# 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
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*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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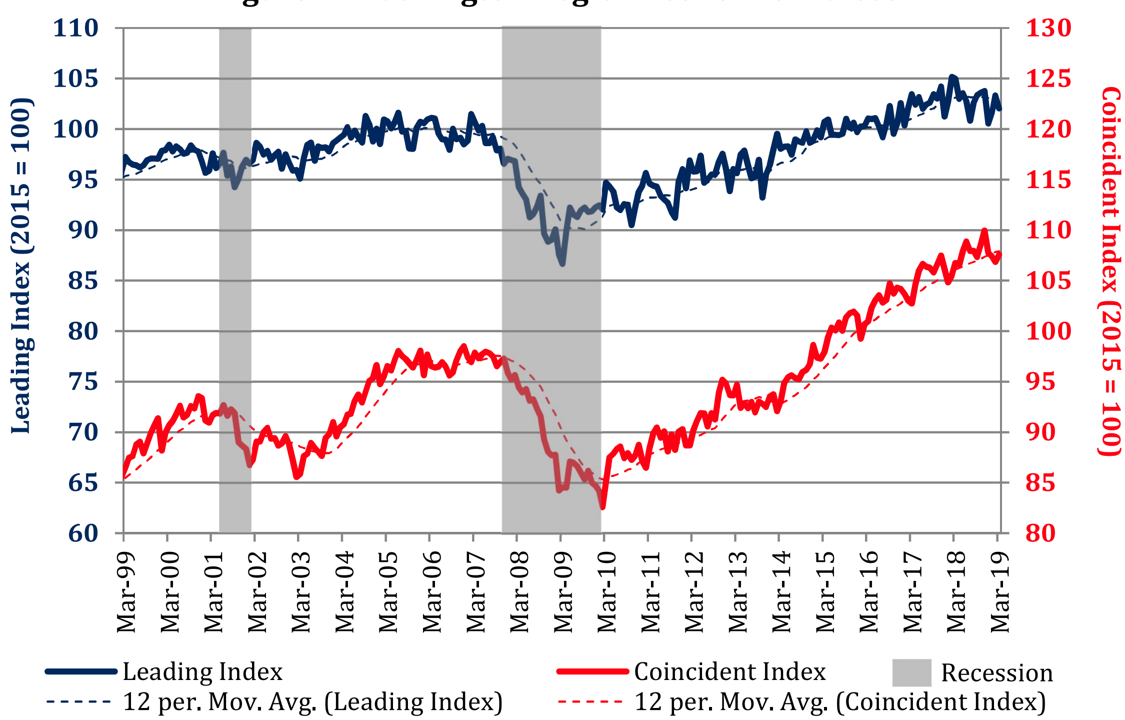
## The Washington Region's Economy Slowed Further in March and Its Outlook Continued to Weaken

The Washington region's Coincident and Leading Indices both revealed continuing weaknesses in March extending their respective trends: the Coincident Index's five-year long growth trajectory has flattened and the Leading Index's downward trend is accelerating. The signs of growing economic weakness point to changes in the economy's underlying conditions. Job growth in March remained well below forecast, consumer spending for durable goods was flat and non-durable goods sales weakened, and consumer confidence in the future (expectations) declined for a third month and consumer confidence in the present was negative for the first time in five years (March 2014). These measures, in combination with other negative trends, are pointing to slower growth than previously forecasted for 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 0.68 percent in March, on a month-to-month basis, after having declined for the previous three months. This reversal in March reflected recovery from the impacts of the 35-day partial federal shutdown as seen in month-to-month gains in three of the Index's four components. Strong gains in nondurable goods retail sales, up 3.1 percent, and domestic passenger traffic at Reagan and Dulles Airports in March, up 4.0 percent are likely to have benefited from renewed springtime tourism in combination with the Cherry Blossom Festival.

On a monthly over-the-year basis, March's Coincident Index registered an increase of 0.79 percent from March 2018, its weakest gain since March 2014 at the depth of the Sequester. Still this increase extended the Index's upward trend to 60 consecutive months, dating from April 2014. The Coincident Index's slower rate of gain is attributable to a decline in consumer confidence accompanied by slower growth of nondurable goods retail sales and below-trend job growth.

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

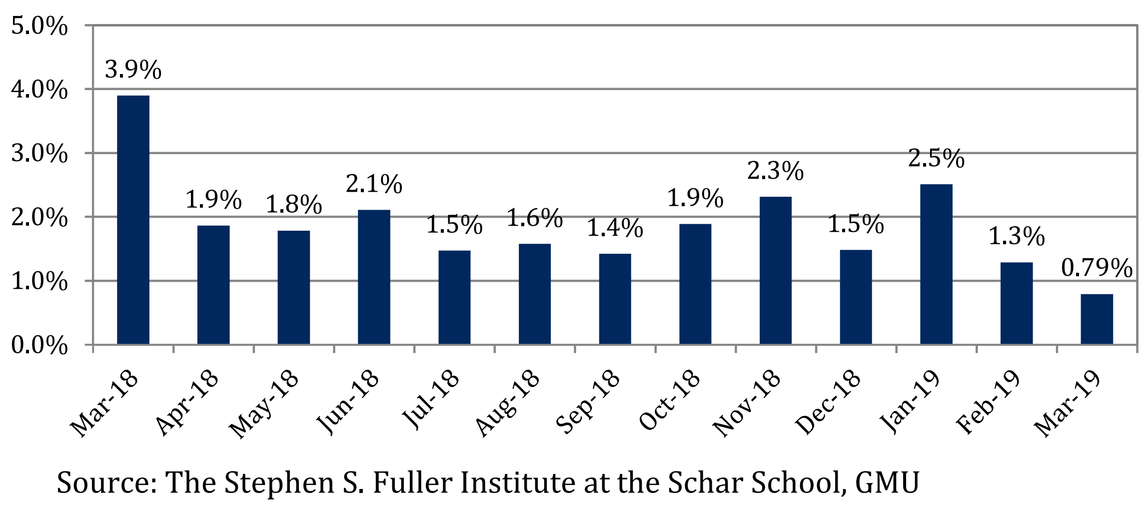
- *Wage and salary employment* in the Washington region increased 0.9% between March 2018 and March 2019;

- *Non-durable goods retail sales* were up 1.4% from March 2018 gaining for a 25th consecutive month on a monthly over-the-year basis; and,

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 1.8% from March 2018; while,

- *Consumer confidence (in the present)* declined by 4.8% from March 2018 for its first decline since March 2014.

**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 2.81 percent in March on a monthly over-the-year basis. The Leading Index has now increased once in the past nine months and has declined for the last five consecutive months. The length of this downward trend, dating to the beginning of 2018, and its accelerating negative magnitude are forecasting the likely slowdown in the region's economic growth in 2019, contrasting with the beginning-of-the-year forecast for stronger gains this year compared to 2018.

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

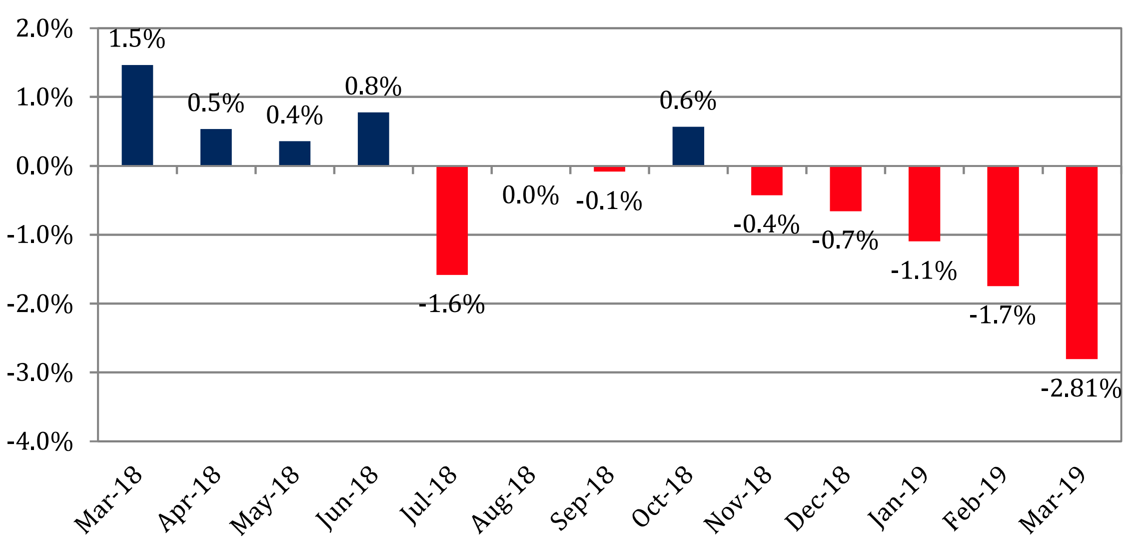
- *Initial claims for unemployment insurance* increased 49.2%, worsening for the tenth consecutive month;

- *Consumer expectations (consumer confidence six months hence)* decreased 14.8% from March 2018 for a third consecutive monthly-over-the year decline; and,

- *Total residential building permits* decreased 21.9% in March for its second consecutive decline after registering strong gains in December and January; while,

- *Durable goods retail sales* experienced no gain from their March 2018 level after declining in February and reflecting a general weakness extending back to September 2018.

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



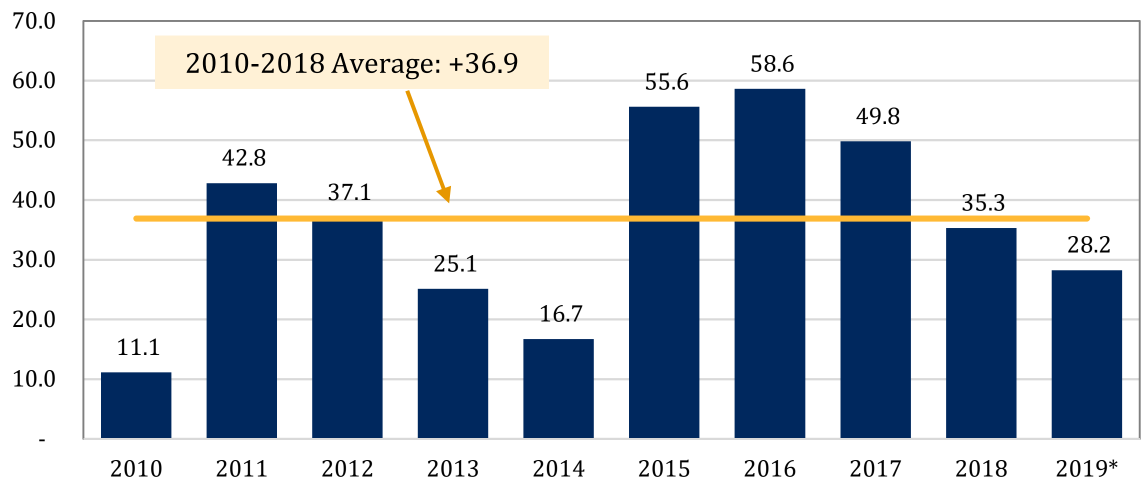

Source: The Stephen S. Fuller Institute at the Schar School, GMU

## Current Performance

The Washington region's economy has sustained its expansion (recovery) from the negative impacts of the 2014 Sequester for 60 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 (on a monthly over-the-year basis) through March 2019. While the Coincident Index has tracked the Washington region's recovery from the economy's decline caused by reductions in federal payroll and procurement spending during the Sequester, it is now confirming that this recovery has slowed and may be stalling.

With job growth as one of the Index's principal components, the consequences of the region's slowing economy can be seen in slower job growth. As shown in Figure 4, the region experienced rapid job gains in the years immediately following the Sequester in 2015 and 2016. In 2017, the number of jobs added was down 15.0 percent from the number of jobs added in 2016 and job growth slowed further in 2018 with job gains down 29.1 percent from job gains in 2017. Average annual job growth for 2019, through fourth months in 2019, has totaled 28,200 jobs extending this downward trend to a third year.

**Figure 4. Job Change in the Washington Region, 2010-2019* (in thousands)**




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

These job growth trends are not the cause of the region's slower growth but rather the result. The underlying causes of the region's apparent economic slowdown are a combination of many factors some of which are reflected in the other components of the Coincident and Leading Indices. Weakening consumer confidence in both the present and the future (expectations) can be pointed to as being consistent with weaker durable and nondurable goods sales. Similarly, weaker consumer confidence maybe contributing to weaker housing demand as seen in the lower number of residential building permits being issued.

So what is causing consumers to be more cautious? Interest rates for home mortgages remain low and have declined in recent months, inflation is low, job growth, while slowing remains solid and unemployment is declining, and personal income growth has accelerated. There are several theories that help explain this pattern. One is business-cycle fatigue; that is consumers are beginning to expect that the best of this business cycle has already occurred and that it is inevitable that a recession or slowdown is coming. Uncertainty remains a valid concern. The daily headlines regarding trade disputes and threats of new tariffs, the stock market's volatility, political bickering, and rising gasoline prices may be contributing to a growing pessimism among consumers.

For the Washington region's economy, how the U.S. economy performs in 2019, and going forward, has become increasingly important, as the growth of the region's economy has become more strongly tied to the performance of its non-federal dependent businesses and organizations. With the growth of the region's gross regional product (GRP) being driven by expansion of non-federally dependent economic activities (federal payroll and federal procurement spending in the Washington region remain well below 2010 levels), the conditions determining GDP growth will also be important to determining the region's GRP growth.

**The U.S. Economy's Outlook in 2019**

After the first-quarter GDP's unexpectedly strong performance, complemented by continuing strong job growth through April (with the exception of February), forecasters have raised the annual GDP forecast for the first time since January to 2.7 percent, year-over-year, from 2.5 percent just last month (IHS U.S. Executive Summary, April and May 2019). However, a closer examination of what drove the first quarter GDP growth to 3.2 percent and consideration of current threats to the U.S. economy's performance going forward suggest that the economy may have a bumpy ride this year. Before placing too much credence in the 3.2 percent GDP growth rate for the first quarter, it should be noted that this was only the first estimate and tis estimate will be revised (or confirmed) two more times before becoming final. For comparison, current estimates (IHS Markit, May 2019) for the next three quarters GDP growth are 2.0%, 2.2% and 2.1%, respectively.

So what drove the strong first-quarter GDP performance? Two components in particular are worth noting: (1) net exports and (2) inventory investment. Net exports increased during the first quarter in response to a surge in imports at the end of 2018 in anticipation of already announced and threatened future increases in tariffs. With this increase in imports in late 2018, inventories grew more than normal and, as a response, imports fell during the first quarter while exports held to their normal pattern thus contributing to an unusually large gain in net exports. This favorable imbalance between imports and exports will not likely be repeated in the second or subsequent quarters. The accumulation of inventory during the first quarter, recorded as contributions to GDP, is not sustainable into subsequent quarters and, with decreasing investment in inventory, this will bring its growth rate lower at least for one quarter and possibly for additional quarters.

Consumer spending will determine the rate at which inventories are reduced and when new investment in inventory replacement resumes. Personal consumption expenditures grew at the annual rate of 1.2% in the first quarter, well off its 2.5% rate for the fourth quarter in 2018. Retail sales for April, reported May 16th, were unexpectedly lower (-0.2%) with weaker motor vehicle sales as well as lower expenditures for clothing and footwear, furnishings and durable household items. Food and beverage sales were also lower in the first quarter. Additionally, consumer confidence weakened during the first quarter (the University of Michigan's Consumer Sentiment Index for May reported May 18th rose sharply to a 15-year high). Also, continuing sluggishness in the home building industry and rising gasoline prices may weigh on the economy's performance in 2019. These trends are likely to be worsened if a trade war with China or other major trading partners materializes from the escalating threats currently being exchanged as part of the Trump Administration's negotiation strategy.

In spite of these shadows hanging over this year's economic performance there are positive indicators of the economy's underlying strength. With the current business cycle now 119 months old and only needing to remain positive through June to tie the all-time record of 120 months, this business cycle, which started in mid-year 2009, can be expected to extend into 2020 even under the most pessimistic scenario. Other positive economic data include the most recent unemployment at 3.6%, the lowest percentage registered since December 1969, and is still expected to move lower over the summer before beginning to rise in 2020. Also, inflation remains near 2.0% and interest rates are now expected to remain stable with the Federal Reserve Board opting to hold its federal funds rate steady at least until its December meeting.

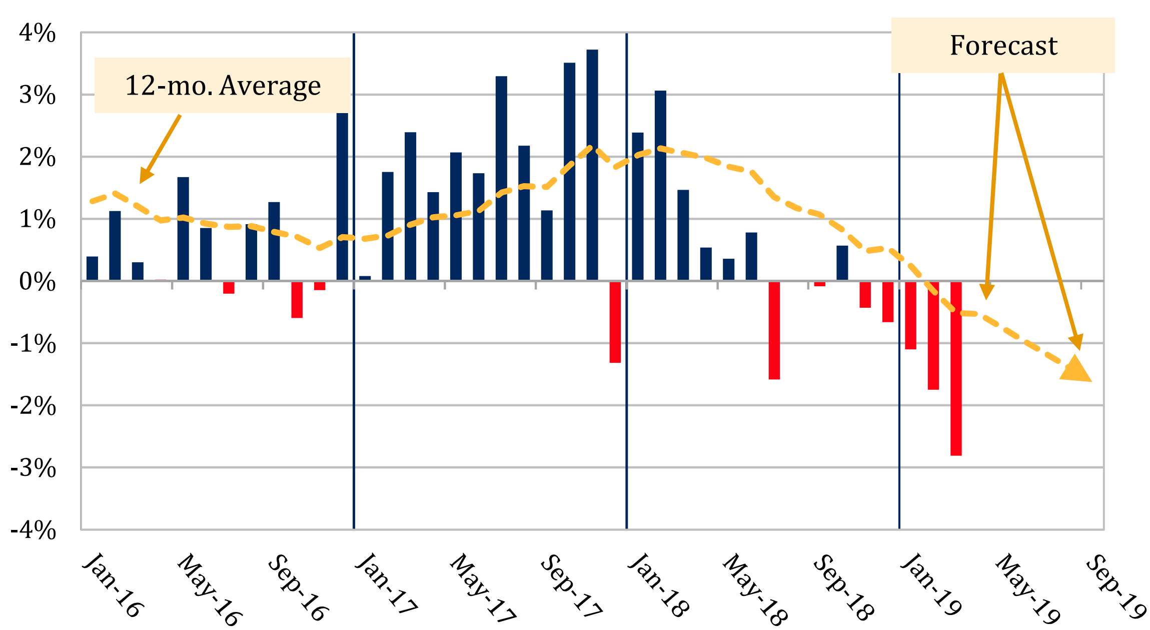
In spite of a favorable interest-rate environment, fixed investment in nonresidential building is projected to slow this year and for the next several years in response to slowing output growth over this period that will take the pressure off of the nation's existing production capacity, both buildings and equipment. Home building continues to struggle following its weak performance in 2018 with residential building permits continuing to lag through the first quarter of 2019. Housing starts began the second quarter with April's starts up 5.7 percent with gains in both single-family and multi-family housing. Still, the May forecast for housing starts for all of 2019 (IHS Markit, May 2019) have these down 4.0 percent from 2018 and subtracting 0.2 percentage points from this year's GDP growth. However, longer-range forecasts have housing starts increasing by 2.0 percent in 2020 and 3.9 percent in 2021.

With the fiscal stimulus provided by the Tax Cuts and Jobs Act of 2017 diminishing from their effects on GDP growth in 2018 and with growing uncertainty generally regarding global economic growth and specifically regarding rising tariffs and weaker international trade, the consensus forecast for GDP growth is that it will slow to near-trend levels (2.0%) between 2018 and 2020. For 2019, how the U.S. economy performs will be determined by short-term policy decisions by the Trump Administration, and these seem to be subject to change on short notice, overlaid on global economic trends that are largely beyond U.S. control.

## Near-Term Outlook

The Washington Leading Index has been tracking a negative trajectory since May 2018 and its decline has accelerated in 2019. For the first time since the Great Recession (for the June 2008 through April 2009) all four of the Leading Index's components have contributed to its decline for two or more consecutive months. In both February and March, none of the Leading Index's four components made a positive contribution to its calculation. In the absence of other indicators at the national or local levels, it would be easy to conclude that the region's economy is headed into a short period of GRP decline or worse, a recession (six or more consecutive months of GRP decline). With other indicators still performing well and pointing to above-trend growth in 2019, the most pessimistic conclusion supported by the Leading Index's continuing patterns of decline should be set aside to a few more months, but not dismissed outright. The Washington Leading Index has correctly anticipated recessions in advance four previous times starting in 1990. The Fuller Institute will continue to carefully watch and report on these trends over the next several months until this signal is confirmed or revised.

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




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

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

| Economic Indicator | Estimates | | | Percent Change | |
|---|---|---|---|---|---|
| | Mar-19 Prelim. | Feb-19 Final | Mar-19 Final | Feb-19 to Mar-19 | Mar-19 to Mar-19 |
| **Washington Area Business Cycle Indicators** | | | | | |
| Coincident Index (2015 = 100) | 107.6 | 106.9 | 106.7 | 0.68% | 0.79% |
| Leading Index (2015 = 100) | 102.0 | 103.3 | 105.0 | -1.26% | -2.81% |
| **Washington Area Coincident Index Components** | | | | | |
| Total Wage & Salary Employment ('000)a | 3,308.3 | 3,289.8 | 3,278.8 | 0.56% | 0.90% |
| Consumer Confidence (South Atlantic)a | 158.1 | 181.6 | 166.0 | -12.94% | -4.76% |
| Domestic Airport Passengers ('000)b | 2,169.8 | 2,085.8 | 2,131.5 | 4.03% | 1.80% |
| Nondurable Goods Retail Sales ($000,000)c | 3,325.8 | 3,225.0 | 3,281.4 | 3.13% | 1.35% |
| **Washington Area Leading Index Components** | | | | | |
| Total Residential Building Permitsa | 1,807.0 | 2,543.0 | 2,315.0 | -28.94% | -21.94% |
| Consumer Expectations (South Atlantic)a | 101.0 | 116.1 | 118.6 | -13.01% | -14.84% |
| Initial Unemployment Claimsb | 1,956.8 | 2,040.2 | 1,311.2 | -4.09% | 49.24% |
| Durable Goods Retail Sales ($000,000)c | 3,817.4 | 3,698.2 | 3,819.0 | 3.22% | -0.04% |
| **Washington Area Labor Force**[a] | | | | | |
| Total Labor Force ('000) | 3,421.6 | 3,412.0 | 3,393.7 | 0.28% | 0.82% |
| Employed Labor Force ('000) | 3,308.3 | 3,292.4 | 3,275.8 | 0.48% | 0.99% |
| Unemployed Labor Force ('000) | 113.3 | 119.7 | 117.9 | -5.28% | -3.89% |
| Unemployment Rate | 3.3% | 3.5% | 3.5% | -- | -- |
| **Washington Area Wage and Salary Employment**[a] | | | | | |
| Total ('000) | 3,308.3 | 3,289.8 | 3,278.8 | 0.56% | 0.90% |
| Construction ('000) | 156.5 | 156.4 | 157.3 | 0.06% | -0.51% |
| Manufacturing ('000) | 55.0 | 54.2 | 54.7 | 1.48% | 0.55% |
| Transportation & Public Utilities ('000) | 68.5 | 68.8 | 66.9 | -0.44% | 2.39% |
| Wholesale & Retail Trade ('000) | 328.8 | 327.4 | 334.6 | 0.43% | -1.73% |
| Services ('000) | 1,991.5 | 1,975.7 | 1,959.1 | 0.80% | 1.65% |
| Total Government ('000) | 708.0 | 707.3 | 706.2 | 0.10% | 0.25% |
| Federal Government ('000) | 361.2 | 362.4 | 362.5 | -0.33% | -0.36% |

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars