Washington Economy Watch

Vol. I, No. 11
November 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

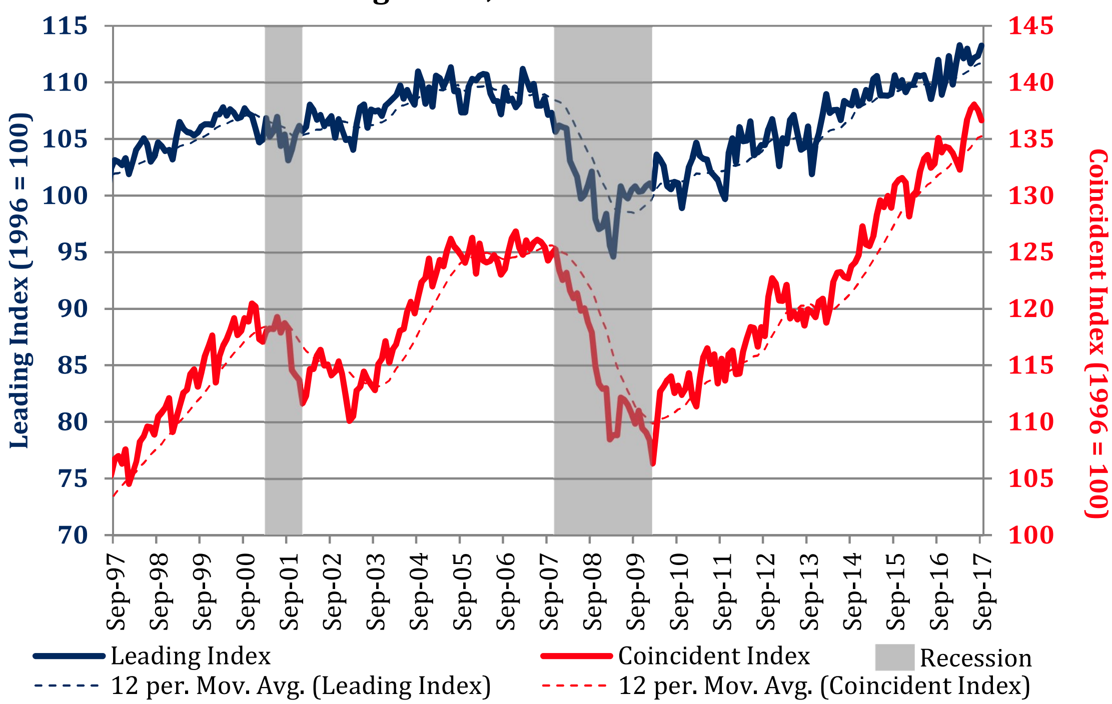
Washington Economy Watch

Vol. I, No. 11 November 2017

The Washington Region's Economic Expansion Is Showing Signs of Moderating

The Washington Leading and Coincident Indices continued to move higher in September but their rates of growth moderated for a second month after peaking in July. The Washington region's current economic expansion dates from April 2014, following the downturn generated by the Sequester in 2013, and has registered 42 consecutive monthly over-the-year gains through September with the Leading Index pointing to this expansion extending at least through the first quarter of 2018. However, the slowdown in the performances of both the Leading and Coincident Indices maybe signaling that the year's stronger growth rate achieved during its first half is moderating during its second half and that economic growth at the beginning of 2018 will be subdued. Looking forward to 2018, the resolution of the federal budget remains the region's biggest source of economic uncertainty.

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, declined 0.67 percent in September (from August), down for the second consecutive month. As in August, three of the Index's four components decreased on a month-to-month basis. Only nondurable goods sales were higher in September than in August. This two-month slowing of the economy's expansion may not be suggestive of a fundamental shift in the economy's growth path but should be monitored going forward.

The Coincident Index's September monthly over-the-year performance increased 1.15 percent from September 2016. While this gain extended the Index's upward trend to 42 consecutive months, it was the smallest gain over this period. The Index's performance this year is taking on a wave pattern; the year started with four month-to-month declines from December 2016, and then the Index accelerated for four months and now has sustained two month-to-month declines. While the trajectory remains positive, this slowdown going into the last four months of 2017 could be a sign of economic fatigue that could reduce the year's overall positive performance to date.

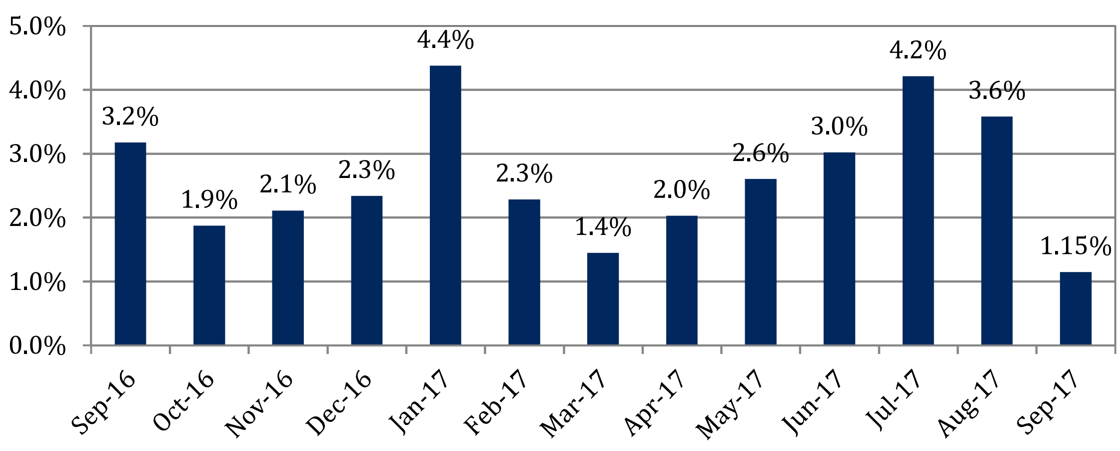
- *Wage and salary employment* growth in the Washington region increased 1.4% between September 2016 and September 2017;

- *Consumer confidence (in the present)* continued its positive trend, increasing by 11.8% from September 2016 for its fifth consecutive double-digit gain; and,

- *Non-durable goods retail sales* increased 0.8% from September 2016, growing for the seventh consecutive month after declining in February; while,

- *Domestic passenger volume at Reagan National and Dulles Airports* decreased 3.7% in September compared to September 2016.

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 September, gaining 1.13 percent from September 2016. While the Leading Index has increased each month in 2017 since registering no gain (+0.05%) in January, it has slowed significantly over the past three months from its July 3.35 percent monthly over-the-year gain; in August its monthly over-the-year increase was 2.22 percent.

The Index's positive performance points to the Washington region's economy continuing its growth through at least the first quarter of 2018 but the slowdown in the Leading Index's growth trajectory maybe signaling slower growth leading into next year.

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

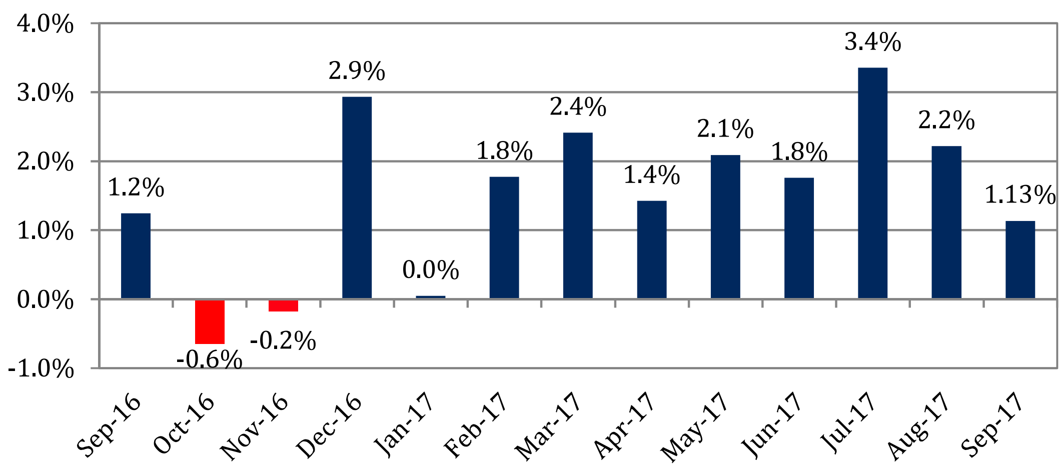
- *Durable goods retail sales* increased 7.7% in September from September 2016 continuing its positive trend from 2016; and,

- *Consumer expectations (consumer confidence six months hence)* extended its upward trend for a twelfth month gaining 10.3% and registering double-digit gains for a tenth consecutive month; while,

- *Initial claims for unemployment insurance* increased (worsened) for the seventh time since the beginning of the year; and,

- *Total residential building permits* declined 7.9% from September 2016 and now have been down in four of the last five months.

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 September continued a pattern reported for August; that is, the Washington region's economic growth rate has moderated after registering a strong first half. The pattern can be seen in the slowing rates of gains for both the Leading and Coincident Indices and in the respective performance patterns of their component indicators. While none of these monthly rates, even those that are negative, are indicative of a major shift in the region's economy, these should be monitored, as this is the way long-term economic trends are shaped.

Some of these slower rates of growth or monthly declines can be attributed to seasonal anomalies such as monthly levels of domestic airport passenger traffic and retail sales. Other indicators follow a longer wave that might be governed by the federal budget (e.g., the acceleration of federal contracting at the end of the fiscal year). The change of Administrations and the added uncertainty of President Trump's policy directions and their potential impacts on federal employment and spending in the region have overshadowed this year's patterns. These uncertainties will likely continue into 2018. The resolution of the FY 2018 budget remains the greatest uncertainty in forecasting the region's performance going forward.

Current Performance

This year's job growth in the Washington region has slowed since July and, while the year's job gains continue to run above beginning-of-the-year forecasts, job growth over the last two months (revised September gains of 51,900 jobs and October job gains of 46,400) were both below the projected annual gain of 53,000. This slowing of job growth is consistent with the performance of the economy's other indicators but they also underscore continuing concerns with the jobs data.

October's job numbers, released on November 17th, show the continuation of several recent trends: the previous month's jobs numbers involve larger than normal revisions, the job estimates for Suburban Maryland are substantially larger than their historic share of the region's total and, correspondingly, Northern Virginia's job totals are substantially lower than its historic share, and the performance of several sectors range widely at the sub-state levels.

While the monthly job estimates are revised the month following their initial release, what has been different recently is that the monthly revision has become larger. For September, the initial estimate was 44,500 jobs; that was revised up to 51,900 with the November jobs report, an increase of 16.6 percent. Increases in leisure and hospitality and education and health services jobs accounted for 5,300 additional jobs or two-thirds of this 7,400-job increase.

October's job gains reported by sub-state portion of the region totaled 40,800 while the total for the region was 46,400. This reporting difference is not unusual; the sub-state areas are estimated separately and often differ from the regional totals.

Historically, the preliminary Maryland estimates have been more aggressive and subject to the largest revisions. In October, this aggressiveness may have contributed to an overestimate for state and local jobs: jobs in this sector increased by 4,800 in Suburban Maryland, but decreased by 4,300 jobs in Northern Virginia and increased by only 800 jobs in the District.

Suburban Maryland's job total for October accounted for almost 50 percent of the total job growth for the three sub-state areas, with Northern Virginia accounting for approximately one-third and the District about 18 percent (approximately its historic contribution). What is different in this allocation of job growth is that Suburban Maryland is larger than Northern Virginia when the historic pattern shows Northern Virginia accounting typically for about one-half of the monthly job gains. The Bureau of Labor Statistics will finalize and re-issue these job totals in March 2018 and it is likely that the sub-state and individual sector totals will be revised. In previous years, these revisions have lowered the job totals in Suburban Maryland.

While the number of new jobs is important, it is the mix of job gains that determines the economy's long-term vitality. The Washington region's strongest sectors continue to be its largest private sectors. While the federal government sector remains the economy's third largest sector with 365,000 jobs, it has been losing jobs this year and has had a negative long-term trend dating from 2010 when the peak monthly federal government job total was 387,700. October's federal job count was 2,300 below its October 2016 total; this pattern of slow attrition is expected to continue in 2018 and possibly longer.

The three large private sectors that have been the principal source of the region's growth since 2010 are: professional and business services, education and health services, and leisure and hospitality services. In October, these three sectors accounted for 33,300 new jobs, or 72 percent of the total gain from October 2016. While there were job gains in several other sectors, three sectors actually lost jobs.

The strength of the economy continues to be narrowly concentrated. Professional and business services accounted for 28.7 percent of the region's new jobs in October outperforming its 23.0 percent of the region's job base. These jobs typically are higher-value added and export-based and are of similar value to the federally supported jobs that have been in decline this decade. In comparison, the 20,000 new education and health services and leisure and hospitality services jobs accounted for 43.1 percent of October's job gain while these two sectors account for only 23.8 percent of all jobs in the region. These jobs typically are local-serving and lower-value added.

The changing balance between these three sectors is important. The region's jobs are becoming more concentrated in these three sectors and the two lower-value added sectors are increasing their share of the region's job base faster than the professional and business services sector. As a consequence of this changing job mix personal incomes and wages are not growing as fast as they did before 2010 when federal government employment and federal contracting were the principal sources of job growth.

Near-Term Outlook

The Washington region's economy has outperformed expectation in 2017: job growth has exceeded beginning-of-the-year forecasts; the Coincident Index continues to increase and now has registered 42 consecutive monthly over-the-year gains albeit it has slowed its growth rate in recent months; and the Leading Index has increased each month this year since a flat beginning in January pointing to continuing growth through the first quarter of 2018 although it has also slowed its growth rate since mid-year. Still, through the year's first three quarters, the Washington region's economy has lived up to and is slightly exceeding expectations for the year. While this growth rate appears to have moderated in recent months, no fundamental changes in the region's economy have been identified.

The national economy appears to have slowed slightly from its beginning-of-the-year forecast but is still on track to achieve at least a 2.4% GDP gain compared to 1.4% gain in 2016. This gain at the national level, combined with the Washington region's underlying economic profile, should support Gross Regional Product (GRP) gains of 2.1% and possibly more this year after growing only 1.1% in 2016. The Washington region's economy continues to suffer from flat or, at best, the slow growth of federal spending that continues to account for its largest source of economic activity. This continuing domination counters the gains of the economy's non-federally dependent sectors to yield a lower average growth rate than generated by the national economy.

This below-GDP level performance may persist into the future. For the Washington region to achieve a faster-than-national growth rate performance will depend on the regional economy's ability to reduce its federal dependence while simultaneously growing its higher-value added, export-based clusters in which it has a competitive advantage, as outlined in the January 2016 *Roadmap for the Washington Region's Economic Future* (see sfullerinstitute.gmu.edu). This structural change is underway but will require many years to achieve. However, the urgency to accelerate this structural pivot may be increased by federal fiscal policy that further reduces federal spending in the region by domestic agencies increasing losses of federal jobs and decreasing federal contractor employment over the next several fiscal years.

The budget resolutions approved by the House and Senate that are currently being debated and could be brought to a final vote before the Christmas recess represent a significant reduction in spending for domestic agencies starting in FY 2019 that would lower discretionary spending by 6.5 percent in the first year with agency spending tracking a lower trajectory through FY 2027. The proposed $632 billion in budget savings over this period is accompanied by an annual 2.5 percent increase in defense spending (which is consistent with the CBO baseline forecast).

The consequences of this spending reduction on the Washington region's economy in its first year would be similar to what the region experienced under the Budget Control Act of 2011 (especially in 2013 as a result of the Sequester), except this time these spending reductions are projected to extend through FY 2027 where the Sequester, and its follow-on spending reductions, were suspended in FY 2015. If these spending reductions are enacted, the current pattern of slow reductions in the federal workforce that is projected to total about 8,200 jobs over the 2018-2027 period would increase to levels that could total three to four times that magnitude with corresponding losses of federal payroll spending within the region's economy. While it is unclear what impacts this budget scenario would have on federal contracting in the region, it is unlikely that with increases in defense spending holding at or near inflation (the real value of spending not increasing), that federal contracting will grow significantly over this period. A more realistic expectation would be for the region to experience deceases in federal contracting in the range that resulted under the Budget Control Act of 2011; that is, the value of procurement outlays to decline in the 8-15 percent range.

The Washington region's economy is on course to improve its performance each year over the next two years assuming that the federal budget reductions included in the current budget resolutions before Congress are not enacted as currently outlined and that other fiscal policy options before Congress are not sufficiently disruptive to the national economy to alter its projected growth path before 2020. Given these assumptions, GDP growth is projected to accelerate in both 2018 and 2019, inflationary pressures are expected to remain within the Federal Reserve Board's target range and increases in interest rates would reflect recent patterns with the current expansion being sustained into the next decade. The Washington region's economy also is projected to following this growth trajectory, but for it, there is a significant risk to the downside from the continuing threats of reductions in federal employment and federal procurement.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Sep-17 Prelim.	Aug-17 Final	Sep-16 Final	Aug-17 to Sep-17	Sep-16 to Sep-17
Washington Area Business Cycle Indicators					
Coincident Index (1996 = 100)	136.6	137.6	135.1	-0.67%	1.15%
Leading Index (1996 = 100)	113.3	112.3	112.0	0.82%	1.13%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,286.0	3,294.4	3,241.5	-0.25%	1.37%
Consumer Confidence (South Atlantic)[a]	150.1	160.5	134.3	-6.48%	11.76%
Domestic Airport Passengers ('000)[b]	2,239.4	2,289.2	2,325.9	-2.18%	-3.72%
Nondurable Goods Retail Sales ($000,000)[c]	3,154.3	3,136.8	3,129.2	0.56%	0.80%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,244.0	2,008.0	2,437.0	11.75%	-7.92%
Consumer Expectations (South Atlantic)[a]	101.8	111.1	92.3	-8.37%	10.29%
Initial Unemployment Claims[b]	1,452.2	1,385.4	1,370.4	4.82%	5.97%
Durable Goods Retail Sales ($000,000)[c]	3,783.8	3,534.8	3,514.2	7.05%	7.67%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,402.9	3,407.2	3,293.5	-0.13%	3.32%
Employed Labor Force ('000)	3,280.6	3,280.1	3,167.0	0.02%	3.59%
Unemployed Labor Force ('000)	122.3	127.2	126.5	-3.80%	-3.32%
Unemployment Rate	3.6%	3.7%	3.8%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,286.0	3,294.4	3,241.5	-0.25%	1.37%
Construction ('000)	163.2	166.2	159.0	-1.81%	2.64%
Manufacturing ('000)	54.1	54.6	53.9	-0.92%	0.37%
Transportation & Public Utilities ('000)	67.8	67.2	64.6	0.89%	4.95%
Wholesale & Retail Trade ('000)	341.3	344.6	338.7	-0.96%	0.77%
Services ('000)	1,960.4	1,983.3	1,928.4	-1.15%	1.66%
Total Government ('000)	699.2	678.5	696.9	3.05%	0.33%
Federal Government ('000)	365.1	366.1	366.7	-0.27%	-0.44%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars