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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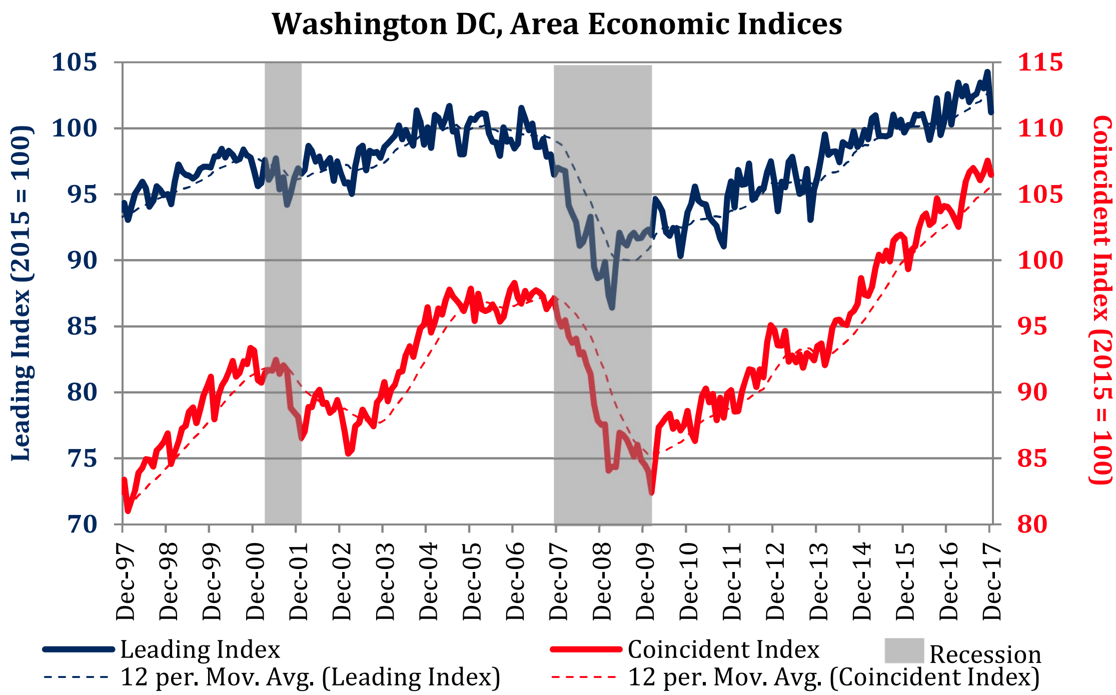
The Washington Region's Economy Stumbles In December Clouding Its Outlook for 2018

The Washington Leading and Coincident Indices in December may have succumbed to the growing discord on the Hill and inability of Congress to agree on a budget for FY 2018. Or, it may have been the weather or just plain economic fatigue. Whatever was it was, it reversed the region's strong and relatively consistent economic performance that had evolved in 2017. The Leading Index declined in December for its only negative performance in 2017 and the Coincident Index, a measure of the current economy's performance, while still increasing from its value in December 2016, broadly declined when compared to its values in November. In fact, the differences between November, the Index's strongest month, and December, the year's weakest monthly performance, could be cause for concern if it wasn't that the economy otherwise outperformed expectation and appears well positioned for an even stronger performance in 2018.



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

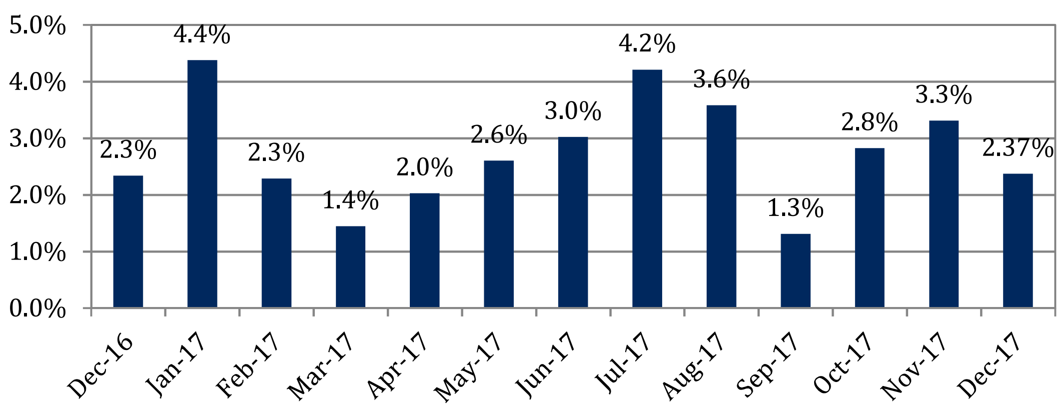
The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, decreased 0.99 percent in December from November, after having increased in October and November on a month-to-month basis. Three of the Index's four components decreased on a month-to-month basis with only wage and salary employment eking out a small gain. This performance is inconsistent with the generally positive growth trend registered over the full year.

In spite of the Coincident Index's month-to-month decline in December, it continued its upward trend on a monthly over-the-year basis increasing 2.37 percent from December 2016. This gain extended the Index's upward trend to 45 consecutive months, dating from April 2014. The Index's performance over the full year has reflected a series of accelerations and decelerations with the sharpest increases occurring in January and July, with the smallest gains registered in March and September. December's increase was smaller than the year's average gain and was also less than the gains in October or November. While the trajectory remains positive, its slowing at the end of 2017 may reflect growing uncertainty that could moderate the projected positive performance in 2018.

In December, all four of the Index's components were positive on a monthly over-the-year basis.

- *Wage and salary employment* growth in the Washington region increased 1.7% between December 2016 and December 2017;
- *Consumer confidence (in the present)* continued its positive trend, increasing by 16.3% from December 2016 for its eighth consecutive double-digit gain;
- *Domestic passenger volume at Reagan National and Dulles Airports* increased 0.9% in December compared to December 2016; and,
- *Non-durable goods retail sales* increased 2.2% from December 2016.

Washington Coincident Index, Monthly Over-the-Year Changes



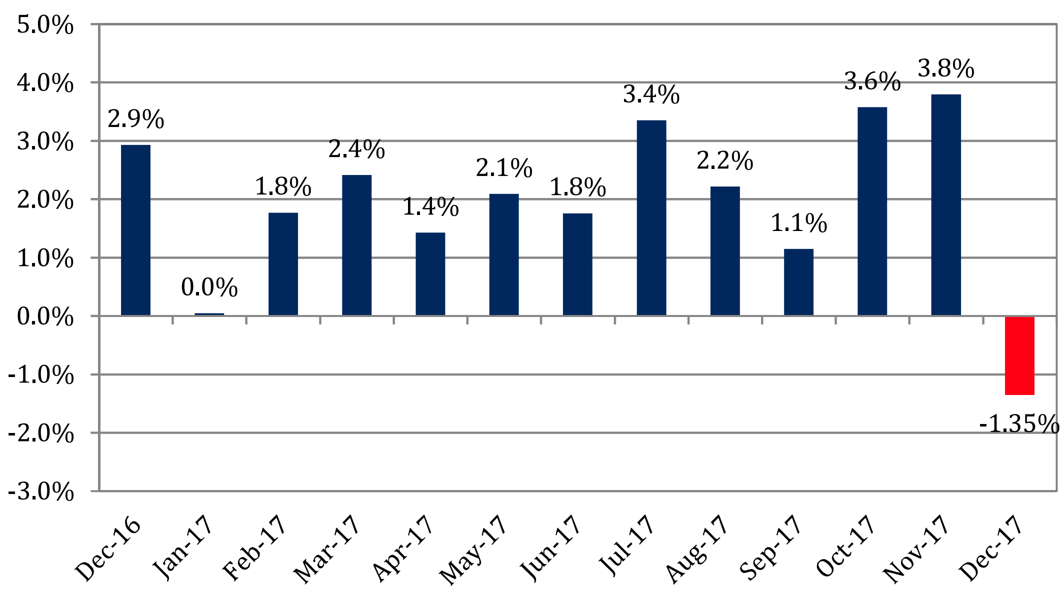
Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy six to eight months in advance, decreased in December, falling 1.35 percent from December 2016. The Leading Index had increased each month in 2017 since registering no gain (+0.05%) in January achieving its largest monthly over-the-year increase in November before pulling back in December. On the heels of strong gains over the previous ten months, December negative performance may be more likely an aberration than the beginning of a slowing trend. Still, this decline in the Leading Index will become important if it is followed in January and February with further slippage in the Indices.

The Index's negative performance in December was broad-based with three of its four components contributing to its decline. This decline contrasts significantly with the Index's performance in November when all four components had contributed to its strong gain.

- *Durable goods retail sales* increased 2.7% between December 2016 and December 2017 continuing its positive trend from 2016; while,
- *Consumer expectations (consumer confidence six months hence)* declined for the first time in more than a year losing 7.7 percent;
- *Initial claims for unemployment insurance* increased 2.3% (worsened); and,
- *Total residential building permits* registered its greatest loss in more than a year, declining 37.4% from its level in December 2016.

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 December was mixed and revealed year-end weaknesses that had not been evident in earlier months. Even though the Coincident Index's long, positive 45-month trend continued through the end of the year, December's Coincident Index declined from November and this decline reflected broad-based weakness across all indicators on a month-to-month basis. And, the Leading Index, the forward looking of the two Indices, declined in December with three of its four component indicators contributing to this decline.

While the region's economy is projected to register its strongest growth in 2018 since 2015, the December performances of the Leading and Coincident Indices should not be ignored. The threat of a federal government shutdown and the failure of Congress to pass the FY 2018 budget may have negatively impacted the region's economy in December. The economy also may have been adversely impacted by the unusual cold weather, including three snow events, the region's experienced during the second half of the month. Uncertainty is never good for the economy and with continuing congressional confrontation with the Administration this uneven economic performance may be reflected in the early months of 2018.

Current Performance

The Washington region ended 2017 growing at a rate slightly less than the U.S. GDP growth rate while having added 55,000 net jobs. The region's estimated 2.1 percent economic growth rate, compared to the 2.3 percent gain in U.S. GDP, provides a clear measure of how far the Washington region's economy has progressed since it was driven negative in 2013 as a result of the Sequester that cost the economy both federal and federal contractor jobs and spending. The region's strong job growth over the past three years, when it added just shy of 170,000 net new jobs, has reduced its historic structural domination of the federal government as the principal driver of annual economic growth. But this changing economic structure has come at a cost.

The region's recent job growth has substantially exceeded historic averages but the number of new jobs is not the only measure of these jobs' values to the region's economy. Not all jobs generate the same value added to the region's gross regional product (GRP). When the average value of a region's new jobs is greater than the average value of his job base, the region is able to support a rising quality of life for its residents. When the average value of jobs being added to the region's economy is lower than its historic average value, the region's existing quality of life is not sustainable.

This is what is happening in the Washington region. The average value of the jobs added between December 2016 and December 2017 was $93,900. The region lost 5,800 federal jobs during this period, whose average GRP value per job was $169,600 (a total GRP loss of $1.14 million) while two-thirds of the region's new jobs were generated by its three other principal sectors (professional & business services, education and health services, and leisure and hospitality services) that together had an average per job value of $97,500.

These different per job GRP values underscore the continuing challenge confronting the region as it shifts away from its economic dependence on the federal government to a more diverse private sector base. The region is adding greater numbers of new jobs with below-average contributions to GRP than jobs with above-average contributions to GRP; this job mix explains the Washington region's comparatively weak economic growth since 2010, ranking 15th out of the nation's 15 largest metropolitan areas.

The Value Added of New Jobs in the Washington Region
December 2016-December 2017

Sectors	**Job Growth % of Total**		**Value Added Per Job**[1]
	(000s)	**% of Total**	
Professional & Business Services	12.7		$156,000
Education & Health Services	17.1		$74,800
Leisure & Hospitality	7.7		$51,800
Sub-total	37.5	*(68.2%)*	$97,500
Federal Government	-5.8	*(-10.5%)*	$197,100*
State & Local Government	2.7		$90,000
Retail Trade	2.5		$73,900
Other Services	5.1		$97,400
Construction	5.3		$125,300
Sub-total	15.6	*(28.4%)*	$101,800
All other sectors	7.7	*(14.0%)*	$137,700
Total	55.0	*(100.0%)*	$93,900
Average value per job, all jobs in metro area			$157,900

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

[1]the average contribution per job to gross regional product in 2016$s

* the total GRP effect of the decrease in federal jobs was $1.14 million

Near-Term Outlook

Over the past year, the Leading Index has been pointing to continuing, if not strengthening, economic growth in the Washington region. This near-term forecast is consistent with others that point to the current expansion continuing into the next decade. Still, the Leading Index's December performance, its weakest of 2017 following November's performance that was the strongest of the year, provides valuable perspective concerning the short-term vulnerabilities that may distinguish the Washington region's economy from other, more diversified metropolitan area economies.

The portions of the Washington region's economy that are export-based and linked to the performance of the national and global economies will track closely with the performances of those larger economies, both of which are projected to record strong and continuing growth in 2018 and 2019. The remainder of the region's externally driven economy is dominated by its national capital functions. These are largely driven by federal payroll and procurement spending that totaled an estimated $120 billion in 2017 accounting directly for 24 percent of the region's gross regional product (not adjusted for their multiplier effects).

Shutdowns or other disruptions to these federal spending streams can have an immediate impact on the region's economy, as illustrated by the Sequester in 2013 when GRP shank 0.8 percent in contrast to GDP growth that year of 1.7 percent. In 2010, the year that federal employment and federal procurement spending peaked in the Washington region, its economy grew 3.8 percent.

The effects of shifting federal employment and procurement spending among agencies would be different than a shutdown or cessation of federal spending on the region's economy but could also quickly diminish its performance; employment (payroll) effects would register more quickly than changes in federal procurement as these are often tied to the annual contracting cycle. However, in any of these cases, a change or disruption in federal spending could alter the trajectory of the region's economic expansion more quickly than a change in the performance of the national or global economies, as these tend to be more gradual and cumulative and are shaped by many more potentially compensating dynamics.

The federal budget agreement that was approved February 9th authorizes significant increases in federal spending for both FY 2018 and 2019 and beyond as well as proposes changes that could shift federal resources—funding and staffing—among federal department and agencies both in the Washington region and to locations beyond the region (thereby reducing the Washington-based federal workforce). At this time, it is unclear how the region's employment base may be impacted by these proposals; that is, whether federal spending will grow and resume its historic role as the major driver of the region's economic vitality or whether federal spending will decline with the result that the region will continue to be increasingly dependent on non-federally dependent business activities to determine its performance over the next several years.

The Administration's budget priories were further revealed in the proposed FY 2019 federal budget that was released February 12th that included the defunding of numerous smaller federal agencies and programs and reductions in spending for major domestic programs and departments. As was true of the Trump Budget Blueprint, released in March 2017 and included many of these same proposed domestic program spending reductions, implementing these major shifts in federal programmatic priorities is more difficult than describing them in a proposed budget document. However, that these proposals have been restated for a second year does give them more credence and may increase the likelihood that they will be adopted in some form this year or next.

If this were to occur, there would be an economic impact on the region. Federal spending remains a significant part of the region's economy, estimated in total to account for an estimated one-third of GRP in 2017. Given that share, a three percent reduction in federal spending would translate into a one-percentage point decrease in GRP growth; that is, rather than growing 2.3 percent as currently projected in 2018, the region's economy would only grow 1.3 percent.

In the absence of any major shifts in federal spending this year, the region continues to be on track to register stronger economic growth in 2018 than in 2017 with this trend continuing into 2019. Even though the economy appears to have ended the year temporarily damaged by the federal budget and debt limit uncertainties and slammed by the coldest temperatures of the winter, these impediments are now history, at least for this season. And, with the new tax law now in effect and reflected in larger take-home paychecks and increasing corporate earnings, the Leading Index and its component parts, which declined in December, are likely to be fully recovered by March and pointing to accelerating growth for the remainder of 2018. Still, with the current Administration's continuing efforts to reversing past federal policies, and as these could quickly translate into negative (or positive) stimulants within the region's economy, uncertainty may continue to cast a shadow over the Washington region's on-going economic performance and raise doubts concerning the sustainability of the current expansion beyond 2018 or 2019.

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Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Dec-17 Prelim.	Nov-17 Final	Dec-16 Final	Nov-17 to Dec-17	Dec-16 to Dec-17
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	106.5	107.6	104.0	-0.99%	2.37%
Leading Index (2015 = 100)	101.2	104.3	102.6	-2.93%	-1.35%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,324.8	3,320.0	3,269.8	0.14%	1.68%
Consumer Confidence (South Atlantic)[a]	149.1	160.0	128.2	-6.81%	16.30%
Domestic Airport Passengers ('000)[b]	2,242.0	2,285.6	2,222.9	-1.91%	0.86%
Nondurable Goods Retail Sales ($000,000)[c]	3,122.1	3,210.0	3,055.1	-2.74%	2.19%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	1,106.0	2,514.0	1,766.0	-56.01%	-37.37%
Consumer Expectations (South Atlantic)[a]	103.3	115.1	111.9	-10.25%	-7.69%
Initial Unemployment Claims[b]	1,490.5	1,782.3	1,457.1	-16.37%	2.29%
Durable Goods Retail Sales ($000,000)[c]	3,722.5	3,905.9	3,626.2	-4.70%	2.66%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,364.9	3,382.6	3,347.5	-0.52%	0.52%
Employed Labor Force ('000)	3,253.7	3,260.2	3,232.1	-0.20%	0.67%
Unemployed Labor Force ('000)	111.2	122.3	115.3	-9.09%	-3.59%
Unemployment Rate	3.3%	3.6%	3.4%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,324.8	3,320.0	3,269.8	0.14%	1.68%
Construction ('000)	158.7	160.4	153.4	-1.06%	3.46%
Manufacturing ('000)	54.2	54.1	54.1	0.18%	0.18%
Transportation & Public Utilities ('000)	72.1	68.2	68.9	5.72%	4.64%
Wholesale & Retail Trade ('000)	353.5	352.5	351.1	0.28%	0.68%
Services ('000)	1,981.9	1,980.0	1,934.8	0.10%	2.43%
Total Government ('000)	704.4	704.8	707.5	-0.06%	-0.44%
Federal Government ('000)	364.0	364.0	369.8	0.00%	-1.57%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars