# Washington Economy Watch

Vol. II, No. 5
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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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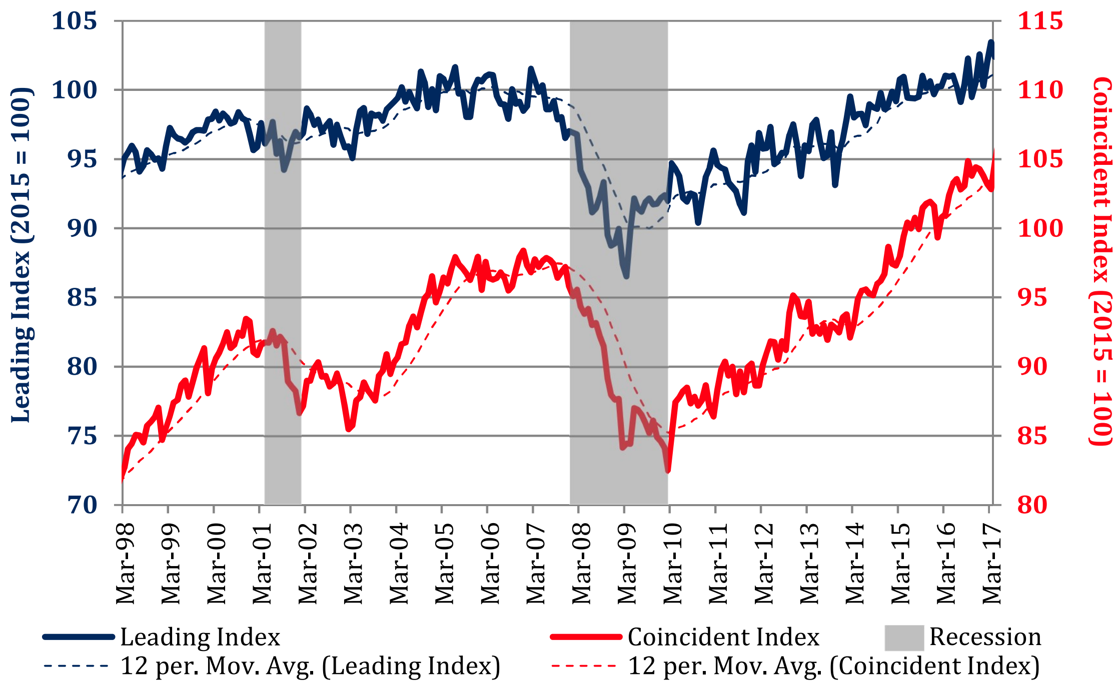
## First Quarter Gains Point to Continued Growth for the Washington Region's Economy

The March 2018 performances of Washington region's Coincident and Leading Indices continued their respective positive trends from 2017. The Coincident Index registered its strongest gain in March in more than a year and extended the economy's long-term positive growth trajectory to a 48th month. The Leading Index's March gain was not as strong as February's, but like in February, it was broad-based with all four of its components contributing to its gain. The Leading Index's positive trajectory 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 possibly becoming 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 1.19 percent in March from February, after having gained only 0.6 percent in February and declining 1.3 percent in January on a month-to-month basis. While the first quarter performance is often subject to seasonal differences, this year's first-quarter performance was stronger than for the same quarter in 2017. In March, three of the Index's components increased on a month-to-month basis. Total wage and salary employment, domestic airport passenger volume and nondurable goods sales were all higher with only consumer confidences declining slightly.

On a monthly over-the-year basis in March, the Coincident Index registered an increase of 3.9 percent from March 2017 for its strongest gain in more than a year. This gain extended the Index's upward trend to 48 consecutive months, dating from April 2014.

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

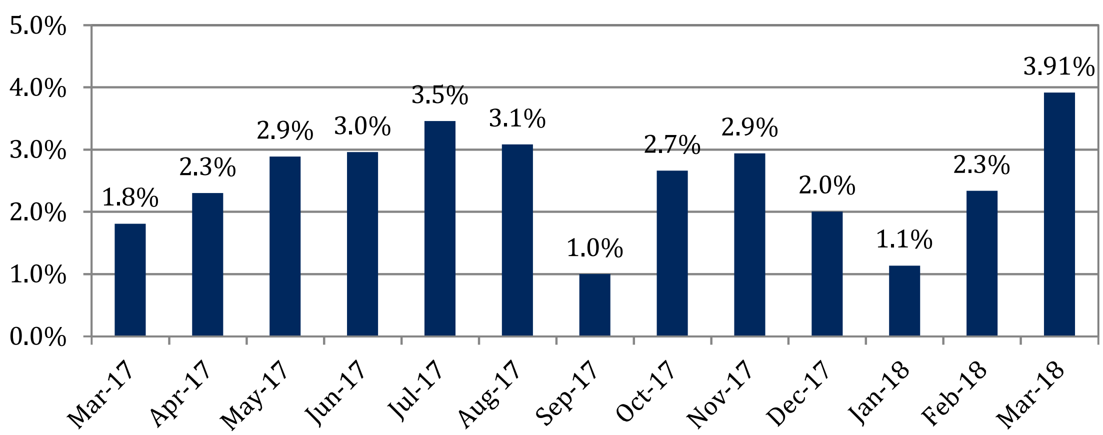
- *Wage and salary employment* in the Washington region increased 1.2% between March 2017 and March 2018;

- *Consumer confidence (in the present)* continued its positive trend, increasing 19.0% from March 2017 and continuing its pattern of double-digit increases experienced over the final eight months of 2017;

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 14.3% in March compared to March 2017 for its largest increase in more than a year; and,

- *Non-durable goods retail sales* increased 3.5% from March 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 March gaining 1.54 percent from March 2017, extending its positive trend to all three months of 2018 after having declined in December. December's decline was the only negative month for the Leading Index in 2017 and was likely linked to severe weather and the continuing budget impasse that threaten a federal government shutdown. This continuing strong performance points to the region's continued economic expansion through at least the third quarter of 2018.

The Leading Index's positive performance in March was broad-based with all of its four components contributing to its gain including double-digit improvements for both initial unemployment claims and, for the second consecutive month, total residential building permits:

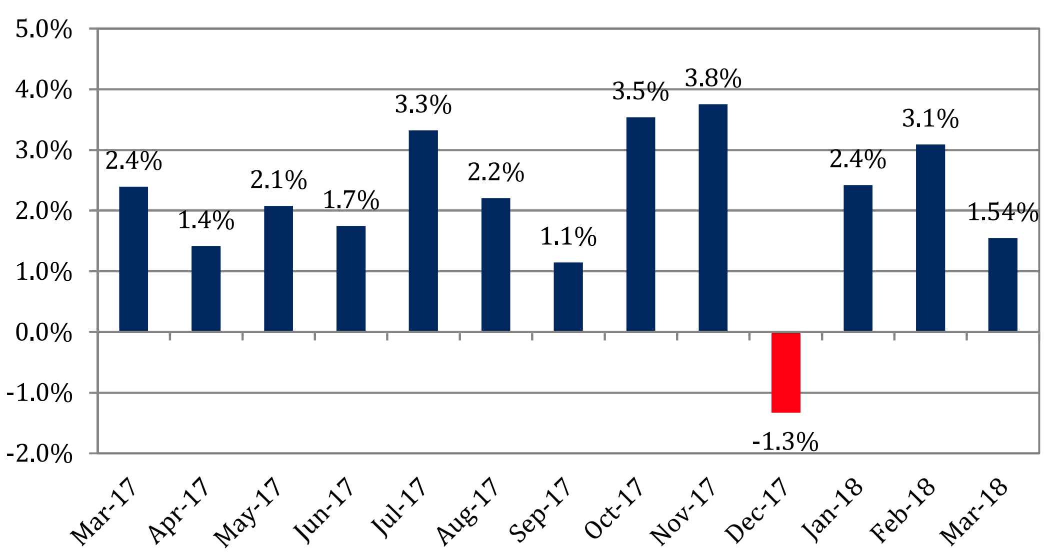
- *Total residential building permits* gained 13.5% in March after increasing 80.4% in February;

- *Consumer expectations (consumer confidence six months hence)* registered a 3.4% gain in March, continuing to track a slower upward trend compared to its double-digit gains in 2017;

- *Initial claims for unemployment insurance* decreased 11.2% (improved) extending its favorable trend to a third month; and,

- *Durable goods retail sales* increased 5.4% between March 2017 and March 2018 continuing its positive trend in 2017 through the first quarter of 2018.

**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 March continued its long recovery from the negative effects of the Sequester in 2013. The Coincident Index has now increased for 48 consecutive months—four years—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 48-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, slightly exceeding the projected U.S. GDP growth rate (2.9%) for 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 performance of the Coincident Index during the first quarter of 2018 has been one of accelerating gains with each succeeding month registering substantially greater gains. This pattern has been achieved with sharp increases in domestic airport passenger volumes at Reagan National and Dulles Airports—suggesting strong gains in business and leisure travel to the Washington area, and in nondurable goods sales—possibly correlated with increased out-of-town visitor traffic and increased spending by residents reflecting their high level of consumer confidence and gains in personal earnings. In contrast, job growth has continued its pattern of moderating growth that dates back to mid-year 2017.

This pattern of gains during the first quarter is likely to moderate without stronger job growth and, if the first quarter's job growth performance is any indication of its future trend, job growth in 2018 appears to be running below it beginning-of-the-year forecast of 47,400 jobs. The long-term job growth pattern in the Washington region is for slower job growth following its growth of more than 50,000 new jobs annually for the last three years. There are several good reasons supporting this slower growth trend. The most important is that businesses have right-sized and have the workforce needed to sustain their profitability. This right-sized status is reinforced by rising wages and low levels of unemployment that make hiring new workers with the required job skills increasingly problematic.

Furthermore, the aging of the business cycle, which is now 35 quarters long dating from July 2009, has businesses being more cautious so to not over extend themselves in the face of a potential future economic slowdown. This cautiousness has been reinforced by continuing uncertainty of the Trump Administration's economic policies that have been accompanied by volatility in the stock markets indices this year.

This growing uncertainty is reflected in recent negativity in the consumer confidence indices. While these remain at high levels, consumer confidence in the present has experienced month-to-month declines four out of the last eight months with its level in March roughly the same as it was in July 2017. Perhaps more telling is the month-to-month decline in consumer expectations; that is, how consumers think the economy will be performing six months hence. Over the last year, there have been eight monthly declines and only four monthly gains. So, while both measures of consumer confidence (in the present and expectations) were higher in March 2018 than in March 2017, this pattern is likely to change in the coming months with consumer confidence drifting lower. As consumer confidence weakens this may take other indicators lower, too, such as durable goods and non-durable goods sales. Consumer spending is closely linked to consumer confidence as is job growth and business and leisure travel.

The early signs of the economy's equilibrium—that is, when the economy has hit its stride given underlining conditions in the regional, national and global economies—and is sustaining its growth rate or perhaps still accelerating slightly can be seen in this year's job growth data. April jobs data were released on May 18$^{th}$. They showed the region adding 38,700 net new jobs between April 2017 and April 2018. While this month's gain equals the region's long-term average gain (38,790) for the 2000-2017 period and was up slightly from March's revised monthly over-the-year gain of 37,700 jobs, it falls well below last year's gain of 50,900 jobs and its tracking below the forecast for 2018 (47,400).

The job growth pattern in April reflects a pattern that has emerged since mid-year 2017. This job growth pattern consists of slowing growth and growing regional variation; that is, growing unevenness in job growth among the sub-state areas comprising the Washington Region. Additionally, dating from 2010, the region's job growth is undergoing structural change that is seen most clearly in the loss of federal jobs and disproportional gains in lower-value added sectors, such as educational and health services and leisure and hospitality services.

The most striking pattern that has emerged since mid-year 2017 has been the dramatic slowing of job growth in Suburban Maryland. For the June 2016-2017 period, Suburban Maryland added 21,300 jobs; by December, these job gains turned to losses with 3,900 few jobs in December 2017 than in December 2016. Suburban Maryland's job growth has been positive in 2018. Through four months it is averaging 1,700 new jobs but for the most recent month, April 2018, Suburban Maryland added only 800 new jobs.

In 2017, Suburban Maryland accounted for 30 percent of the region's job growth; in 2018, through four months, its share was only 5 percent. At the same time, Northern Virginia's share of the region's job growth, which has averaged 52.4 percent over the past three years, has increased to 77.8 percent in 2018 through four months. The District of Columbia's share of the region's job growth has also declined over this period (from 23.6% over the past three years to 17.2% in 2018 through four months). This shift in job growth reflects underlying structural differences in these sub-regional economies as well as differences in their competitive position in both the regional and national economies.

What is clear is that changes in federal spending are having an uneven impact on the region. The District of Columbia has experienced 61.9 percent of the federal job losses (by place of employment) with Suburban Maryland accounting for 25.3 percent of these job losses while Northern Virginia has experienced the smallest share (12.7%) of these federal job losses. In comparison, professional and business services, the sector in which most federal contractor jobs would be classified, grew the most in Northern Virginia; it gained 84.2 percent of these new jobs while the District accounted for 6.3 percent and Suburban Maryland accounted for 9.5 percent during the first four months of 2018. The principal source of job growth in Suburban Maryland was education and health services (4,200 jobs) while the principal source of job growth in Northern Virginia was professional and business services (8,000 jobs). The principal source of job growth in the District was the leisure and hospitality sector (2,400 jobs).

Besides the numerical differences in these sectors' performances, their respective value-added differences underscore the important economic implications of these different job growth patterns to their respective sub-state areas. The 8,000 professional and business services jobs added in Northern Virginia in 2018 (four-month average job gain from the same period in 2017) represent the contribution of $1.14 billion to the economy, while the 4,200 job gain in education and health services added $274 million to the Suburban Maryland economy and the 2,400 jobs added in the leisure and hospitality sector added $104.3 million to the District's economy during this same period.

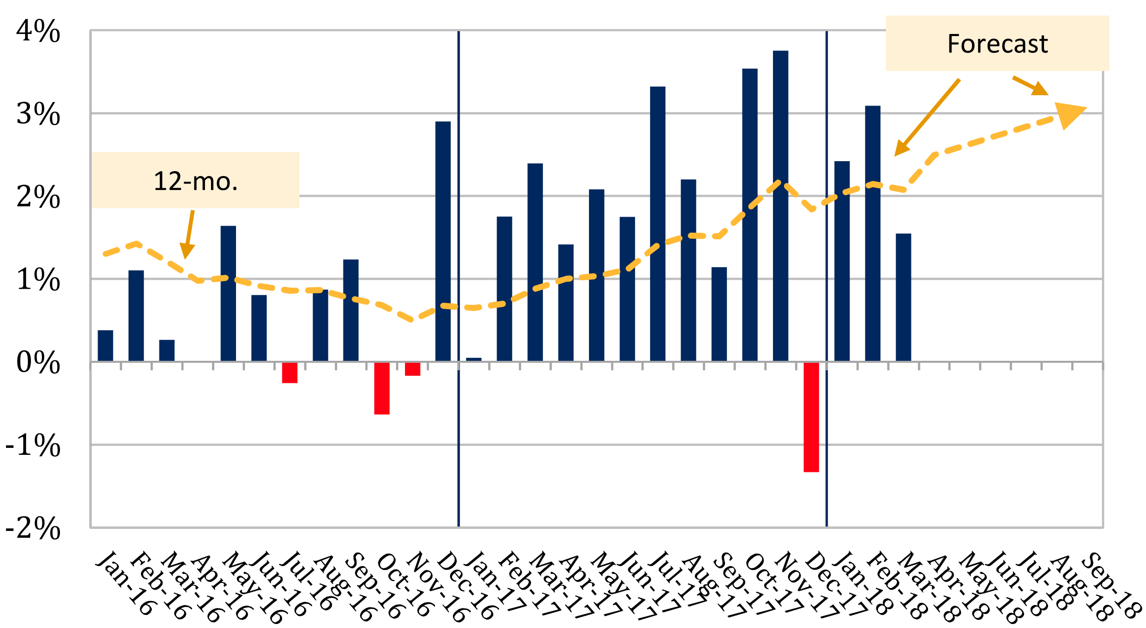
These significant differences in value added reflect both the differences in number of jobs and the value of these jobs to the economy; that is, the salary and corresponding multiplier effect as this economic activity is distributed across the economy's other sectors. This uneven performance may be explained by federal procurement patterns (that would be the easiest explanation) or it may reflect a much more fundamental difference in these economies' structural composition and respective business climates. Regardless of the explanation, if these differential patterns continue, the regional economy will shift further in favor of Northern Virginia (this is not a new shift, in 1970 Northern Virginia's economy accounted for 26.9% of the region's GRP and by 2017 it accounted for 47.1%). Additionally, lagging economic growth in Suburban Maryland and the District of Columbia will slow the region's overall growth rate; growth in Northern Virginia will not be sufficient to make up for slower growth in the other half of the region's economy.

## Near-Term Outlook

The national GDP forecast for 2018 and 2019 (IHS Markit, May 2018) continues to show stronger economic performances than achieved in 2017—2.3% in 2017, 2.8% in 2018, and 2.8% in 2019. This latest forecast has shifted 0.1 percentage of growth from 2019 forward to 2018. These 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.

This pattern of near-term performance for the Washington region's economy is confirmed by the trajectory of 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

The Washington region's economy consists of three major drivers, each representing approximately one-third of its total value: the federal sector, the non-federally dependent, export-based clusters, and the locally dependent sectors. 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 and to clusters of economic activities serving non-local markets. The positive growth forces at the national level projected for the next eighteen months can be expected to stimulate faster economic growth of these types of businesses within the Washington region.

Growth of the region's local-serving sectors will complement the growth of the region's non-federally dependent, export-based sectors. Federal fiscal stimuli in the forms lower taxes and increased spending should increase the rates of consumer spending locally. Higher wages, continuing job growth, and positive consumer confidence should fuel continuing growth in the retail and consumer services sectors, residential construction, and locally supported recreational and leisure activities with eating and drinking establishments remaining major beneficiaries.

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. With renewed growth in federal spending in the region, should this materialize in 2018 and 2019, in combination with gains in the region's two other major drivers, non-federally dependent clusters and local-service sectors, the Washington region's expansion could overtake and surpass U.S. GDP and position the region's economy for above-GDP rates of growth going forward.

Still, a range of forces will shape how each of these major economic drivers performs over the next several years. 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 any of these disruptions were to occur, the optimistic forecasts for the U.S. and Washington region's economies for 2018 and 2019 could be undermined and the current business cycle could be brought to a premature end. At this time the probability of such an inglorious conclusion to what could become the longest business cycle in U.S. history (it needs to continue to February 2020) is estimated at 20 percent.

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

| Economic Indicator | Estimates | | | Percent Change | |
|---|---|---|---|---|---|
| | Mar-18 Prelim. | Feb-18 Final | Mar-17 Final | Feb-18 to Mar-18 | Mar-17 to Mar-18 |
| **Washington Area Business Cycle Indicators** | | | | | |
| Coincident Index (2015 = 100) | 106.9 | 105.6 | 102.8 | 1.19% | 3.91% |
| Leading Index (2015 = 100) | 105.0 | 105.2 | 103.4 | -0.13% | 1.54% |
| **Washington Area Coincident Index Components** | | | | | |
| Total Wage & Salary Employment ('000)[a] | 3,288.3 | 3,277.7 | 3,250.6 | 0.32% | 1.16% |
| Consumer Confidence (South Atlantic)[a] | 166.0 | 170.1 | 139.5 | -2.41% | 19.00% |
| Domestic Airport Passengers ('000)[b] | 2,131.5 | 2,088.7 | 1,864.9 | 2.05% | 14.29% |
| Nondurable Goods Retail Sales ($000,000)[c] | 3,285.4 | 3,131.6 | 3,175.4 | 4.91% | 3.46% |
| **Washington Area Leading Index Components** | | | | | |
| Total Residential Building Permits[a] | 2,351.0 | 2,599.0 | 2,072.0 | -9.54% | 13.47% |
| Consumer Expectations (South Atlantic)[a] | 118.6 | 122.8 | 114.7 | -3.42% | 3.40% |
| Initial Unemployment Claims[b] | 1,311.2 | 1,313.0 | 1,475.9 | -0.14% | -11.16% |
| Durable Goods Retail Sales ($000,000)[c] | 3,815.6 | 3,694.2 | 3,618.5 | 3.29% | 5.45% |
| **Washington Area Labor Force[a]** | | | | | |
| Total Labor Force ('000) | 3,423.8 | 3,417.0 | 3,381.5 | 0.20% | 1.25% |
| Employed Labor Force ('000) | 3,299.4 | 3,292.9 | 3,256.0 | 0.20% | 1.33% |
| Unemployed Labor Force ('000) | 124.3 | 124.1 | 125.5 | 0.19% | -0.97% |
| Unemployment Rate | 3.6% | 3.6% | 3.7% | -- | -- |
| **Washington Area Wage and Salary Employment[a]** | | | | | |
| Total ('000) | 3,288.3 | 3,277.7 | 3,250.6 | 0.32% | 1.16% |
| Construction ('000) | 160.4 | 158.5 | 156.0 | 1.20% | 2.82% |
| Manufacturing ('000) | 54.7 | 54.6 | 54.6 | 0.18% | 0.18% |
| Transportation & Public Utilities ('000) | 68.1 | 67.7 | 64.6 | 0.59% | 5.42% |
| Wholesale & Retail Trade ('000) | 338.1 | 334.6 | 335.8 | 1.05% | 0.68% |
| Services ('000) | 1,961.5 | 1,959.7 | 1,931.0 | 0.09% | 1.58% |
| Total Government ('000) | 705.5 | 702.6 | 708.6 | 0.41% | -0.44% |
| Federal Government ('000) | 361.3 | 362.6 | 368.0 | -0.36% | -1.82% |

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars