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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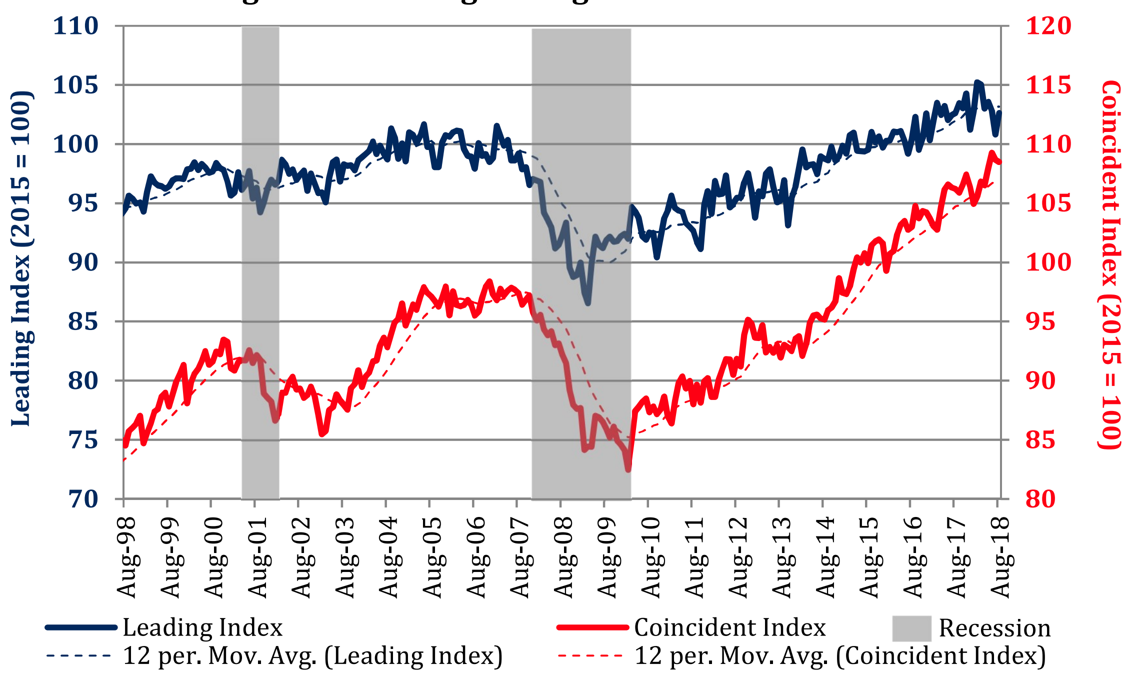
This Year's Strong Economic Performance Has Encountered Headwinds Over the Summer Months

As in July, the August 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, continued to exhibit solid gains for the year through August. In contrast, the Leading Index has now experienced two weak monthly performances, declining sharply in July and registering no change in August on a monthly over-the-year basis. This decline is 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 into 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 for a second month losing 0.16 percent in August from July after having decreased 0.5 percent from June to July. On a month-to-month basis, the Coincident Index has decreased four times in the year's first eight months. Job growth declined in August by 0.9 percent for the first time since last January (on a month-to-month basis), but this month-over-month decline may be more a reflection of seasonal patterns and is not an indicative of a slowdown in the region's job growth trend. Also in August, domestic passenger traffic at Reagan National and Dulles Airports declined from July.

On a monthly over-the-year basis, August's Coincident Index registered an increase of 2.14 percent from August 2017 extending its upward trend to 53 consecutive months, dating from April 2014. The Index's August 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 August, three out of four of the Index's components were positive on a monthly over-the-year basis:

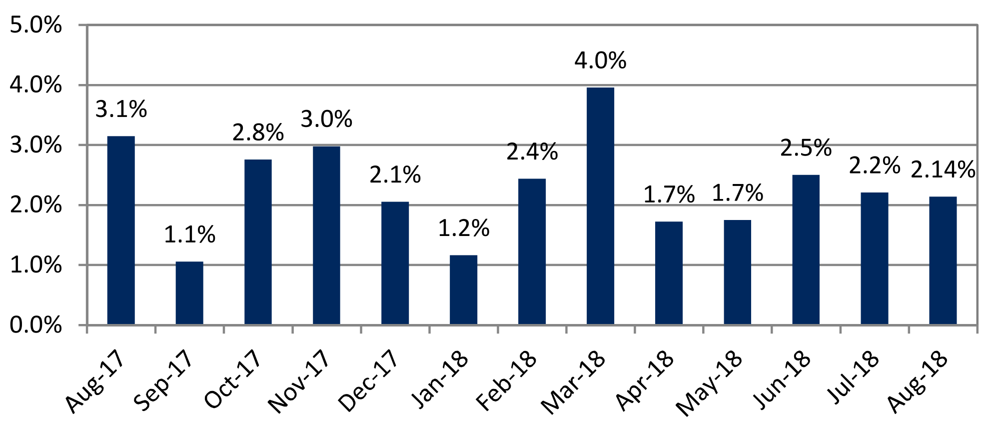
- *Wage and salary employment* in the Washington region increased 2.0% between August 2017 and August 2018;

- *Consumer confidence (in the present)* extended its positive trend increasing 10.0% from August 2017, regaining its pattern of double-digit increases experienced over the past year; and,

- *Non-durable goods retail sales* were up 3.8% from August 2017 up for a 18th consecutive monthly over-the-year gain, while,

- *Domestic passenger volume at Reagan National and Dulles Airports* decreased 2.6% after registering gains in the two previous months.

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, was unchanged in August compared to August 2017 after declining 1.6 percent in July on a monthly over-the-year basis. The Leading Index has now performed below trend for five consecutive months, dating from March. This performance pattern lowers the positive trajectory of the economy's forecast for the remainder of the year and early 2019. The Leading Index is being dragged lower by double-digit gains in initial claims (worsened), the continuing weak performance of the home building sector, and by slower growth in consumer expectations.

In August, only two of the Leading Index's four components were positive:

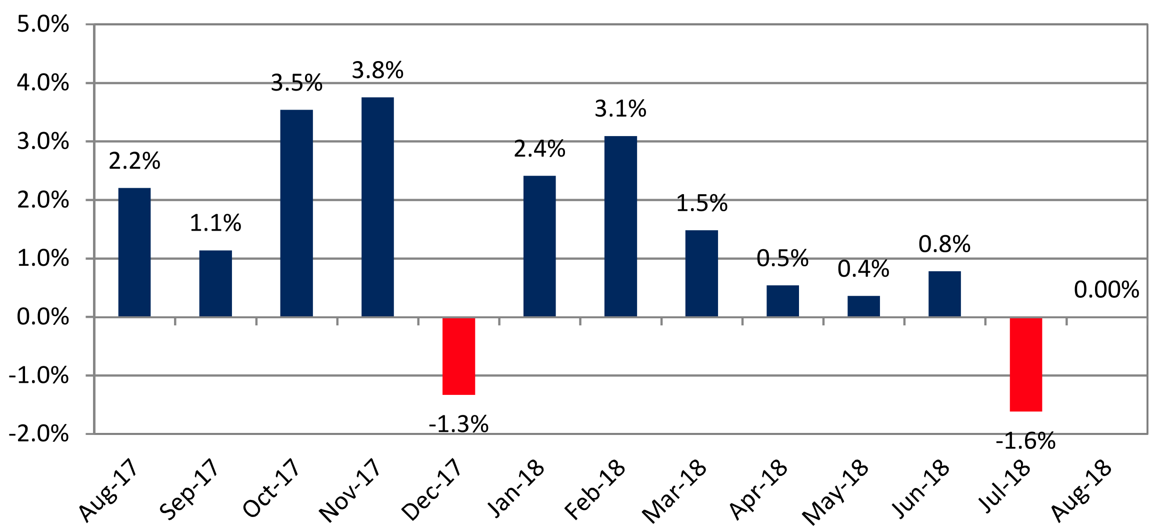
- *Durable goods retail sales* increased 4.4% between August 2017 and August 2018 continuing its long-term positive trend; and,

- *Consumer expectations (consumer confidence six months hence)* increased 7.3% from its August 2017 level after being declining in July; while,

- *Total residential building permits* decreased 8.0% in August and now has declined in five of eight months this year; and,

- *Initial claims for unemployment insurance* increased 30.2% (worsened) for a third consecutive month after having improved (decreased) in each of the year's first five months.

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



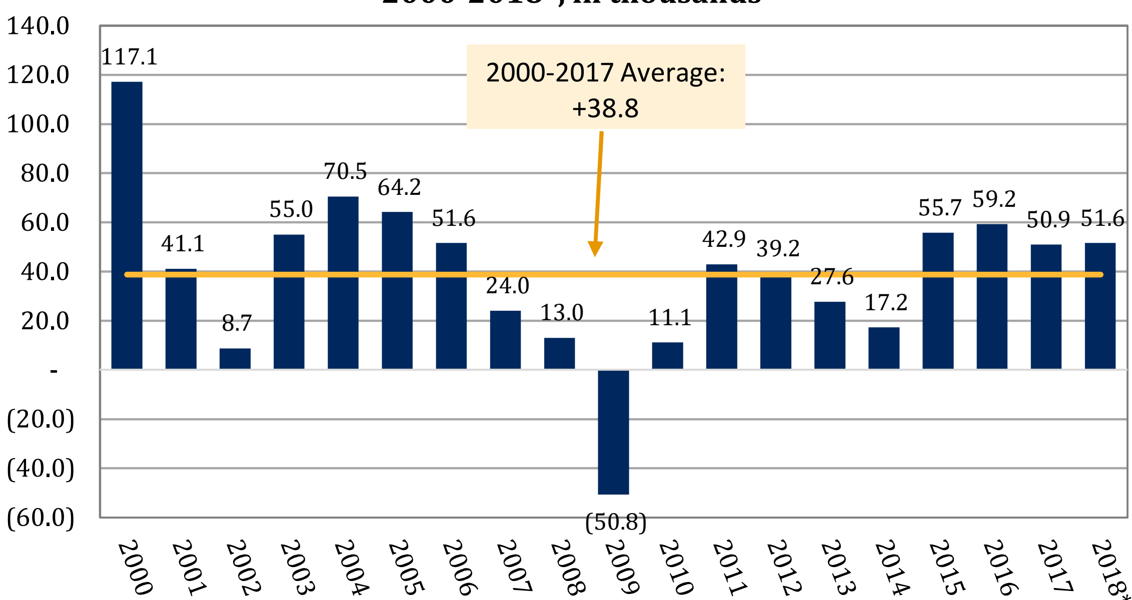
Source: The Stephen S. Fuller Institute at the Schar School, GMU

Current Performance

The Washington region's economy has sustained its expansion (recovery) from the negative impacts of the Sequester for 53 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 August 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%, October 2018, IHS Markit).

Job growth is the most widely cited measure of the economy's performance, even though it masks the question of whether the jobs being added contribute to income growth to a greater or lesser magnitude than the jobs being lost. Still, an economy generating large numbers of net new jobs is better than one that is losing jobs or adding jobs only slowly. The Washington region has experience all three situations. As shown in Figure 4, it lost almost 51,000 jobs in 2009 during the depth of the Great Recession and it has experienced slow job growth leading into and out of that Recession and again during the Sequester in 2013. For the past four years it has been adding on average 54,350 jobs annually far exceeding the region's long-term average of 38,790 jobs per year since 2000.

Figure 4. Job Change in the Washington Region 2000-2018*, in thousands



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

Job growth in 2018, through three-quarters, is averaging 51,600 jobs. While this year's job numbers will be revised and new monthly counts released next March, the preliminary jobs numbers provide several clues to the type of economic growth the region is experiencing this year. First, three sectors—professional & business services, education & health services, and leisure & hospitality services—are substantially outperforming their historic job growth patterns. Together these three sectors account for 46.2 percent of the region's total jobs but they are generating 67.0 percent of this year's net job increase. Each sector individually experiencing job gains this year a full 7 percentage points faster than their historic share of the region's jobs.

Second, the government sector—federal and state & local—are barely experiencing net new job growth this year; the federal government has shed 6,000 jobs through September and state & local government has added 6,200 jobs. Basically, all job growth in the Washington region is being generated by private and non-profit organizations and businesses. The retail trade and other services (which includes many consumer services) sectors are underperforming as are the information services, wholesale trade, and manufacturing sectors. The only other growth sectors this year are construction and transportation & utilities, both are adding new jobs at a much higher rate than their historic share of the job base. The financial activities sector is slightly outperforming its historic share. Taken altogether, the job growth in the Washington region is very concentrated; that is, it is increasingly focused in three large sectors and two moderate-size sectors. Government employment is no longer a net source of new jobs.

Lastly, job growth has shifted to Northern Virginia. This year, it is accounting for 63.6 percent of the new job growth while historically Northern Virginia has accounted for 44.8 percent of the region's jobs. In contrast, 30.9 percent of the region's jobs are in Suburban Maryland but this year, Suburban Maryland has only accounted for 19.1 percent of the region's job growth. Similarly the District of Columbia is under performing this year. With 24.2 percent of the region's jobs, it has only generated 17.3 percent of this years job gains. Among other factors, this shift in job mix and location reflects the changing structure of the region's economy, its shift away from government as its major driver of economic growth.

Near-Term Outlook

As this year winds down, economists are looking forward to 2019 with forecasters generally agreeing that the U.S. economy will continue to grow at an above-trend rate for one more year. With this year's 2.9 percent gain almost assured, building on a 4.2% second quarter gain, employment and income growth are continuing, consumer confidence continues to grow supporting strong consumer spending, and the global economy and world trade remains unhampered by threats of trade wars and the new tariffs already in place.

Still, there are constraints to the economy's growth that will dampen next year's performance and these are likely to increase as the year progresses. Chief among these are increasing interest rates; the federal reserve is expected to increase its federal funds rate in December and then three more times in 2019 until it tops out at 3.5%. Simultaneously, inflation pressures will increase next year, energy costs are projected to remain high with Brent Crude selling at or above the $80 per barrel level throughout next year, and new housing construction is projected to slow. Most central to this year's strong performance has been the fiscal stimulus provided by the Tax Cut and Jobs Act of 2017 but this stimulus will fall to zero by the end of 2019 unless new legislation is approved. Still, the forecast for 2019 remains just a tenth below this year's rate at 2.8%.

However, the forecasts for the first several years of the next decade are for much slower growth, ranging from 2.0% in 2020 down to 1.5% by 2023. Clearly, much can change globally and in the U.S. over the coming five years that could drive the economy lower (a popular scenario shows a slight recession in 2020, with the GDP contracting 0.3%) or possibly faster than forecast (2020 is an election year).

The U.S. economic performance this year and into the future provides the background for the Washington region's current and future economic performance. As noted previously, the Washington region's economy has recovered from the Sequester and loss of federal jobs and federal procurement spending that in 2013 undermined its recovery from the Great Recession. As a consequence of these post-Sequester gains, the Washington region's economy is positioned to outperform the U.S. economy this year and next, and possibly into the 2020.

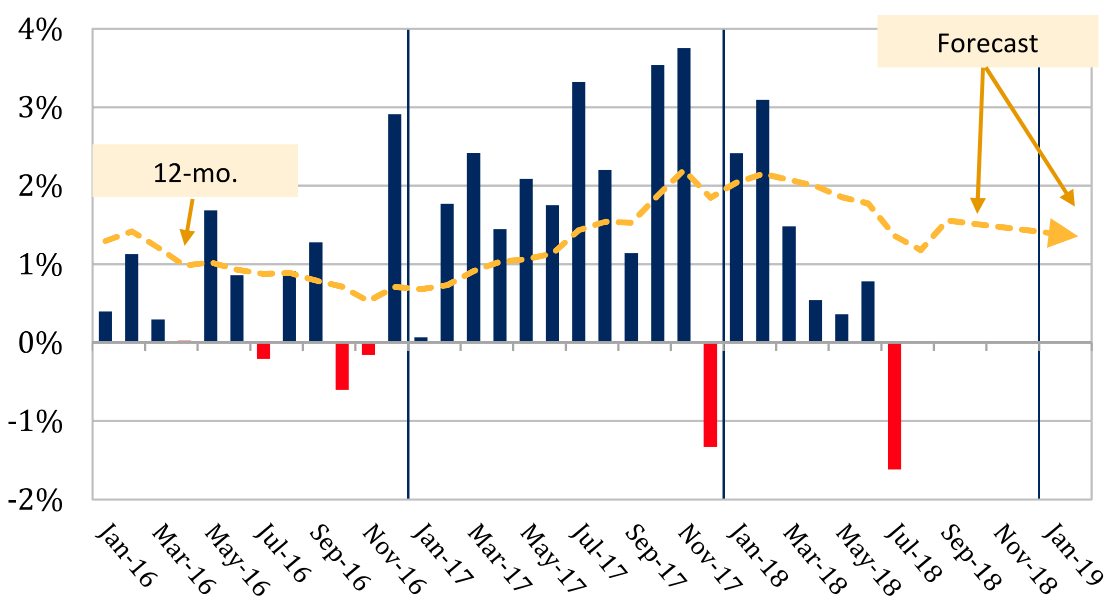
The backdrop to the region's recent economic performance is the loss of approximately 25,000 federal jobs with 6,000 federal jobs being lost this year (through September), and the short-term $12.6 billion decline in federal procurement spending between 2010 and 2013 with this spending holding basically flat in 2014 and 2015, followed by gains in 2016 and 2017 totaling $9 billion. FY 2018 federal procurement spending is not yet available but indicators point to it having surpassed its 2010 peak level.

While this increase in federal procurement spending in the region's economy has been an important driver of its performance this year, it is the growth of non-federally dependent businesses and organizations that have put the Washington region's economy on the path to more-balanced growth going forward. Non-government job growth overall has been strong for four years, averaging better than 50,000 jobs annually. While many of these jobs have been in the education and health services and leisure and hospitality services (including restaurants) sectors that tend to be largely dependent on the local market, the region's non-federal federally dependent, export-based, high-value added clusters registered their strongest performance in three years during 2017 and factors supporting this performance should carry over into 2018.

These non-federally dependent sectors employ an estimated 750,000 workers representing 26.7 percent of the region's non-federal economy. This performance reflects these businesses' ability to compete in the national and global economies and, in 2017, their annual jobs growth rate increased to 2.4 percent, up from 1.3 percent in 2016 and just 1.1 percent in 2015. Five of the region's seven non-federally dependent clusters performed better in 2017 than in 2016. Besides experiencing stronger growth in 2017, these non-federal dependent clusters also performed better than their national counterparts, which had a combined increase of 2.2 percent. Four of the region's seven non-federally dependent clusters performed better than their counterpart clusters performed at the national level.

With federal spending still accounting for approximately 29 percent of the Washington region's economy, the increasing share of the region's economy that is now being driven by non-federally dependent business activities is key to its long-term growth trajectory. With federal procurement spending in the Washington region expected to grow in 2018 and 2019, from its 2017 level of $77.9 billion, and the region's non-federally dependent clusters also experiencing an improving performance based on their stronger competitive positions within national and global markets, the region's economy appears well positioned for above-trend growth over the next several years. Still, the Washington region's economy is vulnerable to changing federal budget policies, as was clearly demonstrated with the Sequester and the Budget Control Act of 2011, and the performance of its non-federally dependent clusters has lagged nationally in the past. Economic diversification by itself is no guarantee of a strong and competitive future economy. The quality of the jobs being generated, their value added to the economy remains the key to maintaining a growing and vital economy able to sustain the region's high quality of life.

Figure 5. Washington Region Leading Index
Monthly Over-the-Year Percent Change



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

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Aug-18 Prelim.	Jul-18 Final	Aug-17 Final	Jul-18 to Aug-18	Aug-17 to Aug-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	108.5	108.7	106.2	-0.16%	2.14%
Leading Index (2015 = 100)	102.6	100.8	102.6	1.80%	0.00%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,331.2	3,359.8	3,266.3	-0.85%	1.99%
Consumer Confidence (South Atlantic)[a]	176.5	161.9	160.5	9.02%	9.97%
Domestic Airport Passengers ('000)[b]	2,229.3	2,257.8	2,289.2	-1.26%	-2.61%
Nondurable Goods Retail Sales ($000,000)[c]	3,255.3	3,236.7	3,136.4	0.57%	3.79%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	1,848.0	2,015.0	2,008.0	-8.29%	-7.97%
Consumer Expectations (South Atlantic)[a]	119.2	100.0	111.1	19.20%	7.29%
Initial Unemployment Claims[b]	1,803.2	1,942.7	1,385.4	-7.18%	30.16%
Durable Goods Retail Sales ($000,000)[c]	3,701.8	3,636.7	3,544.8	1.79%	4.43%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,405.5	3,471.6	3,393.0	-1.90%	0.37%
Employed Labor Force ('000)	3,287.1	3,349.6	3,262.4	-1.86%	0.76%
Unemployed Labor Force ('000)	118.4	122.0	130.6	-2.95%	-9.34%
Unemployment Rate	3.5%	3.5%	3.8%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,331.2	3,359.8	3,266.3	-0.85%	1.99%
Construction ('000)	170.3	169.2	163.0	0.65%	4.48%
Manufacturing ('000)	55.5	56.4	55.0	-1.60%	0.91%
Transportation & Public Utilities ('000)	70.0	69.6	66.7	0.57%	4.95%
Wholesale & Retail Trade ('000)	343.3	342.4	340.8	0.26%	0.73%
Services ('000)	2,010.6	2,020.8	1,961.9	-0.50%	2.48%
Total Government ('000)	681.5	701.4	678.9	-2.84%	0.38%
Federal Government ('000)	362.4	364.3	367.3	-0.52%	-1.33%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars