



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



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.

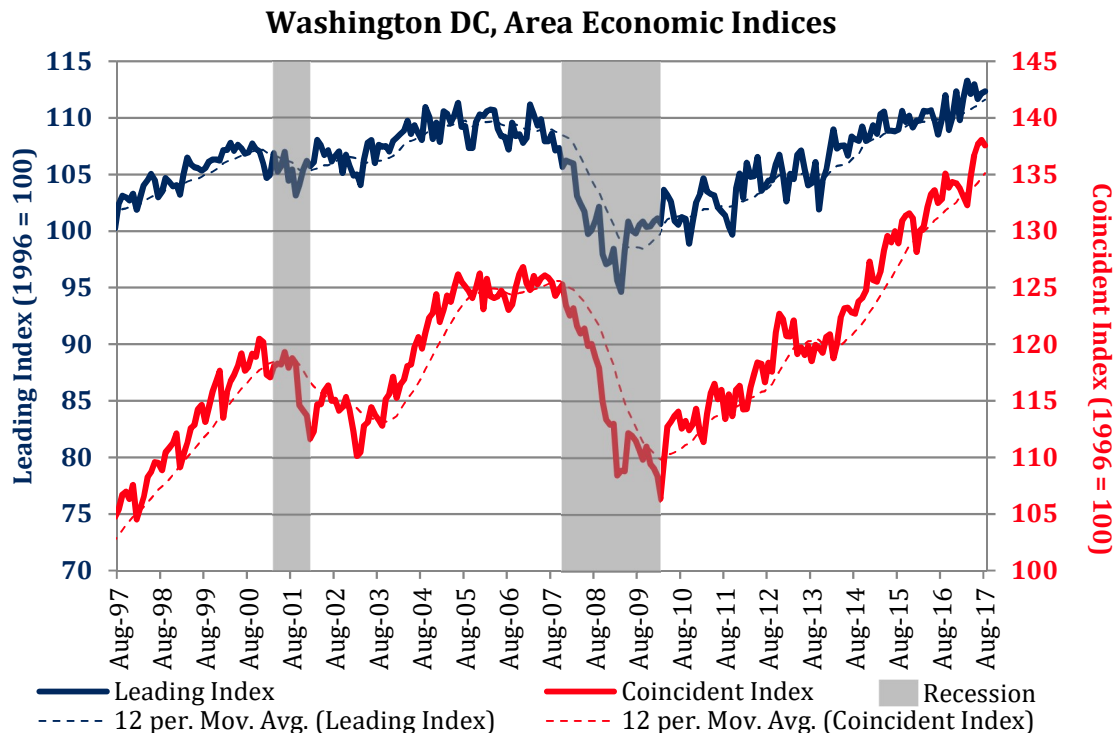
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The Washington Region's Economy Continued to Expand in August

The Washington Leading and Coincident Indices continue pointing to a stronger performance in 2017 than in 2016 with this growth trend carrying forward into next year. The performance of the Coincident Index has improved each month since March and registered its strongest gains since January in July and August. August was the fifth consecutive month in which all four of the Index's components were positive underscoring the breadth of the economy's expansion. The Leading Index has increased each month since January. This performance is forecasting continued economic expansion through the first quarter of 2018 with the region's economy on track to achieving its strongest performance since 2010 next year.



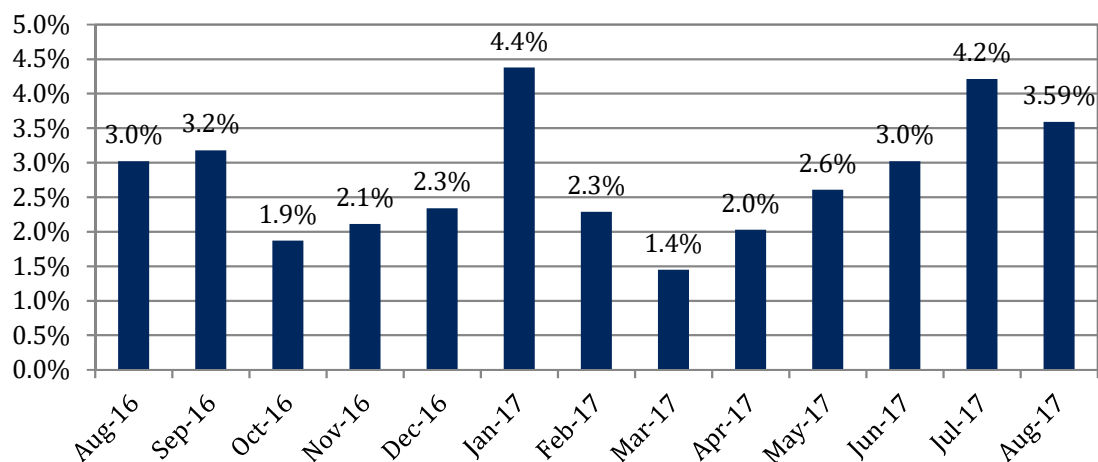
Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, declined 0.3 percent in August (from July) with three of the Index's four components decreasing on a month-to-month basis. Only domestic Airport Boardings were higher in August than in July. This one-month slowing of the economy's expansion (following four strong monthly gains) when Congress was not in session and many residents were out-of-town on vacation is not suggestive of a fundamental shift in the economy's growth path as reflected in its long-term trend.

Compared to August 2016, the Coincident Index's August monthly over-the-year performance increased 3.59 percent and now has increased for 41 consecutive months. The Index started the year with one of its strongest gains since turning positive in April 2014 but then slowed through the first quarter. In the second quarter, it gained strength each month and now in the third quarter, in July and August, it registered its strongest gains since January. For the fifth month in a row, and sixth time this year, all four of the Coincident Index's components were positive on a monthly over-the-year basis.

- *Wage and salary employment* growth in the Washington region increased 2.1% between August 2016 and August 2017;
- *Consumer confidence (in the present)* continued its positive trend, increasing by 23.4% from August 2016 for its fourth consecutive double-digit gain;
- *Domestic passenger volume at Reagan National and Dulles Airports* increased 6.3% in August compared to August 2016 and has now increased in seven of this year's first eight months on a monthly over-the-year basis; and,
- *Non-durable goods retail sales* increased 2.1% from August 2016, growing for the sixth consecutive month after declining in February.

Washington Coincident Index, Monthly Over-the-Year Changes



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

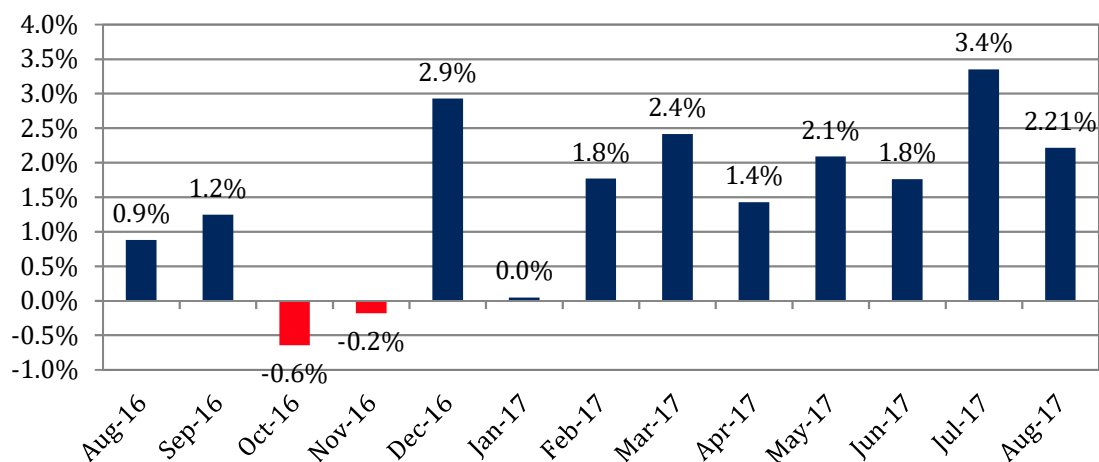
The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy six to eight months in advance, increased in August, gaining 2.21 percent from August 2016. The Leading Index has now registered solid gains each month in 2017 since registering no gain (0.05%) in January. This upward trend represents the strongest sustained performance for the Leading Index since 2014. The Leading Index's continuing strong performance points to sustained economic growth during the remainder of 2017 and through at least the first quarter of 2018.

On a month-to-month basis, however, the Leading Index decreased from July with two of its four components growing and two declining. This monthly slowdown reflects seasonal patterns and not a shift in the trajectory of the region's economy.

In August, three of the Leading Index's four components contributed to its gain from August 2016.

- *Durable goods retail sales* increased 5.0% in August from August 2016 continuing its positive trend from 2016;
- *Consumer expectations (consumer confidence six months hence)* extended its upward trend for an eleventh month gaining 27.0% and registering double-digit gains for a ninth consecutive month; and,
- *Initial claims for unemployment insurance* decreased (improved) for the second time in three months reversing an upward trend dating from November 2016; while,
- *Total residential building permits* declined 13.8% from August 2016 after 48.6% increase in July.

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 August extended its growth trajectory to a 41st month and showed that the momentum established in the first half of the year is continuing. Each of the four components of the Coincident Index was stronger in August than a year ago confirming the positive direction and breadth of the region's current economic performance.

The performance of the region's forward-looking indicators continues to suggest stronger growth six to eight months ahead. Seven strong monthly gains since January present a clear signal that the region's economy should registered a stronger year overall in 2017 than in 2016 and that this upward trend will be carried into 2018. While the economy's monthly performance in August reflected some normal seasonal slowing in comparison to July's metrics, overall the economy continued to support above-average levels of net job growth; the leisure and hospitality sector registered strong gains, and consumer spending continued to grow, all pointing to gains in the region's core summer business—tourism, gains in personal earnings—job growth and wages gains, and continued consumer and business confidence going forward.

The outlier in this forecast remains the uncertainty of federal fiscal policy. With the FY 2018 budget coming up for approval—the current budget agreement expires on December 8th—and with the status of Administration proposals for tax reform and policies relating to immigration and health care uncertain, not to mention the Debt Ceiling extension coming due in January, the wildcards are many and could easily alter the trajectory of the Washington region's economy.

Forecasts for the national economy's performance for 2017 and 2018 were revised lower in October by IHS Markit to reflect the impacts of Hurricanes Harvey, Irma and Maria and the likelihood that tax reform will not affect the 2018 economy. These revised assumptions lowered the GDP forecast for 2018 from 2.8% to 2.4%. While some form of fiscal stimulus is still expected, current thinking now points to its impacts, whatever these might be, being realized in 2019 rather than 2018. As the Washington region's economic performance has become more closely linked to the performance of the national economy with its declining dependency on federal spending, changes in the performance of either or both the national economy and in federal spending within the Washington region's economy could compound the magnitude of these effects within the region's economy and quickly alter its direction.

Current Performance

This year's job growth through September continues to increase at well above the 20-year average and also has exceeded this year's projection averaging 57,378 jobs on an annualized basis. While these job estimates will be subject to revision after the end of the year and reissued in March 2018, and should be expected to be lowered, they still are consistent with other indicators pointing to this year's performance

being one of the strongest since 2010 when the region's economy was rebounding from the Great Recession and GRP grew 3.8%.

September's job growth provides the most recent measure of the region's economic performance. The 44,500 new jobs added between September 2016 and 2017 were the second smallest number added in any month this year and only slightly more than one-half the peak job gain of 85,000 in July and only two-thirds of the job gain registered in August (67,100).

This rapid slowing of job growth in the third quarter can be attributable to a mix of factors, none of which can be considered representing a signal that the economy's growth has peaked. Beyond the seasonal factors at play during the third quarter—first the peaking and then the slowing of the leisure and hospitality sector, the local government hiring surge associated with the beginning of the school year, the impact of an early Labor Day weekend extended vacation time into the first week of September—there are some continuing performance differences among the region's sub-state portions that suggest methodological differences in estimating job changes that will result in larger than normal revisions after the end of the year. Estimates for Suburban Maryland are running far greater than its historical share of the region's employment base while estimates for the District of Columbia and Northern Virginia are lower—DC and Northern Virginia's job growth in September were down 46 percent and 57 percent respectively from these sub-state area's job growth averages for January-August.

The September jobs report does include several notable findings. All but two sectors had fewer jobs in September than in August. Transportation and utilities, with a total of 67,800 jobs in the region, added 600 jobs in September and state and local government, with a total of 334,100 jobs, reported an increase of 21,700 jobs. This gain is a reflection of hiring patterns by the region's public school systems and their recreation departments and is not a true measure of any major change in the economy. The largest decline came in the leisure and hospitality sector, which lost 12,900 jobs. This is a normal seasonal pattern.

The decrease of 7,100 jobs in the professional and business services sector, the region's largest sector, could represent a sign of a shift in the economy. The August to September is typically negative in the Washington region, reflecting seasonal patterns; in the five years before the Recession it averaged -2,620 jobs. Since the Sequester, the change has been increasingly negative (averaging -7,460) and has been driven by declines in Northern Virginia. In September 2017, 85 percent of this decrease was reported in Northern Virginia. Most federal contractor jobs are included in the professional and business services sector. Because businesses located in Northern Virginia account for almost one-half of the region's federal contracting outlays, they are also more vulnerable to changes in federal contract spending. September was the end of the fiscal year. Therefore, it is possible that these job losses resulted from weaker federal contracting at the close of FY 2017 or

expected slowing of contracting during the coming fiscal year, at least under the provisions of the Continuing Budget Resolution that runs until December 8th.

As has been noted in previous *Washington Economic Watch* reports, the mix of the region's job growth is also important; that is, it is not only the number of jobs that matters but whether these jobs are export-based or local-serving, whether they are high-value added with above-average salaries or not, and whether they are federally dependent or compete in national and global markets. The region's pattern of job growth has shifted since 2010 with declines in federal government and federal contractor jobs and the growth of local-serving, lower-value added jobs.

The job increase in September was disproportionately concentrated in four sectors—professional and business services, education and health services, leisure and hospitality services, and retail trade—that together accounted for 81.0 percent of the total job gain from September 2016. This job growth concentration confirms both the concentrated strength of the Washington region's economy and its lack of diversification, at least across the breadth of the economy. Within these four core sectors, professional and business services represents the jobs with the highest GRP value per worker; this is the sector, as noted previously, where most of the federal contractor jobs are counted. This sector, which is the largest in the region's economy and upon which the region's economic sustainability depends, experienced strong gains over the September 2016-2017 period, accounting for 37.3 percent of all job gains, well above its 23.0 percent share within the overall employment base. This sector's pattern of growing at above its long-term average growth rate is reflected in the economy's recovery since the Sequester when the professional and business services sector actually lost jobs for 16 months spanning the May 2013-May 2014 period.

Still, the other three core sectors—these are largely local-serving and lower-value added jobs—account for a greater percentage of the job growth in the region each month than the professional and business services sector; in September these three sectors accounted for 43.7 percent of the total job gain.

October jobs data will be revealing. The economy during October is less affected by seasonal factors than the summer and winter months and also is less affected by holidays. Also, Congress is in session and it is the first month of the new fiscal year. As such, job growth in October will provide an important symptomatic measure of the economy's true performance at this stage of the business cycle.

Near-Term Outlook

The 41 consecutive monthly over-the-year gains in the Coincident Index and the continuing strong positive performance of the Washington region's forward-looking indicators comprising the Leading Index are pointing to continuing economic gains extending through the first quarter of 2018. These gains will be measured in

continuing greater-than-expected job growth, even if the mix is not as favorable as preferred, low unemployment and rising labor force participation rates, continuing personal income growth, and higher labor costs in sectors experiencing strong growth trends.

The Washington region's current economic growth trajectory has its gross regional product (GRP) growing for the full year in 2017 at double the rate it did in 2016, increasing to a projected 2.2% from 1.1%. If the region is to achieve this rate of growth (this assumes that federal spending during 2017 will not be interrupted or seriously threatened), the region's economy would match the current U.S. economy projected growth rate for the first time since 2010 (IHS Markit's *US Executive Summary*, October 2017).

The GDP growth rate will be subject to further revision as the full value of the costs of Hurricane Harvey and Irma are measured as well as the off-setting magnitude of reconstruction spending becomes known and how much of this occurs in the 4th quarter and how much is shifted into 2018. Maria's costs and reconstruction benefits may not be a factor in the GDP performance as Puerto Rico's economy is not included in the U.S. GDP calculation. Still, much of the reconstruction benefit may be registered within the U.S. economy as the source of the goods and services transferred to Puerto Rico. Few of these effects will directly impact the Washington region's economy, so for now its projected growth of 2.2% is not expected to change unless there is an abrupt change in federal spending during the last quarter of this year.

While a major or an abrupt change in federal spending is not expected in 2017, it is possible that the final budget for FY 2018 and for future federal budgets will alter federal spending patterns in the Washington region. It has happened before, usually following the end of a major war but federal spending patterns have also been altered by legislative change, most recently by the Budget Control Act of 2011.

The Stephen S. Fuller Institute has recently assessed the impacts of the federal spending reductions on the performance of the Washington region's economy during the 2010-2016 period (<http://sfullerinstitute.gmu.edu/consequences-federal-reduction/>). This assessment provides a baseline for projecting the possible impacts of a future federal spending reduction (or increase) as potentially reflected in the FY 2018 federal budget and other federal policy changes that may change the magnitude and mix of federal contracting flows within the region.

The findings of the above-referred assessment are that the Washington region's economy, its GRP, would have been 7.3 percent greater if the region's economy has just performed as well as the U.S. economy during the 2011-2016 period; that is, had its federal job base not been cut by approximately 6 percent and the value of federal procurement contracting not reduced by 15.5 percent between mid-2010 and 2015. This reduction in direct federal spending—3.8 percent of GRP—was

found to have a 7.3 percent negative impact on the region's GRP growth for a multiplier effect of 1.92.

**Washington Area Economic Indicators
Current and Previous Months**

Economic Indicator	Estimates			Percent Change	
	Aug-17 Prelim.	Jul-17 Final	Aug-16 Final	Jul-17 to Aug-17	Aug-16 to Aug-17
Washington Area Business Cycle Indicators					
Coincident Index (1996 = 100)	137.6	138.0	132.8	-0.34%	3.59%
Leading Index (1996 = 100)	112.3	112.2	109.9	0.16%	2.21%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000) ^a	3,294.9	3,323.4	3,227.3	-0.86%	2.09%
Consumer Confidence (South Atlantic) ^a	160.5	161.4	130.1	-0.56%	23.37%
Domestic Airport Passengers ('000) ^b	2,289.2	2,240.1	2,153.1	2.19%	6.32%
Nondurable Goods Retail Sales (\$000,000) ^c	3,136.6	3,139.2	3,072.7	-0.08%	2.08%
Washington Area Leading Index Components					
Total Residential Building Permits ^a	2,008.0	2,314.0	2,329.0	-13.22%	-13.78%
Consumer Expectations (South Atlantic) ^a	111.1	113.7	87.5	-2.29%	26.97%
Initial Unemployment Claims ^b	1,385.4	1,452.4	1,551.5	-4.61%	-10.71%
Durable Goods Retail Sales (\$000,000) ^c	3,534.1	3,489.9	3,364.3	1.27%	5.05%
Washington Area Labor Force^a					
Total Labor Force ('000)	3,405.9	3,452.9	3,299.0	-1.36%	3.24%
Employed Labor Force ('000)	3,278.4	3,318.9	3,168.4	-1.22%	3.47%
Unemployed Labor Force ('000)	127.5	134.0	130.6	-4.85%	-2.37%
Unemployment Rate	3.7%	3.9%	4.0%	--	--
Washington Area Wage and Salary Employment^a					
Total ('000)	3,294.9	3,323.4	3,227.3	-0.86%	2.09%
Construction ('000)	165.0	163.9	159.2	0.67%	3.64%
Manufacturing ('000)	54.7	54.4	54.2	0.55%	0.92%
Transportation & Public Utilities ('000)	67.8	66.8	64.3	1.50%	5.44%
Wholesale & Retail Trade ('000)	344.9	346.4	341.7	-0.43%	0.94%
Services ('000)	1,984.2	1,991.2	1,933.8	-0.35%	2.61%
Total Government ('000)	678.3	700.7	674.1	-3.20%	0.62%
Federal Government ('000)	365.9	368.4	366.8	-0.68%	-0.25%

^aUnadjusted data

^bSeasonally adjusted data

^cSeasonally adjusted constant (1996) dollars