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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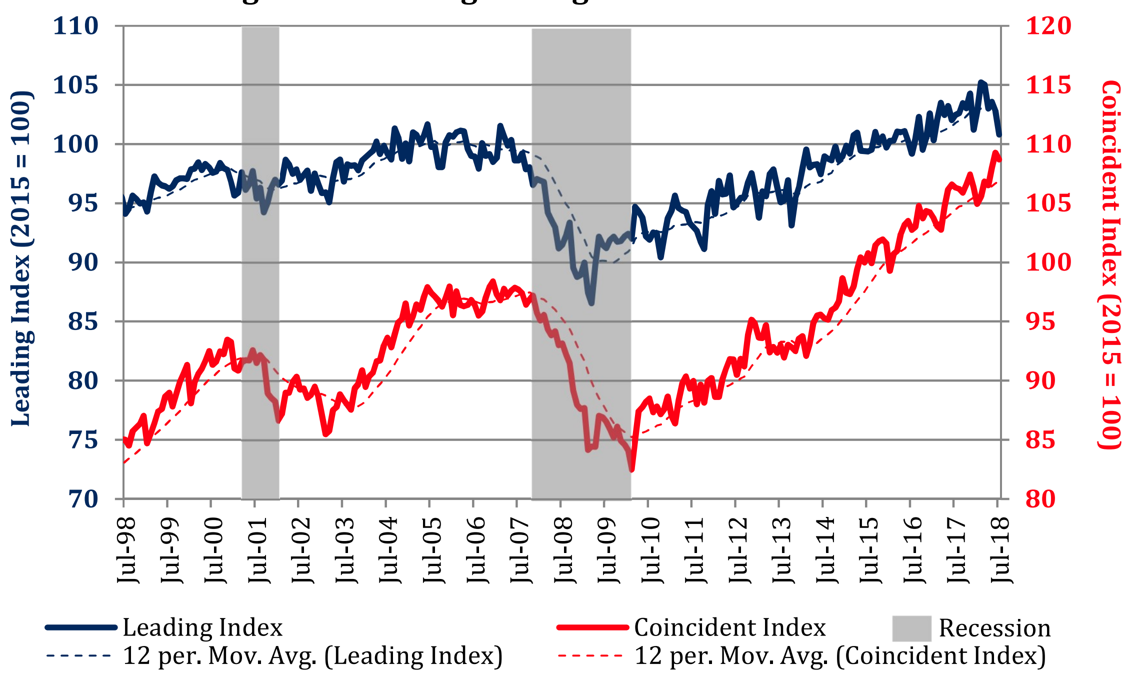
The Washington Region's Strong Economic Performance Is Tempered By Early Signs of Weakening

The July 2018 performances of the Washington region's Coincident and Leading Indices send a mix message regarding the region's economy. The economy's current performance, as measured by the Coincident Index, experienced broad-based gains with all four of its component indicators being positive for a second consecutive month. In contrast, the Leading Index experienced its largest monthly over-the-year decline in almost five years pointing to a moderation in the economy's growth trajectory in the coming months. Still, with the U.S. economy projected to register its strongest growth rates of the decade in 2018 and 2019 and with regional job growth holding strong with an increasingly favorable mix of higher-value added jobs, expectations for the Washington region's economy remain favorable at least through next year.

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, decreased 0.5 percent in July from June after having increased 1.2 percent from May to June. On a month-to-month basis, the Coincident Index has decreased three times in the year's first seven months. Consumer confidence in July, an underlying condition supporting consumer spending, declined sharply (on a month-to-month basis) retreating 7.2 percent and has now been negative in 2018 in March, April and May as well as in July.

On a monthly over-the-year basis, July's Coincident Index registered an increase of 2.24 percent from July 2017 extending its upward trend to 52 consecutive months, dating from April 2014. The Index's July performance extends a pattern of slightly more moderate and consistent growth that, with the exception of March's sharp gain, describes this year's current growth trajectory.

In July, and for a second month in a row, all four of the Index's components were positive on a monthly over-the-year basis:

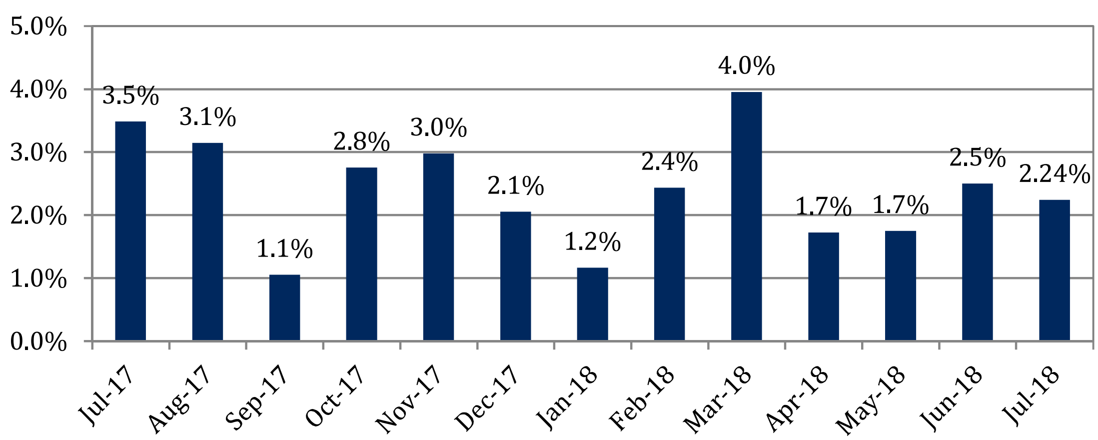
- *Wage and salary employment* in the Washington region increased 2.3% between July 2017 and July 2018;

- *Consumer confidence (in the present)* just barely extended its positive trend, increasing 0.3% from July 2017, slowing substantially from its pattern of double-digit increases experienced over the past year;

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 0.8%, gaining for a second consecutive month; and,

- *Non-durable goods retail sales* were up 3.4% from July 2017 up for a 17th consecutive monthly over-the-year gain.

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, experienced its greatest decline in more than two years in July, decreasing 1.63 percent from July 2017 for its first negative month since December. July's negative performance follows three months of less than 1.0 percent growth. Two key indicators contributed to the Index's decline: consumer expectations fell 12.0 percent and initial claims for unemployment insurance, which had been declining (improving) for five months pointing to increasing employment of unemployed workers has now increased (worsened) for two months in a row. July's performance of the Leading Index lowers the positive trajectory of the economy's performance forecast for the remainder of the year based on the performance of its forward looking indicators after seven months.

In July, three of the Leading Index's four components contributed to its decline from July 2017:

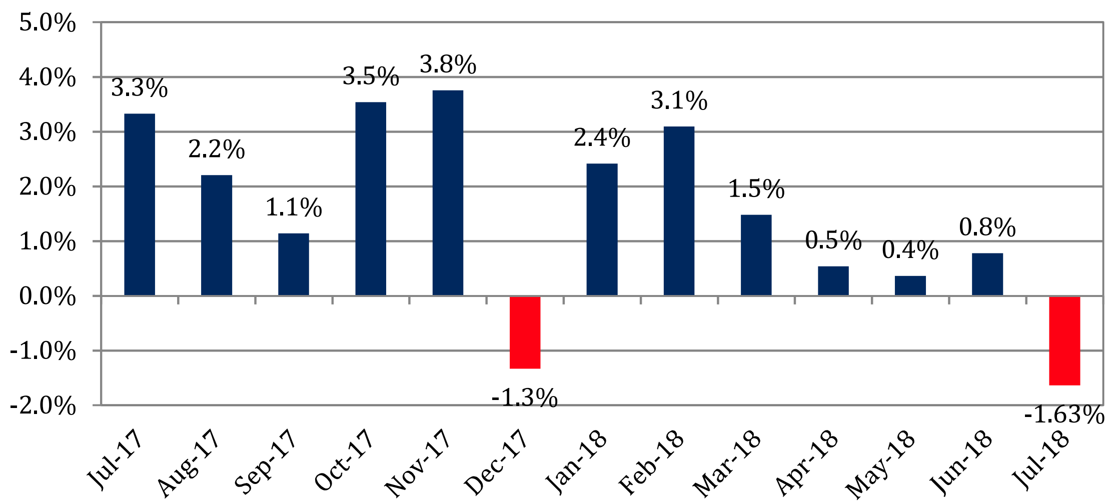
- *Durable goods retail sales* increased 3.6% between July 2017 and July 2018 continuing its long-term positive trend; while,

- *Consumer expectations (consumer confidence six months hence)* decreased 12.0% from its July 2017 level;

- *Total residential building permits* decreased 12.9% in July and now has declined in three of the last four months; and,

- *Initial claims for unemployment insurance* increased 33.8% (worsened) for a second month after having improved (decreased) in each of the year's first five months.

Figure 3. Washington Leading Index, Monthly Over-the-Year Changes



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

Current Performance

The Washington region's economy has sustained its expansion (recovery) from the negative impacts of the Sequester for 52 consecutive months; that is, the Washington region's Coincident Index, which is designed to measure the region's current economic performance, has increased each month since April 2014 through July 2018. These gains are seen in the region's gross regional product increasing from a negative 0.8 percent in 2013 (the economy actually contracted that year) to a projected growth rate of 3.0 percent in 2018, a rate closely parallel to the projected increase in U.S. GDP (2.9%, September 2018, IHS Markit).

The Bureau of Economic Analysis issued its estimates for gross regional product for 2017 (including revisions for 2015 and 2016) for the nation's metropolitan areas on September 18th. They showed that the Washington region's economy grew 2.1 percent in 2017, slightly faster than previous estimates, but that this growth rate was the fifth slowest among the nation's 15 largest metropolitan areas. Based on the value of the region's economy, $530.0 billion in current dollars, the Washington region ranked fifth largest among the 15 largest metropolitan areas with the Dallas metro area ranking 4th and growing at 3.9% the rate last year, while the San Francisco-Oakland metro area ranked sixth in size and grew 3.4%. Over the 2010 and 2017 period, the Washington region's economy grew the slowest of the largest 15 metropolitan areas averaging 1.1 percent annual growth. Still, given its recent gains and improving job mix, the Washington region's economy is well positioned if the national economy slows down and should improve its ranking relative to other metropolitan areas going forward.

This year's economic performance suggests that the regional economy has all but recovered from the negative effects of the Sequester (which were more impactful than the Great Recession) with it benefiting from both stronger federal procurement spending (federal employment remains down 5,900 jobs through eight months compared to the same period in 2017) and gains in its non-federally dependent sectors that account for the majority of region's employment. The region's three largest non-government sectors—professional and business services, education and health services, and leisure and hospitality services—account for 46.6 percent of the region's employment base but have generated 68.7 percent of this year's new jobs through eight months.

Most important to the region's economic expansion is the disproportionally high job gains in professional and business services. While only accounting for 22.8 percent of the region's employment base, this sector has accounted for 30.5 percent of its new jobs this year. In August, compared to August 2017, this sector added 23,200 new jobs and accounted for 35.7 percent of all jobs added during that twelve-month period. Even though job growth in 2018 is not expected to match the annual levels of the past three years, the mix of this year's jobs is more favorable; that is, job growth appears to be shifting more in favor of higher-value added jobs than in recent years. This combination of stronger job growth with a more favorable mix of new jobs that are not federally dependent and increased federal procurement spending should result in the Washington region achieving higher economic growth rates than the nation in 2018 and will cushion it from the full impact of slower national economic growth after 2019.

Near-Term Outlook

The U.S. economy is performing at its highest level since the Great Recession and is expected to continue on this trajectory for the next six to twelve months. This year's GDP growth rate is currently projected at 2.9% to be followed by a 2.7% gain next year (IHS Markit, September 2018). This strong performance is being supported in part by the fiscal simulation of the Tax Cuts and Jobs Act of 2017, an increase in federal government spending, the strong job growth and increases in personal earnings, broad-based gains in the personal assets, and the consumer confidence these economic gains have generated.

September marks the 111th month for the current business cycle, a recovery and subsequent expansion that began in July 2009. This business cycle, although it has been characterized by slow and uneven growth, is now the second longest business cycle in U.S. history dating back to 1854. It would need to sustain this growth pattern for twelve more months to become the all-time record holder at 123 months. At this time, the odds are favorable that it will continue to September 2019 to set this record.

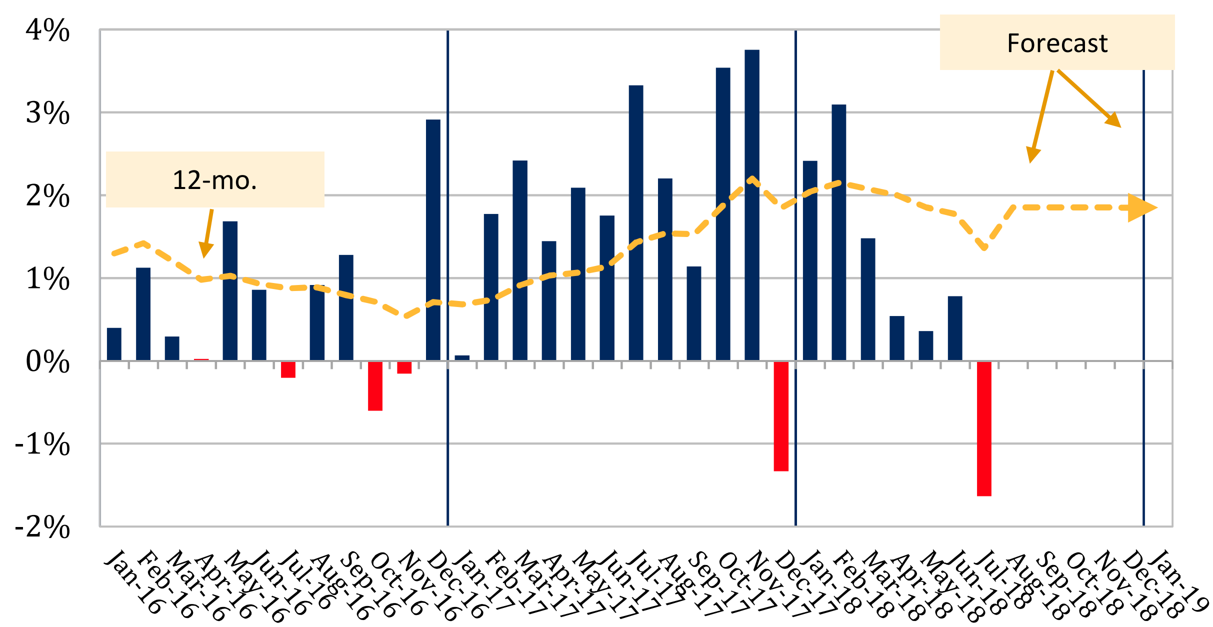
What could bring this cycle to an end? As with most business cycles, they have been sustained by gains in consumer confidence and increasing consumer spending and are brought to an end by the loss of consumer confidence and a decline in consumer spending. When consumers look out 6 to 8 months and sense that the near-term future economy will not be as good as it is today, their aversion to risk increases. They start reducing their financial exposure paying off credit lines, increasing their savings, and spending less. Increasing interest rates that will put further pressure on consumers to cut back their borrowing.

As consumer spending is key to how long this business cycle continues and consumer confidence is one metric that appears to determine consumer-spending patterns, it is important to note that consumer confidence in the Washington region has weakened in recent months. Consumer confidence (in the present) has declined on a month-to-month basis four of this year's first seven months; it decreased 7.2 percent in July. However, on a monthly over-the-year basis, consumer confidence registered a 0.3 percent gain from its July 2017 level. This was its smallest increase since it turned positive more than 4 years ago and may represent the plateauing of consumer confidence in the present.

Consumer expectations is a key measure of aversion to risk and may also be a precursor of declining consumer confidence in the present. Consumer expectations, on a month-to-month basis, was down 15.1 percent in July and has now decreased five times on a month-to-month basis since January. On a monthly over-the-year basis, Consumer Expectations was down 12.0 percent in July. How consumers feel about the economy will be critical to it being able to sustain this business cycle as the fiscal boost it received in December 2017 from the Tax Cut and Jobs Act plays out in 2019.

The Washington Region Leading Index provides short-term direction for these long-term forecasts. One month clearly does not make a trend but can identify a tendency or a potential vulnerability. Beyond Consumer Confidence (and Expectations) are other forward-looking measures. Durable goods sales has sustained a positive trend from more four years reflecting strong job and income growth over that period; job and income growth is projected to continue over the coming five years although not at current rates. As seen in Figure 4, the economy's path forward appears to be moderating based on July's data and the slower gains registered since February. Nevertheless, the region's economy is likely to achieve is strongest performance in 2018 since 2010.

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

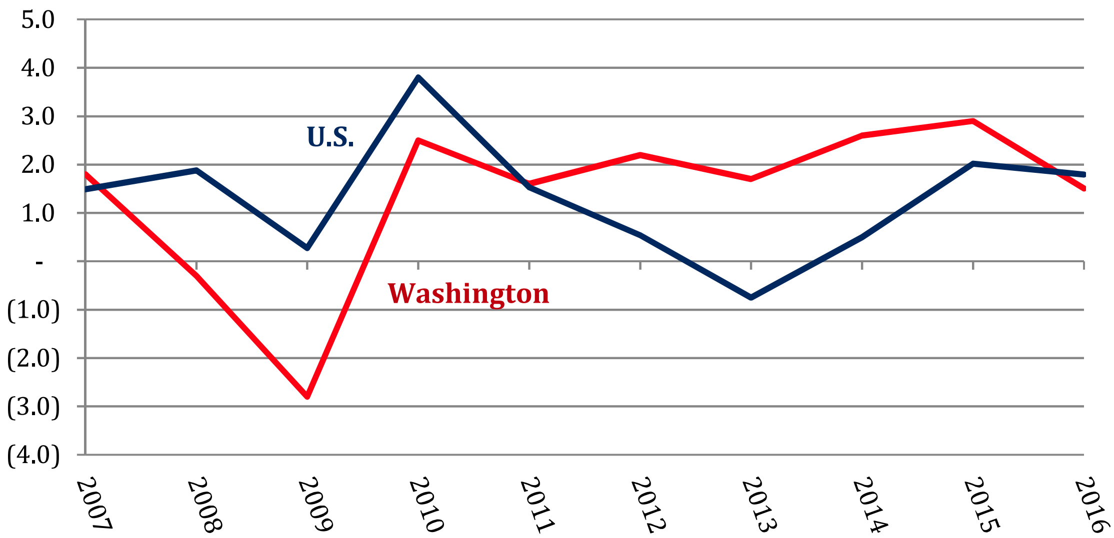


Source: The Stephen S. Fuller Institute at the Schar School, GMU

Beyond the symptomatic indicators, unexpected or unpredictable shocks can stall the business cycle and drive it negative by quickly unnerving consumers and investors with reinforcing consequences. For the Washington region, one potential shock confronting it each October 1st is the threat of a federal shutdown. In 2013, the federal government was unfunded and technically closed for 16 days and this had a measurably negative impact on growth that year.

As shown in Figure 5, the 2013 Sequester and the Shutdown impacted the Washington region's economy to a much greater extent than they did the U.S. economy.

Figure 5. GDP and the Washington Region GRP 2007-2017 (Annual Percent Change)



Source: U.S. Bureau of Economic Analysis, The Stephen S. Fuller Institute at the Schar School, GMU

The forecasts beyond this year suggest that as the fiscal stimuli that lifted this year's growth begins to diminish next year, in combination with growing concerns regarding the inherent distortions building within the economy, the economy may begin to pull back in late 2019. While the current GDP consensus forecast for 2020 is for 2.0% growth following by 1.7% in 2021, there are alternative forecasts being offered that show the economy re-balancing itself in 2020 and experiencing a short and shallow recession. What could this look like? Well, first off, nothing like what was experienced in 2008. Forecasters are projecting a short recession that could span the last quarter of 2019 and the first half of 2020 with the full downturn being sufficiently shallow that it would only take 2020 slightly negative (- 0.4%) followed by a weak recovery in 2021 and 2022.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Jul-18 Prelim.	Jun-18 Final	Jul-17 Final	Jun-18 to Jul-18	Jul-17 to Jul-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	108.7	109.3	106.3	-0.51%	2.24%
Leading Index (2015 = 100)	100.8	102.8	102.5	-1.96%	-1.63%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,360.2	3,357.3	3,283.1	0.09%	2.35%
Consumer Confidence (South Atlantic)[a]	161.9	174.5	161.4	-7.22%	0.31%
Domestic Airport Passengers ('000)[b]	2,257.8	2,286.0	2,240.1	-1.23%	0.79%
Nondurable Goods Retail Sales ($000,000)[c]	3,241.1	3,247.5	3,134.7	-0.20%	3.39%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,015.0	2,595.0	2,314.0	-22.35%	-12.92%
Consumer Expectations (South Atlantic)[a]	100.0	117.8	113.7	-15.11%	-12.05%
Initial Unemployment Claims[b]	1,942.7	2,109.9	1,452.4	-7.92%	33.76%
Durable Goods Retail Sales ($000,000)[c]	3,630.2	3,707.4	3,503.0	-2.08%	3.63%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,479.9	3,463.2	3,438.3	0.48%	1.21%
Employed Labor Force ('000)	3,357.7	3,335.5	3,304.0	0.67%	1.62%
Unemployed Labor Force ('000)	122.3	127.7	134.4	-4.29%	-9.01%
Unemployment Rate	3.5%	3.7%	3.9%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,360.2	3,357.3	3,283.1	0.09%	2.35%
Construction ('000)	169.2	168.0	163.2	0.71%	3.68%
Manufacturing ('000)	55.9	55.9	55.2	0.00%	1.27%
Transportation & Public Utilities ('000)	69.8	70.7	66.9	-1.27%	4.33%
Wholesale & Retail Trade ('000)	342.4	343.3	340.7	-0.26%	0.50%
Services ('000)	2,022.0	2,015.1	1,968.5	0.34%	2.72%
Total Government ('000)	700.9	704.3	688.6	-0.48%	1.79%
Federal Government ('000)	364.3	363.8	369.1	0.14%	-1.30%

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