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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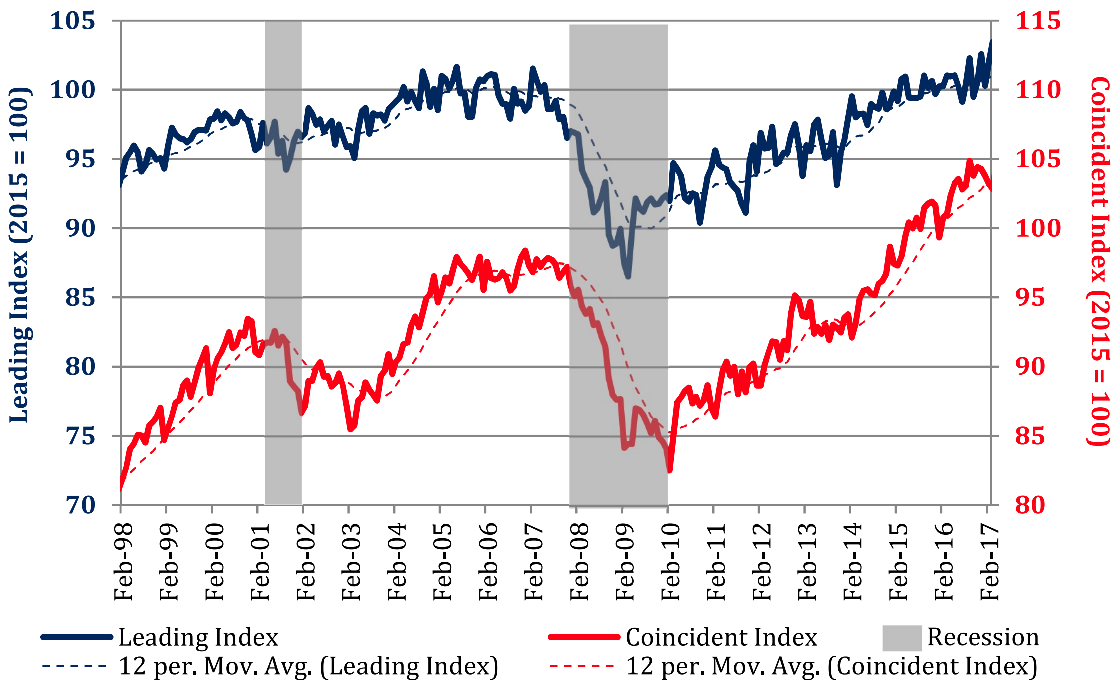
The Washington Region's Economy Continued Its Positive Growth Trajectory in February

The February 2018 performances of Washington region's Coincident and Leading Indices continued their respective positive trends from 2017. The Coincident Index registered a stronger gain in February than it had in January and extended the economy's long-term positive growth trajectory to a 47th month. The Leading Index's February gain exceeded both January's gain and last year's average monthly over-the-year increase. This continuing positive trend points to the region's economic growth continuing at least through the third quarter of 2018. Other forecasts for the Washington region's economy are pointing to these gains accelerating over the course of this year and becoming even stronger in 2019 before moderating in 2020.

Figure 1. Washington Region 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 0.57 percent in February from January, after having decreased in each of the two preceding months on a month-to-month basis. Similar multi-month, monthly decreases had occurred previously during the first and third quarters of 2017. Such patterns often reflect seasonal factors or one-time events. In February, two of the Index's components increased on a month-to-month basis—total wage and salary employment and consumer confidence, and two components decreased—domestic airport passenger volume and nondurable goods sales.

On a monthly over-the-year basis in February, the Coincident Index registered an increase of 2.70 percent from February 2017. This gain extended the Index's upward trend to 47 consecutive months, dating from April 2014. The Index's February increase was the largest since November 2017 and exceeded last year's 12-month average gain of 2.66 percent.

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

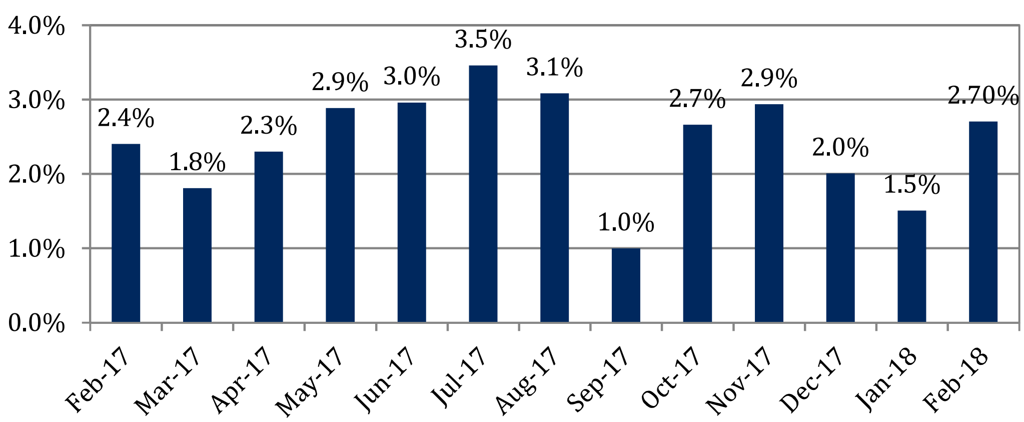
- *Wage and salary employment* in the Washington region increased 1.4% between February 2017 and February 2018;

- *Consumer confidence (in the present)* continued its positive trend, increasing by 17.6% from February 2017 regaining its pattern of double-digit increases experienced over the final eight months of 2017;

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 2.4% in February compared to February 2017 after declining in January; and,

- *Non-durable goods retail sales* increased 3.8% from February 2017.

Figure 2. 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 February gaining 2.50 percent from February 2017, building on January's increase of 1.8 percent. The Leading Index had been positive in eleven of last year's twelve months, the only exception being December's decline that was likely linked to severe weather and the continuing budget impasse that threaten a federal government shutdown. This overall strong performance in 2017 has now continued through the first two months of 2018 and points to the region's continued economic expansion through at least the third quarter of 2018.

The Index's positive performance in February was broad-based with three of its four components contributing to its gain with an especially strong performance for initial unemployment claims that declined (improved) 18.4 percent for a second consecutive month of double-digit improvement:

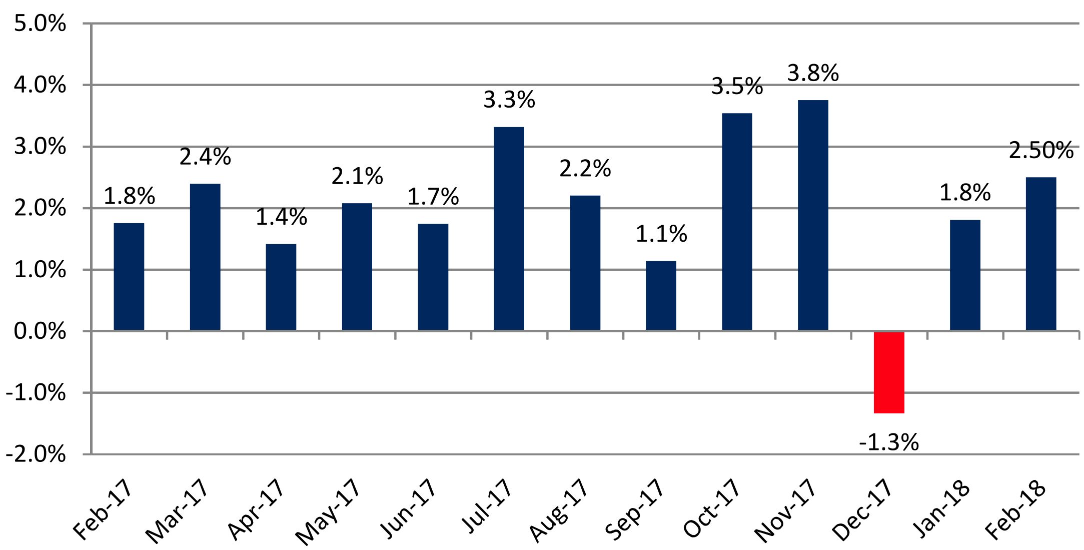
- *Total residential building permits* rebounded 80.4% in February after declining 1.8% in January;

- *Consumer expectations (consumer confidence six months hence)* registered a 7.9% gain in February slowing its long-term upward trend; and,

- *Initial claims for unemployment insurance* decreased 18.4% (improved) continuing its favorable trend from January; while,

- *Durable goods retail sales* decreased 1.0% between February 2017 and February 2018 for its first decline in more than a year.

Figure 3. 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 February continued its long recovery from the negative effects of the Sequester in 2013. The Coincident Index has now increased for 47 consecutive months, beginning in April 2014, tracking the region's economic recovery from the Sequester. During this period, the region's economy has been buffeted by decreases in federal employment, threatened federal government shutdowns, and the uneven performance of the national economy. In spite of these and other uncertainties, the Washington region's economy sustained an average job gain totaling 55,267 over the past three years, a gain exceeding the region's average job growth of 38,790 since 2000 by 42.5 percent. During this 47-month continuous expansion, the region's economy has increased its growth rate from a negative 0.8 percent in 2013 to an estimated 1.9 percent in 2017. This annual growth rate is currently projected to peak at 3.0 percent in 2019, equaling the projected U.S. GDP growth rate that year.

Whether the Washington region's economy can sustain growth rates that parallel the U.S. GDP growth or exceed these after 2019 will depend on the economy's continuing diversification into non-federal markets in combination with federal spending that at least maintains its current trajectory of small annual increases. With the possibility of larger annual federal spending levels under the newly approved federal spending plans for 2018 and 2019, the Washington region's economy would appear well-positioned to outperform the U.S. GDP growth rate into the early 2020s.

Current Performance

The economy's performance during the first two months of the year cannot be expected to provide reliable signals for assessing the growth patterns in subsequent months. Individually, these months more than any others are more subject to seasonal impacts that can have a negative effect on their performance. Also, these months often appear to be affected by political events; the Presidential Inauguration in January 2017 made that month appear strong relative to January 2016 and made January 2018's performance appear weak in comparison. February 2016 had 29 days so it did not offer a perfect comparison to the last two Februarys with 28 days. Still, when measured as part of a longer continuum, one month may either confirm a pattern or possibly point to a trend's change in direction.

February's performance, as measured by the Coincident Index, was 2.7 percent better than in was in February 2017 and its February 2017 performance was 2.4 percent better than its February 2016 performance. In fact, as previously noted, February's monthly over-the-year performance extends the positive performance of the Coincident Index to 47 consecutive months. The Washington region's economy has sustained its expansion, following the Sequester-induced decline in 2013, for just one-month short of four full years. And, the likelihood is good that this positive trend will continue as demonstrated (and discussed later) by the strong performance of the Washington region's Leading Index.

Beyond the region's continuing economic growth trend (as measured by its ability to generate jobs and support increases in retail spending) and expanding business activity (as measured by gains in regional domestic airport passenger volume), the value added of the economy's job growth may be a more revealing metric of the region's economic health going forward. The mix of the region's job growth has changed since 2010. The most visible change in the region's job mix is seen in the decline in federal government employment, which peaked in July 2010 at 387,700 and now stands at 361,300, a decrease of 26,400 jobs or 6.8 percent. During this period, the region's other large sectors—professional and business services, education and health services and leisure and hospitality services—grew at higher rates than their historic share of the employment base. The net effect of this change in job mix favoring non-federal employment has been the slower growth of personal earnings as the numbers of lower-value added jobs being added to the region's economy have increased faster than the number of higher-value added jobs.

This and several other patterns can be seen in the most recent jobs data for March 2018. With one quarter of the year's job growth reported, several potentially important trends can be identified. First, the region's economy is not generating new jobs as fast as it did over the past three years when it was averaging approximately 55,300 new jobs annually. For the first quarter, the Washington region's economy has averaged only 41,300 jobs (annual average). This number also falls roughly 13 percent below the year's annual forecast of 47,400 new jobs.

What is even more striking in these first quarter jobs data are their geographic distribution. Where the historic distribution of the region's job growth has had the District of Columbia and Suburban Maryland accounting for a combined share averaging between 45 and 50 percent of the region's total and Northern Virginia accounting for the other 50 to 55 percent, job growth in this year's first quarter has significantly favored Northern Virginia; it has accounted for 78 percent while Suburban Maryland's share has declined to 4.8 percent and the District's share was 17.1 percent. While the District's share is down only slightly from 2017 and 2016, it is the slow pace of job growth in Suburban Maryland that has no recent historical basis. In 2017, the suburban Maryland economy accounted for 29.8 percent of the region's job growth and it accounted for 23.9 percent in 2016.

This slowdown in Suburban Maryland extends back into 2017. During the first half of 2017, Suburban Maryland annual job growth averaged 20,267 jobs while in the second half of 2017 this average was only 5,333 jobs. Beginning at mid-year, job growth in Suburban Maryland has been slower in each month and actually turned negative in November and December. Considering only the last two months of 2017 and the first three months of 2018, the Suburban Maryland economy's annual average job growth has been negligible (fewer than 200 jobs). While it is too soon to know what would account for Suburban Maryland's significant slowdown in job growth, it might be linked to changes in federal procurement spending, possibly shifts between domestic federal agencies and non-domestic federal agencies that would have favored Northern Virginia's economy over Suburban Maryland's.

In addition to slowing of job growth this year to date and the changes in its geographic distribution, its sectoral mix continues to change. As noted above, this shift has been accelerated by decreases in federal jobs (for the full year 2017, federal jobs were flat but between March 2017 and March 2018 they were down by 6,700 jobs). At the same time, professional and business service jobs (this sector includes federal contractors) have continued to grow; in March they accounted for 25.5 percent of all new jobs, slightly above their historic percentage (22.7%). Education and health services and leisure and hospitality services also have continued to increase their respective shares of the overall job base. Education and health services account for 13.6 percent of all jobs in the region; their increase in March accounted for 21.5 percent of the increase in total jobs. Leisure and hospitality services jobs account for 9.9 percent of the region's job base; in March they accounted for 19.5 percent of the increase in total jobs.

The long-term consequences of these changes in the region's mix of jobs will be measured by changes in personal earnings and related changes in consumer spending, both determinants of the region's overall economic performance. This pattern of job growth for 2018 is still emerging and will become more certain in three to six months.

Near-Term Outlook

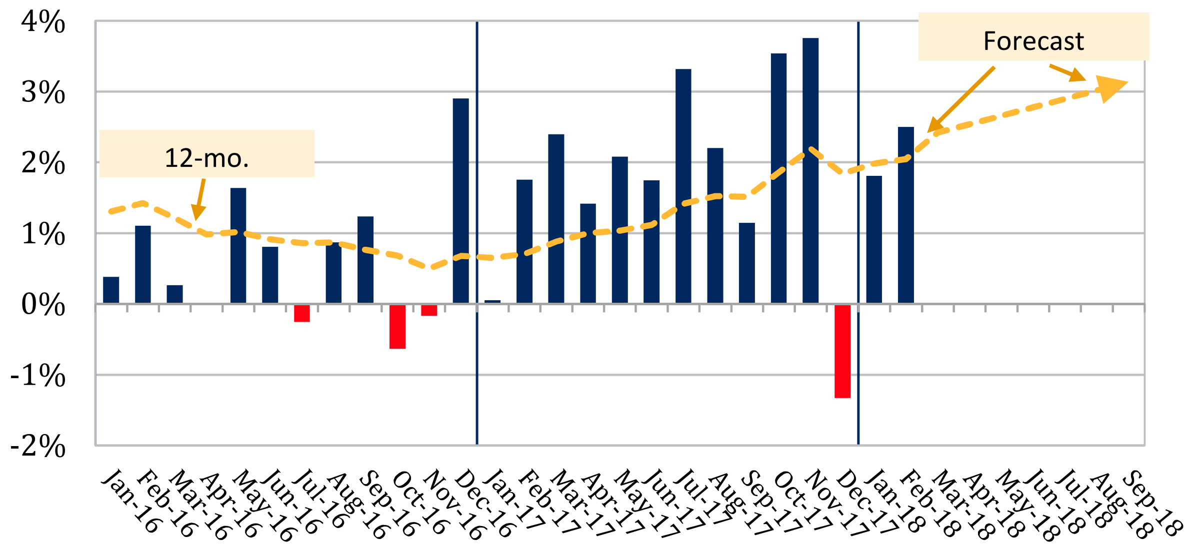
The national GDP forecast for 2018 and 2019 (IHS Markit, April 2018) continues to show stronger economic performances than achieved in 2017—2.3% in 2017, 2.7% in 2018, and 2.9% in 2019. These increasingly strong forecasts incorporate the expected economic benefits of the Tax Cuts and Jobs Act and the omnibus Consolidated Appropriations Act of 2018, enacted in March. Several forecasts show even stronger GDP growth rates for both of these years after which there is wide consensus that the U.S. economy will slow and fall below the 2.0 percent annual average growth trajectory of the first eight years of the current business cycle.

As noted last month, these positive growth forces at the national level can be expected to stimulate faster economic growth within the Washington region. Federal fiscal stimuli in the forms lower taxes and increased spending will increase the rates of consumer spending locally and are expected to increase the rates of corporate capital investment. Increased federal spending at the national level likely will have a corresponding benefit for the regional economy to the extent that this increased spending translates into increased federal hiring and/or increased federal procurement from local federal contractors. The current patterns of accelerated job growth in Northern Virginia and significantly slower job growth in Suburban Maryland may already be reflecting shifts in federal procurement spending in the region that could further shape the region's future economic performance during.

Even before factoring in the possibilities of a strengthening federal sector—a sector that has been a drag on the region's economic performance over the past seven years—the forecast for the Washington region's economy has been for accelerating growth based on the performance of the national economy. The Washington region's economy is in a much better position to benefit from expansionary national economic forces in 2018 than it was in 2010 as a result of its slow diversification away from its historic federal dependency.

This pattern of near-term performance is established in the Leading Index as shown in Figure 4. The Washington Region Leading Index has presented an upward growth path and forecast for more than a year and points with a high probability to this current expansion continuing at least through the third quarter of 2018.

Figure 4. Washington Region Leading Index
Monthly Over-the-Year Percent Change



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

If the national economic projections are achieved this and next year and the federal spending increases provided for in the Consolidated Appropriations Act of 2018 disproportionally benefit the Washington region's economy, its performance will likely exceed the national growth rate as it did prior to the Great Recession when federal spending in the region was the prime stimulus behind the region's strong performances. Still, these positive national and regional growth forces in 2018 and 2019 could be negated by unanticipated shocks. As noted previously, uncertainty generated by dramatic fluctuation in the stock market, an international trade war, and unpredictable political upheaval could result in undermining business and consumer confidence with resulting reductions in business investment and consumer spending. If this were to occur, the optimistic forecasts for the U.S. and Washington region's economies for 2018 and 2019 would have to be reconsidered.

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Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Feb-18 Prelim.	Jan-18 Final	Feb-17 Final	Jan-18 to Feb-18	Feb-17 to Feb-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	106.0	105.4	103.2	0.57%	2.70%
Leading Index (2015 = 100)	104.6	102.1	102.0	2.42%	2.50%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,278.1	3,256.2	3,233.3	0.67%	1.39%
Consumer Confidence (South Atlantic)[a]	170.1	150.0	144.6	13.40%	17.63%
Domestic Airport Passengers ('000)[b]	2,088.7	2,142.3	2,039.6	-2.50%	2.41%
Nondurable Goods Retail Sales ($000,000)[c]	3,193.2	3,230.1	3,077.4	-1.14%	3.76%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,599.0	1,529.0	1,441.0	69.98%	80.36%
Consumer Expectations (South Atlantic)[a]	122.8	127.0	113.8	-3.31%	7.91%
Initial Unemployment Claims[b]	1,313.0	1,638.1	1,608.1	-19.85%	-18.35%
Durable Goods Retail Sales ($000,000)[c]	3,511.3	3,534.0	3,545.5	-0.64%	-0.97%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,416.7	3,390.7	3,365.7	0.77%	1.52%
Employed Labor Force ('000)	3,294.0	3,263.7	3,235.4	0.93%	1.81%
Unemployed Labor Force ('000)	122.7	127.0	130.2	-3.36%	-5.76%
Unemployment Rate	3.6%	3.7%	3.9%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,278.1	3,256.2	3,233.3	0.67%	1.39%
Construction ('000)	158.7	156.9	154.6	1.15%	2.65%
Manufacturing ('000)	54.2	54.2	54.4	0.00%	-0.37%
Transportation & Public Utilities ('000)	67.8	68.0	64.4	-0.29%	5.28%
Wholesale & Retail Trade ('000)	334.3	337.9	334.9	-1.07%	-0.18%
Services ('000)	1,960.7	1,946.7	1,919.3	0.72%	2.16%
Total Government ('000)	702.4	692.5	705.7	1.43%	-0.47%
Federal Government ('000)	362.4	363.9	369.0	-0.41%	-1.79%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars