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 mid-2009.

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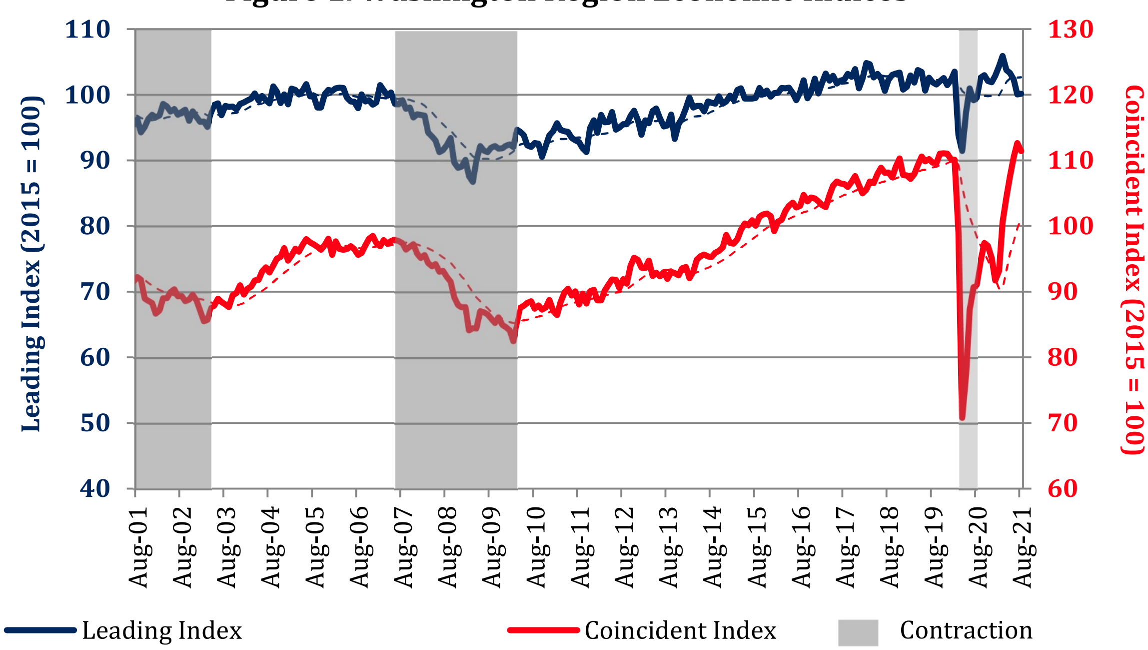
The Washington Region's Economic Recovery Slowed in August 2021

The Washington region's current economic activity weakened in August 2021 and the Coincident Index decreased 1.1 percent from July 2021. This was its first month-to-month decrease in seven months and was driven by declines in three of its four components. The moderation in current economic activity corresponded with the third local wave of COVID-19. This wave peaked in the middle of September 2021 and the economic recovery in September, as measured by jobs, consumer confidence and air travel, remained weak. In August 2021, the Leading Index increased 0.1 percent from July 2021, marking its first month-to-month gain in five months. This improvement was driven by two of the Index's four components. The recent pattern of losses and gains suggests that economic activity will remain subdued in the fall and winter but improve in the spring. If the third wave of COVID-19 subsides quickly, then the region's recovery may resume this winter. However, labor force and supply chain constraints may dampen the magnitude of these gains.

Figure 1. Washington Region 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, decreased 1.1 percent between July 2021 and August 2021, marking its first decline in seven months.[1] This decline was the driven by three of the Index's four components: domestic airport passenger volume (-8.6%), consumer confidence (-8.0%), and wage and salary employment (-0.3%). Non-durable goods sales increased 3.3 percent from July 2021.

In August 2021, the Coincident Index increased 22.40 percent from August 2020 and was 1.2 percent larger than its pre-pandemic reading in February 2020. Even though the Index was fully recovered, only one of the its three components had recovered and the recent readings disproportionately reflect the large month-to-month gains that occurred during the spring and summer; that is, the Index is overstating the magnitude of the recovery as it is constructed using historic patterns that are not applicable in this extremely unusual recovery. Compared to August 2020, all four components improved:

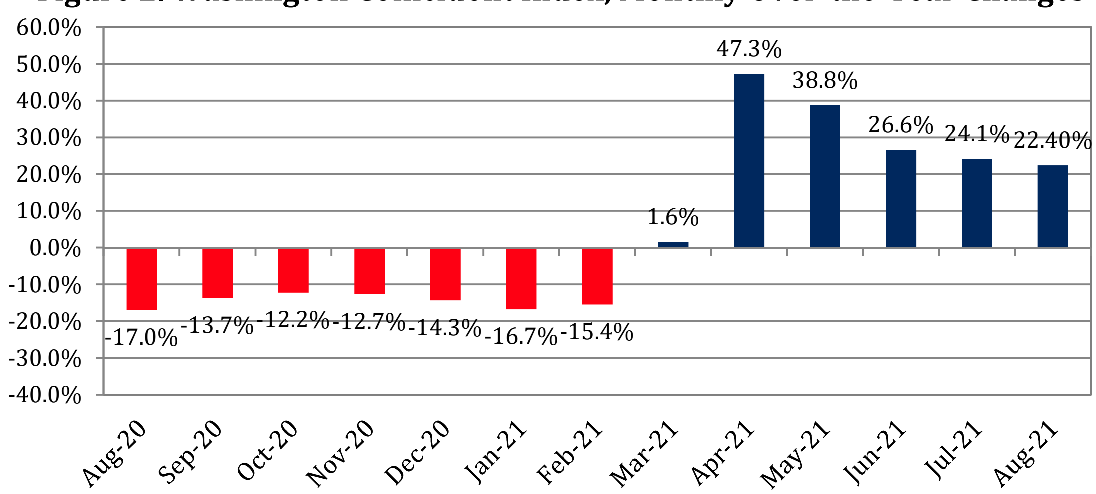
- *Domestic passenger volume at Reagan National and Dulles Airports* increased 188.0% from August 2020 but decreased 34.6% from August 2019; and

- *Consumer confidence (in the present)* increased 84.1% from August 2020 but was 14.1% smaller than its August 2019 reading; and

- *Non-durable goods retail sales* increased 14.5% from August 2020 and continued to be the only component to exceed its 2019 levels, increasing 13.5% from August 2019; and

- *Wage and salary employment* in the Washington region increased 3.3% from August 2020 but decreased 3.6% from August 2019.

Figure 2. Washington Coincident Index, Monthly Over-the-Year Changes



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

[1] The June and July 2021 Coincident Index was revised upwards to reflect more complete data.

The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy in six to eight months, increased 0.1 percent between July 2021 and August 2021, marking its first increase in five months. This improvement was the result of gains in two of the Index's four components: residential building permits (+6.5%) and durable goods sales (+0.3%). Initial unemployment insurance claims increased 11.1 percent (worsened) and consumer expectations decreased 8.7 percent.

Between August 2020 and August 2021, the Leading Index increased 0.63 percent for its ninth consecutive monthly over-the-year increase. While the monthly over-the-year growth rate of the Index continued to moderate, the month-to-month pattern suggests that the rate recovery will increase in the spring of 2022. In August 2021, three of the Index's four components improved compared to August 2020, while three components worsened compared to August 2019:

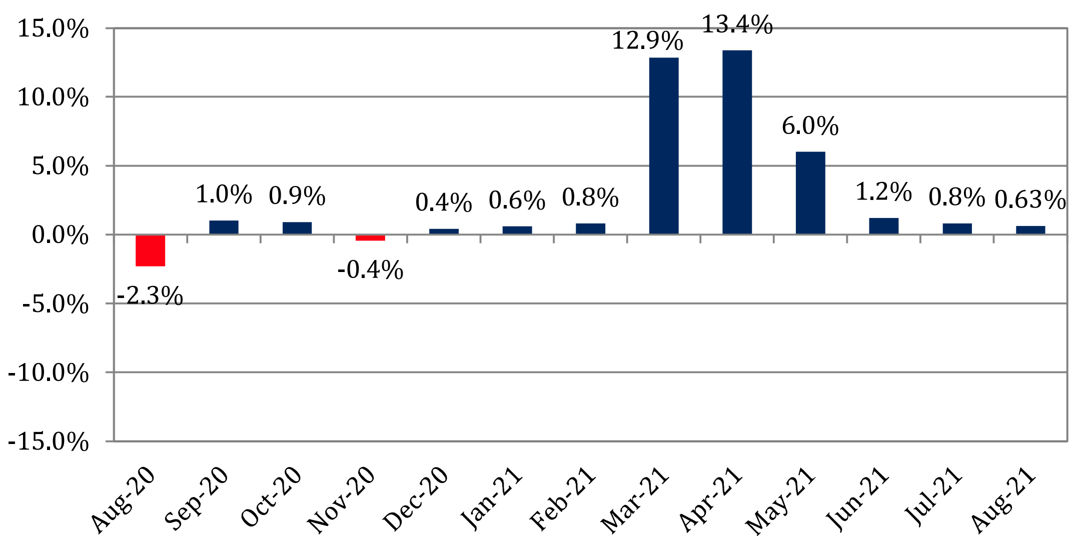
- *Consumer expectations (consumer confidence six months hence)* increased 9.9% from August 2020 but decreased 18.0% from August 2019; and

- *Total residential building permits* increased 5.3% from August 2020 but decreased 2.8% from August 2019; and

- *Durable goods retail sales* increased 5.1% from August 2020 and increased 5.7% from August 2019; while

- *Initial claims for unemployment insurance* increased 45.8% (worsened) compared to August 2020, its first monthly over-the-year increase in six months, and increased 433.3% (worsened) from August 2019.

Figure 3. Washington Leading Index, Monthly Over-the-Year Changes



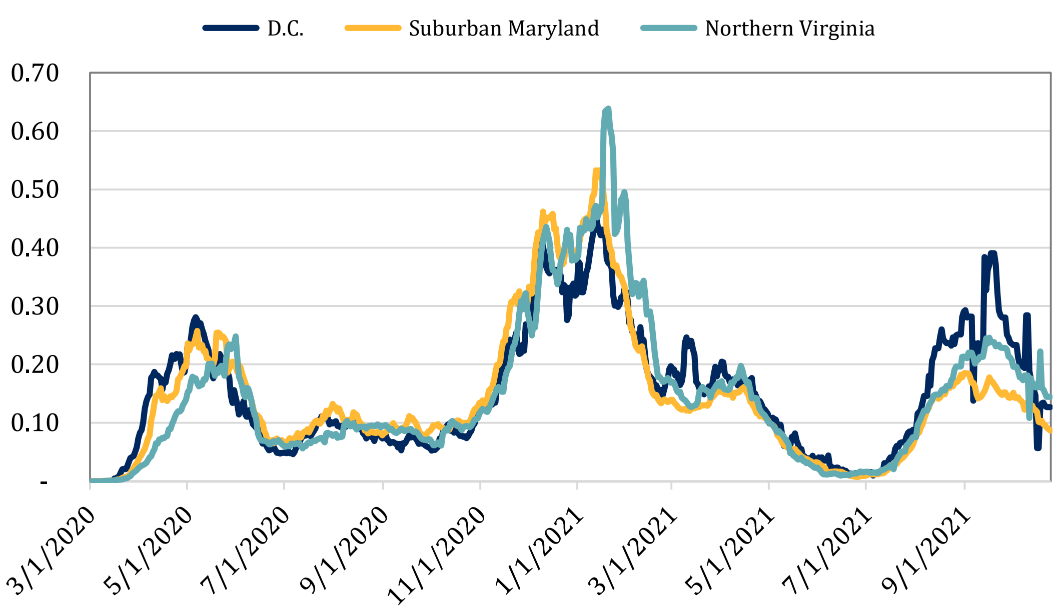
Source: The Stephen S. Fuller Institute at the Schar School, GMU

Current Performance

The Washington region's economic recovery slowed in August 2012 as the region had its third local wave of COVID-19. Three of the Coincident Index's four components decreased between July 2021 and August 2021 and only non-durable goods retail sales increased. This slowdown in economic activity continued in September 2021: the region's job growth slowed, local consumer confidence decreased, and national domestic passenger travel moderated. The third wave of COVID-19 peaked in mid-September and rates are projected to decline, albeit modestly, through the end of November 2021. The pivot in the health metrics may correspond with a modest improvement in economic activity in October and into November.

The third local wave of COVID-19 began in August 2021 and peaked in mid-September 2021. At its peak, new daily case rates during the third wave were 57.4 percent smaller than during the second wave during the fall of 2020 but 7.3 percent larger than the peak of the first wave in May 2020. As of October 24, 2021, new daily case rates decreased 48.7 percent from their mid-September level. The Centers for Disease Control and Prevention publishes forecasts of new cases by county in the next four weeks. The median forecast for the Washington region projects that new case rates will continue to decline through the end of November, although the rate of decline is forecasted to be modest. Still, these models project that new case rates will decrease 6.5 percent in the region between the end of October and the end of November, bring rates to their lowest level since the middle of August 2021.

Figure 4. New Daily COVID-19 Cases per 1,000 Residents by Sub-State Area
Washington Region, 7-Day Average, 3/1/20 – 10/24/21



Sources: Johns Hopkins University Center for Systems Science and Engineering; U.S. Census Bureau (2020 Decennial Census); The Stephen S. Fuller Institute at the Schar School, GMU

As the third wave began in August 2021, the Washington region's economic activity slowed. The Coincident Index decreased 1.1 percent compared to July 2021, primarily driven by declines in consumer confidence and domestic passenger volume at Reagan National and Dulles airports. Consumer confidence levels have been sensitive to changes in the pandemic's trajectory and peaked in July 2021, reaching 90.9 percent of its pre-pandemic peak in January 2020. This peak occurred when local case rates were small and prior to concerns about variants and the need for booster shots to bolster any waning vaccine immunity. In August, confidence decreased 8.0 percent from July 2021, reflecting the deterioration in current health conditions and the increased uncertainty about near-term health trends. Consumer confidence declined further in September, decreasing 3.5 percent and marking its first two-month period of consecutive month-to-month declines since the summer of 2020. Consumer confidence improved in October 2021, increasing 6.7 percent, reflecting the decrease in new local cases and the clarity around the need and availability of booster shots. Even with this improvement, consumer confidence levels were 5.3 percent smaller than in July 2021 and 13.9 percent smaller than in January 2020 and consumers remain relatively cautious.

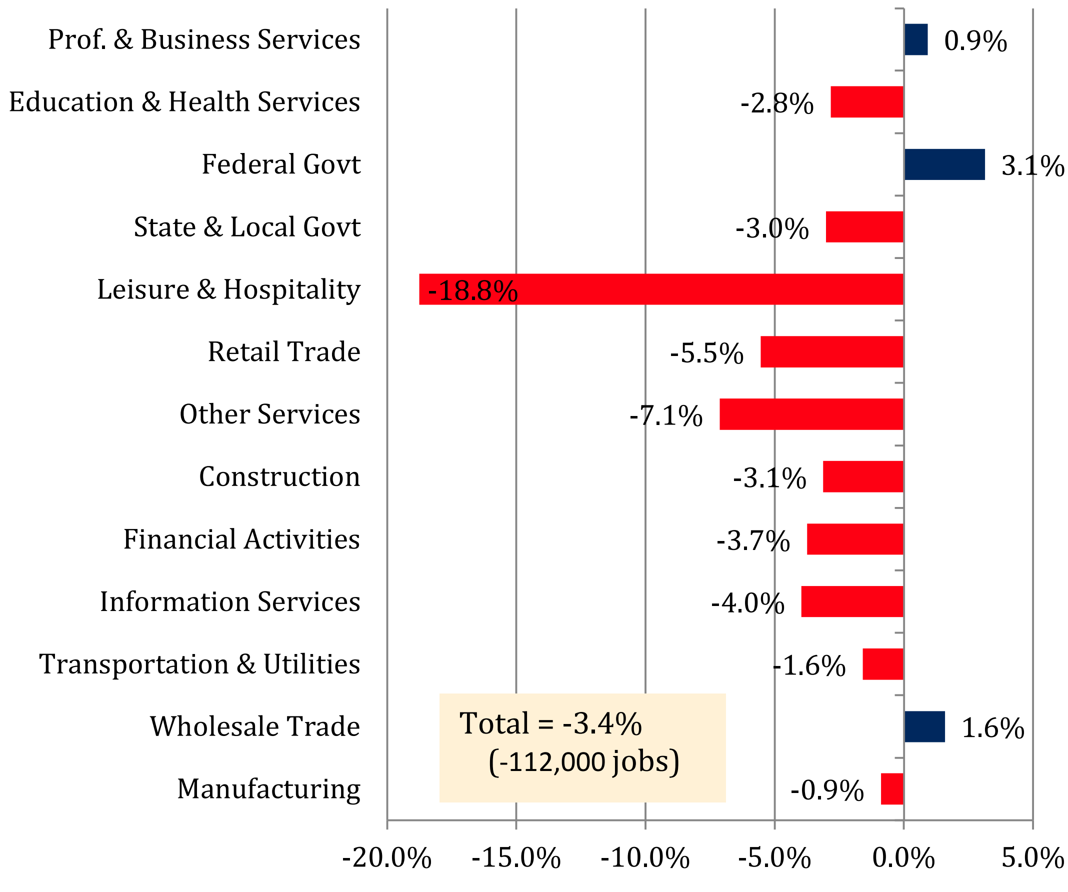
Domestic air passenger volume in the Washington region decreased 8.6 percent between July 2021 and August 2021. The majority of this decline was seasonal, as fewer people typically travel in September; nationally, the number of passengers traveling through Transportation Security Administration checkpoints decreased 9.0 percent during this period and the regional decline was similar. Compared to August 2019, passenger volume decreased 34.6 percent and was about 39.1 percent recovered, the least recovered of any component in the Coincident Index. Based on national trends, air travel in the region will likely moderate in September and October 2021 and the overall recovery in air travel appears to have plateaued between August and October.

Wage and salary employment in the Washington region improved in August and September 2021, but the gain in September was relatively small. In August, the region had recovered about 60 percent of the jobs that were lost during the pandemic. In September, the region had recovered about 61 percent of the jobs that were lost and the rate of recovery slowed, mirroring the slowdown in improvement that occurred last fall. Part of this moderation was from State & Local Government jobs as it appears that schoolteachers were counted in August payrolls this year; typically, schoolteachers are not reflected until the September jobs report and their earlier-than-usual presence bolstered the August report. Three sectors had a moderation in gains that was unrelated to seasonal patterns: Other Services, Leisure & Hospitality, and Education & Health Services. While these sectors continued to recover, the rate of recovery in September was significantly slower than in prior months.

Altogether, the Washington region had 112,000 fewer jobs in September 2021 than in September 2019, or a decline of 3.4 percent. Three sectors had fully recovered and had more jobs compared to 2019. The region's largest sector, Professional &

Business Services, increased by 7,200 jobs or 0.9 percent. This increase was driven entirely by the Professional, Scientific & Technical Services & Management sub-sector which added 15,800 jobs (+2.8%). The Administrative & Waste Management sub-sector lost 8,600 jobs (-4.1%) compared to September 2019 and was about two-thirds recovered from to its trough in June 2020. The region's third largest sector, the Federal Government, added 11,400 jobs (+3.1%) between September 2019 and September 2021 and had the largest percentage gain. The region's second smallest sector, Wholesale Trade, added 1,000 jobs (+1.6%) compared to September 2019 and has now increased compared to the same month in 2019 for six consecutive months.

Figure 5. Job Change by Sector, Washington Region September 2019 to September 2021 (in 000s)



Sources: U.S. Bureau of Labor Statistics; The Stephen S. Fuller Institute at the Schar School, GMU

Job losses continued to be largest in the Leisure & Hospitality sector. Between September 2019 and September 2021, this sector decreased by 18.8 percent (-63,000 jobs). The Accommodation sub-sector decreased by 38.6 percent and had the largest percentage losses of any sub-sector. The Arts, Entertainment & Recreation sub-sector decreased 21.3 percent during this period, while the Food Services & Drinking Places sub-sector decreased 14.4 percent. The sector with the second largest percentage losses was Other Services, which includes personal care services, repair and maintenance, and associations. This sector decreased by 7.1 percent (-14,900 jobs) compared to September 2019. The third largest percentage losses were in the Retail Trade sector, which decreased by 5.5 percent and by 14,800 jobs during this period.

Of the components in the Washington Index, non-durable goods retail sales had the largest gain in August 2021, increasing 3.3 percent from July 2021 and 14.5 percent from August 2020. Non-durable goods sales recovered quickly during the pandemic and have also been larger than their 2019-level for every month in 2021; compared to August 2019, sales increased 13.5 percent in August 2021. In addition to registering strong growth, the absolute level of sales in August was the largest on record, with data beginning in 1980, after adjusting for inflation and seasonal patterns. This unusually strong sales level may have partially been the result of consumers and businesses purchasing more goods that usual in anticipation of the third wave of COVID-19. Non-durable goods sales have likely peaked or will do so in the upcoming months.

The Washington region's economic recovery slowed in August 2021 and most likely stalled in September 2021, mirroring the slowdown in growth that occurred prior to the second local wave of COVID-19 that occurred last fall. The third local wave has been relatively milder and is likely to be somewhat shorter than the second wave, which could position the region for some modest improvement in December.

Washington Region's Near-Term Outlook

During normal business cycles, the Washington region's Leading Index projects economic performance six to eight months in advance. Since 2020, the health crisis has driven the economic trends and it will continue to be the key factor in the region's economic performance in the upcoming months. Still, the Leading Index is a measure of what consumers and businesses expect will occur in the economy as a result of the health crisis and is indicative of the region's potential capacity for near-term growth. The Leading Index decreased between March 2021 and July 2021 and increased modestly between July 2021 and August 2021. This pattern suggests that the region's economic expansion will continue to moderate during the fall and winter and that the recovery will strengthen during the spring of 2022.

Two of the Index's four components improved between July 2021 and August 2021. The largest increase was in residential building permits, which increased 6.5 percent. Compared to August 2020, permits increased 5.3 percent, marking the first monthly over-the year increase in three months. This gain was driven by multi-family permits (+30.9%) and single-family permits decreased 6.6 percent between August 2020 and August 2021. Permit activity in September 2021 was relatively strong, increasing 4.2 percent from September 2020 and increasing 18.7 percent from September 2019. This activity will bolster the Leading Index and the regional outlook in the spring of 2022.

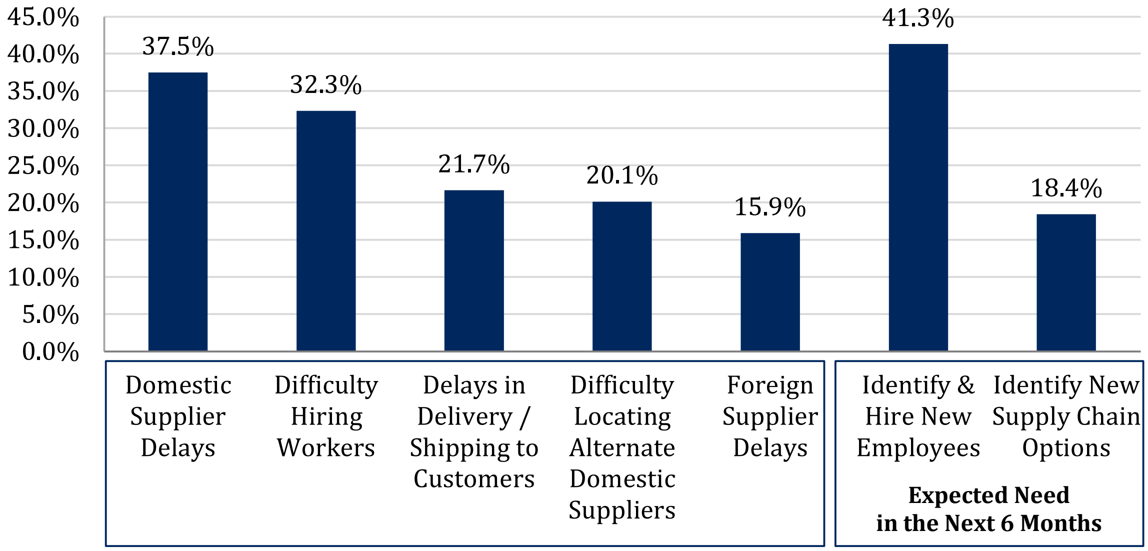
Durable goods retail sales increased 0.3 percent between July 2021 and August 2021 for its first month-to-month increase in five months. This component was the first to recovery during the pandemic and sales increased 5.1 percent compared to August 2020 and 3.9 percent compared to August 2019. During the first eight months of 2021, sales have increased 71.5 percent compared to the same period in 2019, after adjusting for inflation. Durable goods sales during this period also reached their largest level on record, with data starting in 1980. This magnitude of increasing and the historically large sales levels are unlikely to be sustained in the upcoming months, even in absence of any supply chain bottlenecks or price increases.

Two of the Index's components worsened between July 2021 and August 2021: consumer expectations in the South Atlantic region and initial claims for unemployment insurance. Consumer expectation decreased 8.7 percent marking its second consecutive month-to-month decline. This decline likely reflects the anticipation of the third local wave of COVID-19 and was temporary. Consumer expectations increased 0.7 percent between August 2021 and September 2021 and increased 1.4 percent between September and October 2021. The pattern of declines in July and August followed by gains in September and October indicates that consumers expect economic conditions to worsen during the winter and improve during the spring of 2022, in line with last year's economic recovery.

Initial claims for unemployment insurance increased (worsened) by 11.1 percent between July 2021 and August 2012 for its third consecutive month-to-month gain. Initial unemployment claims also increased 45.8 percent compared to August 2020, marking its first monthly over-the-year gain in six months. While the increases in new claims could suggest that the labor is becoming more available, the total labor force in the Washington region remained tight in August; the region's labor force decreased 5.0 percent from February 2020 and the region has 177,330 fewer residents either employed or actively looking for a job. Instead, the recent increase in initial unemployment claims most likely reflects labor force adjustments as employers and workers realign themselves to find the optimal arrangement for each.

In the near-term the Washington region's growth prospects may be limited because of supply chain constraints and labor availability. In the Washington region, the supply chain bottlenecks are primarily domestic, although these issues may be indirectly linked to foreign supply chain delays. Between September 20, 2021 and October 17, 2021, 37.5 percent of small business in the Washington region reported that they had experienced a domestic supplier delay. While a slightly larger share of businesses experienced supply chain delays than experienced problems finding labor, labor availability issues affected 32.3 percent of all small businesses in the region in recent weeks.

Figure 6. Current and Future Small Business Difficulties and Expectations Washington Region, Sep 20, 2021-October 17, 2021



Sources: U.S. Census Bureau (Small Business Pulse Survey); The Stephen S. Fuller Institute at the Schar School, GMU

In the next six months, labor availability will likely surpass supply chain constraints as the key challenge for small business in the Washington region. More than two-fifths (41.3%) of small businesses expect that they will need to hire new employees in the next six months; 18.4 percent expect that they will need new supply chain options. The slow return of the region's labor market in combination with the increasing need for labor suggests that future growth will be hindered by the lack of workers and the potential misalignment between the available workforce and the vacant jobs. Supply chain constraints will compound these issues, but regional businesses appear to be somewhat less concerned about supply chain difficulties in the upcoming months.

Overall, the Leading Index suggests that the rate of economic recovery will be modest this fall and winter and improve during the spring of 2022. The region still faces two key headwinds: labor availability and supply chain disruptions. In reaction to these bottlenecks, businesses and consumers may be making their purchases and realigning their workforces earlier than they would have otherwise. This activity may bolster the Leading Index in September and indicate an acceleration of economic growth during the late spring and early summer of 2022.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Aug-21 Prelim.	Jul-21 Final	Aug-20 Final	Jul-21 to Aug-21	Aug-20 to Aug-21
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	111.4	112.7	91.0	-1.10%	22.40%
Leading Index (2015 = 100)	100.2	100.0	99.5	0.11%	0.63%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,204.9	3,214.5	3,103.2	-0.30%	3.28%
Consumer Confidence (South Atlantic)[a]	155.0	168.4	84.2	-7.96%	84.09%
Domestic Airport Passengers ('000)[b]	1,458.6	1,596.0	506.5	-8.61%	187.96%
Nondurable Goods Retail Sales ($000,000)[c]	3,868.4	3,743.7	3,378.0	3.33%	14.52%
Washington Area Leading Index Components					
Total Residential Building Permitsa	1,651.0	1,550.0	1,568.0	6.52%	5.29%
Consumer Expectations (South Atlantic)[a]	91.8	100.6	83.5	-8.75%	9.94%
Initial Unemployment Claims[b]	10,162.7	9,147.8	6,972.4	11.09%	45.76%
Durable Goods Retail Sales ($000,000)[c]	3,983.1	3,971.9	3,789.7	0.28%	5.10%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,365.7	3,417.0	3,431.2	-1.50%	-1.91%
Employed Labor Force ('000)	3,200.1	3,242.4	3,163.7	-1.30%	1.15%
Unemployed Labor Force ('000)	165.6	174.6	267.4	-5.17%	-38.08%
Unemployment Rate	4.9%	5.1%	7.8%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,204.9	3,214.5	3,103.2	-0.30%	3.28%
Construction ('000)	162.9	163.6	162.0	-0.43%	0.56%
Manufacturing ('000)	55.9	56.1	54.3	-0.36%	2.95%
Transportation & Public Utilities ('000)	73.2	72.8	72.2	0.55%	1.39%
Wholesale & Retail Trade ('000)	316.7	321.4	305.5	-1.46%	3.67%
Services ('000)	1,921.8	1,913.1	1,825.5	0.45%	5.28%
Total Government ('000)	674.4	687.5	683.7	-1.91%	-1.36%
Federal Government ('000)	374.1	374.9	376.5	-0.21%	-0.64%

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