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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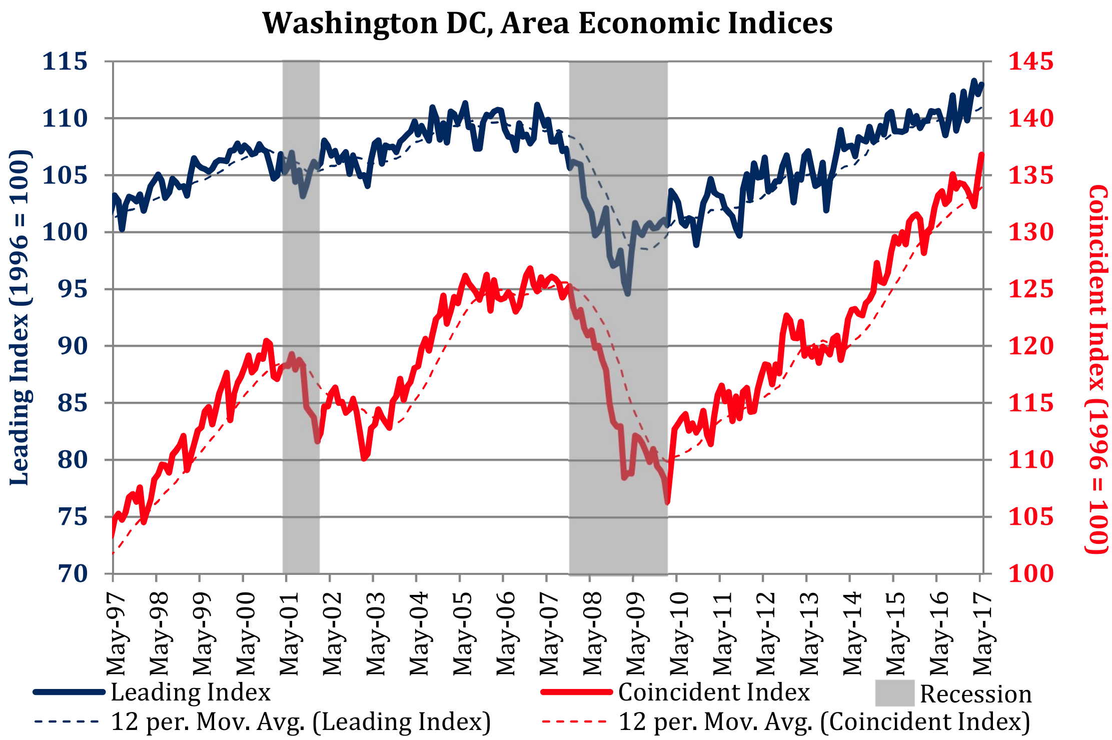
The Washington Region's Current Economic Performance and Outlook Strengthen in May

The Washington Leading and Coincident Indices were stronger in May than in April and together point to a better performance in 2017 than in 2016. May's economic performance reflects broad-based strength with all indicators gaining on a month-to-month basis for the first time since September 2016 while the Leading Index's forward-looking indicators continue pointing to accelerating gains during the year's second half. While the region's economy appears to be gaining strength in spite of threatened federal spending reductions and continuing uncertainty regarding the federal budget, its future performance remains strongly tied to changes in federal payroll and procurement spending that will be established in the FY 2018 budget and its adoption before the end of September to avoid the consequences of an extended federal shutdown.



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, increased for a second consecutive month in May registering a 1.5 percent gain from April 2017 with all four of the Index's components higher. This is the first time since September 2016 that all four of the Index's components registered positive month-to-month increases. Prior to April, the Index had declined in five of the previous six months on a month-to-month basis.

This second month-to-month gain in May 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 38 months). May's gain of 2.67 percent from May 2016 represents its strongest monthly over-the-year gain since January and its second strongest performance since September 2016.

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

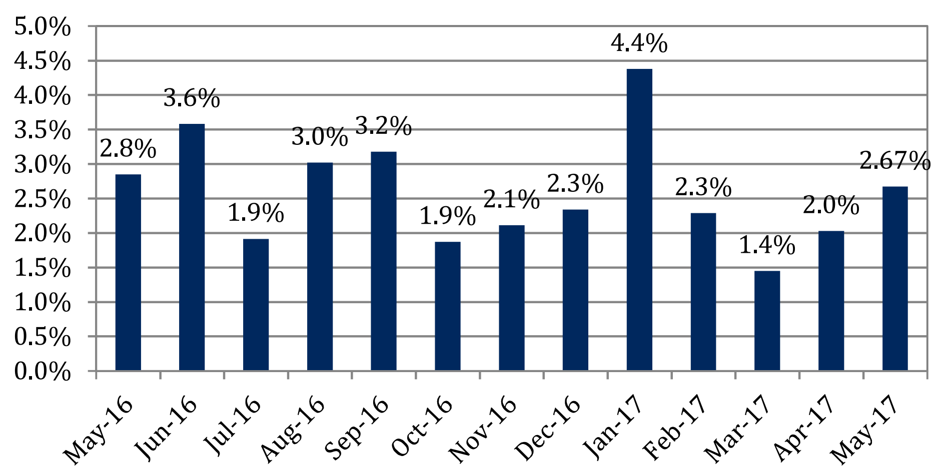
- *Wage and salary employment* growth in the Washington region increased 1.5% between May 2016 and May 2017;

- *Consumer confidence (in the present)* continued its positive trend, increasing 19.5% from May 2016;

- *Non-durable goods retail sales* increased 2.5% from May 2016, growing for a third consecutive month after declining in February; and,

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 2.8% in May compared to May 2016 and has now increased in six of the last seven months on a monthly over-the-year basis.

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 May, gaining 2.08 percent from May 2016. The Leading Index has now achieved five strong increases over the past six months. These gains represent the strongest sustained performance for the Leading Index in three years dating since 2014.

This recent accelerating performance follows a period dating back to the beginning of 2016 in which the Leading Index was either negative or registering only moderate increases pointing to the slower economic growth rates than are now being predicted by the Index's current trajectory. The Leading Index's recent gains continue to point to stronger economic growth during the year's second half.

Still, the Index's gains in May reflect sharp increases in only two of its four components.

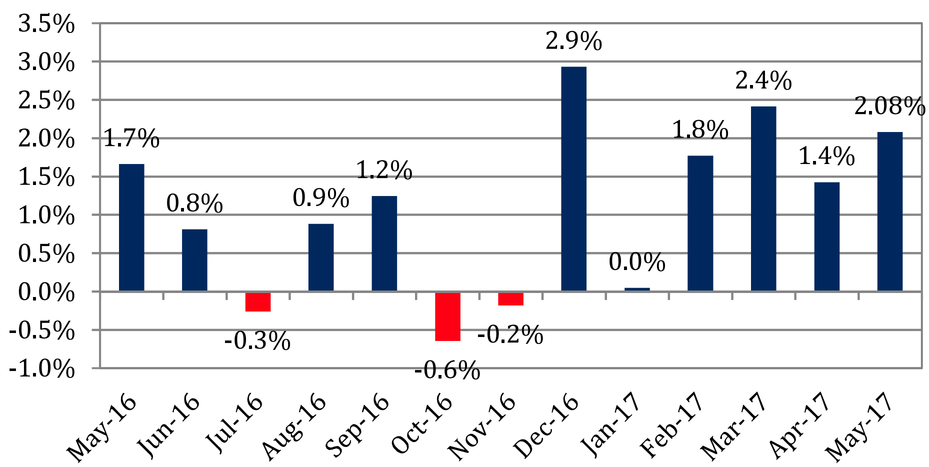
- *Durable goods retail sales* increased 10.1% in May from May 2016 continuing its positive trend from 2016 when it increased every month; and,

- *Consumer expectations (consumer confidence six months hence)* extended its upward trend for an eighth month gaining 30.4% and registering double-digit gains for a sixth consecutive month; while,

- *Total residential building permits* declined sharply, falling 28.7% below its value in May 2016 after recording gains in February and April; and,

- *Initial claims for unemployment insurance* increased (worsened) for a seventh consecutive month pointing to growing weakness in the DC labor market.

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 May extended its continuing recovery from the negative effects of federal spending reductions during the Sequester that resulted in its 0.5 percent contraction in 2013. May's Coincident Index reflected gains in both the month-to-month and monthly over-the-year values for all four of its components for the first time in nine months. This broad-based positive performance provides a solid foundation to support continuing and possibly accelerating growth going forward.

The performance of the region's forward-looking indicators continues to suggest stronger growth six to eight months ahead. Five strong monthly gains over the past six months present a clear signal that the economy is poised for stronger future growth than it has experienced in this year's earlier months. What the Leading Index cannot project are the impacts of external disruptions to the region's economy that could dampen or possibly 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 principal determinants of the economy's path forward over the remainder of this year and into 2018.

Current Performance

Through five months, the Washington region's economy has held up better than projected at the beginning of the year. Over this period, its annual rate of job growth has averaged 50,800 jobs. While this number is below job growth totals in 2016 and 2015, 55,600 jobs and 57,700 jobs respectively, the current rate of job growth is well above the 45,900 jobs projected at the beginning of the year for 2017.[1] However, not all of the region's sub-state regions are participating in this year's greater-than-projected job growth to date. Job growth in Northern Virginia is in line with the forecast while in the District of Columbia job growth is running approximately 25 percent below the forecast. However, the big winner is Suburban Maryland where job growth is currently exceeding forecast by roughly 50 percent.

While the absolute numbers of net new jobs provides an important measure of the economy's performance, the mix of these new jobs has taken on new importance. As the region's employment base has shed higher paying jobs and added larger numbers of lower paying jobs, the ability of the economy to maintain its historically high growth rates has been diminished. The good news is that through the year's first five months, the region's largest sector, professional and business services—the sector where most of the federal contracting jobs are found and the sector with wages averaging at nearly $100,000—has been adding jobs are a rate exceeding their share of all jobs. From January through May (compared to the same five months in 2016), professional and business services sector jobs increased by 17,300 and accounted for 40.0 percent of the total private sector job increase during this period while only representing 29.3 percent of all private sector jobs in the region in January 2017.

[1] The forecast is available online at http://sfullerinstitute.gmu.edu/2017/04/12/jobs-forecast/.

In contrast, the region's other primary sources of job growth—education and health services, leisure and hospitality services, and retail trade—accounted for 61.3 percent of the job gains during the year's first five months (compared to the same five months in 2016) but only accounted for 41.0 percent of the region's private sector job base in January 2017. The region's seven other private sectors, while smaller and together accounting for 29.7 percent of the region's private sector job base, together lost 600 jobs (-0.07%). Government sectors added 7,400 jobs during this period, a gain of 1.1 percent.

These job growth trends show the region's job base becoming narrower rather than more diversified. They also show that the share of new jobs that are lower paying is growing faster than the share of new jobs that is higher paying. Most important, the sector that offers the greatest opportunity to diversify into higher-value added, export-based and non-federally dependent jobs, the professional and business services sector, is accounting for a larger share of gains (40.0%) compared to its 29.3 percent base in the private sector but its continuing dependence on federal procurement spending has constrained the ability of businesses in this sector to fully realize their national and global market potentials. As a result, local-serving, lower-value added, and lower-wage sectors have become the primary source of job growth driving the region's economic growth.

The June jobs report, released July 21st, shows that these job growth trends to have continued for a sixth month. June's increase of 59,400 jobs from June 2016 continues to run ahead of forecast but these gains continued to be concentrated in lower-value added, local-serving sectors. Education and health services, leisure and hospitality services (mainly food and beverage services), and retail trade accounted for 66.2 percent of June's monthly over-the-year job private sector increase while professional and business services accounted for 27.6 percent, almost five percentage points less than its share over the year's first five months. June's job report also showed that the federal government lost 1,300 workers compared to June 2016, the first year-over-year decrease since 2014.

Near-Term Outlook

The Leading Index has been trending higher since it registered no change in January. The two components driving this increasingly favorable outlook are strong durable goods retail sales, largely automobiles but include appliances and furniture, and double-digit increases in consumer expectations. Consumer expectations (consumer confidence in the future) was up 30.4 percent in May compared to its value a year ago in May 2016. Consumer expectations have been higher on a monthly over-the-year basis for eight consecutive months and these gains have been double-digit for each of the last six months. When consumers believe the future economy will be stronger than the current economic situation they are more prone to taking on debt and making longer-term purchases as confirmed by the upswing in durable goods sales. This is usually a good sign for the housing industry and yet residential building permits were down sharply in May, off 28.7 percent from May 2016 although they were up slightly in April.

However, low unemployment, relatively strong and continuing job growth, and the underlying wealth embedded in the Washington region's economy have created a sense of prosperity that is not supported by the economy's performance relative to its peers. A report released by the Stephen S. Fuller Institute (The Washington Region's Declining Economic Brand, July 12, 2017)[2] showed that the Washington region's economy ranked 15th in its annual economic performance over the last six years when compared to the 15 largest metropolitan areas. It also ranked 15th in terms of personal income growth over this period but ranked third for its high cost of living and second highest for its average rental housing costs; these were 69.1 percent higher than the U.S. average. With slower economic growth and higher costs of living it is no wonder that the Washington region's population growth has slowed from 1.9 percent between 2010 and 2011 to 0.9 percent between 2015 and 2016 and that the region has experienced net domestic out-migration, averaging close to 30,000 persons, in each of the last three years.

While the Leading Index is pointing to stronger growth, the starting point for this growth trajectory was – 0.5% in 2013 at the bottom of the Sequester. Whether the region's annual growth rate will reach or exceed 2.3% for 2017, the July IHS Markit projection for the U.S., will depend on achieving growth in federal spending to complement the growth being achieved in lower-value added, local-serving businesses and non-federally dependent businesses that in aggregate have yet to achieve their national average growth rates.

That the Washington region's economic performance continues to be governed by federal spending for payroll and procurement underscores its continuing vulnerability to the vicissitudes of politics and the resultant federal spending decisions that will be embodied in the FY 2018 budget and the spending levels it codifies not only for the coming year but for future years. The current budget proposal that aims to shift funds from domestic programs to the Departments of Defense and Homeland Security, with significant corresponding reductions in federal employment in the Washington region, will generate a sufficiently large negative impact on the region's economy to more-than-offset its other growth sectors. The result of this federal budget scenario will be to reverse the Washington region's current growth trajectory that is currently pointing to stronger growth in the year's second half continuing at least into early 2018.

[2] The report is available online at http://sfullerinstitute.gmu.edu/research/reports/declining-economic-brand/.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	May-17 Prelim.	Apr-17 Final	May-16 Final	Apr-17 to May-17	May-16 to May-17
Washington Area Business Cycle Indicators					
Coincident Index (1996 = 100)	136.8	134.8	133.3	1.48%	2.67%
Leading Index (1996 = 100)	113.0	112.1	110.7	0.75%	2.08%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,288.3	3,266.0	3,240.0	0.68%	1.49%
Consumer Confidence (South Atlantic)[a]	147.2	133.2	123.2	10.51%	19.48%
Domestic Airport Passengers ('000)[b]	2,255.5	2,168.5	2,195.0	4.01%	2.76%
Nondurable Goods Retail Sales ($000,000)[c]	3,171.2	3,163.8	3,094.2	0.24%	2.49%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,406.0	1,845.0	3,375.0	30.41%	-28.71%
Consumer Expectations (South Atlantic)[a]	113.8	112.4	87.3	1.25%	30.36%
Initial Unemployment Claims[b]	1,606.4	1,565.5	1,580.5	2.61%	1.64%
Durable Goods Retail Sales ($000,000)[c]	3,581.9	3,470.9	3,253.3	3.20%	10.10%
Wahington Area Labor Force[a]					
Total Labor Force ('000)	3,385.3	3,368.6	3,281.7	0.50%	3.16%
Employed Labor Force ('000)	3,262.1	3,252.9	3,165.3	0.28%	3.06%
Unemployed Labor Force ('000)	123.2	115.7	116.4	6.47%	5.86%
Unemployment Rate	3.6%	3.4%	3.5%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,288.3	3,266.0	3,240.0	0.68%	1.49%
Construction ('000)	159.2	156.5	158.0	1.73%	0.76%
Manufacturing ('000)	53.5	53.6	54.1	-0.19%	-1.11%
Transportation & Public Utilities ('000)	66.3	65.1	64.4	1.84%	2.95%
Wholesale & Retail Trade ('000)	342.0	340.0	339.6	0.59%	0.71%
Services ('000)	1,959.9	1,946.8	1,922.8	0.67%	1.93%
Total Government ('000)	707.4	704.0	701.1	0.48%	0.90%
Federal Government ('000)	368.4	366.9	366.9	0.41%	0.41%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars