in three years dating from the Sequester.

The Index's recent performance appears be pointing to a new acceleration in the region's economic performance in the coming months. In March, two of the Index's four components contributed to its monthly over-the-year increase.

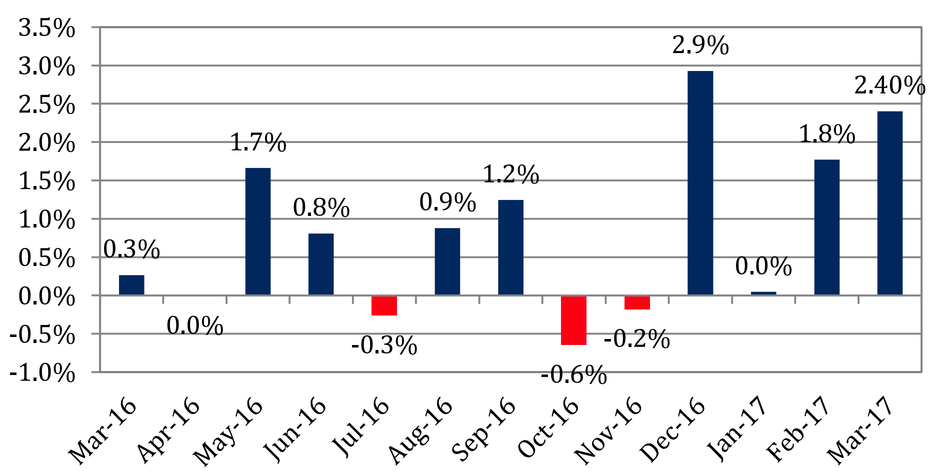
- *Durable goods retail sales* increased sharply in March gaining 7.1% from March 2016, after registering a gain of only 1.6% in February, continuing its positive trend from 2016 when it increased every month; and,

- *Consumer expectations (consumer confidence six months hence)* extended its upward trend for a sixth month registering its second largest ever gain of 27.7% in March following February's gain of 31.6%; while,

- *Total residential building permits* was unchanged from its March 2016 level following a 16.4% increase in February; and,

- *Initial claims for unemployment insurance* increased (worsened) for a fifth consecutive month.

Washington Leading Index, Monthly Over-the-Year Changes



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

March's performances of the Coincident and Leading Indices show the region's economy to be slowing down in the first quarter at the same time its outlook appears to be getting a boost. While the Coincident Index has increased (on a monthly over-the-year basis) every month starting in April 2014 with this trend now extending 36 months through March 2017, its growth rate has slowed since the beginning of the year. In contrast to this slowing of the current economy's performance, the Leading Index has accelerated since the beginning of 2017 and, as it stands currently, appears to be pointing to a reacceleration in the region's economy during the year's third quarter. What the Leading Index cannot project are the impacts of external disruptions on the region's or nation's economies that may dampen or further fuel their future performances.

Current Performance

The Washington Region added 51,900 net new jobs between March 2016 and March 2017. In an historical context, this level of job growth is respectable, but it was the weakest of the year's first three months. Taking the first quarter as a whole, annual job growth averaged 57,800 net new jobs, a level that would far exceed the job forecast for all of 2017 if the region's job production was to continue at this level for the full year. It also far exceeds average job growth for the fourth quarter of 2016 (42,400).

However, the job growth trend for the first quarter is not a good base on which to build the year's forecast, as unpredictable externalities tend to impact the first quarter more than the other three quarters of the year. Weather is perhaps the chief variable but, for the Washington area, political change and budgetary uncertainty may also be a factor in the economy's performance and there are other beginning-of-the-year factors (e.g., new taxes and regulations that take effect) that could disrupt or dampen the economy's performance. At the national level, the first estimate for 1st quarter GDP performance of 0.7% to be followed by a projected 3.4% gain for 2nd quarter GDP illustrates these differences. By the second quarter, especially April, the economy has figured out the year's new rules and adjusted to the new order and digested the differences from the preceding year and the weather is no longer a constraint. April is often thought of as the benchmark month for the full year.

The first glimpse of how the economy performed in April is now emerging. At the U.S. level, job growth in April rebounded sharply from its weak performance in March adding 211,00 net new jobs for the month, up from 79,000 jobs in March (both are seasonally adjusted gains). This job growth put the U.S. economy back on track for a 2.2% GDP annual performance compared to 1.6% for 2016.

April jobs data for the Washington metropolitan area, released on May 19th, tell a very different and much more worrisome story. Rather than registering a strong gain in April, as did job growth in the U.S. economy, the Washington region experienced a significant slowdown in job production. Comparing employment levels for April 2016 with April 2017, the region only added 38,000 net new jobs. This is far below the 1st quarter monthly over-the-year average of 57,800 jobs and well below the year's annual forecast of 45,900 jobs.

Job growth in the District of Columbia has experienced the greatest slowdown over the last year. Job growth averaged (annual rate) 16,600 new jobs during the first half of 2016 but only 9,200 jobs during the second half of 2016 for a full year gain of 13,000. In 2015, the District generated 15,900 net new jobs. So far through four months in 2017, the District is averaging 7,300 new jobs; from April 2016 to April 2017, job growth in the District total 3,800; a year earlier, April 2015 to April 2016, the District added 20,400 new jobs. The District of Columbia's economy has the greatest direct and indirect dependency on the federal government of any of the three state-subareas comprising the Washington region and its vulnerability is clearly evident in these recent job growth trends.

An examination of the distribution of job increases and losses by sector confirms what has been long feared. The Washington region's dependence on the federal government for economic growth and its inability to diversify this economy, thereby reducing this dependence, has made the region's economy vulnerable to changes in federal policy impacting federal employment and spending in the local economy. Job gains in three sectors accounted for 82.6 percent of April's total job increase: professional and business services, leisure and hospitality services, and education and health services. Retail also showed a relatively strong gain for a sector that had no net job growth in 2016.

Eight of the regional economy's sectors (out of 13) experience little or no change in jobs from April 2016. Most important among these non-performing sectors was the federal government: this is the region's third largest employment sector and it gained only 1,000 jobs since April 2016. Of the 10,800 job increase in the leisure and hospitality services sector, at least one-third of these jobs is accounted for by the MGM entertainment complex in Prince George's County that was not included in the April 2016 count. Construction job growth is normally at full speed in April as it is weather impacted during the 1st quarter and possibly further constrained by the regulatory environment at the beginning of the year. April's construction job growth of 100 should raise questions. Part of the answer is that MGM's construction workforce was included in the April 2016 data but not in the April 2017; that is, construction jobs were distorted in 2016 in ways that are impacting the 2017 job report.

Most concerning in the April jobs report was the weak performance of the professional and business service sector. This is the region's largest sector with 750,000 jobs and this sector has been responsible for the largest job gains since the Sequester. In 2016, professional and business services added 17,000 net new jobs accounting for 30.6 percent of the total year's increase. In March, the professional and business services added 20,700 jobs (from March 2016) accounting for 39.9

percent of the total job gain. April's jobs report showed professional and business services jobs increasing by only 12,800, accounting for 33.7 percent of the total net new jobs. The slowing of this key sector—these are generally office-using workers with average salary and wages among the highest of all sectors—reflects weakness in the federal contracting sector (this could be explained by the uncertainty hanging over the federal budget that was not clarified until April 28th).

Further insight into the region's jobs report may be culled from the decrease of 2,300 jobs in the employment services subsector of professional and business services. This subsector consists largely of temporary employment agencies and has been experiencing weakness each month this year with April's decline being the largest since November 2009. Declining demand for temporary workers generally precedes a weaker employment market; that is, the employment requirements of local businesses are being adequately satisfied by payroll employment and growth is no longer demanding the availability of temporary workers to the extent it had previously by strong growth in 2015 or 2016. April is only one month, albeit an important benchmark month. Job growth performance over the next several months will clarify the region's economic path forward and will depend on federal policies impacting the FY 2018 budget—its adoption and redistribution and magnitudes of spend across federal agencies.

Near-Term Outlook

The Leading Index is designed to forecast the near-term performance of the Washington region's economy two to three quarters in advance. The Leading Index's strong performance in February and March, following its large gain in December 2016, is a notable change in its recent uneven performance dating back into 2015. It would be easy to conclude from these three monthly over-the-year gains, that the Washington region's economy is poised to take off during the year's second half. The Leading Index certainly is pointing to that possibility.

A better interpretation would be that the broad indicators of the economy's future performance are aligned in support of its future growth and, if the national economy continues to perform well this year and next, as it is currently forecast, then the Washington economy should participate in this acceleration in the business cycle projected over the coming eighteen months. What the Washington Leading Index does not, and cannot internalize, is the Washington economy's vulnerabilities resulting from its (1) historic dependence on federal spending (spending patterns that can change quickly) and (2) its resultant lack of diversification across the breadth of the economy compared to its peer metropolitan areas.

The region's current performance is clearly being undermined by the uncertainty resulting from the disruptive policy positions of the new Trump Administration. The April jobs data illustrate the stark differences between the U.S. economy and the Washington region's economic performance. The U.S. economy recovered nicely in

April from a March that had been hammered by unusually bad weather from coast to coast. The Washington region's job performance in April was opposite from that experienced nationally. Job growth crashed. Why?

Federal hiring had been frozen in January for several months resulting in month-to-month decline in the region's third largest employment sector and, even though the freeze has been lifted, hiring is constrained by the budget and new leadership at the departmental levels. Then there was the threat of a federal shutdown on April 28th with the expiration of the continuing budget resolution; that was averted and now the 2017 federal budget (really the FY 2015 spending plan) has been extended to September 30th. Not only does this budget extension continue to constrain federal spending and is likely to impact negatively on federal hiring and federal contracting, it sets up the likelihood that next year's federal budget will not be approved by October 1st and the region will again face the prospects of a shutdown. Both the President and his Treasury Secretary have touted the benefits of a shutdown.

The Washington metropolitan area economy is unique in having these counter forces working to undermine the otherwise positive national and global forces that should be accelerating its performance. Consequently, the outlook for the Washington region's economy is for slower than national economic growth in 2017.

The Washington Leading Index is currently pointing to the region's continuing and possibly accelerating economic growth under conditions in which federal policy is not disruptive. Given the Washington region's dependence on federal spending, it economic growth clearly would be stronger if the Administration's budget favored fiscal expansion and growth in government spending. But just as clearly, a tightening of federal spending will undermine the Washington region's economic performance going forward. Unfortunately, the Washington region is not in a position to counter the negative impacts of future reductions federal spending should these occur.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Mar-17 Prelim.	Feb-17 Final	Mar-16 Final	Feb-17 to Mar-17	Mar-16 to Mar-17
Washington Area Business Cycle Indicators					
Coincident Index (1996 = 100)	132.1	133.0	130.4	-0.73%	1.29%
Leading Index (1996 = 100)	113.3	111.7	110.6	1.40%	2.40%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,245.0	3,240.0	3,194.5	0.15%	1.58%
Consumer Confidence (South Atlantic)[a]	139.5	144.6	107.5	-3.53%	29.77%
Domestic Airport Passengers ('000)[b]	1,864.9	2,039.6	2,066.7	-8.57%	-9.77%
Nondurable Goods Retail Sales ($000,000)[c]	3,152.5	3,077.4	3,124.2	2.44%	0.91%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,072.0	1,441.0	2,071.0	43.79%	0.05%
Consumer Expectations (South Atlantic)[a]	114.7	113.8	89.8	0.79%	27.73%
Initial Unemployment Claims[b]	1,475.9	1,608.1	1,450.5	-8.22%	1.75%
Durable Goods Retail Sales ($000,000)[c]	3,615.1	3,545.5	3,374.3	1.96%	7.14%
Wahington Area Labor Force[a]					
Total Labor Force ('000)	3,369.8	3,365.7	3,304.3	0.12%	1.98%
Employed Labor Force ('000)	3,245.4	3,235.4	3,170.7	0.31%	2.36%
Unemployed Labor Force ('000)	124.4	130.2	133.6	-4.45%	-6.88%
Unemployment Rate	3.7%	3.9%	4.0%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,245.0	3,240.0	3,194.5	0.15%	1.58%
Construction ('000)	150.1	151.1	153.6	-0.66%	-2.28%
Manufacturing ('000)	52.9	52.5	53.2	0.76%	-0.56%
Transportation & Public Utilities ('000)	64.4	63.6	63.1	1.26%	2.06%
Wholesale & Retail Trade ('000)	338.8	338.9	334.4	-0.03%	1.32%
Services ('000)	1,933.6	1,931.9	1,892.0	0.09%	2.20%
Total Government ('000)	705.2	702.0	698.2	0.46%	1.00%
Federal Government ('000)	366.8	367.2	364.9	-0.11%	0.52%

[a]Unadjusted data
[b]Seasonally adjusted data
[c]Seasonally adjusted constant (1996) dollars