



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



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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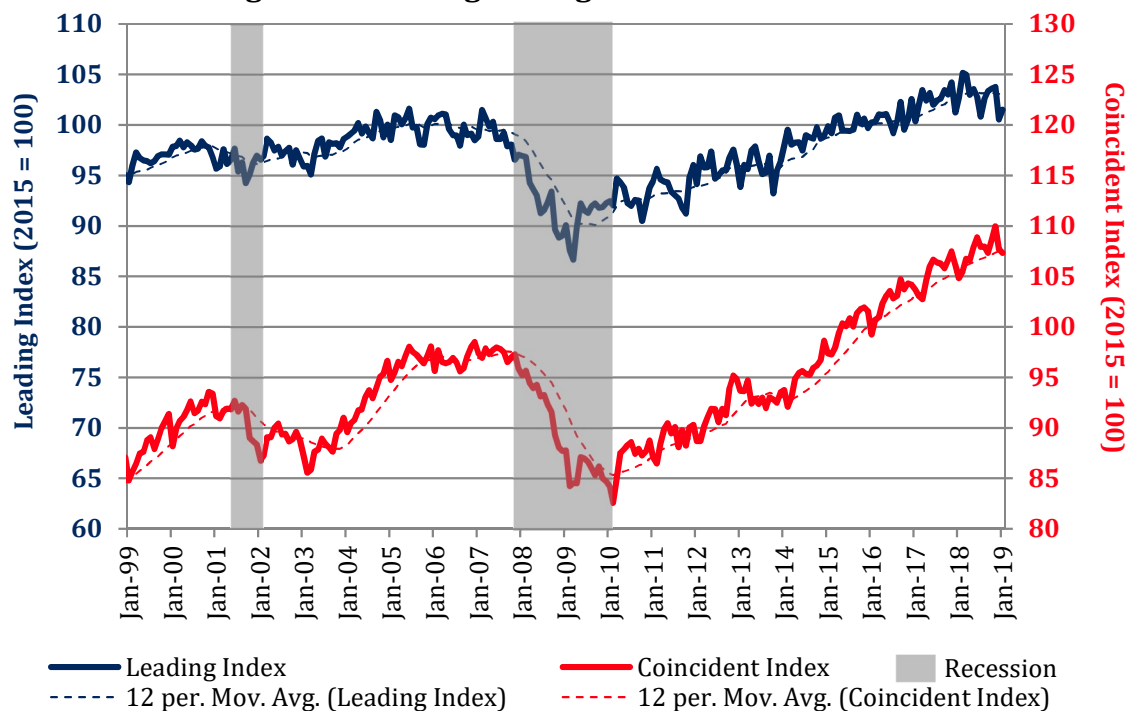
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The Washington Region's Weakened 2018 Economic Performance Threatens Its Outlook For 2019

Recalculation of the Washington Coincident Index to reflect revised job estimates by the U.S. Bureau of Labor Statistics shows the region's economic expansion to have continued through 2018 but that it followed a slightly lower trajectory than previously reported, especially over the year's last six months. The Leading Index, which was not affected by these revisions, has continued to track negatively since mid-year 2018 with this pattern now extending through January 2019. These trends clearly raise questions concerning the economy's outlook this year. Looking forward, a slowing U.S. economy in 2019, now expected to grow only 2.1 percent, may result in the Washington region's economy growing at a slower rate than previously projected.

Figure 1. Washington Region Economic Indices



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

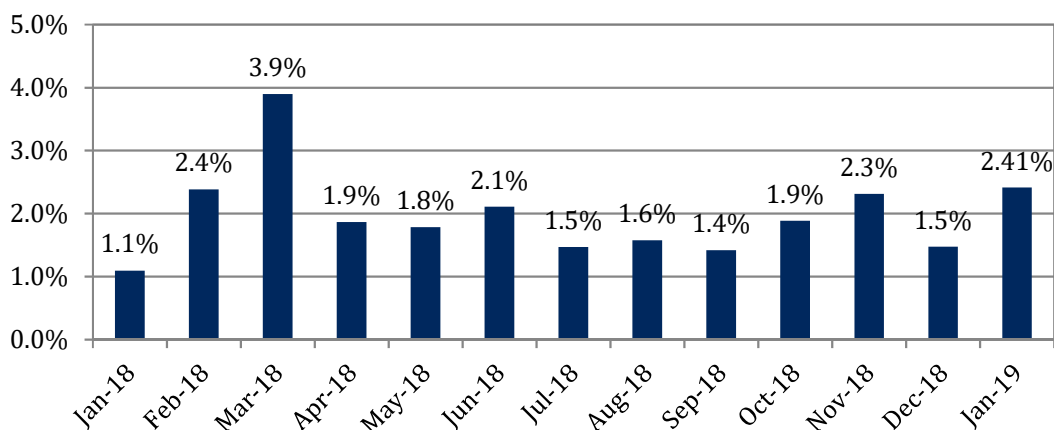
The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, decreased for a second month in January, on a month-to-month basis, declining 0.34 percent. These month-to-month declines may be in part reflective of the partial-federal government shutdown that spanned 35 days during these two months. In January, two of the Index's four components (job change and domestic airport passenger traffic) had month-to-month declines.

On a monthly over-the-year basis, January's Coincident Index registered an increase of 2.41 percent from January 2018 extending its upward trend to 58 consecutive months, dating from April 2014. The Index's January calculation includes the annual BLS job revisions for 2018 (as well as for previous years) that reduced the rates of monthly over-the-year increases from previous reports with this adjustment lowering the growth trajectory of the Index for 2018. Still, it remained positive and extended its pattern of continuing growth for the full year.

In January, for the fourth 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 1.0% between January 2018 and January 2019;
- *Consumer confidence (in the present)* extended its positive trend increasing 18.9% from January 2018;
- *Domestic passenger volume at Reagan National and Dulles Airports* increased 2.2% from January 2018; and,
- *Non-durable goods retail sales* were up 3.4% from January 2018 gaining for a 23th consecutive month on a monthly over-the-year basis.

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



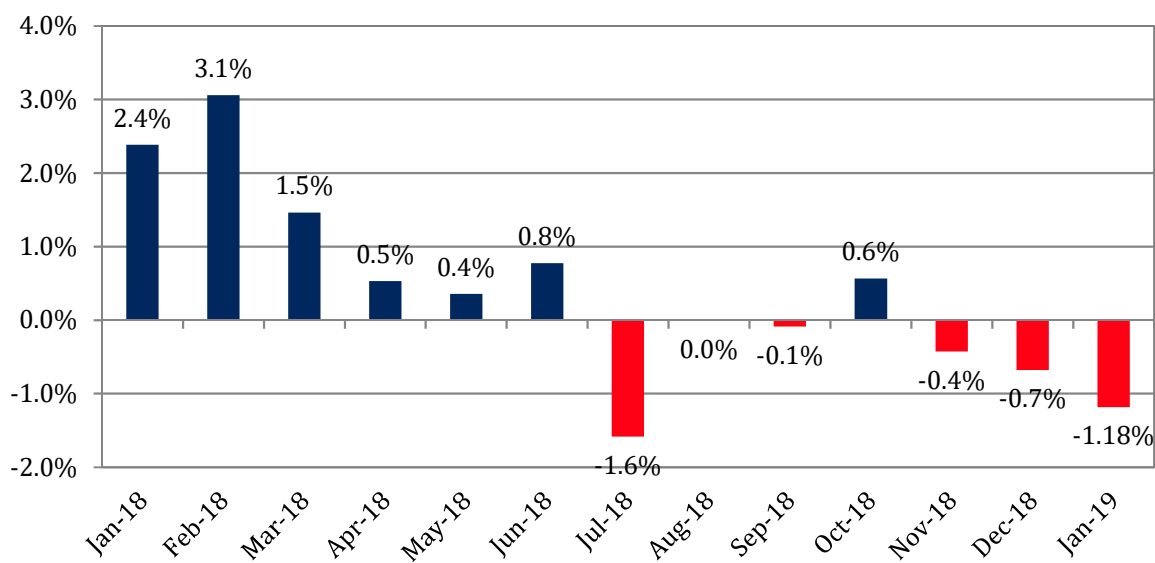
Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy six to eight months in advance, declined by 1.18 percent in January on a monthly over-the-year basis. The Leading Index has now only increased once since mid-year 2018 and is forecasting slower economic growth over the next several quarters. The Leading Index is being dragged lower by double-digit gains in initial claims (worsened) each month since May 2018 and a slowdown in the growth of Consumer Expectations that turned significantly negative in January.

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

- *Initial claims for unemployment insurance* increased 28.9%, worsening for the eighth consecutive month, including an increase of 94.6% in December, with both months reflecting the impacts of the partial-federal shutdown; and,
- *Consumer expectations (consumer confidence six months hence)* decreased 21.3% from its January 2018 level after growing only slightly in November and December; while,
- *Total residential building permits* increased 57.0% in January after increasing 74.6% in December following five monthly over-the-year declines dating to mid-year 2018; and,
- *Durable goods retail sales* increased 1.3% between January 2018 and January 2019 extending its long-term positive trend from 2018 during which it registered only one monthly decrease.

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 2013-2014 Sequester for 58 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 January 2019. However, the annual revisions by the U.S. Bureau of Labor Statistics (BLS), released March 11th, show that the Washington region's job growth slowed in 2018 to 35,300 jobs, revised down from the estimated 52,100 jobs based on monthly releases throughout the year. While BLS made these job revisions back to 1991, they were only significant for a few years beyond 2018. Total job growth in 2017 was revised down by 1,100 jobs and previously reported gains in 2012 and 2013, were revised down by 2,100 and 2,500 jobs, respectively; these two years were both impacted by substantially reduced federal spending under the provisions of the Budget Control Act of 2011.

The 16,800 job downward revision for 2018 (32.2%) also revealed that the region's job growth was slowing throughout the year. In January 2019, the Washington region added 32,100 jobs. Just released BLS data for February, show the region generated 20,700 net new jobs, only one-half the number registered in February 2018 when 41,900 jobs were added.

This slowdown also affected the region's sub-state areas differently. Where Suburban Maryland had added 15,200 new jobs in 2017, it only added 3,000 jobs in 2018, down 80.3 percent. In comparison, the District of Columbia generated 8,700 new jobs in 2017 and 7,200 jobs in 2018, down 17.2 percent, and Northern Virginia, which added 25,900 in 2017, added 25,100 jobs in 2018, for a decrease of 3.1 percent.

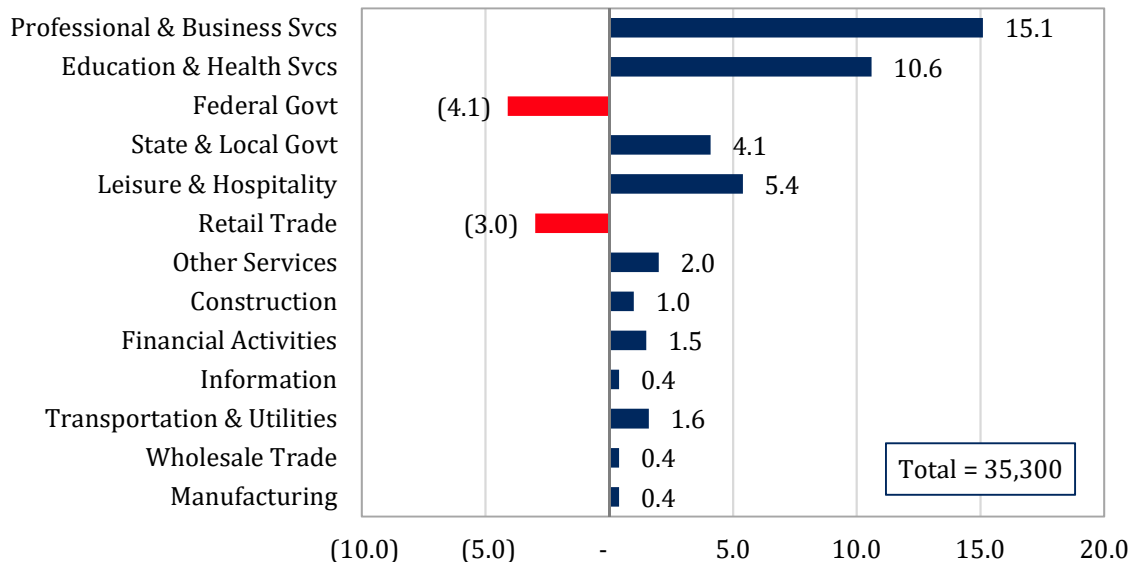
The sectoral mix of the jobs added in 2018 (see Figure 4) changed slightly with the revisions from BLS's earlier estimates. Federal government job losses were not as great as previously estimated (down 4,100 jobs rather than 5,700 jobs). Construction job gains were revised down to 1,000 from 5,300 jobs; this was the largest percentage reduction (down 81.1%) among all sectors. Annual job growth in Leisure and Hospitality Services, was also revised downward significantly, from 9,100 jobs to 5,400 jobs, down 40.6 percent.

Education and Health Services was revised upward from 8,200 jobs to 10,600 jobs, up by 29.3 percent, underscoring the growing importance of the region's second largest employer. Professional and Business Services, the region's largest sector, added a revised 15,100 new jobs in 2018, down slightly from its previous estimate of 16,000 jobs (- 5.6%).

The region's largest three private sectors—Professional and Business Services, Education and Health Services, and Leisure and Hospitality Services—accounted for

88.1 percent of the region's new jobs in 2018 while representing only 46.1 percent of the region's total employment base at the beginning of the year. These were the sectors driving the region's economic growth in 2018 and are likely to continue to drive growth in 2019 as the economy continues to diversify and become less dependent on federal government spending to drive the economy in the future.

Figure 4. Washington Region Job Change by Sector, 2018
 (in 000s, Ranked by size in 2018)



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

Near-Term Outlook

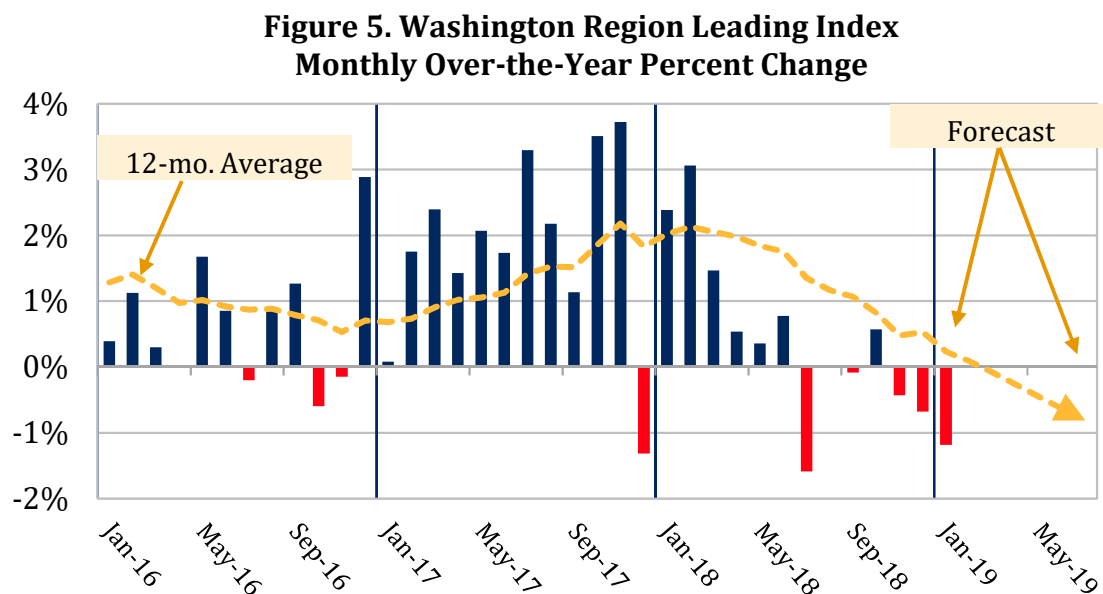
Following its March 20th meeting, the Federal Reserve Board announced that it had revised the U.S. GDP forecast down to 2.1 percent from 2.3 percent and that it would not be raising the federal funds rate any further in 2019; only in January the Federal Reserve Board had announced that it would likely raise the federal funds rate once in 2019 rather than the two or possibly three times it had planned previously. Furthermore, the possible March 2020 federal funds rate increase that had been expected after the January Board meeting now appears to be off the table.

The Federal Reserve Board reports that the U.S. economy ended 2018 in a strong but slowing position. The year-end sell off in the equity markets, which erased the year's market gains, the 35-day partial-federal shutdown, the weaker economies being experienced across the European Union including the uncertainty of Brexit and the British economy and the fourth-quarter contraction of the German economy, the slowing of the Chinese economy and the looming trade war between China and the US, among other international uncertainties, are all pointing to slower growth globally in 2019 and beyond.

The Federal Reserve Board reported that it expects job growth in the U.S. to slow and for unemployment to rise by two-tens of a point by year's end, still a low rate by historic standards. Inflation remains in check and is expected to range up to 2.1 percent over the year as energy prices remain low but are expected to decline over the coming year with U.S. production increasing to mitigate international constraints on oil sales. Tariffs and their impact on prices remain a question mark as do the early rounds of the Presidential campaign that could dampen consumer confidence and create additional uncertainty in the economy's performance. Finally, fiscal policy will not be the positive force it was in stimulating consumer spending in 2018 as the effects of the 2017 Tax Cuts and Jobs Act moderate in 2019.

These factors are dampening GDP growth in 2019, reducing it towards the 2.0 percent trend level from 2.9 percent in 2018, and are increasing the risk of a downturn ending what will become the longest business cycle in U.S. history if the current cycle continues through June as expected. While the probability of a downturn in 2020 remains low, and the Fed's suspension of further federal funds rate increases helps to extend the longevity of the current business cycle, the economy's ability to absorb shocks is being diminished by a long and growing list of threats and uncertainties.

This pattern of growing weakness in the U.S. economy is being mirrored to a degree in the Washington region's economy as seen in the performance of its Leading Index, as shown in Figure 5. January's Leading Index was down 1.2 percent following December's index decline of 0.7 percent and November's Index decline of 0.4 percent. This deepening of the Index's negative trend builds on a pattern of slowing growth during the year's first half that transitioned into the Index's decline over the second half of 2018.



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

After peaking in February 2018 at 105.2, the Leading Index stood at 100.5 in December, its lowest value since January 2017. This pattern of slowing growth followed by actual declining values forecasts a slowing performance of the current economy during the first three-quarters of 2019. While this pattern could reverse and forecast higher growth in 2019, such a reversal would require a positive combination of stronger housing construction, business investment, consumer spending and federal outlays for payroll and/or procurement from local contractors.

Homebuilding, as measured by residential building permits in the Leading Index, consistently underperformed forecast in 2018. Residential building permits declined in eight of the year's twelve months in the Washington region. Numerous reasons have been cited to explain this problem: fewer household formations due to slower immigration and the burden of student loans, increasing mortgage interest rates in the year's first half, rising construction costs due to new tariffs on steel and lumber, changes in the federal tax law that were unfavorable to homeownership, construction labor shortages and rising labor costs, and an unfavorable or burdensome regulatory climate delaying and adding costs to new residential development. With the exception of mortgage rates, which have declined in recent months, these factors will continue to weigh on the home building industry in 2019. Slowing job growth generally and growing economic uncertainty may add to the list of unfavorable market conditions constraining this industry's important contribution to the economy's growth in 2019.

The one advantage the Washington region has over other metropolitan area economies is its mix of federal and non-federal economic activities. With the national economy slowing in 2019, those non-federally dependent business activities in the Washington region serving national and global markets can also be expected to slow or at least have more difficulty growing faster than last year. However, a slowing private sector economy will not necessarily cause the federally dependent economy to slowdown. With approximately 31 percent of the region's economy tied directly or indirectly to federal spending, the certainty of this spending can cushion the economy's overall performance in a slowing national and global economy. However, if federal spending also slows down or is disrupted simultaneously with the slowing non-federal economy, then the Washington region's economy could experience the combined effects of both its federal and non-federal sectors contracting. With the federal budget uncertainty at the end of the current fiscal year as well as a debt ceiling showdown likely in September, or possibly sooner, the region's recent experiences with federal government shutdowns suggest that this year's second half economic performance might face additional headwinds making it more difficult to achieve this year's potential growth target of 2.8 percent.

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

Economic Indicator	Estimates			Percent Change	
	Jan-19 Prelim.	Dec-18 Final	Jan-18 Final	Dec-18 to Jan-19	Jan-18 to Jan-19
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	107.3	107.7	104.8	-0.34%	2.41%
Leading Index (2015 = 100)	101.5	100.5	102.7	0.97%	-1.18%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000) ^a	3,276.4	3,324.6	3,244.3	-1.45%	0.99%
Consumer Confidence (South Atlantic) ^a	178.3	161.3	150.0	10.54%	18.87%
Domestic Airport Passengers ('000) ^b	2,188.7	2,318.8	2,142.3	-5.61%	2.17%
Nondurable Goods Retail Sales (\$000,000) ^c	3,266.4	3,125.0	3,157.5	4.52%	3.45%
Washington Area Leading Index Components					
Total Residential Building Permits ^a	2,401.0	1,931.0	1,529.0	24.34%	57.03%
Consumer Expectations (South Atlantic) ^a	100.0	104.3	127.0	-4.12%	-21.26%
Initial Unemployment Claims ^b	2,112.1	2,900.4	1,638.1	-27.18%	28.94%
Durable Goods Retail Sales (\$000,000) ^c	3,780.3	3,726.1	3,731.7	1.45%	1.30%
Washington Area Labor Force^a					
Total Labor Force ('000)	3,394.3	3,398.1	3,390.7	-0.11%	0.11%
Employed Labor Force ('000)	3,269.4	3,301.0	3,263.7	-0.96%	0.17%
Unemployed Labor Force ('000)	125.0	97.1	127.0	28.74%	-1.57%
Unemployment Rate	3.7%	2.9%	3.7%	--	--
Washington Area Wage and Salary Employment^a					
Total ('000)	3,276.4	3,324.6	3,244.3	-1.45%	0.99%
Construction ('000)	156.4	161.5	154.8	-3.16%	1.03%
Manufacturing ('000)	53.6	55.2	54.4	-2.90%	-1.47%
Transportation & Public Utilities ('000)	71.1	74.7	67.3	-4.82%	5.65%
Wholesale & Retail Trade ('000)	332.9	343.9	339.0	-3.20%	-1.80%
Services ('000)	1,967.9	1,985.2	1,935.3	-0.87%	1.68%
Total Government ('000)	694.5	704.1	693.5	-1.36%	0.14%
Federal Government ('000)	361.9	362.9	364.5	-0.28%	-0.71%

^aUnadjusted data

^bSeasonally adjusted data

^cSeasonally adjusted constant (1996) dollars