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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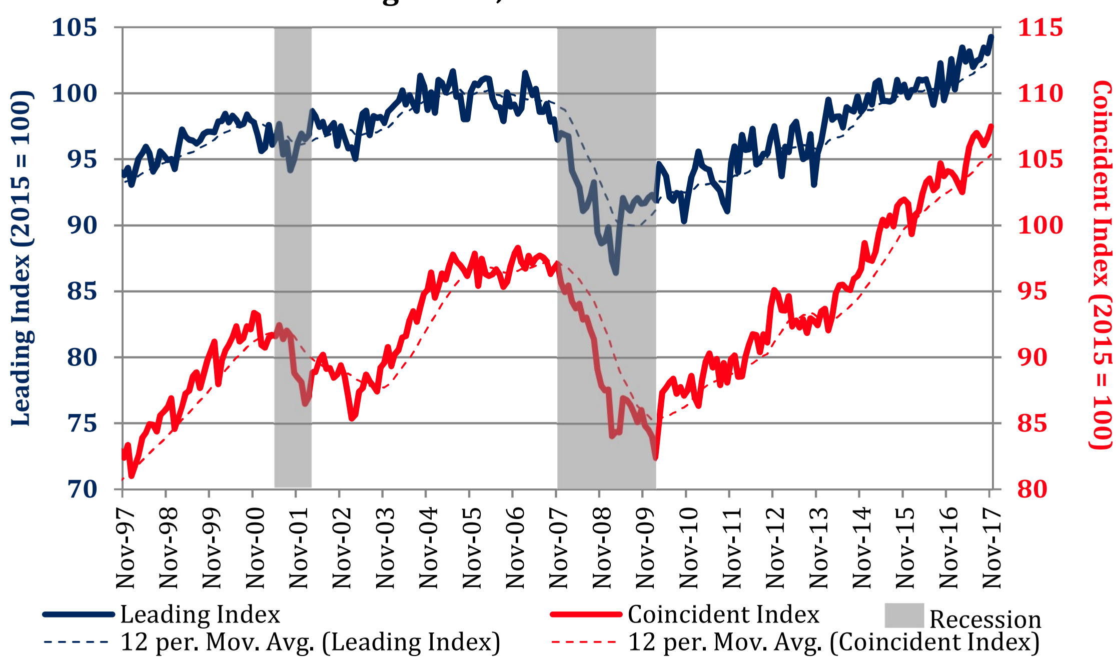
The Washington Region's Economy Is Well Positioned for Growth in 2018

The Washington Leading and Coincident Indices moved higher in November after an uptick in growth in October, pointing the way to an even stronger performance in 2018. The Washington region's current economic expansion dates from April 2014, following the downturn generated by the Sequester in 2013, and has now registered 44 consecutive monthly over-the-year gains through November with the Leading Index suggesting that this expansion will extend at least through mid-2018. With these gains since 2014, the Washington region's economy has regained a growth rate almost equivalent to the nation's growth trend (GDP). This is a significant achievement in the absence of increased federal spending and highlights the importance of the gains achieved by the region's non-federally dependent businesses. Looking forward to 2018, and with the first federal government shutdown in almost four years behind us but another shutdown looming, this budget debate remains this year's biggest source of regional 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, increased 0.79 percent in November from October, increasing for a second month after having declined in August and September. Three of the Index's four components increased on a month-to-month basis with gains being reported in wage and salary employment, consumer confidence, and non-durable goods sales while domestic passenger volume was down just 0.1 percent. This performance is consistent with the Washington region's positive economic trajectory in 2018.

The Coincident Index's November 2017 performance increased 3.2 percent from November 2016. This gain extended the Index's upward trend to 44 consecutive months, dating from April 2014, and was the fourth largest for the year. The Index's performance this year is taking on a wave pattern. The year started with four month-to-month declines from December 2016, then the Index increased for four months, then it declined twice, and now it has increased. While the trajectory remains positive, this unevenness could be a sign of economic fatigue that could moderate next year's projected positive performance. All four of the Index's components were up in November.

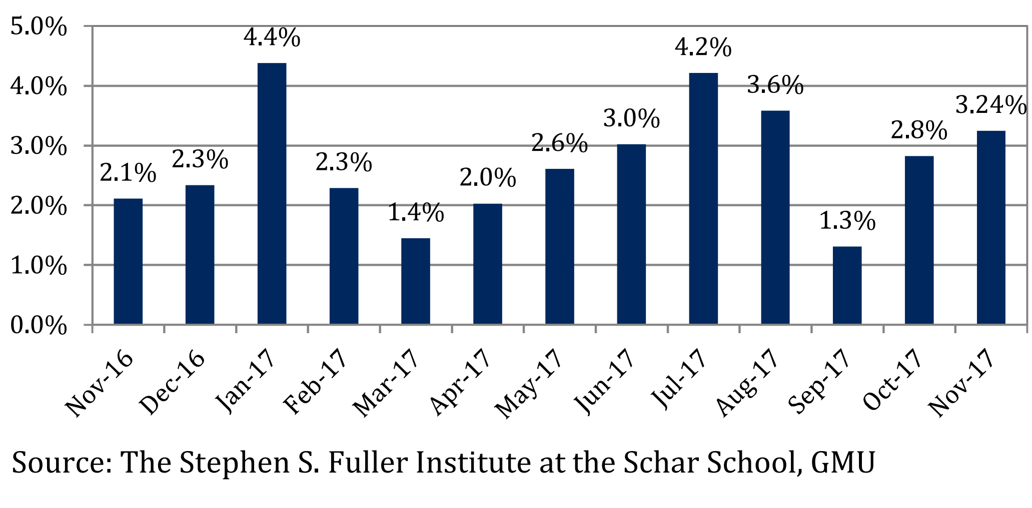
- *Wage and salary employment* growth in the Washington region increased 1.5% between November 2016 and November 2017;

- *Consumer confidence (in the present)* continued its positive trend, increasing by 31.8% from November 2016 for its seventh consecutive double-digit gain;

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 2.0% in November compared to November 2016; and,

- *Non-durable goods retail sales* increased 3.3% from November 2016 portending a strong holiday shopping season.

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 November, gaining 3.79 percent from November 2016. The Leading Index has increased each month in 2017 since registering no gain (+0.05%) in January and has accelerated significantly since September, which had the year's smallest increase, with gains of 3.6 percent in October and this 3.8 percent gain in November. These two monthly over-the-year gains were the strongest in three years. The Index's positive performance points to the Washington region's economy continuing to grow through at least mid-year 2018.

For the first time in 2017, all of the Leading Index's four components contributed to its gain from November 2016.

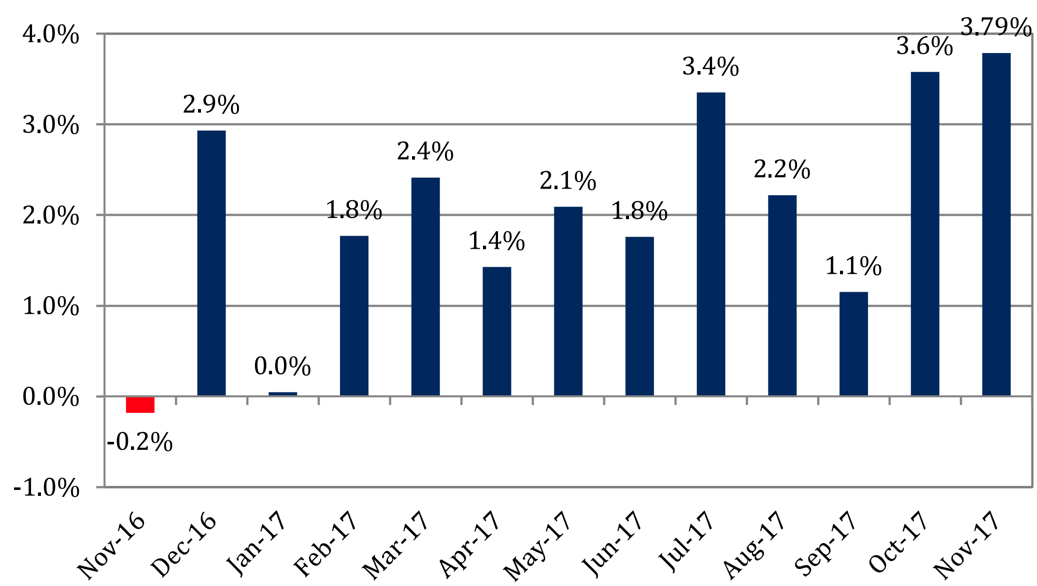
- *Durable goods retail sales* increased 8.6% between November 2016 and November 2017 continuing its positive trend from 2016;

- *Consumer expectations (consumer confidence six months hence)* extended its upward trend, dating from September 2016, gaining 15.1% and registering double-digit gains for a twelfth consecutive month; while,

- *Initial claims for unemployment insurance* decreased 2.1% (improved) for only the third time since the beginning of the year; and,

- *Total residential building permits* registered its second consecutive strong gain, increasing 109.2% in November after registering a 90.8% increase in October.

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 November (and October) showed renewed strength following a slower period of growth in August and September. The pattern can be seen in the accelerating rates of gains for both the Leading and Coincident Indices and in the respective performance patterns of their component indicators. This strong performance in the year's fourth quarter, combined with its strong performance in the second quarter, and continuing strength in key indicators—job growth, consumer confidence, durable and non-durable goods sales—confirms the economy's underlying strength as it moves into 2018 with its upward trajectory projected to continue well into the year. With the added stimulus provided by the newly enacted federal tax law, the Washington region's economy appeared well positioned at the end of 2017 to register its best economic performance of the decade in 2018.

Current Performance

In 2017, the Washington region's economy registered its second fastest growth rate since 2010 gaining an estimated 2.1 percent (it gained 2.4% in 2015) and almost equaled the 2.2 percent gain in U.S. GDP. The region's economic recovery from the Sequester in 2013, when gross regional product (GRP) declined by 0.8 percent while GDP grew by 1.7 percent, attests to the inherent resilience of the regional economy's non-federally dependent businesses as this recovery was achieved without a significant uptick in federal spending.

While federal procurement spending has risen since 2013 (it had declined 15.6% since 2010) increasing a total of $9 billion (13.1%) through 2017 and federal employment regained some of its lost jobs (federal employment was basically flat in 2017), the remainder of the region's economy has experienced accelerating growth and, as a result, has substantially increased its share of the region's economy. In 2010, federal government spending in the Washington region accounted for 39.8 percent of GRP; by 2017, this share had declined to an estimated 29.9 percent.

In the last three years, the Washington region generate a total of 169,800 net new jobs. This scale of job growth was sustained for all three years, increasing by 57,700 jobs in 2015, 55,600 in 2016 and an estimated 56,500 in 2017. In 2017, three of the region's sectors accounted for 75 percent of the jobs—professional and business services, education and health services, and leisure and hospitality services. Retail trade and state and local government sectors also added significant numbers of new jobs, together accounting for 17.3 percent of the total increase. Five sectors, then, accounted for 92.3 of the region's new jobs in 2017. The remaining sectors either lost jobs or added small numbers, including the region's second largest sector, the federal government, which lost 400 jobs.

The Washington region remains specialized. Even though the federal government did not generate meaningful job growth in 2017, it accounts for 11.2 percent of the region's job base. The region's other three major sectors that generated 75.0 percent of the new jobs only account for 46.7 percent of the region's job base. The region's economy is not diversified and does not appear to be diversifying even though it has experienced well above average job growth over the last three years.

End-of-the-year jobs data, released on January 23rd, show the region's job growth has not slowed down; the region added 55,000 net new jobs between December 2016 and December 2017. The federal government reported 5,800 fewer jobs in December 2017 compared to December 2016, the sharpest monthly over-the-year decline during the year; federal job growth had been positive during the year's first half but these gains have now been largely lost over the second half. This trend may portend continuing federal job losses in 2018 and beyond.

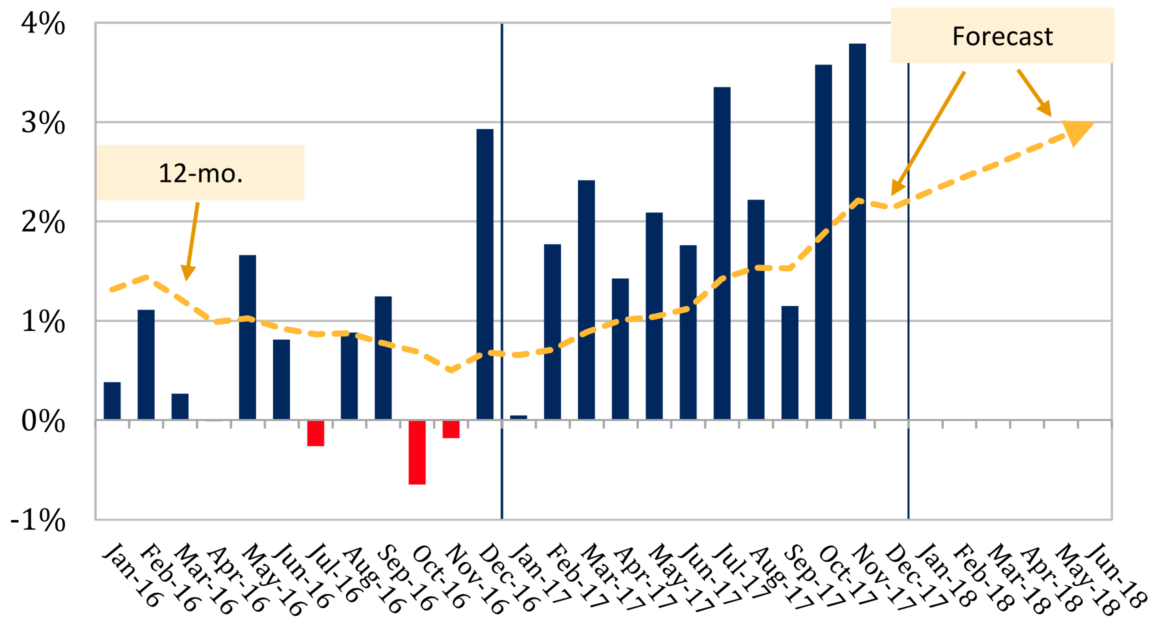
The region's three major growing sectors remain professional and business services, education and health services, and leisure and hospitality services. These accounted for 68.2 percent of the job gain. Both professional and business services and leisure and hospitality services job growth slowed in December while gains in education and health services increased compared to their annual average performances. Construction and other services ended the year strong.

Job gains at a sub-state area level in December (from December 2016) have resumed their historic trends, with job gains in Northern Virginia accounting for approximately one-half of the total, job gains in Suburban Maryland accounting for 30 percent and the District of Columbia accounting for 20 percent. Earlier in 2017, job gains in Suburban Maryland were stronger and, for several months, exceeded job gains in Northern Virginia. Job growth in the District has also moderate since the beginning of 2017. Still, for all sub-state areas, job growth in 2017 has been strong but sustaining this magnitude of job growth in 2018 will be a challenge.

Near-Term Outlook

The Washington region's economy has outperformed expectation in 2017 and has returned the region's economy almost to parity with the U.S. economy. The Coincident Index continues to increase and now has registered 44 consecutive monthly over-the-year gains and accelerated its gains in the fourth quarter; the Leading Index has increased each month this year and registered its strongest two monthly over-the-year increases in October and November pointing to continuing growth through the second quarter of 2018.

Washington Region Leading Index, Monthly Over-the-Year Percent Change



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

While the outlook remains strong for 2018 (and 2019 as well), the Washington region's economy will have difficulty outperforming the U.S. economy. Having so large a federal dependency built into the region's economy damps its overall growth unless federal spending is growing and these prospects have been dimmed by the Trump Budget Blueprint (March 2017) and the proposed budget for FY 2018, which has yet to be adopted putting federal government spending on a "continuing resolution" basis thereby continuing spending constraints well into the fiscal year.

Nevertheless, the national economy (GDP) is projected to grow 2.7 percent in 2018, up from 2.2 percent in 2017. This stronger growth rate is based largely on the accumulated economic gains since 2013 as seen in strong job growth and, more recently, increases in personal earnings, continuing high consumer confidence, stronger exports, increased industrial output and increases in productivity, and continuing moderate energy prices. The wealth effect of a record high stock market has also created a growing sense of confidence in the health of the economy adding additional fuel to the economy's expansion.

The new federal tax law is likely to add additional spending power to this already-strong economy. At present, the forecast for 2018 includes a small (0.1 percentage point) increase in GDP as a result of increased consumer and business spending as a result of lower tax rates and the benefits of increased business investment in plants and equipment. This small increase is a result of taxpayers not knowing what their actual increases in disposable income will be from changes in their tax rates and not fully understanding how the new tax rules will affect their total tax liability in 2018. Also, it is expected that a significant portion, more than one-half, of these tax benefits will be saved or used to pay down debt, leaving less than one-half of these tax savings to be spent during the tax year. Forecasts for 2019 increase this tax effect to 0.2 percentage points with GDP growth projected at 2.6 percent.

In order for the Washington region's economy to outperform national economic growth forecasts, non-federally dependent businesses need to perform at a much higher rate in 2018 than they did in 2017. Unfortunately, there are no signs that such a performance level can be realized based on these sectors' performances in 2017. While several clusters (of sub-sectors) of non-federal dependent businesses had their strongest performances in 2017 since the Sequester, much of the increase over their previous year's performance appears to be associated with the presidential election cycle, especially a cycle that ends with a change in administrations. The Business and Leisure Travel cluster register strong gains in 2017 but it is unlikely that these gains can be realized again in 2018; just maintaining these gains achieved in 2017 into 2018 may be a challenge. The Advocacy cluster, which includes all of those businesses and organizations that represent their constituencies to the federal government, or more broadly to the general population, experienced an uptick in employment in 2017, growing in one year almost twice the rate of the previous two years. Again, it is easy to discount this faster job growth in 2017, the first year of a controversial presidential administration, as a one-year event that will not be replicated going forward.

Job growth forecasts for 2018 and beyond are for slower growth. This slowdown in job growth has several causes. The most significant include: strong jobs growth over the past three years has reduced the availability of qualified workers (unemployment in the region stands at 3.6 percent), rising wages, higher interest rates, business cycle fatigue, and continuing uncertainty—especially with respect to the Trump Administration's plans for reducing the budget authority of domestic agencies and shifting these funds to defense and homeland security. A full discussion of the Washington region's outlook for 2018 and beyond was released January 18th and is posted on the Institute's website.

The Washington region's actual economic performance in 2018 will be shaped more by risks than opportunities. The forecast for stronger growth this year seems achievable but may present the best outcome possible given the national and global economic outlooks. The possibility of underperforming the forecast is larger than usual given the shadow of this year's mid-term elections on the ability of Congress and the Administration to do the business of the federal government in a manner that does not negatively impact the Washington region's economy. The potential negative impacts of a shutdown can be calculated. A long shutdown will definitely erode the region's GRP. Continuing federal job reductions will also diminish the region's economic performance. Uncertainty undermines investors' confidence. While the outlook for 2018 is good, the threats to the forecast are real.

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

SCHAR School of Policy and Government GEORGE MASON UNIVERSITY

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Nov-17 Prelim.	Oct-17 Final	Nov-16 Final	Oct-17 to Nov-17	Nov-16 to Nov-17
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	107.5	106.6	104.1	0.79%	3.24%
Leading Index (2015 = 100)	104.3	103.0	100.5	1.20%	3.79%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,316.7	3,307.3	3,267.8	0.28%	1.50%
Consumer Confidence (South Atlantic)[a]	160.0	156.9	121.4	1.98%	31.80%
Domestic Airport Passengers ('000)[b]	2,285.6	2,287.7	2,239.8	-0.09%	2.05%
Nondurable Goods Retail Sales ($000,000)[c]	3,210.3	3,119.6	3,109.1	2.91%	3.26%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,514.0	3,179.0	1,202.0	-20.92%	109.15%
Consumer Expectations (South Atlantic)[a]	115.1	100.3	100.0	14.76%	15.10%
Initial Unemployment Claims[b]	1,782.3	1,678.2	1,820.0	6.20%	-2.07%
Durable Goods Retail Sales ($000,000)[c]	3,902.8	3,734.7	3,593.4	4.50%	8.61%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,380.5	3,391.1	3,337.2	-0.31%	1.30%
Employed Labor Force ('000)	3,257.9	3,267.8	3,213.6	-0.30%	1.38%
Unemployed Labor Force ('000)	122.6	123.3	123.6	-0.52%	-0.79%
Unemployment Rate	3.6%	3.6%	3.7%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,316.7	3,307.3	3,267.8	0.28%	1.50%
Construction ('000)	160.1	163.4	156.1	-2.02%	2.56%
Manufacturing ('000)	54.1	54.3	54.4	-0.37%	-0.55%
Transportation & Public Utilities ('000)	68.4	67.3	66.6	1.63%	2.70%
Wholesale & Retail Trade ('000)	351.3	344.6	348.0	1.94%	0.95%
Services ('000)	1,977.9	1,976.1	1,936.4	0.09%	2.14%
Total Government ('000)	704.9	701.6	706.3	0.47%	-0.20%
Federal Government ('000)	364.0	365.0	368.2	-0.27%	-1.14%

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