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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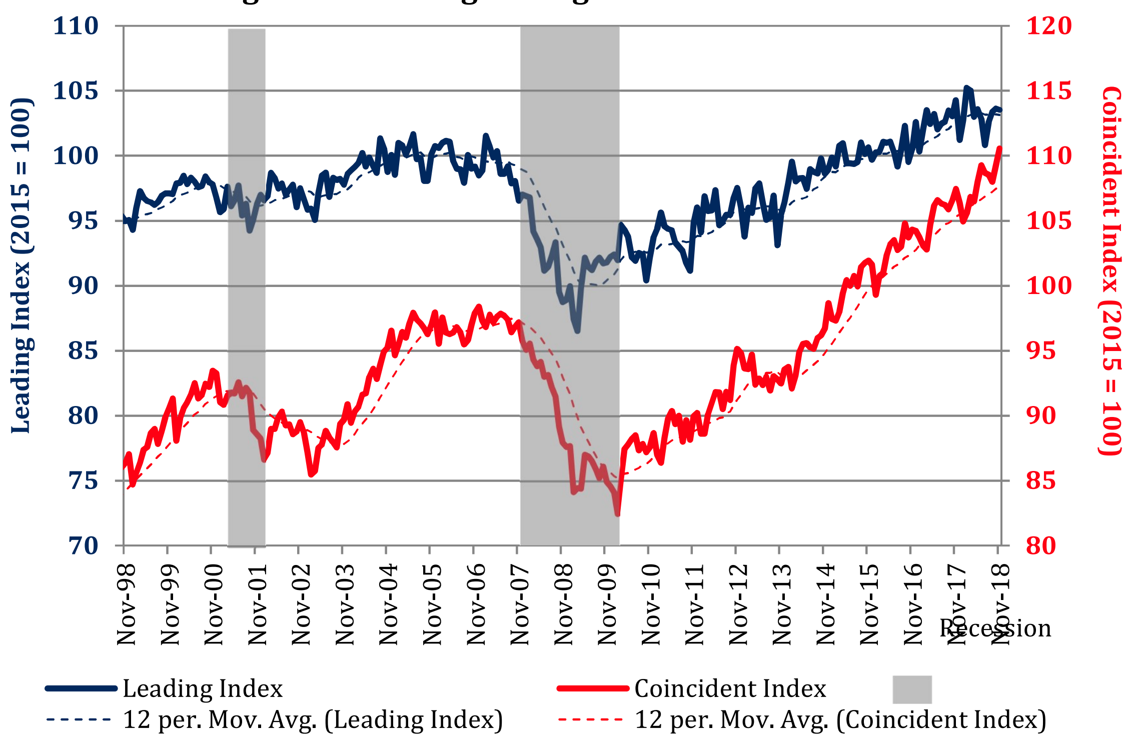
The Region's Strong Economic Performance Continued Through November 2018 But Outlook Weakens

The performances of the Washington region's Coincident and Leading Indices in 2018 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 November compared to the same period in 2017, but on a month-to-month basis, it experienced three monthly declines during the third quarter. The Leading Index has now experienced four decreases over the past five months on a monthly over-the-year basis through November after starting the year with sharp gains. This trend clearly raises questions concerning the economy's growth trajectory in 2019. Looking forward, a slowing U.S. economy in 2019 and the unexpectedly long partial Federal shutdown may result in the Washington region's economy underperforming its growth potential in 2019.

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 for a second month in November, on a month-to-month basis, gaining 1.2 percent. These two month-to-month gains follow three consecutive month-to-month declines. On a month-to-month basis, the Coincident Index now has increased six times in the year's first eleven months. For the second month in a row, all four of the Index's indicators were positive.

On a monthly over-the-year basis, November's Coincident Index registered an increase of 2.91 percent from November 2017 extending its upward trend to 56 consecutive months, dating from April 2014. The Index's November performance extends a pattern of relatively steady growth that describes the trajectory of the year's economic expansion.

In November, for the second consecutive month, all four of the Index's components were positive on a monthly over-the-year basis:

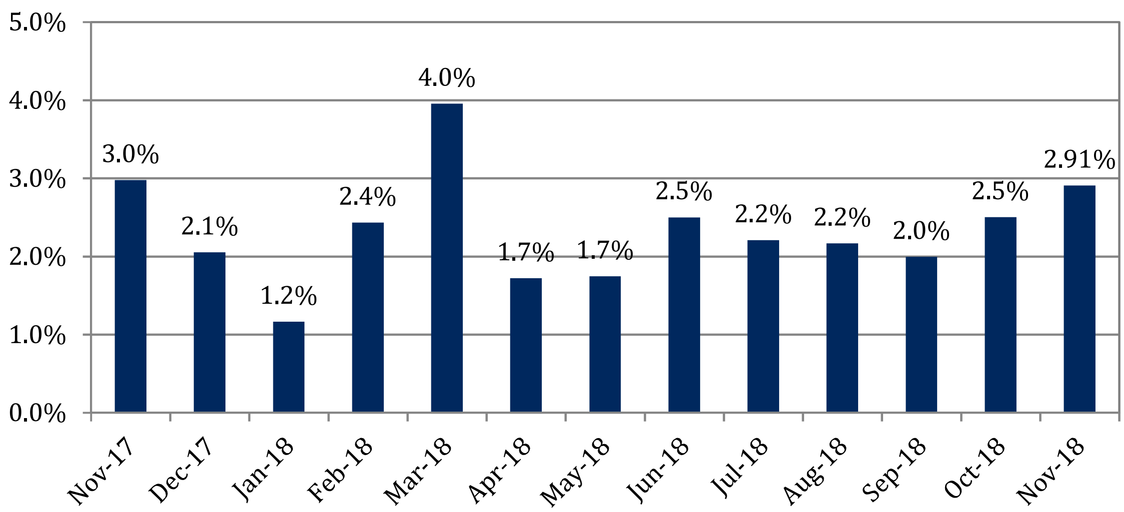
- *Wage and salary employment* in the Washington region increased 1.6% between November 2017 and November 2018;

- *Consumer confidence (in the present)* extended its positive trend increasing 12.8% from November 2017;

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 4.0% from November 2017 after gaining 1.6% in October reversing a two-month decline spanning August and September; and,

- *Non-durable goods retail sales* were up 4.1% from November 2017 gaining for a 21st consecutive month on a monthly over-the-year basis.

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, decline in November by 0.70 percent. This is the Leading Index's fourth decrease in five months on a monthly over-the-year basis extending a moderating performance pattern dating back to March. The Leading Index is being dragged lower by double-digit gains in initial claims (worsened) each month since May and the continuing weak performance of the home building sector—the number of residential building permits issued decreasing in seven of the last eight months, and, while Consumer expectations have continued to increase, they are increasing more slowly than earlier in the year and have experienced decreases on a month-to-month basis in three of the last five months, suggesting that they may have peaked.

In November, two of the Leading Index's four components contributed to its decline:

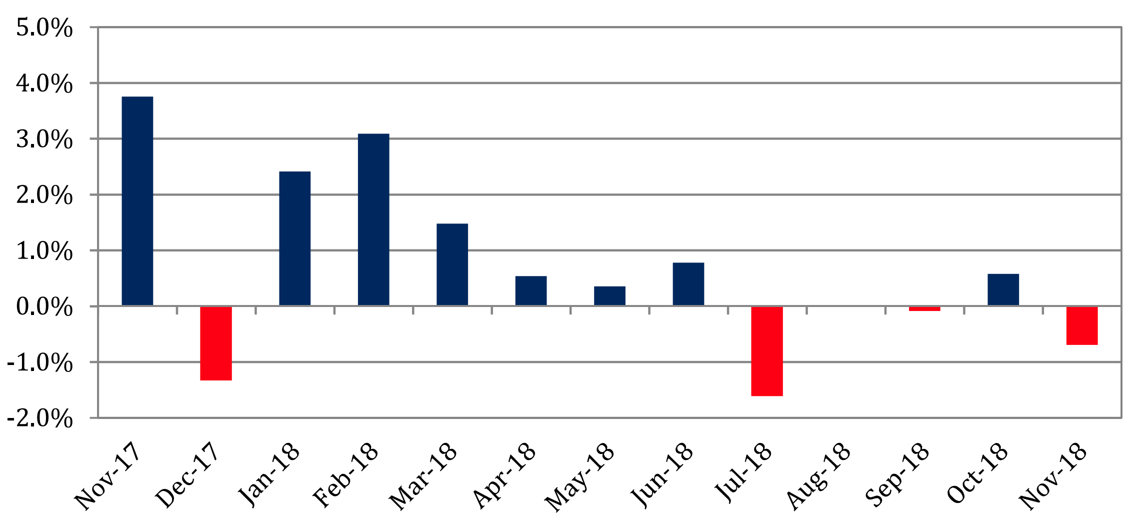
- *Total residential building permits* decreased 23.3% in November and now has declined eight times in the year's first eleven months; and,

- *Initial claims for unemployment insurance* increased 28.1% worsening for a sixth consecutive month after having improved (decreased) in each of the year's first five months; while,

- *Consumer expectations (consumer confidence six months hence)* increased 6.9% from its November 2017 level gaining for a fourth consecutive month; and,

- *Durable goods retail sales* increased 1.6% between November 2017 and November 2018 extending its long-term positive trend-it has declined only once in 2018.

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 56 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 November 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. The estimated 52,100 job growth for 2018 exceeds beginning-of-the-year expectations by almost 10 percent.

While this year's job numbers will be revised and new monthly counts released in March, the preliminary jobs numbers provide several clues to the type of economic growth the region is experienced in 2018. Three sectors—professional & business services, education & health services, and leisure & hospitality services—substantially outperformed their historic job growth patterns. Together these three sectors accounted for 46.5 percent of the region's total jobs but generated 63.9 percent of the year's net job increase.

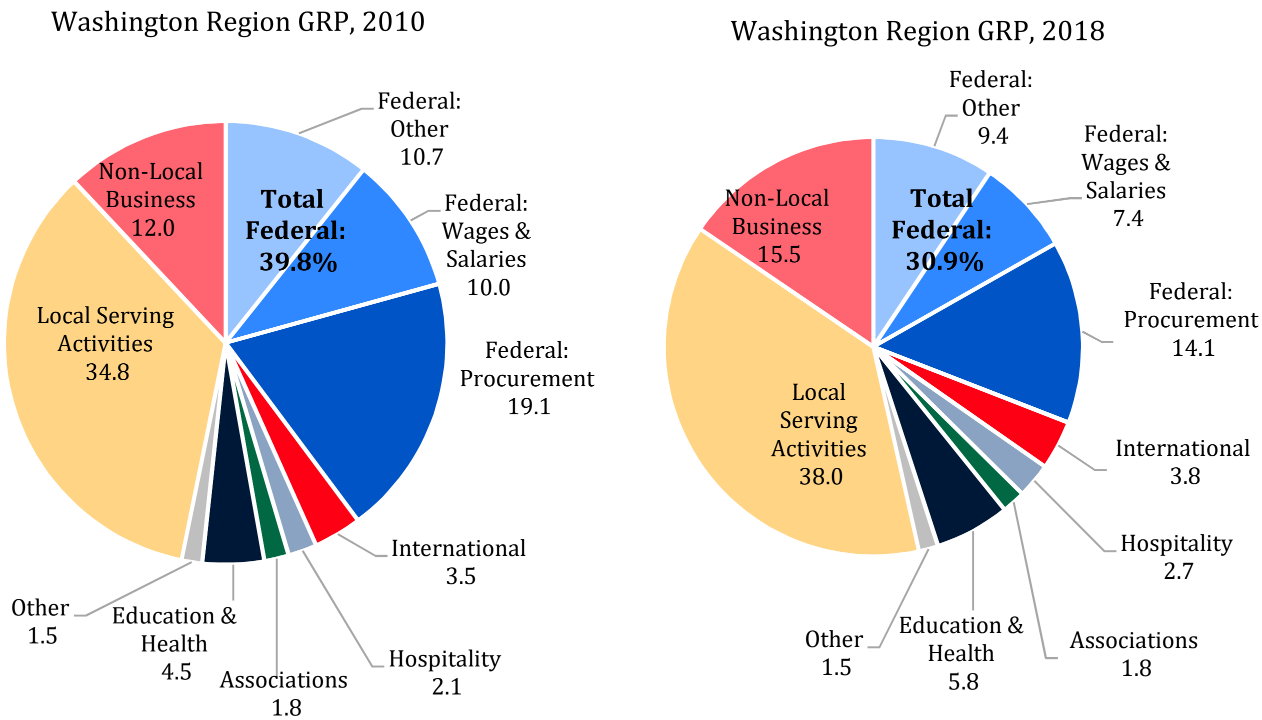
The government sector—federal and state & local—continued to experience a mixed performance in 2018. Federal jobs decreased by 5,700 from 2017 while local and state governments have added 7,200 jobs.

All of the region's other sectors added jobs in 2018 but only construction, with 5,300 new jobs and transportation and utilities with 3,300 new jobs, grew faster than their percentage share of the region's total employment base, thereby increasing their share of all jobs in the Washington region. The employment shares of the region's other six sectors—retail trade, other services, financial activities, information services, wholesale trade and manufacturing—declined in 2018.

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%, and in the three following years, the region's economic growth has underperformed U.S. GDP.

The diversification process has been slow and has contributed to the region's slower economic growth over the last eight years. Still, the region's economic dependence on federal spending declined to an estimated 30.9 percent in 2018. One measure of the benefits of this transformation is seen in the region's increasing economic growth rate since the Sequester. Since 2013, when GRP declined by 0.8 percent, GRP has increased to an estimated 2.6 percent in 2018. And, the Washington region had the lowest average growth rate in comparison to the nation's fifteen largest metro areas between 2010 and 2017; it ranked 10th in 2017.

Figure 4. The Changing Structure of the Washington Region Economy



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

Near-Term Outlook

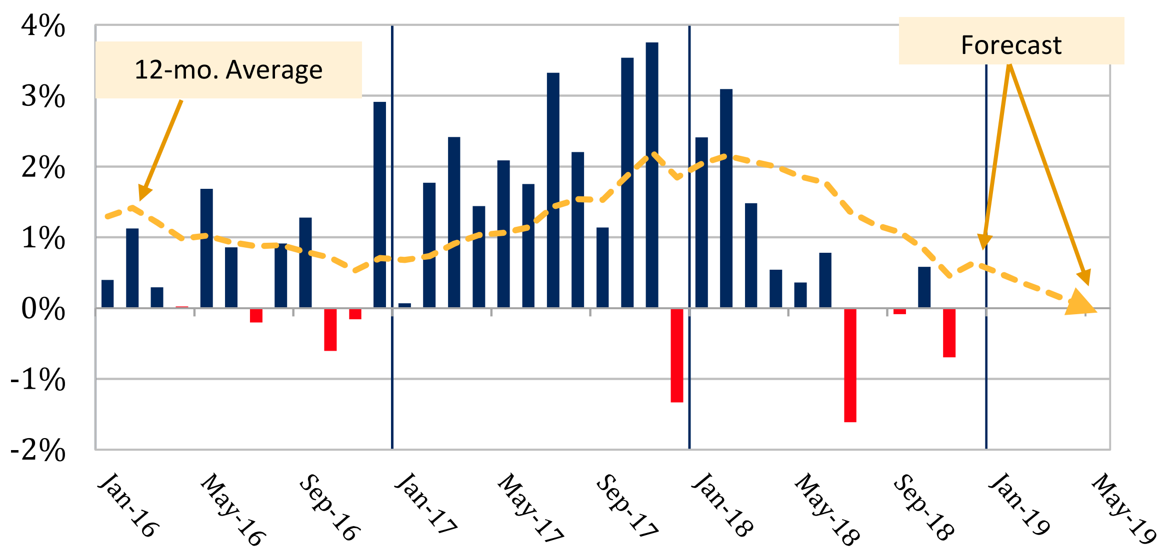
The 2019 forecast for U.S. economy has been revised downwards several times since November. In January, ISH Markit lowered its forecast for 2019 from 2.6 to 2.5 percent after the Federal Reserve Board issued its forecast of 2.3 percent following its December meeting. 2019's economic growth rate was expected to be below the 2018 rate of 2.9 percent, reflecting the diminishing fiscal stimulus at play going forward, higher interest rates, weaker international trade due to higher tariffs, and weaker economic growth in China and Europe, among other head winds impacting this year's economic growth and continuing into the next decade. What was not factored into these forecasts was a long partial federal shutdown that is now entering its second month.

In the absence of this shutdown, with the U.S. economy projected to grow between 2.3 and 2.5 percent, the forecast for the Washington region had its growth rate running slightly above the U.S. GDP rate due to the positive impacts of the economy's federal spending dependency and the higher growth performance of the Washington region's core non-federal sectors—these are projected to grow faster than sectors in which the region is not specialized, such as manufacturing. Before the U.S. economy's growth rate was downgraded at the beginning of the year and before the partial federal shutdown the Washington region was projected to grow 2.8 percent in 2019.

However, even before the downgrading of the U.S. economy's forecast for 2019 and partial federal shutdown there was a growing number of economists (and others) pointing to the growing possibility of a recession in 2020, and maybe even as soon as the fourth quarter of 2019. Weakening business and consumer confidence in the future (expectations) and growing uncertainty in global markets have raised the possibility that the current expansion, now the second longest in history at 115 months, will turn negative for two or three quarters within the next twelve months.

The GDP growth sequence for that scenario has the growth rate for 2019 at 2.3 percent and at 0.8 percent for 2021 with a negative 0.6 percent rate for 2020. Under such a growth scenario at the national level, the economic forecast for the Washington region would also be lower with slower growth (2.5%) than currently projected for 2019 (2.8%), slowing to 1.0 percent in 2020 and then reaccelerating in to 1.4 percent 2021. An early sign of this pattern can already be seen in 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

With the onset of the partial federal shutdown beginning on December 22nd a new variable was introduced into the economy's performance calculation. While the economic impact of the shutdown was muted by it only affecting 40 percent of the federal workforce and 9 executive agencies, by approximately 55 percent of the work of the closed agencies was still being performed, and by its timing at the economy's weakest period of the year, the lengthening duration of the shutdown has begun to make these impacts more threatening to this year's performance of the U.S. economy and to the economy of the Washington region.

For the Washington region's economy, with an estimated 40 percent (145,000) of its 360,000 federal workers furloughed or working without pay and an estimated 25 percent of the region's federal contractor workforce potentially laid off during the shutdown, these direct impacts and their indirect and induced effects on the region's economy can be estimated. While these impacts will be diminished when the shutdown is over and federal workers are compensated for their lost payroll during the shutdown, these federal workers and the uncompensated federal contractors will have reduced their spending during the shutdown costing the economy during the shutdown period and the economy will have lost output that will not be recaptured when the shutdown is over. Additionally the economy will have experienced costs not included in the GRP effect of these workers absence from the workforce during this extended period. Some of these costs may be transferred to local governments (increased public expenditures and decreased revenues), some of these are collateral costs such as lost Metro revenues estimated to be running at $400,000 per day, and some will be lost productivity in businesses and organizations dependent on federal support, approvals, or regulation.

For those costs that can be measured, the direct, indirect and induced costs associated with the furloughing of approximately 145,000 federal workers (including workers still working but without pay) and the layoff or furlough of federal contract workers, it is estimated that these represent the loss of up to $119.2 million dollars a day to the Washington region's economy or 7.3 percent of the $1.635 billion per day that the economy is projected to be generating (assuming that output is the same each day of the year). Once federal workers are reimbursed for their forgone pay during the shutdown, this loss could be reduced to the equivalent of 2.8 percent of daily GRP or $46.4 million per day.

The costs will continue to accumulate and deepen the longer the shutdown continues. For the month of January, these costs could total as much as $3.338 billion and, if not partially recaptured when the federal employed get paid, this lost output would constitute a loss of 0.1 percentage point of economic growth reducing GRP growth in 2019 from 2.8 to 2.7 percent. If the shutdown continued through February, its costs would reduce GRP growth by another 0.1 points to 2.6 percent assuming that the US economy does not slow further bringing region's lower with it. The outlook for 2019 is much less certain at the beginning of the year and this outlook was at this same time a year ago and uncertainty is not good for the economy. The long-term impacts of the partial federal shutdown will become clearer in the next several months.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Nov-18 Prelim.	Oct-18 Final	Nov-17 Final	Oct-18 to Nov-18	Nov-17 to Nov-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	110.6	109.2	107.4	1.22%	2.91%
Leading Index (2015 = 100)	103.5	103.6	104.3	-0.09%	-0.70%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,360.3	3,349.0	3,306.2	0.34%	1.64%
Consumer Confidence (South Atlantic)[a]	180.5	174.6	160.0	3.38%	12.81%
Domestic Airport Passengers ('000)[b]	2,377.6	2,324.1	2,285.6	2.30%	4.02%
Nondurable Goods Retail Sales ($000,000)[c]	3,336.7	3,235.8	3,204.7	3.12%	4.12%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	1,929.3	2,486.0	2,514.0	-22.39%	-23.26%
Consumer Expectations (South Atlantic)[a]	123.0	128.6	115.1	-4.35%	6.86%
Initial Unemployment Claims[b]	2,282.8	2,327.4	1,782.3	-1.92%	28.08%
Durable Goods Retail Sales ($000,000)[c]	3,972.1	3,884.0	3,910.3	2.27%	1.58%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,405.0	3,406.2	3,387.9	-0.03%	0.51%
Employed Labor Force ('000)	3,301.9	3,297.0	3,269.0	0.15%	1.00%
Unemployed Labor Force ('000)	103.1	109.2	118.9	-5.50%	-13.22%
Unemployment Rate	3.0%	3.2%	3.5%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,360.3	3,349.0	3,306.2	0.34%	1.64%
Construction ('000)	168.9	168.5	159.6	0.24%	5.83%
Manufacturing ('000)	56.2	56.0	55.1	0.36%	2.00%
Transportation & Public Utilities ('000)	71.9	69.9	67.8	2.86%	6.05%
Wholesale & Retail Trade ('000)	350.0	344.6	346.8	1.57%	0.92%
Services ('000)	2,000.9	2,001.1	1,968.7	-0.01%	1.64%
Total Government ('000)	712.4	708.9	708.2	0.49%	0.59%
Federal Government ('000)	359.9	360.9	365.9	-0.28%	-1.64%

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