



The
STEPHEN S. FULLER INSTITUTE
for Research on the Washington Region's Economic Future



Washington Economy Watch

Vol. II, No. 11
November 2018

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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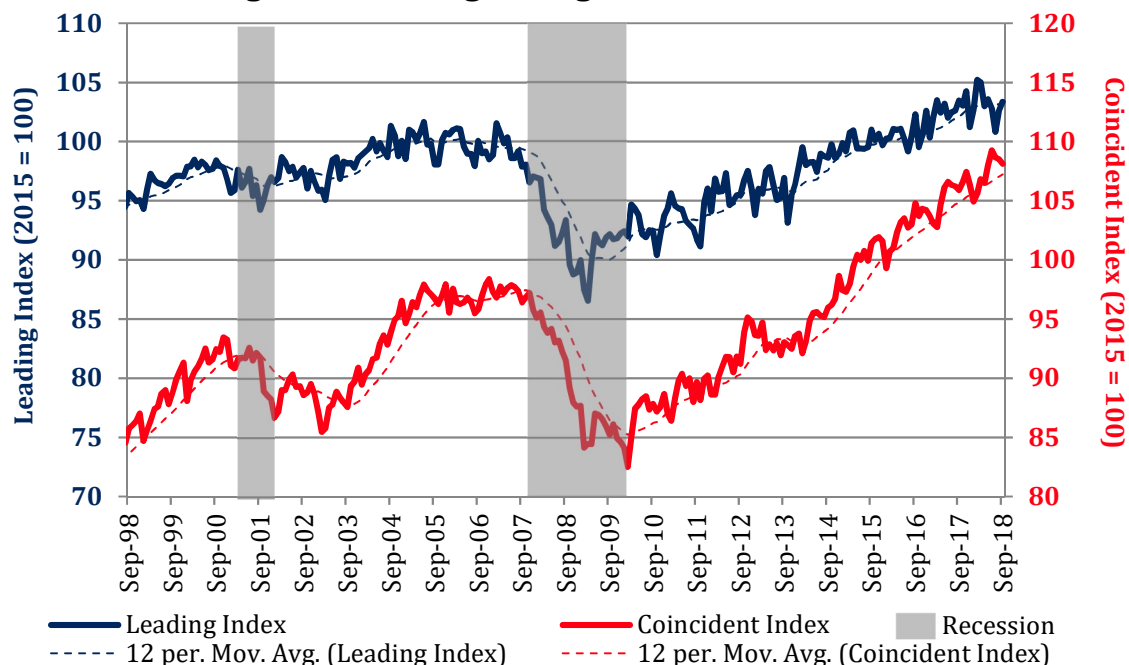
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After a Strong First-Half, Economic Performance Experienced Unevenness in the Third Quarter in 2018

The third quarter performances of the Washington region's Coincident and Leading Indices have sent a mixed 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 September compared to the same period in 2017, but on a month-to-month basis, it has declined in each month of last three months. The Leading Index has now experienced three consecutive decreases on a monthly over-the-year basis averaging a monthly decline of 0.57 percent over the quarter. This three-month performance follows the second quarter's average 0.56 percent gain and the Index's first quarter average monthly gain of 2.3 percent. This nine-month trend clearly raises questions concerning the economy's growth trajectory over the remainder of 2018 and into 2019. In spite of this third-quarter softness at the regional level, the national forecast continues to be favorable through 2019 with the expansion projected to continue regionally over this period as well.

Figure 1. Washington Region Economic Indices



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

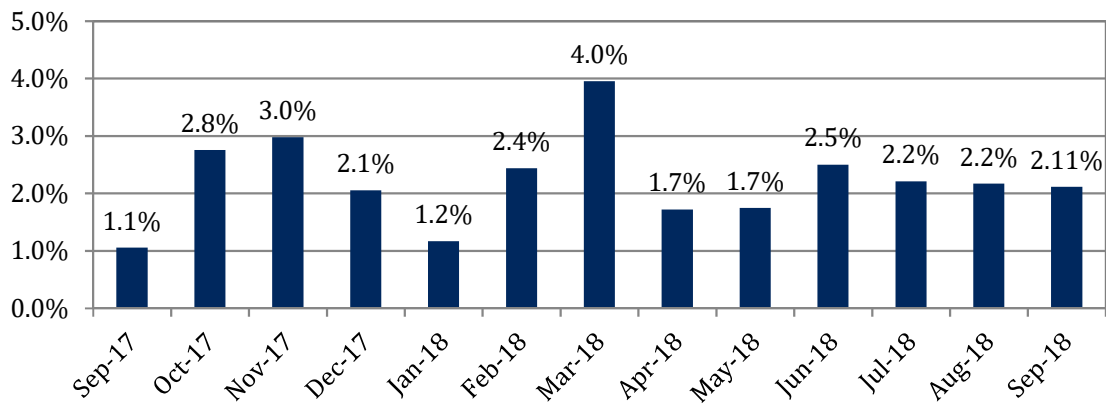
The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, decreased for a third month losing 0.37 percent in September from August after having decreased 0.1 percent from July to August and declining 0.5 percent from June to July. On a month-to-month basis, the Coincident Index now has decreased five times in the year's first nine months. Three of the Index's four indicators declined in September from August with only wage and salary employment increasing, but only by 0.2 percent.

On a monthly over-the-year basis, September's Coincident Index registered an increase of 2.11 percent from September 2017 extending its upward trend to 54 consecutive months, dating from April 2014. The Index's September performance extends a pattern of moderate and consistent growth that, with the exception of March's sharp gain, describes this year's current growth trajectory.

In September, 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 September 2017 and September 2018;
- *Consumer confidence (in the present)* extended its positive trend increasing 9.0% from September 2017 but has registered month-to-month declines in five of this year's first nine months; and,
- *Non-durable goods retail sales* were up 2.3% from September 2017 gaining for a 19th consecutive monthly over-the-year gain; while,
- *Domestic passenger volume at Reagan National and Dulles Airports* decreased 0.5% from September 2017 extending its downward trend to a second consecutive month and to five out of the year's first nine months.

Figure 2. Washington Coincident Index, Monthly Over-the-Year Changes



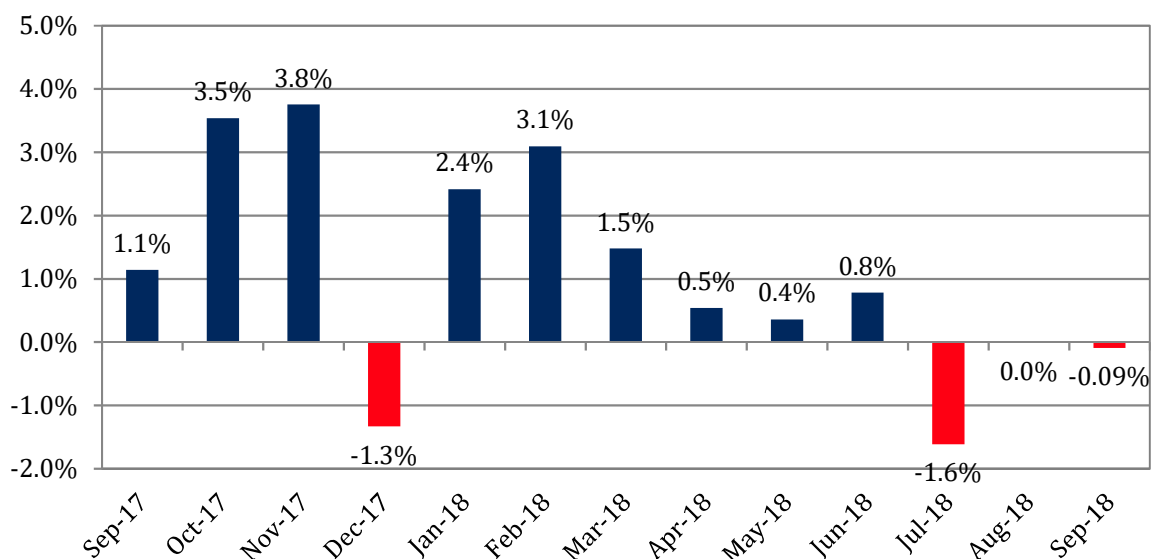
Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy six to eight months in advance, was down slightly in September compared to September 2017, losing 0.09 percent, after declining 0.01 percent in August and 1.6 percent in July, on a monthly over-the-year basis. The Leading Index has now performed below trend for six consecutive months, dating from March. This performance pattern clouds the outlook for the region's economy for the remainder of this year and for the first quarter of 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 a reduction in durable goods sales. Consumer expectations were higher in September, compared to September 2017, but declined from their peak value in August.

In September, only one of the Leading Index's four components was positive:

- *Consumer expectations (consumer confidence six months hence)* increased 13.4% from its September 2017 level gaining for a second month after declining 12.0 percent in July; while,
- *Total residential building permits* decreased 5.8% in September and now has declined each month in the third quarter and in six of nine months this year;
- *Initial claims for unemployment insurance* increased 23.5% worsening for a fourth consecutive month after having improved (decreased) in each of the year's first five months: and,
- *Durable goods retail sales* decreased 1.8% between September 2017 and September 2018 reversing, at least temporarily, its long-term positive trend.

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 54 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 September 2018. Job growth is the most widely cited measure of the economy's performance and the Washington region continues to add significant numbers of new jobs. Job growth in 2018, through ten months, is averaging 52,200 jobs and continues to outpace beginning-of-the-year expectations.

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. 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 65.1 percent of this year's net job increase through ten months.

The government sector—federal and state & local—continues to underperform, with federal jobs decreasing by 5,900 from 2017 through ten months while state and local governments have added 6,600 jobs. Basically, all job growth in the Washington region is being generated by private businesses and non-profit organizations.

The third notable trend is the changing distribution of jobs within the region. Job growth has shifted to Northern Virginia. This year, it is accounting for 63.3 percent of the new job growth while historically Northern Virginia has accounted for approximately 45 percent of the region's jobs. In contrast, Suburban Maryland has historically accounted for approximately 31 percent of the region's jobs but to date in 2018 has generated only 21.6 percent of the region's new jobs. The District of Columbia is generating new jobs this year close to its historical average.

These employment shifts are the result of significant restructuring within the Washington region's economy. Since 2010, the Washington region's economy has been diversifying away from its dependency on the federal government as its principal driver of growth. Federal spending, directly or indirectly, generated 39.8 percent of the region's Gross Regional Product (GRP) in 2010. The consequences of the high level of dependence were seen over the ensuing years as both the federal workforce and federal procurement spending declined. The Sequester in 2013 drove the region's GRP negative by 0.8% while the U.S. economy (GDP) increased 1.7%. With the region's economic vulnerability clearly in evidence, state and local elected and business leaders shifted their economic development focus to diversification.

The Roadmap for the Washington Region's Economic Future, prepared in 2015 with support from the 2030 Group and 12 other regional organizations, identified seven advanced industrial clusters in which the Washington region had a competitive advantage in the national economy. By definition, these clusters were non-federally dependent, export-based, and high-value added, and rapidly growing. These seven clusters accounted for about 710,120 jobs in the region (January 2014), about one-quarter of all jobs, and appeared to offer the potential to compensate for the federal government's declining role in the region's future growth.

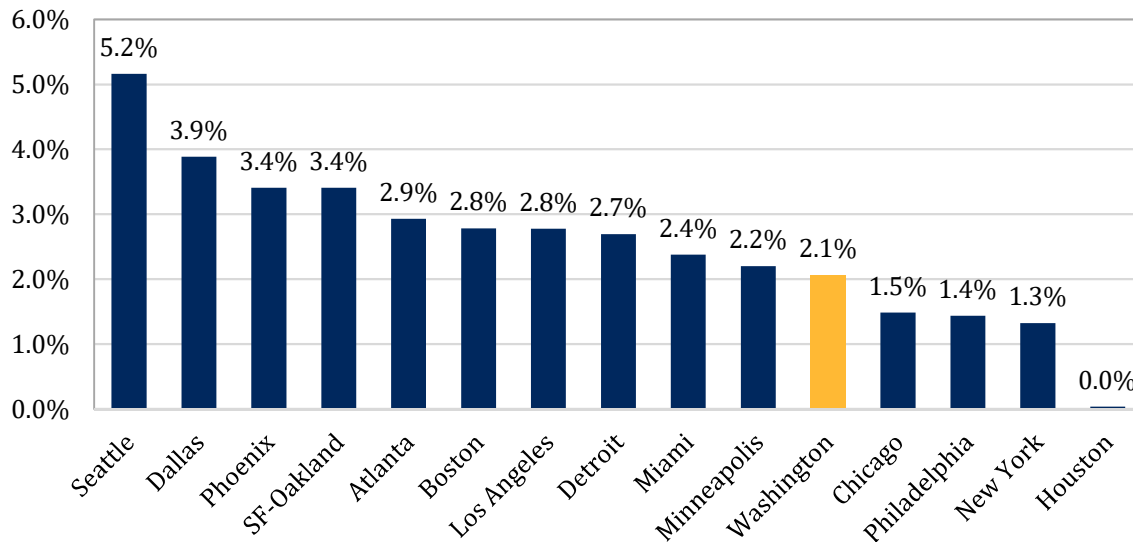
By the end of 2017, federal spending as a percentage of the region's GRP had declined to 31.2 percent, reflecting the loss of approximately 20,000 federal jobs since 2010 and a pattern of federal procurement spending that fell 15.5 percent between 2010 and 2013 and recovered 13.1 percent through 2017. This pattern of weaker federal spending with the resultant declining share of the region's economy is expected to continue; by 2022, federal spending is projected to account for 27.2 percent of GRP. Which alternative sectors and business activities replace the federal sector to become the future drivers of the region's growth will determine whether the region's economy can continue to support the high levels of personal earnings and attendant quality of living that the Washington region has enjoyed historically.

The continuing challenge for the region's economy is to generate high-value added jobs; these jobs tend to provide goods and services to national and global markets in contrast to businesses that only serve local markets in which the value-added by these jobs tend to be constrained by their smaller markets. These differences and their consequences have been significant. The jobs lost in the private sectors in the Washington region during the Great Recession (roughly late 2007-March 2010) had an average GRP value of \$173,166 while the jobs added over the period from April 2010 through mid-year 2018 had an average GRP value of \$128,405.

For the Washington region's economy to grow with this evolving mix of jobs, it has had to generate more jobs as each job has been worth less. With the region averaging more than 50,000 jobs a year beginning in 2015, these jobs would have supported much faster economic growth had they had a more favorable value mix than they have actually had. Instead, the result has been that the Washington region's economy has averaged 1.1% growth per year since 2010, the slowest of the nation's 15 largest metropolitan areas.

However, there are signs that the diversification of the Washington region's economy has accelerated and has begun to shift the quality of the new jobs more towards the higher-value added sectors. The performance of the region's seven advanced industrial clusters in 2017, as defined in 2015 by the Roadmap, was the best since 2014 and, in aggregate, for the first time they outperformed their same clusters at the national level growing 2.4 percent compared to their 2.2 percent rate nationally. With the mix of the region's job growth improving in 2017 the pace of region's GRP increased to 2.1% and its ranking rose to 10th in comparison with the 15 largest metropolitan areas, as shown in Figure 4.

Figure 4. 2017 GRP Change in the Largest Metros
(inflations-adjusted)



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

Amazon's decision to locate one-half of its HQ2 in Arlington County's Crystal City, adding 25,000 jobs and likely more high-value added, export-based, non-federally dependent jobs to the region's economy will reinforce the region's efforts to reduce its federal dependence, even with HQ2's build-out stretching into the mid-2030s. These jobs will have an average salary of \$150,000 (in 2019\$s), double the region's average salary for all jobs. And, it is likely that Amazon's decision to locate in the Washington region will attract other high-value added, export-based business investments to the region during the coming decade helping it to secure an even better balance between its federal base, which will always be an important contributor to the region's economic vitality, and its non-federal base. Amazon's decision highlights the region's competitive assets that are already contributing to its diversification and should help drive the region's growth at above-average rates well into the future.

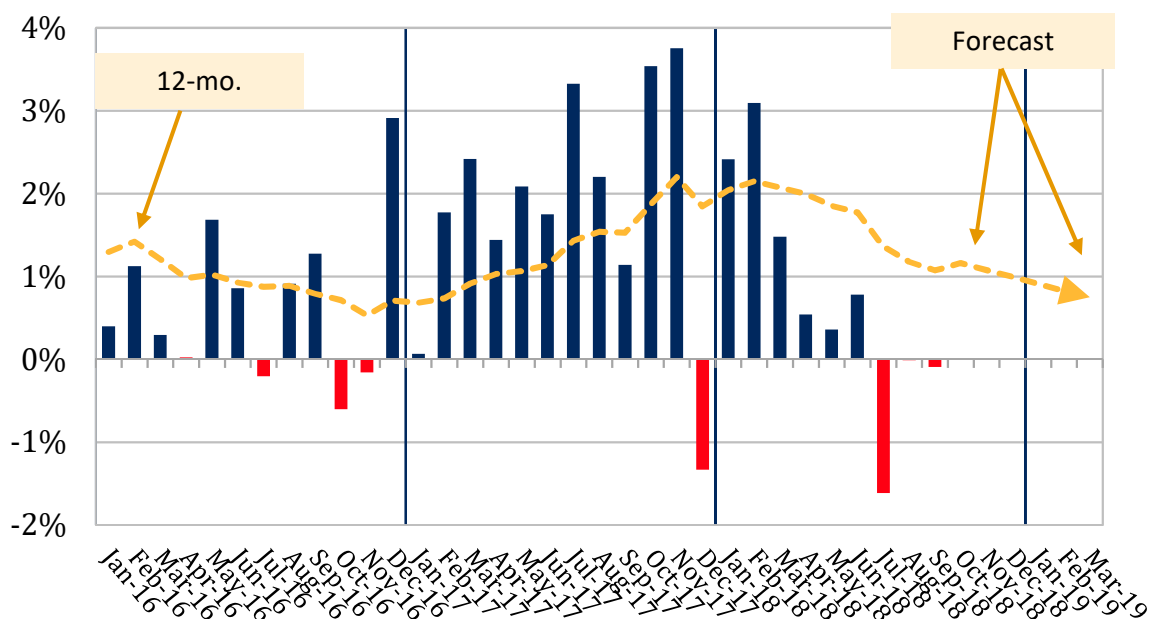
Near-Term Outlook

The U.S. economy continues to perform well. The first estimate of third quarter GDP growth rate was 3.5% following 4.2% for the second quarter. The year's GDP growth continues to be targeted at 3.0%, the best performance of the decade. However, there is consensus that this growth rate will moderate in 2019. This expectation for slower economic growth in 2019 is attributable to the diminishing impact of the fiscal stimuli flowing from the 2017 Tax Cuts and Jobs Act and slowing federal spending. Combined with more restrictive monetary policy and the negative effects

of new tariffs and the strong dollar, both the US and World economies are expected to slow in the second half of 2019 and continue slower into the coming decade.

These same factors dampening the US economy will act to slow growth in the Washington region, although the magnitude of its slowdown from 2018 will be more sensitive to changing federal budget constraints than to slowing international trade. With the FY 2019 federal budget still requiring final approval by the lame-duck Congress (spending authority expires on December 7th for all agencies with the exception of DOD and HHS), the shape of the federal sector for the remainder of FY 2019 will be determined soon. In the longer term, divided Government with the House under the control of Democrats and the Senate and Executive Branch under the control of Republicans, points to possible further tightening of federal spending over the next two years. If this occurs, it would reduce the contribution of the federal sector to the region's economy more quickly than any accelerated, offsetting growth that the private and non-profit sectors could generate, especially if the national and global economies are weakening at the same time. These uncertainties suggest that the region's economy could experience slower growth as early as the second half of 2019 with this trend continuing into 2020. The possibility of this slower growth pattern going forward is already being signaled by the current trajectory of the Washington Leading Index as shown in Figure 5.

**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	
	Sep-18 Prelim.	Aug-18 Final	Sep-17 Final	Aug-18 to Sep-18	Sep-17 to Sep-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	108.1	108.5	105.9	-0.37%	2.11%
Leading Index (2015 = 100)	103.4	102.6	103.5	0.73%	-0.09%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000) ^a	3,342.3	3,334.0	3,275.4	0.25%	2.04%
Consumer Confidence (South Atlantic) ^a	163.6	176.5	150.1	-7.31%	8.99%
Domestic Airport Passengers ('000) ^b	2,227.1	2,229.3	2,239.4	-0.10%	-0.55%
Nondurable Goods Retail Sales (\$000,000) ^c	3,226.5	3,250.6	3,155.3	-0.74%	2.26%
Washington Area Leading Index Components					
Total Residential Building Permits ^a	2,114.0	1,848.0	2,244.0	14.39%	-5.79%
Consumer Expectations (South Atlantic) ^a	115.4	119.2	101.8	-3.19%	13.36%
Initial Unemployment Claims ^b	1,792.8	1,803.2	1,452.2	-0.57%	23.46%
Durable Goods Retail Sales (\$000,000) ^c	3,730.0	3,697.5	3,797.1	0.88%	-1.77%
Washington Area Labor Force^a					
Total Labor Force ('000)	3,395.3	3,406.8	3,396.0	-0.34%	-0.02%
Employed Labor Force ('000)	3,284.0	3,288.5	3,272.8	-0.14%	0.34%
Unemployed Labor Force ('000)	111.3	118.3	123.2	-5.90%	-9.66%
Unemployment Rate	3.3%	3.5%	3.6%	--	--
Washington Area Wage and Salary Employment^a					
Total ('000)	3,342.3	3,334.0	3,275.4	0.25%	2.04%
Construction ('000)	170.0	169.7	162.3	0.18%	4.74%
Manufacturing ('000)	56.0	55.8	54.7	0.36%	2.38%
Transportation & Public Utilities ('000)	70.4	70.0	67.0	0.57%	5.07%
Wholesale & Retail Trade ('000)	342.5	344.2	337.1	-0.49%	1.60%
Services ('000)	2,001.4	2,012.8	1,954.3	-0.57%	2.41%
Total Government ('000)	702.0	681.5	700.0	3.01%	0.29%
Federal Government ('000)	360.3	362.4	366.6	-0.58%	-1.72%

^aUnadjusted data

^bSeasonally adjusted data

^cSeasonally adjusted constant (1996) dollars