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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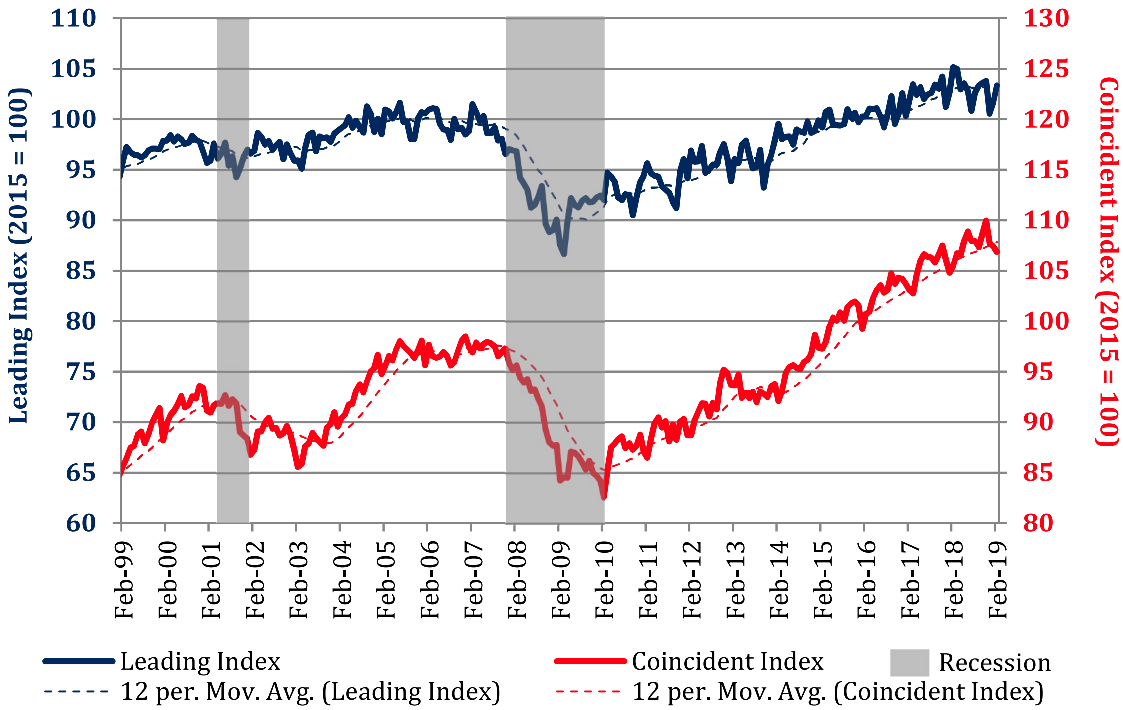
The Washington Region's Economy Slowed in February and Its Outlook Continues to Weaken

The Washington region's Coincident and Leading Indices both revealed further weaknesses in February following their December and January performances that had been undercut by the negative effects of the 35-day partial-federal government shutdown. While February weather can often be blamed for the economy's poor results, several signs of growing economic weakness point to changes in the economy's underlying conditions. Job growth in February slowed to its lowest rate in almost five years, consumer spending both for durable goods and non-durable goods slowed—this pattern is now in its third month, and consumer confidence, both in the future (expectations) and in the current situation is showing continuing weakness. While these conditions may be temporary, the longer they persist, the more damaging they can be to the economy's long-term performance.

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 in February, on a month-to-month basis, declining 0.54 percent. These month-to-month declines reflect, in part, the combined effects of the partial-federal government shutdown that spanned 35 days during December and January and the severe winter weather moving across the country from the Pacific to the Atlantic during February. In February, two of the Index's four components (domestic airport passenger traffic and nondurable goods sales) had month-to-month declines.

On a monthly over-the-year basis, February's Coincident Index registered an increase of 1.28 percent from February 2018 extending its upward trend to 59 consecutive months, dating from April 2014. While continuing to expand, the Coincident Index registered its slowest gain in more than a year, as job growth In February slowed to its lowest rate in almost five years.

In February, three of the Index's four components were positive on a monthly over-the-year basis:

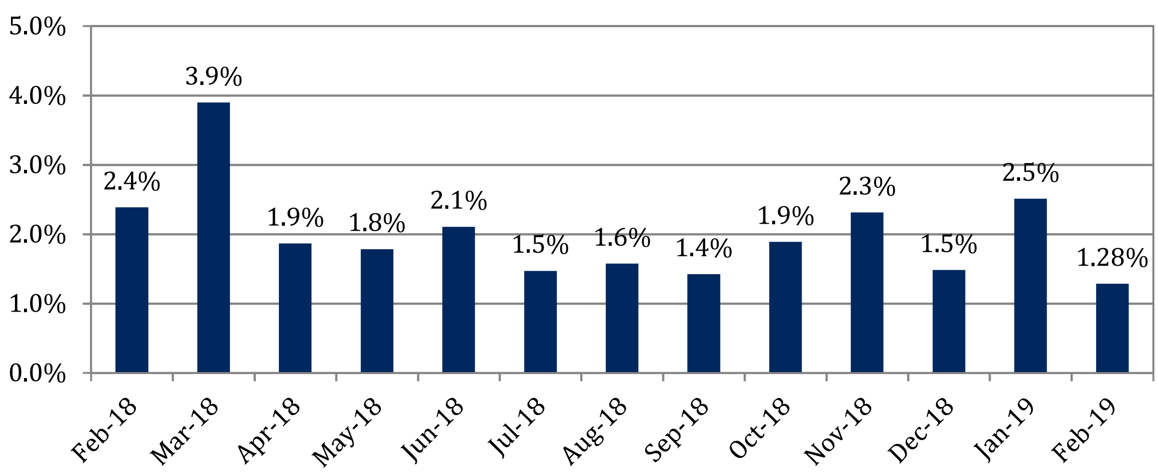
- *Wage and salary employment* in the Washington region increased 0.6% between February 2018 and February 2019;

- *Consumer confidence (in the present)* extended its positive trend increasing 6.8% from February 2018; and,

- *Non-durable goods retail sales* were up 3.1% from February 2018 gaining for a 24th consecutive month on a monthly over-the-year basis; while,

- *Domestic passenger volume at Reagan National and Dulles Airports* decreased 0.1% from February 2018.

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 1.73 percent in February on a monthly over-the-year basis. The Leading Index has now increased once in the past eight months and its average twelve-month change is a negative 0.16 percent. This performance is forecasting a likely slowdown in the region's economic growth during the second and third quarters. The 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 and continued to decline in February.

In February, three of the Leading Index's four components contributed to its decline; the Index's fourth indicator was unchanged from February 2018:

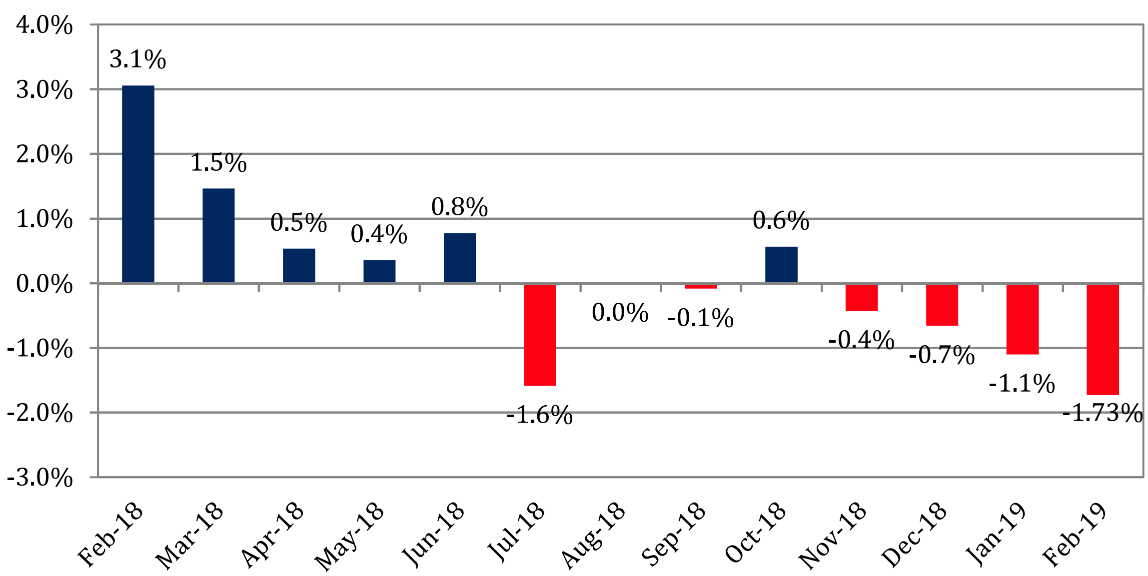
- *Initial claims for unemployment insurance* increased 55.4%, worsening for the ninth consecutive month;

- *Consumer expectations (consumer confidence six months hence)* decreased 5.5% from its February 2018 for a second consecutive monthly-over-the year decline; and,

- *Total residential building permits* decreased 2.2% in February after registering strong gains in December and January; while,

- *Durable goods retail sales* registered no gain from their February 2018 level reflecting a general weakness continuing since November.

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

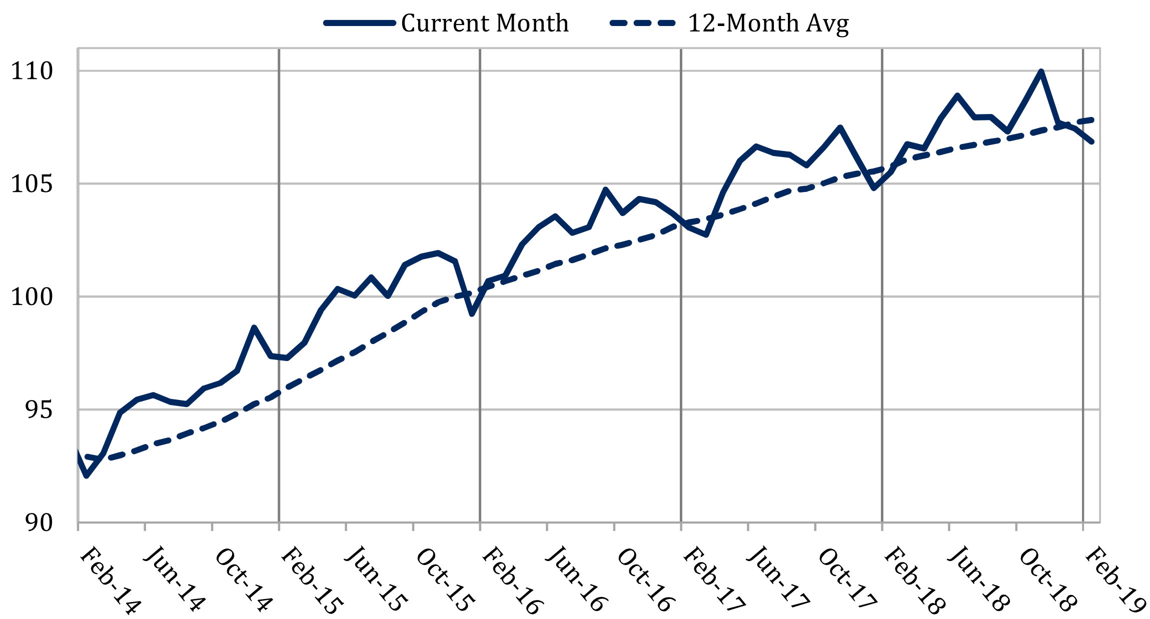


Source: The Stephen S. Fuller Institute at the Schar School, GMU

Current Performance

The Washington region's economy has sustained its expansion (recovery) from the negative impacts of the 2013-2014 Sequester for 59 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 February 2019. While this Index is composed of four indicators that have been found to be strongly correlated with the economy's growth (gain or decline in gross regional product), job growth has the strongest correlation and accounts for the largest percentage of Coincident Index's monthly calculation. Consequently, it is not surprising that the region's 20,900 net job gain in February from February 2018 contributed to the Index's slowing trajectory (see Figure 4). This February's job gain falls well below job gains between February 2017 and 2018 (41,900), job gains for all of 2018 (35,300), and the average rate of job gain for the 2010-2018 period (36,900) that included the sharp slowdown experienced during the Sequester.

Figure 4. Washington Region Coincident Index (2015 = 100)



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

March jobs data, released on April 19th, show that this pattern of slow job growth is continuing in the Washington region in contrast to the national data that showed a substantial bounce back in March following a weak February jobs report. Job growth in March for the Washington Region totaled 29,500 jobs. While this is an improvement from February's gain of 20,900 jobs, it continues to fall well below job growth in 2018 (35,300) and the average annual job gains for the previous three years (54,650).

This pattern of slower job growth has multiple possible explanations. Slower consumer spending is certainly one of these and it might help explain the loss of 6,800 jobs in the retail sector between March 2018 and 2019. Of course, increasing on-line retail shopping could account for this loss of retail jobs, too. Federal government job losses have slowed in 2019 but not stopped. And, the job base of many smaller sectors appears to have stabilized suggesting that they have right-sized or possibly that hiring qualified workers has become so challenging due to continuing low unemployment that businesses and organizations are employing alternative strategies (new technologies, part-time workers, over-time) to meet their output requirements.

Three sectors continue to dominate the Washington region's economic growth, as measured by job gains. Professional and business services, the region's largest sector with 768,500 jobs (23.2% of all jobs) added 15,100 new jobs accounting for 51.2 percent of the March job gain. Education and health services, the region's second largest sector with 448,800 jobs (13.6% of all jobs) added 6,200 new jobs accounting for 21.0 percent of the March job gain. Leisure and hospitality services, the region's fifth largest sector with 337,800 jobs (10.2% of all jobs) added 14,000 new jobs accounting for 47.4 percent of the March gain. These three sectors, which together account for 47.0 percent of the region's total job base generated 35,300 new jobs or approximately 120.0 percent of the job gain in March. These three non-government sectors continue to be the region's principle sources of new job growth underscoring the continuing shift of the Washington region's economy away from its historic government employment base.

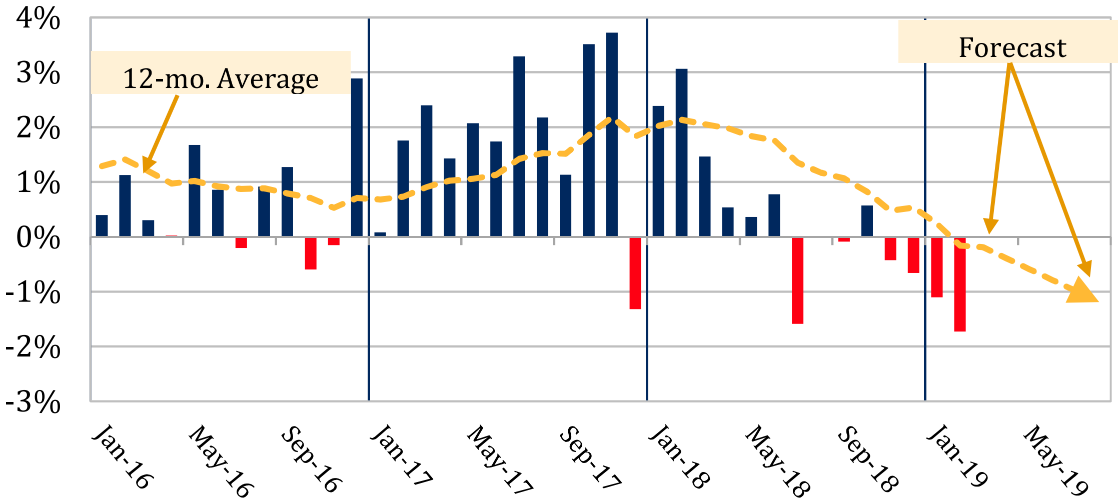
The geographic distribution of the region's job growth continues to be uneven. While this is not a new pattern, it has become more uneven over the past 18 months. For all of 2018, Northern Virginia accounted for 71.1 percent of the region's new jobs while during the previous three years it had accounted for 52.2 percent of the region's new jobs. Suburban Maryland's share of the region's job growth in 2018 fell to 8.5 percent down from 24.4 percent for the previous three years while the District's share of the region's new jobs in 2018 was 20.4 percent, down slightly from its 23.4 percent share during the previous three years. This pattern has become more pronounced in 2019 as Suburban Maryland has experienced job losses in the first quarter 2019 compared to first quarter 2018. Overall in the region, job growth in March was up 0.9 percent from last year. In comparison, in the District job growth was up 0.4 percent while in Northern Virginia it was up 1.8 percent; in Suburban Maryland it was down 0.3 percent.

Near-Term Outlook

The Washington Leading Index has been tracking lower for a full year with its February 2019 value now standing 1.7 percent below the Index's all-time high value achieved in February 2018 for a twelve-month average change of negative 0.16 percent. This negative trajectory forecasts a slowing growth trend or possibly even a downward trend for the Coincident Index (Figure 4) over the coming six to eight months.

How vulnerable the Washington region's economy is in the near term depends on how the global and national economies perform during the middle quarters of 2019 and whether federal spending is disrupted due to the failure to fund federal government operations at the beginning of the FY 2020 (October 1, 2019). Raising the federal deficit ceiling in September could be part of this story. The current prognosis is that budgetary authority will be extended through use of continuing resolutions (CRs) into FY 2020 averting a federal shutdown in October.

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



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

As the Washington region's economy becomes less dependent on federal spending to drive its growth, how the non-federal economy performs has become more important to determining the region's growth path going forward. Growth concerns regarding the weakening of the business cycle and whether the U.S. economy would slip into a recession in 2020 appear to have substantially abated in the last month, largely due to the Federal Reserve Board announcing that its planned increases in the federal funds rate were being put on hold and that further increases in this rate in 2019 were unlikely. While forecasters continue to expect one further rate increase to cap the Feds move to a neutral interest rate position, there have been recent prognostications that the next move by the Federal Reserve Board could be to lower its fed funds rate by a quarter point to stimulate the economy going into next year. Either way, up or down, the federal funds rate will not have much effect on the U.S. economy over the coming year as these potential changes have already been largely accommodated in major investment and pricing decisions.

Perhaps the most visible impact of the Fed's action to suspend its planned increases in interest rates was the quick response by banks and other financial institutions in lowering mortgage rates that had already pushed upward to 5.0% last summer in anticipation of higher federal funds rates in 2019 and 2020. With these rates frozen, mortgage rates are down a half point from the recent high and will not be the constraint to home buying that had threatened the homebuilding industry last year and that was an important factor in its below-forecast performance in 2018.

However, other factors are still be in play and will help shape the U.S. economy's performance in 2019 and could also impact this year's performance of the Washington region's economy. The U.S. economy is projected to grow significantly slower in 2019 than it did in 2018, primarily due to the fiscal stimuli that fueled growth last year not being a major factor in this year's economic performance. While job and income growth remain a positive force n the U.S. economy, these are not expected to remain as strong a force in 2019 as they were in 2018; slower job growth is projected with unemployment remaining a historically low levels. Still, consumers appear to be less comfortable with current and projected economic conditions and have reduced their consumption spending in recent months. This has shown up in lower automobile and other durable goods sales as well as in weaker non-durable goods and homes sales. This uncertainty has been stoked by threats of a trade war, growing political friction, weaker economic reports from important trading partners in Europe and Asia, and possibly from business-cycle fatigue. Current GDP forecasts for 2019 are now at near-trend levels (2.0%) down from 2.9% for all of 2018.

The good news is that the world economy may be stronger than currently being reported and that the first quarter is not indicative of the full year's performance. The U.S. economy remains solid with job growth bouncing back in March from a poor performance in February. Trade negotiations between China and the U.S. continue and seem to hold some promise of small gains to the benefit of the U.S economy. Inflation remains low even with some expected increases in energy prices over the year and interest rates are now set for the year.

If the Congress and the White House can resolve the FY 2020 funding package, even using continuing resolutions to avoid an October shutdown, the Washington region's economy should be able to outperform the U.S. economy because of its beneficial mix of federally dependent and non-federally dependent sectors comprising the regional economy. With federal dependence down from near 40 to about 30 percent over the past eight years, and the mix of non-federally dependent, export-based, high-value added businesses and organizations favoring the more rapidly growing services, the Washington region is positioned to take advantage of its complementary economic strengths. However, a federal government budget impasse would do considerably more damage to the region's economy than it would to the Nation's. Consequently, the region's 2019 economic performance remains vulnerable to its principle competitive advantage, its federal government base.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Feb-19 Prelim.	Jan-19 Final	Feb-18 Final	Jan-19 to Feb-19	Feb-18 to Feb-19
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	106.9	107.4	105.5	-0.54%	1.28%
Leading Index (2015 = 100)	103.3	101.6	105.2	1.72%	-1.73%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,289.8	3,275.9	3,268.9	0.42%	0.64%
Consumer Confidence (South Atlantic)[a]	181.6	178.3	170.1	1.85%	6.76%
Domestic Airport Passengers ('000)[b]	2,085.8	2,188.7	2,088.7	-4.70%	-0.14%
Nondurable Goods Retail Sales ($000,000)[c]	3,224.1	3,285.4	3,127.7	-1.87%	3.08%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,543.0	2,401.0	2,599.0	5.91%	-2.15%
Consumer Expectations (South Atlantic)[a]	116.1	100.0	122.8	16.10%	-5.46%
Initial Unemployment Claims[b]	2,040.2	2,112.1	1,313.0	-3.41%	55.39%
Durable Goods Retail Sales ($000,000)[c]	3,704.9	3,808.5	3,703.8	-2.72%	0.03%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,411.8	3,395.6	3,389.4	0.48%	0.66%
Employed Labor Force ('000)	3,292.1	3,271.0	3,264.9	0.65%	0.83%
Unemployed Labor Force ('000)	119.7	124.7	124.5	-3.96%	-3.82%
Unemployment Rate	3.5%	3.7%	3.7%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,289.8	3,275.9	3,268.9	0.42%	0.64%
Construction ('000)	156.4	156.6	156.1	-0.13%	0.19%
Manufacturing ('000)	54.2	53.9	54.5	0.56%	-0.55%
Transportation & Public Utilities ('000)	68.8	70.8	66.8	-2.82%	2.99%
Wholesale & Retail Trade ('000)	327.4	332.1	334.8	-1.42%	-2.21%
Services ('000)	1,975.7	1,968.1	1,951.0	0.39%	1.27%
Total Government ('000)	707.3	694.4	705.7	1.86%	0.23%
Federal Government ('000)	362.4	361.9	363.4	0.14%	-0.28%

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