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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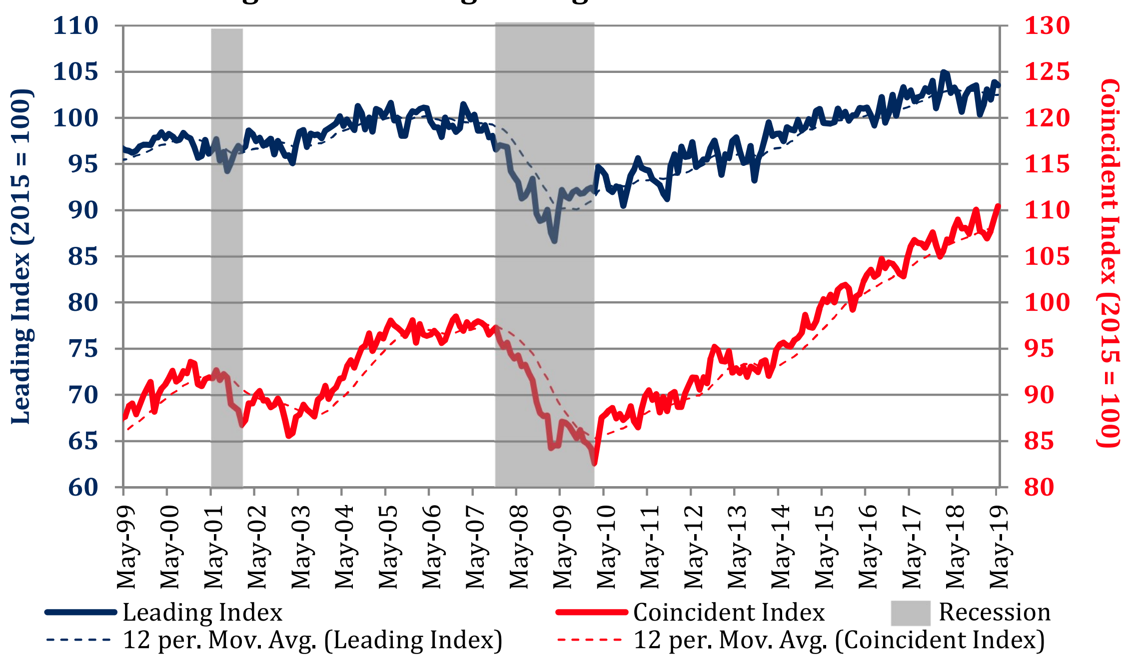
The Washington Region's Economy Continued To Grow in May Reversing Its First Quarter Weaknesses

The Washington region's Coincident and Leading Indices were both positive in May building on their gains in April: the Coincident Index registered a strong gain in May, its 62nd consecutive monthly over-the-year increase, and the Leading Index was up slightly from April extending its positive trend to a second month in contrast with its negative trend dating back to July 2018. As in April, all of the Coincident Index's four components and three of the Leading Index's components contributed to this overall positive performance. Still, the Leading Index's weak but positive performance in May continues to leave open the question regarding the economy's future performance. Job growth in May remained well below forecast and June jobs numbers, released July 19th, showed this slower growth trend continuing. With the U.S. economy slowing, global trade tensions continuing, the Federal Reserve Board reversing its position on interest rates, and the FY 2020 federal budget impasse not yet fully resolved, this year's economic performance remains uncertain.

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 third consecutive month, increasing 1.23 percent in May, on a month-to-month basis, building on its gain of 1.2 percent in April and 0.8 percent in March after having declined in the three preceding months. These three positive monthly gains contrast with the three monthly declines that overlapped the 35-day partial federal shutdown and underscore the impacts that this partial federal shutdown had on the region's economy and the economy's continuing vulnerability to abrupt changes in federal spending.

On a monthly over-the-year basis, May's Coincident Index registered an increase of 2.21 percent from May 2018. This increase extended the Index's upward trend to 62 consecutive months, dating from April 2014. The Coincident Index's continuing strong performance can be attributed to increases in consumer confidence accompanied by gains in nondurable goods retail sales and the strongest gain in domestic airport passenger traffic (at Reagan National and Dulles Airports) in more than a year.

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

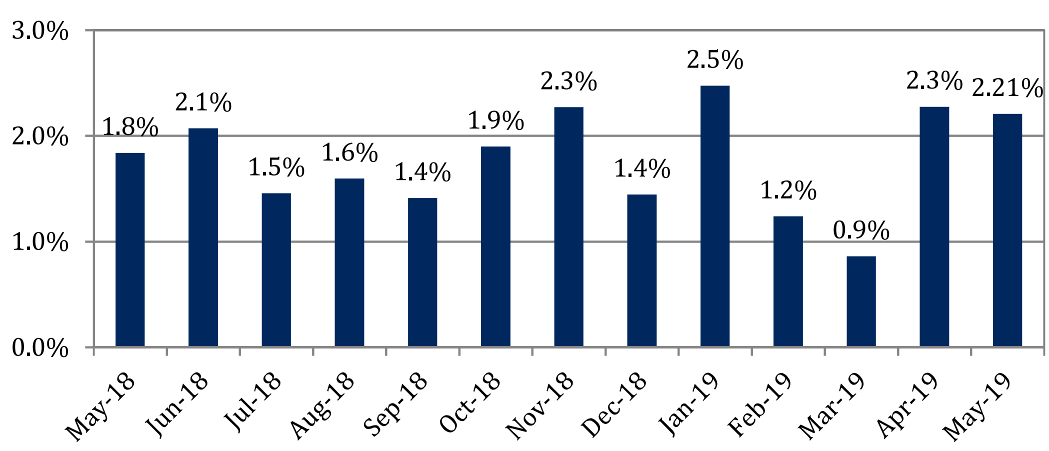
- *Wage and salary employment* in the Washington region increased 0.8% between May 2018 and May 2019;

- *Non-durable goods retail sales* were up 3.2% from May 2018 gaining for a 27th consecutive month on a monthly over-the-year basis;

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 4.8% from May 2018; and,

- *Consumer confidence (in the present)* increased by 12.0% from May 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, increased by 0.25 percent in May on a monthly over-the-year basis registering its second consecutive gain and only the third increase since June 2018. The Leading Index's decline had accelerated over the November-March period raising concerns regarding the region's economic performance going forward into 2020. However, this second, albeit small increase in the Leading Index, appears to be pointing to a stronger outlook going forward although it would be premature to conclude that the region's economy has overcome its long-term challenges. The Leading Index's short-term positive trend remains tenuous and there are clouds on the horizon that could further test its long-term performance.

In May, three of the Leading Index's four components contributed to its increase.

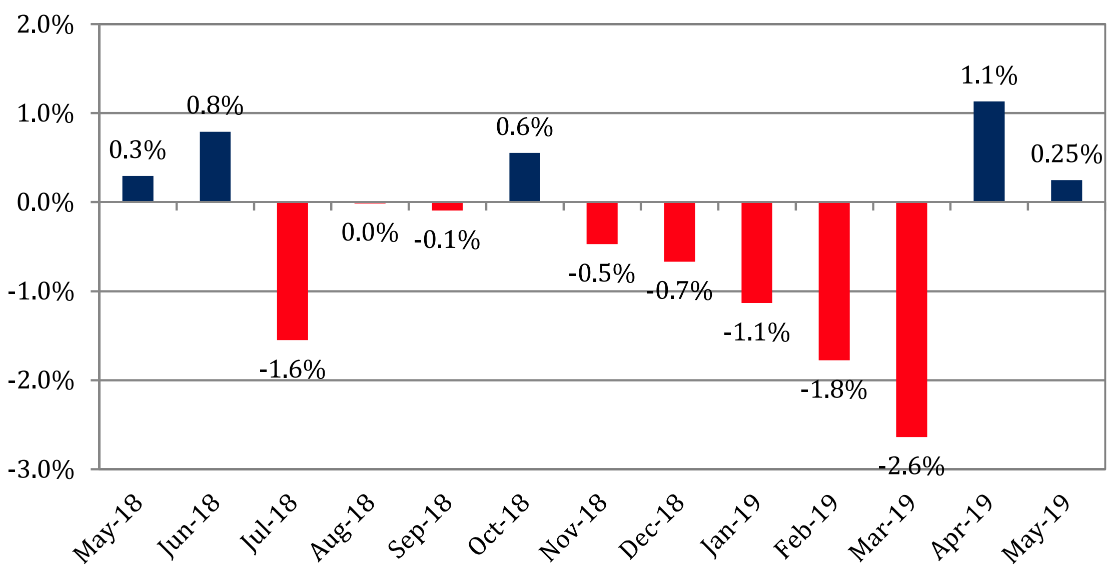
- *Consumer expectations (consumer confidence six months hence)* increased for as second consecutive month, gaining 4.5% from May 2018 after declining in each of the year's first three months;

- *Total residential building permits* increased 41.2% in May for a second strong monthly gain after declining in both February and March; and,

- *Durable goods retail sales* were up 1.1% from their May 2018 level building on their strong gain in April; while,

- *Initial claims for unemployment insurance* increased 38.3%, worsening for the twelfth consecutive month.

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 62 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 May 2019. While the Coincident Index two strong gains in April and May appear to confirm the region's continuing economic vitality, this performance has not been reflected in this year's pattern of regional job growth.

The beginning of the year jobs forecast for the region was for a gain of 38,200 jobs, up from a gain from the 35,300 jobs added in 2018. However, job growth through the year's first half is only averaging 26,100 jobs and recent trends have not shown any significant pick up in job growth during the second quarter. And, the uneven job growth performance among the region's sub-state areas, as reported previously, continues. Suburban Maryland lost jobs for the fifth consecutive month in June and, for the first half, is down by an average of 2,100 jobs. The District's share of the region's job growth has averaged 14.5 percent (3,400 jobs) during the year's first half while Northern Virginia's share has averaged 94.4 percent (22,100 jobs). This slower than projected and uneven job growth points to structural issues that will slow the region's economic growth if not corrected.

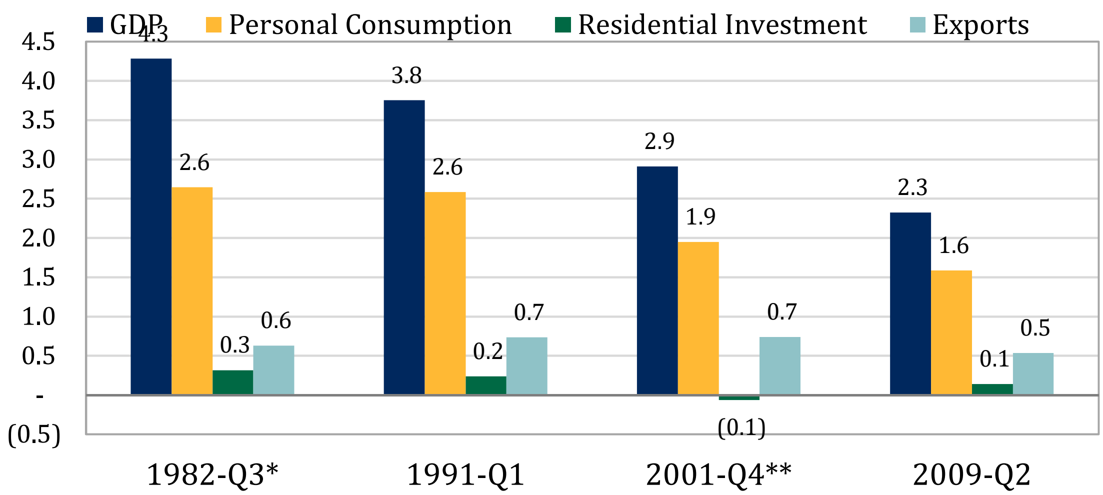
National Economic Outlook

The economic expansion that began in mid-2009, following the worst recession since the Great Depression, is now the longest expansion in U.S. history, surpassing the ten-year expansion (trough to peak) between March 1991 and March 2001. And, this expansion still has legs; the consensus is that it will continue beyond 2020. There is also consensus that its current growth rate is slowing from last year's peak of 2.9 percent and is likely to drop below trend (2.0%) in 2020 to 1.8 percent and could remain below trend well into the coming decade.

While this expansion's duration is record setting, it has also been different from recent expansions (see Figure 4). Compared to the 1991-2001 expansion, which averaged 3.8 percent annual GDP growth, the current expansion has averaged approximately 2.3 percent annual GDP growth tracking a 40 percent slower trajectory over its 10-year run.

Additionally, the contributions of the GDP's major components to its growth help explain some of its performance differences. Personal consumption has always been the largest driver of GDP growth but its share of GDP growth in the current expansion has been the greatest among recent expansions (69.6%). Residential investment during the current expansion was weak in the early years (this would have been expected given the role that housing played in the Great Recession) with its percentage contribution to GDP growing over the course of the expansion where residential investment has more commonly slowed as expansions have aged. Exports have made an above-average contribution to GDP growth during the current expansion compared to recent expansions (this may not hold true once the impacts of the recent tariffs wars are accounted for) reflecting the strong U.S. dollar and parallel expansions being experienced by our trading partners.

Figure 4. Contributions to Post Recession Recoveries Average Growth After 39 Quarters



Sources: Bureau of Economic Analysis; The Stephen S. Fuller Institute at the Schar School, GMU *After 31 Quarters; **After 24 Quarters

As the Federal Reserve contemplates reducing its federal funds rate at its July 30th-31st meeting, it must balance numerous performance measures that are providing conflicting guidance. None is pointing to a decline in GDP performance in the coming months but many are trending slower in spite of continuing strong job growth (224,000 jobs in June), low unemployment (3.7%) and below-target inflation (1.65%, June 2019). With job growth this strong and the unemployment rate at a near-50 year low, wage inflation would normally be a concern. However, wage growth (3.1% in June) continues to lag behind expectations and suggests that the expansion is incomplete. Still, a tight labor market may cause businesses to reduce their hiring plans and investment in the second half.

The Institute for Supply Management's (ISM) Manufacturing and Non-Manufacturing Indices provide two monthly measures of the economy's near-term outlook. These are designed to report changes in the growth rates respectively for the manufacturing and the non-manufacturing sectors. In June, both indices showed the economy to be expanding but at a slower rate than in May. The ISM Manufacturing Index recorded its lowest level since May 2016 and continued a slowing trend dating from September 2018. June's ISM Non-Manufacturing Index recorded its lowest level since June 2017. Correlations between overall economic performance (GDP) and the ISM's Indices' monthly performances suggest that GDP growth is running at an annual rate of 2.6 percent. This growth rate is consistent with IHS Markit's current GDP growth forecast (U.S. Economic Summary, July 2019).

The U.S. Leading Economic Index provides a composite measure designed to project the economy's performance six to eight months in advance. The Leading Index's growth rate peaked in September 2018 (up 6.7%) but it has slowed each month since this peak through June (the most recently release data point) when it was up 1.4 percent. While still pointing to continuing GDP growth through the end of the year, the Leading Index is clearly pointing to slower future economic growth.

With consumer spending accounting for approximately 70 percent of GDP growth, the factors driving this spending may be the ones that will ultimately determine the duration of this expansion. Continuing growth of consumer spending depends personal income growth, which is a combination of job growth and wage growth, consumer confidence, and inflation, among other factors. Job growth, while strong for this stage of the expansion has slowed from its 2018 level (job growth averaged 223,000 jobs per month in 2018 and is averaging 172,000 jobs per month in 2019 through June) and is expected to slow further in 2020. While wage growth has been slower than projected this year, wage growth is expected to accelerate in the second half of 2019 with unemployment projected to remain at historically low levels.

Consumer confidence may have peaked in 2018 and, while it moderated slightly in recent months, both consumer expectations and confidence in the present remain high. Lower gasoline prices this summer may have helped stem the decline in consumer confidence for the time being but the uncertainty introduced into the economy as a consequence of threated trade wars could easily dampen consumers' spending as the year moves into the back-to-school and holiday shopping seasons.

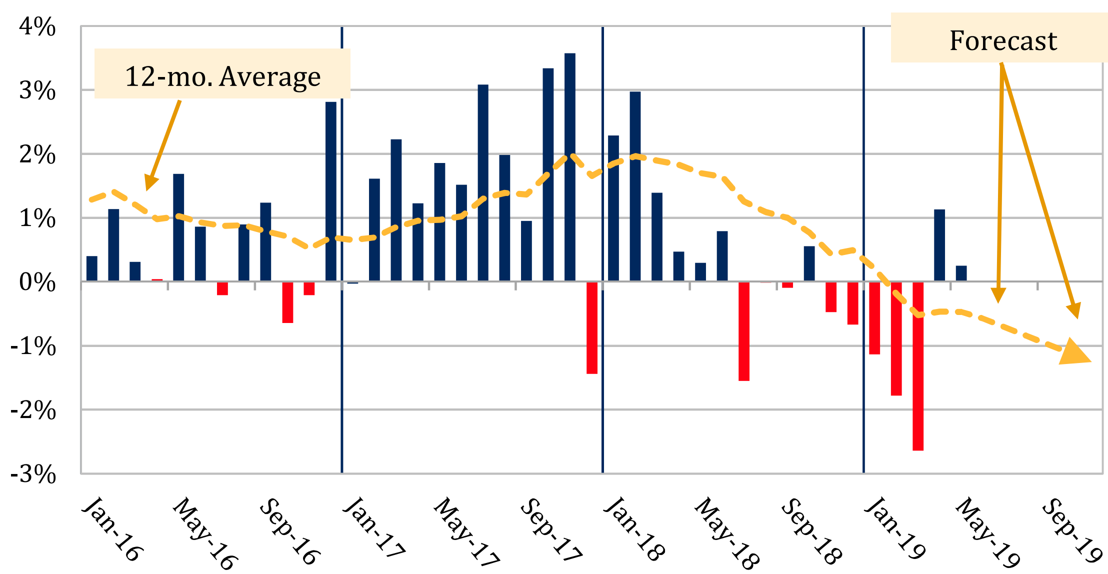
The biggest short-term threat to consumer confidence and, therefore, to continued growth of consumer spending, appears to be close to resolution. This is the federal budget and debt ceiling impasses in Congress. The debt ceiling must be raised in early September and federal budget adopted in some form by October 1st. Failure to do both could have severe consequences to the economy and consumers will take notice as they become better informed of how they will be directly affected by a federal shutdown and/or by the federal government not paying its bills or paying them late.

The Federal Reserve Board is expected to lower its Federal Funds rate a quarter point on July 31st; this is already baked into the markets and current economic forecasts. However, this interest rate reduction may be more symbolic than impactful. Residential mortgage rates declined last year even as the Federal funds rate was increased four times (one percentage point in total). And, the expected ¼ point interest rate reduction will not bolster consumer spending as consumer debt is already high and likely to be a counterforce to increased spending. If the federal budget and debt ceiling crises are not resolved, the Federal Reserve Board's interest rate reduction will not be sufficient to save the economy. Hopefully, all of this drama will play out in the next six weeks and then the longer-term forces shaping the economy's growth path will be back in play. These will need to be closely monitored in order to track the economy's growth path going forward.

Washington Region's Near-Term Outlook

The Washington Leading Index has had a negative trajectory since March 2018, as seen in Figure 5. This decline became broader and deeper through this year's first quarter. Now, for two months, the Leading Index has been positive, although May's 0.25 percent gain from May 2018 does not provide a strong indication that this two-month trend will carry forward into the future. Still, based on this two-month trend, it would appear that the region's economy is recovering from multiple shocks over the past year, especially the weakening of consumer expectations and slowdown in the homebuilding industry.

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



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

The Washington Leading Index's May positive but weak performance presents a mixed message. Consumers remain positive but not as positive about the near-term outlook for the economy. While the gain in residential building permits was strong in May, was not as strong as in April and, for the year, homebuilding continues to track lower than in 2018. And, the potential for a federal shutdown in October remains a possibility until the Congress acts and the President signs the legislation. Should a federal shutdown occur, it would certainly drive this year's economic growth below the 2.7 percent forecast. The Stephen S. Fuller Institute will continue to watch and report on these trends and other factors that may impact the economy's near-term performance.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	May-19 Prelim.	Apr-19 Final	May-18 Final	Apr-19 to May-19	May-18 to May-19
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	110.4	109.1	108.0	1.23%	2.21%
Leading Index (2015 = 100)	103.5	103.9	103.3	-0.33%	0.25%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,339.7	3,326.9	3,314.7	0.38%	0.75%
Consumer Confidence (South Atlantic)[a]	183.2	180.7	163.6	1.38%	11.98%
Domestic Airport Passengers ('000)[b]	2,333.5	2,209.8	2,227.7	5.60%	4.75%
Nondurable Goods Retail Sales ($000,000)[c]	3,396.1	3,348.8	3,291.0	1.41%	3.19%
Washington Area Leading Index Components					
Total Residential Building Permitsa	2,350.0	2,622.0	1,664.0	-10.37%	41.23%
Consumer Expectations (South Atlantic)[a]	123.7	124.6	118.4	-0.72%	4.48%
Initial Unemployment Claims[b]	2,080.4	2,059.7	1,503.9	1.01%	38.33%
Durable Goods Retail Sales ($000,000)[c]	3,780.6	3,697.1	3,740.3	2.26%	1.08%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,439.6	3,412.3	3,395.5	0.80%	1.30%
Employed Labor Force ('000)	3,332.1	3,314.9	3,287.6	0.52%	1.35%
Unemployed Labor Force ('000)	107.6	97.4	107.9	10.46%	-0.34%
Unemployment Rate	3.1%	2.9%	3.2%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,339.7	3,326.9	3,314.7	0.38%	0.75%
Construction ('000)	160.5	158.7	160.0	1.13%	0.31%
Manufacturing ('000)	55.3	54.8	55.3	0.91%	0.00%
Transportation & Public Utilities ('000)	70.3	68.4	67.8	2.78%	3.69%
Wholesale & Retail Trade ('000)	332.6	328.7	337.3	1.19%	-1.39%
Services ('000)	2,009.9	2,006.8	1,984.6	0.15%	1.27%
Total Government ('000)	711.1	709.5	709.7	0.23%	0.20%
Federal Government ('000)	362.7	363.0	363.6	-0.08%	-0.25%

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