Washington Economy Watch

Vol. I, No. 6
June 2017

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.

The STEPHEN S. FULLER INSTITUTE
for Research on the Washington Region's Economic Future

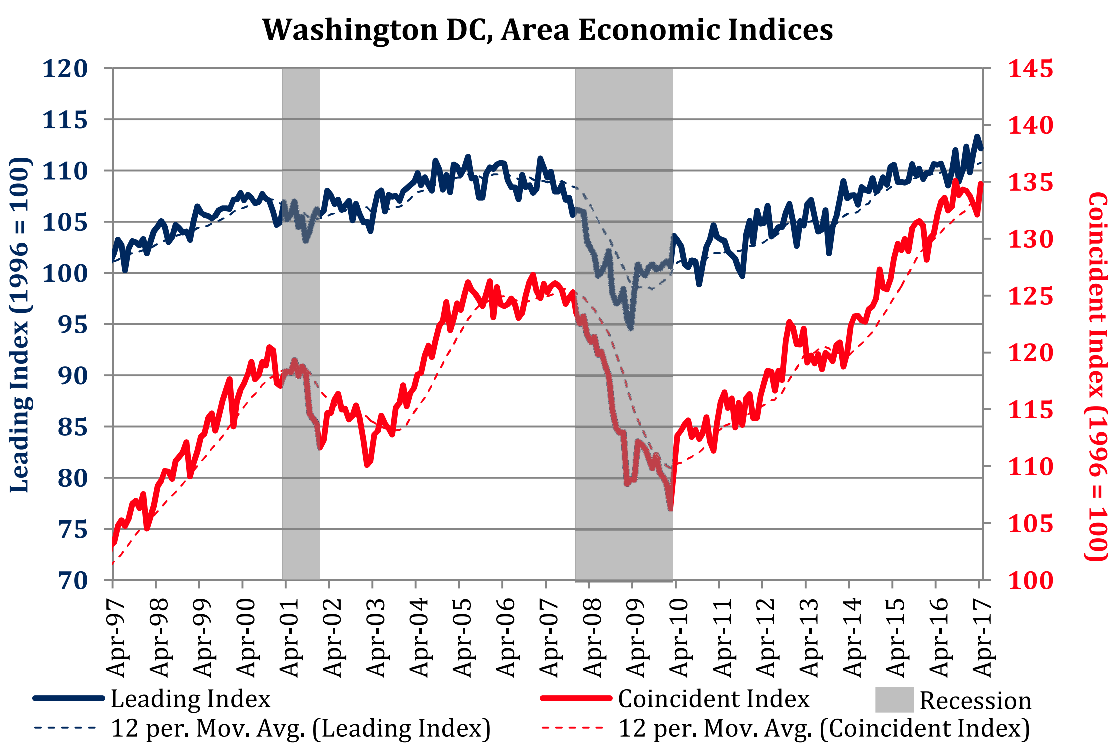
SCHAR School of Policy and Government
GEORGE MASON UNIVERSITY

Washington Economy Watch

Vol. I, No. 6 June 2017

The Washington Region's Economy Continues To Grow Slowly Yet There Are Signs Pointing To Faster Growth Ahead

The Washington Leading and Coincident Indices in April were both positive but the performance of the region's economy lagged its post-Sequester trends. Still, the Leading Index's forward-looking indicators are pointing to accelerating gains during the year's second half. While the Washington region's economy continues to grow, its growth rate remains below its historic trend reflecting weakness in its core industry—the federal government—and indecision by investors and consumers due to the uncertainty of the FY 2018 budget cycle and potential changes in federal policy that could negatively impact the local economy. These uncertainties are reinforced by declines in federal employment and the slowing of federal procurement contracting during the early months of the new 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, reversed its month-to-month negative trend in April registering a 2.0 percent gain from March 2017. On a month-to-month basis, the Index had declined in five of the previous six months.

This month-to-month trend reversal in April reflected monthly over-the-year gains in all four of the Index's components and continued the Index's positive long-term trend (as measured on a monthly over-the-year basis) extending back to April 2014 (totaling 37 months). While April's gain of 2.02 percent from April 2016 represents an improvement compared to March, it still fell below the long-term growth rate for the Coincident Index over the last three years dating from the Sequester.

In April, all four of the Coincident Index's four components were greater than in April 2016.

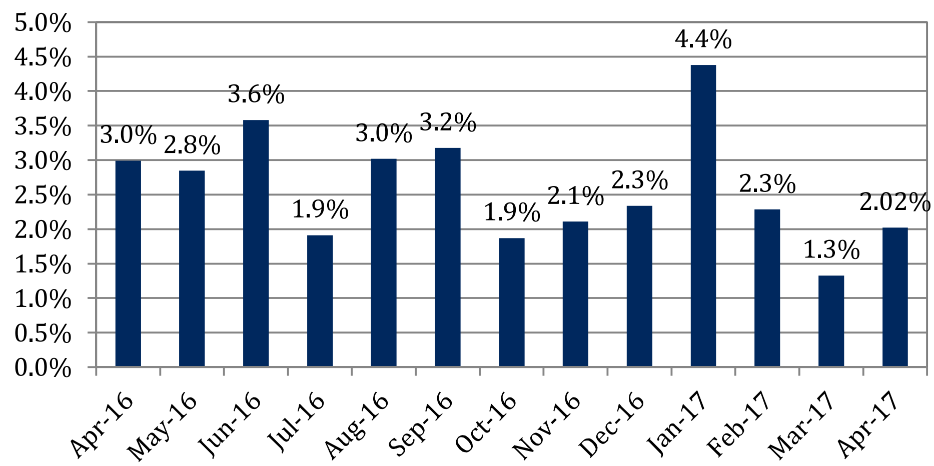
- *Wage and salary employment* growth in the Washington region increased 1.1% between April 2016 and April 2017;

- *Consumer confidence (in the present)* continued its positive trend, increasing 8.3% from April 2016;

- *Non-durable goods retail sales* increased 1.6% from April 2016, growing for a second month after declining in February; and,

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 5.1% in April compared to April 2016 reversing its 9.8% decline in March and has now increased in five of the last six months.

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, increased in April, gaining 1.45 percent from April 2016, after registering a strong 2.4 percent gain in March. The Leading Index has now achieved four strong increases over the past five months; monthly over-the-year gains for December, February and March are the biggest gains in three years dating since 2014.

The Index's strong performance since November 2016 follows a period dating back to the beginning of 2016 in which the Leading Index was negative for four of these eight months pointing to the more moderate economic growth rates that have been experienced in early 2017. In contrast, the Leading Index's gains since November are now pointing to stronger economic growth in the year's second half.

Three of the Index's four components contributed to its monthly over-the-year increase.

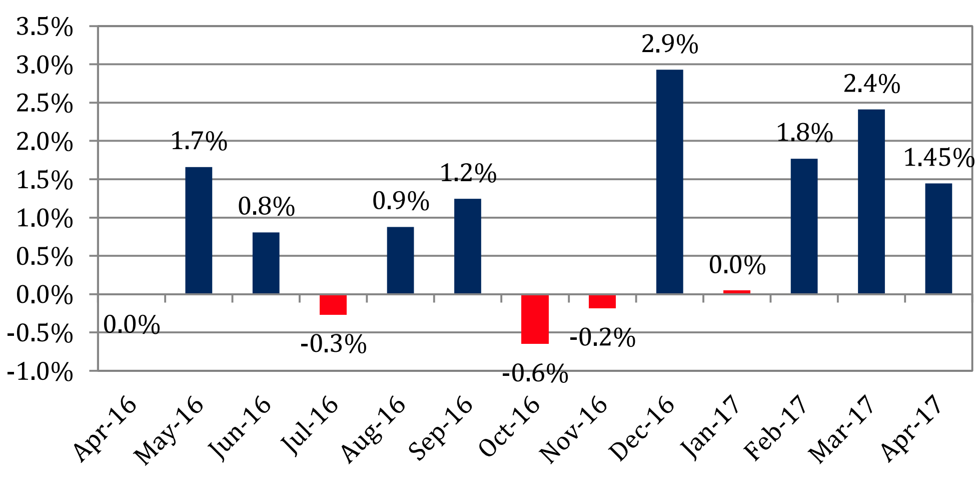
- *Durable goods retail sales* increased 3.7% in April from April 2016 after gaining 7.1% in March, continuing its positive trend from 2016 when it increased every month;

- *Consumer expectations (consumer confidence six months hence)* extended its upward trend for a seventh month and registered double-digit gains for a fifth consecutive month; and,

- *Total residential building permits* increased 3.1% from April 2016 after registering no gain over the March 2016-March 2017 period; while,

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

Washington Leading Index, Monthly Over-the-Year Changes



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

The Washington region's economic performance in April did not deviate substantially from its pattern during the year's first three months with the exception that job growth slowed dramatically. Still, the Coincident Index has increased (on a monthly over-the-year basis) every month starting in April 2014 with this trend now extending 37 months through April 2017, so this one-month slowdown in job growth should not be misinterpreted. Rather, it could be concluded that the region's economy is still digesting the possible impacts of new fiscal policies that are being considered by the Trump Administration and once these are clarified, the region's economy will settle in for whatever is coming— still to be determined.

Setting those uncertainties aside, the current performance of the region's forward-looking indicators continue to suggest stronger growth six to eight months ahead. Four strong monthly gains over the past five months present a clear signal that the economy is poised for stronger future growth than it is currently experiencing. What the Leading Index cannot project are the impacts of external disruptions to the region's economy that could dampen or accelerate its future performance. The results of budget deliberations on Capitol Hill and whether the FY 2018 federal budget is in place on October 1st will be the primary determinant of the economy's path forward over the remainder of this year and in 2018.

Current Performance

The most current metric by which to measure the Washington region's performance is the BLS monthly jobs report. For the first three months of 2017, job growth has averaged 57,800. This compares favorably with job growth in 2016 (55,600) and was well ahead of the Institute's forecast for job growth for all of 2017 (45,900).[1]

However, April's initial jobs report was for only 38,000, as reported in Economy Watch last month. April's job estimate was revised downward to 35,700 with the BLS May jobs release on June 16, 2017. At a minimum, this significantly slower jobs growth rate in April should be considered a "yellow" flag; that is, the economy might be slowing in response to a fundamental disruption. This is especially significant, as job growth at the national level in April was considered strong for this phase of the expansion.

The May jobs data for the Washington region showed 48,300 new jobs, an improvement from April but still well below the first quarter average. The preliminary analysis of these jobs shows that the strength of the region's economy is limited to three sectors: professional and business services (32.3%), education and health services (17.8%), and leisure and hospitality services (27.5%). These three sectors accounted for 77.6 percent of all of the new jobs in May. The federal government added 1,500 jobs accounting for 3.1 percent of the month's job growth. State and local government jobs added 4,800 jobs (9.9%). All the other sectors,

[1] http://sfullerinstitute.gmu.edu/2017/04/12/jobs-forecast/

eight in total, added or lost jobs at an insignificant level; these were basically neutral in the economy as sources of job change.

This performance confirms that the Washington region's economy has not diversified across its other sectors. It also shows that that the federal sector, which still accounted for 368,400 jobs (11.2% of all jobs), only accounted for 3 percent of the new jobs. When one of the economy's major sectors underperforms its share in the overall job base, it is likely to drag the economy's other sectors to a slower level. While the underperformance of the federal sector could be compensated for by faster gains in other major sectors, the mix of this growth between sectors that typically sell their goods and services in national and global markets (professional & business services, 32.3%) and sectors that depend heavily for their sales on local markets (education and health services, 17.8% and leisure and hospitality services, 27.5%) will determine whether the economy will growth faster than the national average or slower.

The current performance of the Washington region still favors below-average economic growth in 2017 continuing a pattern that dates back to 2010 the last year that the Washington region's economy outperformance the U.S. (3.3% vs. 2.5%). One explanation for the region's slower job growth is the shortage of qualified labor; that is, there are insufficient workers to fill the jobs and this is resulting in lower jobs gains and slower economic growth.

There are data to support this line of reasoning:

- Unemployment overall is low standing at 3.4% for the metropolitan area in April, a full percentage point below the national average. Many jurisdictions are reporting unemployment rates closer to 2%.

- Another indicator of this labor market tightening is the performance of the Employment Services sub-sector of the Professional & Business Services Sector. This is the sub-sector representing temporary/staffing services. Its job count was down 2,300 in April and 1,800 in May. It has been negative five months in a row; this is the longest consecutive negative trend since the Sequester. When the job market is tight, employers hire full-time workers and not part-time or temps. Workers that could only hope to find temporary assignments in the past can now find full-time jobs.

- There are also reports of large numbers of job openings in the region. Nationally, there were 6 million job openings on April 30th. This is an all time high for this data series.

- The Washington region has also experienced a slowing of its population growth rate since 2010 and for the last three years has experienced net domestic outmigration; that is, it has had a greater number of residents moving out of the metropolitan region to other locations in the U.S. than it has experienced moving into the metropolitan area from other locations in the U.S.

All of these trends are worrisome. They all point to an economy that is constrained and is underperforming. The question remains whether slower job growth is a function of a shortage of workers or the shortage of workers is a function of the region's declining competitive position relative to its peers in attracting net in-migration to fill jobs and fuel the economy.

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, now for three consecutive months following its large gain in December, is a notable change from its previous uneven performance dating back into 2015. With this trend approaching six month in duration, it is becoming easier to conclude that the Washington region's economy is shaking off the uncertainty of the Trump Administration and the historic baggage of being a company town. However, as we stated last month, 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.

The reality is that the Washington region's economy has significant assets and a strong competitive position in the national and global economies but it is also the least diversified of its peers and its specialization in government, as the Nation's Capital, currently puts its economy in jeopardy. What the Washington Leading Index does not, and cannot internalize, is the Washington economy's vulnerabilities resulting from: (1) its 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.

Two patterns within the federal government's role as the largest single source of spending in the Washington region have emerged over the past six years, since 2010. These provide a definitive measure of the region's dependency on increases in federal spending to drive growth and have proven that decreases in federal spending will undermine the economy's growth rate to the point of taking it negative, as it did in 2013.

Federal employment peaked in 2010 at 387,700 jobs with a payroll of $41.4 billion. Today this federal workforce totals 368,400, down 19,300 jobs or 5.0 percent. In May 2016, the Federal payroll now stands at an estimated $39.8 billion; this payroll value would be equivalent to $36.2 billion adjusted for inflation since 2010.

Federal procurement spending in the Washington region in 2010 totaled $81.5 billion. In 2016, federal procurement spending in the region totaled $73.5 billion. It had declined to $68.9 billion in 2013; that's the year the region's economy shrank by 0.5 percent. Still, in a $508.3 billion economy in 2016, the combination of federal spending ($113.3 billion) is important accounting for 22.3 percent of all economic activity on a direct basis and an estimated 32.9 percent of GRP when the indirect and induced effects of this direct spending are included.

When one-third of the region's economy is held hostage, the impact should be relatively certain. Federal job growth is projected to continue to decline under the budget constraints already in place losing approximately 16,500 more federal jobs by 2020 and, if the Trump budget blueprint were enacted, this could cost the region double this number of federal jobs. Even though this is unlikely, it is even less likely that the Trump budget will increase the size of the region's federal workforce.

Federal procurement spending in the Washington region increased every year for 30 years between 1980 and 2010 but now it is unclear whether this spending in the has reached a new but below peak equilibrium. To date it appears that federal spending during the first quarter of 2017 has been slowed by the change in government; that is, the appointment of new leadership in the federal agencies has been unusually slow and this has had the effect of slowing spending decisions. However, the FY 2017 budget has been approved and the funds usually get spent before the end of the fiscal year so an acceleration of federal spending might be anticipated.

This potential increase in federal procurement spending between now and September 30 would move a portion of this work into the last the months of the calendar year and the remainder into 2018. The effect of these spending delays could easily increase the region's economic growth at the end of the year and bolster the region's performance in 2018 while weakening the economy in the short term.

How all this works out will be revealed over the next three months and will have a substantial impact on the region's future economic performance over the next 18 months. For now, the Washington region's economy appears positioned to accelerate over the year and to achieve its best performance in 2018 before slowing in the final years of the decade.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Apr-17 Prelim.	Mar-17 Final	Apr-16 Final	Mar-17 to Apr-17	Apr-16 to Apr-17
Washington Area Business Cycle Indicators					
Coincident Index (1996 = 100)	134.8	132.1	132.1	2.03%	2.02%
Leading Index (1996 = 100)	112.1	113.3	110.6	-1.01%	1.45%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,266.0	3,246.4	3,230.3	0.60%	1.11%
Consumer Confidence (South Atlantic)[a]	133.2	139.5	123.0	-4.52%	8.29%
Domestic Airport Passengers ('000)[b]	2,168.5	1,864.9	2,063.9	16.28%	5.07%
Nondurable Goods Retail Sales ($000,000)[c]	3,162.9	3,154.8	3,112.6	0.25%	1.62%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	1,845.0	2,072.0	1,789.0	-10.96%	3.13%
Consumer Expectations (South Atlantic)[a]	112.4	114.7	94.3	-2.01%	19.19%
Initial Unemployment Claims[b]	1,565.5	1,475.9	1,462.4	6.07%	7.05%
Durable Goods Retail Sales ($000,000)[c]	3,477.1	3,618.5	3,354.6	-3.91%	3.65%
Wahington Area Labor Force[a]					
Total Labor Force ('000)	3,370.4	3,370.4	3,285.0	0.00%	2.60%
Employed Labor Force ('000)	3,254.4	3,246.5	3,169.1	0.24%	2.69%
Unemployed Labor Force ('000)	116.0	123.9	115.9	-6.34%	0.17%
Unemployment Rate	3.4%	3.7%	3.5%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,266.0	3,246.4	3,230.3	0.60%	1.11%
Construction ('000)	156.5	150.5	156.6	3.99%	-0.06%
Manufacturing ('000)	53.6	52.8	53.7	1.52%	-0.19%
Transportation & Public Utilities ('000)	65.1	64.7	63.8	0.62%	2.04%
Wholesale & Retail Trade ('000)	340.0	338.4	336.7	0.47%	0.98%
Services ('000)	1,946.8	1,935.2	1,921.5	0.60%	1.32%
Total Government ('000)	704.0	704.8	698.0	-0.11%	0.86%
Federal Government ('000)	366.9	366.8	365.9	0.03%	0.27%

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