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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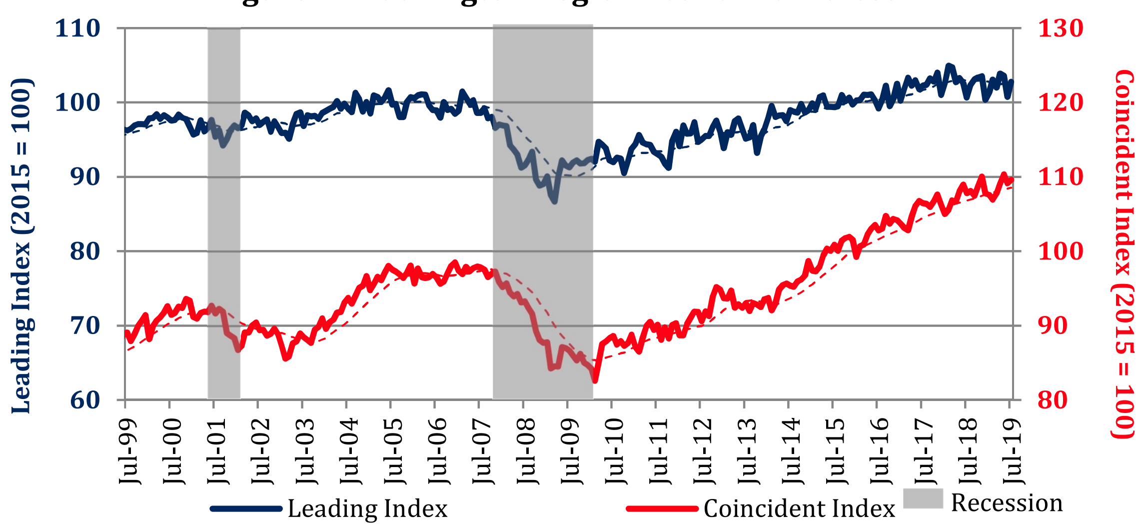
The Washington Leading and Coincident Indices Register Strong Gains in July

In July, the Washington region's Coincident and Leading Indices both rebounded from their June performances: the Coincident Index's gain slightly exceeded the average monthly over-the-year gain for the year's first six months and extended its consecutive monthly over-the-year increase to a 64th month and the Leading Index registered its strongest increase in more than a year and, in combination with its gains in April and May, may be pointing to a more positive future performance for the region's economy than it had previously. Over seven months this year, both the Coincident and Leading Indices have been pointing to slower economic growth for the full year than had been projected at the beginning of the year. The economy's underperformance can be credited to a long list of factors not the least of which is the national economy's slowdown from its best performance of the decade at 2.9 percent GDP growth in 2018 to a rate now projected to range between 2.2 and 2.3 percent. With consumer spending threatened by increased tariffs on Chinese imports and with continuing uncertainty regarding the FY 2020 federal spending levels, how the Washington region's economy tracks going forward remains in question.

Figure 1. Washington Region Economic Indices



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

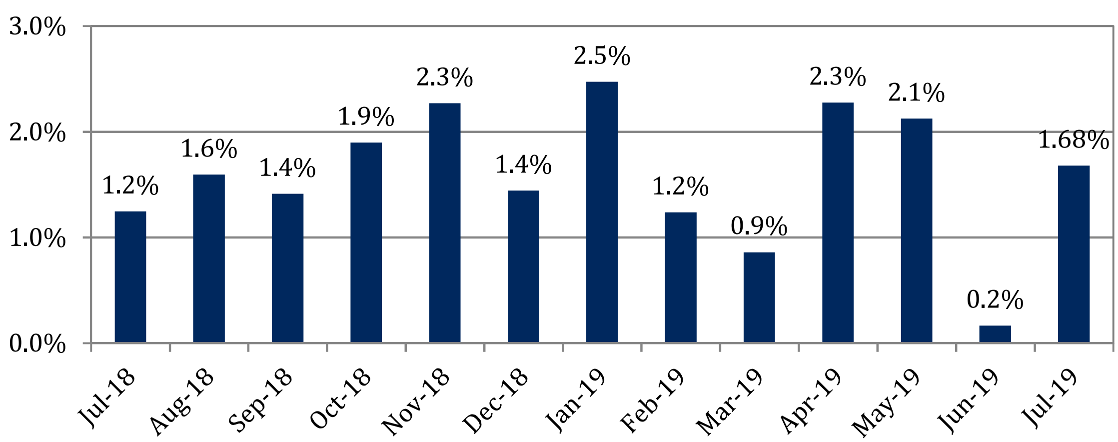
The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, increased 0.42 percent in July reversing its 1.1 percent decline in June on a month-to-month basis. July's monthly gain extends the Index's positive trend that followed the year's weak first quarter performance that reflected the consequences of the 35-day federal government shutdown that had begun in December.

On a monthly over-the-year basis, July's Coincident Index registered a strong gain of 1.68 percent from July 2018 rebounding from a 0.2 percent gain in June that had been its smallest increase since March 2014. July's gain extended the Index's upward trend to 64 consecutive months, dating from April 2014. This strong performance reflected increases in all four of the Index's indicators; this is the eighth time in the last twelve months in which all four of its indicators were positive underscoring the breath of the region's economic performance.

In July, all four of the Coincident Index's component indicators were positive:

- *Wage and salary employment* in the Washington region increased 0.7% between July 2018 and July 2019;
- *Non-durable goods retail sales* were up 4.5% from July 2018 gaining for a 29th consecutive month on a monthly over-the-year basis;
- *Domestic passenger volume at Reagan National and Dulles Airports* increased 0.2% from July 2018 and has now increased in five of the year's first seven months; and,
- *Consumer confidence (in the present)* increased by 7.9% from July 2018 after decreasing 3.7% in June.

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 by six to eight months, increased by 2.09 percent in July on a monthly over-the-year basis reversing it June decrease. July's increase was the Index' third gain in four months possibly pointing to the emergence of a positive trend after having trended negatively since mid-2018. The Leading Index registered only one positive month over the nine-month period beginning in July 2018 and extending through March 2019. This negative trend was clearly forecasting a turning signal for the Washington region's economy. The three monthly over-the-year gains that the Leading Index registered between April and July are suggesting that the outlook for the Washington region's economy may have improved and possibly become more positive looking ahead to 2020.

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

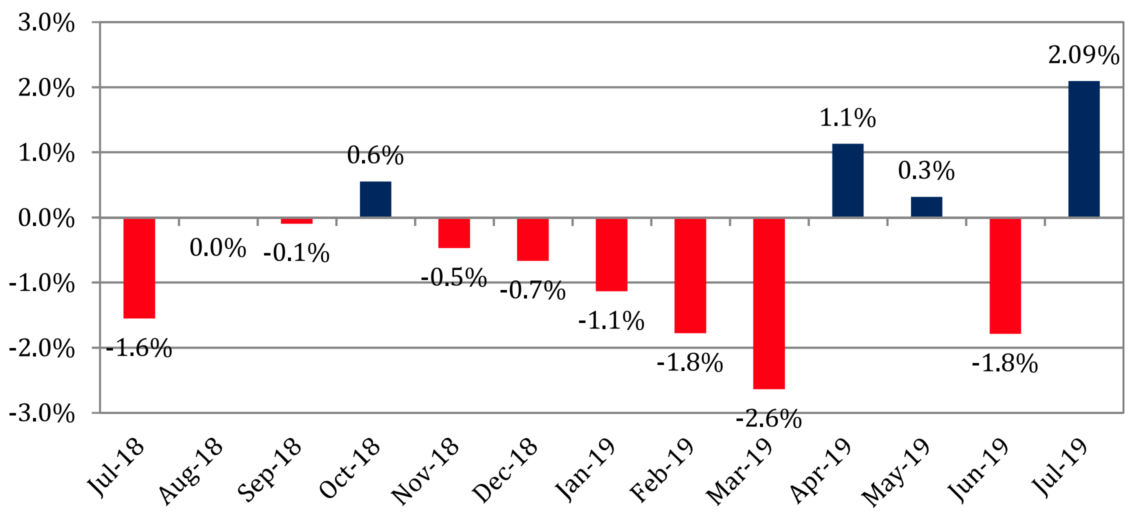
- *Consumer expectations (consumer confidence six months hence)* increased 15.5% from July 2018 after declining in June; just released August data show this indicator to have declined reaffirming a longer-term downward trend dating to the beginning of the year;

- *Total residential building permits* increased 42.4% in July continuing its volatile pattern over the last year during which it has increased only five times in twelve months; and,

- *Durable goods retail sales* increased 3.8% from their July 2018 level after declining in June; while,

- *Initial claims for unemployment insurance* increased 5.0% (worsened) and extended its upward trend to a fourteenth 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 been slowing down since late in 2018. This slowdown was accelerated by the interruption of federal spending as a result of the federal budget impasse that lead to a 35-day federal government shutdown. The first quarter's weaker-than-expected performance appears to have undercut the economy's performance in subsequent months with job growth and consumer spending lagging last year's performance.

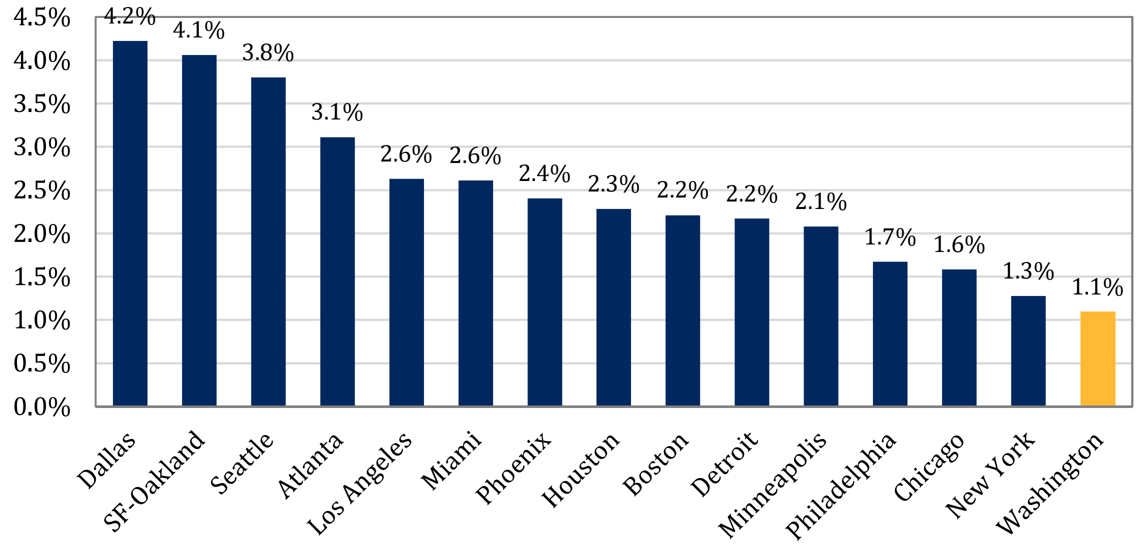
This weaker performance is a reminder that the region's economy remains overly dependent on federal spending as a source of its vitality and that efforts to diversify the regional economy away from this dependence are incomplete. While the region's economy is less dependent on federal spending than it was during the Sequester in 2013 and 2014, expanding its non-federally dependent sectors takes time and has its own risks.

As the region's economy approaches its fourth quarter, the beginning of a new fiscal year offers both promise and uncertainty. While it appears unlikely that the federal government will start the new fiscal year on October 1st facing a shutdown, funding for FY 2020 remains clouded by an apparent agreement to fund it only until November 21st. And, there is growing concern that continuing budget issues will not be resolved by November 21st and this could lead to a shutdown as it did last December or result in an agreement to extend the Continuing Resolution generating further uncertainty for the region's federal workers and contractors.

However, if these disputes can be resolved and the FY 2020 budget plan is funded as agreed to by Congress last summer, it will provide increased spending levels for many agencies. Additionally, with the limitations of the Budget Control Act of 2011 no longer a threat to federal spending flows going forward, the Washington region's economy should benefit from increased federal spending, at least for the next two years, in combination with and complemented by its continuing diversification into non-federally dependent sectors.

The economic transformation that has been underway in the Washington region since 2010, when federal spending accounted for almost 40 percent of the region's economy, has resulted in this percentage declining to an estimated 31 percent in 2018 while other segments of the economy have expanded to drive regional economic growth. With non-federally dependent sectors driving growth, their job mix and earnings profiles are shaping the economy's performance. The value added of the jobs lost from the region's economy since 2010 has been greater than the value added by the jobs gained during this period. As a consequence, the Washington region's economy, which in 2010 had the highest growth rate among the nation's fifteen largest metropolitan areas, had the slowest average annual growth rate over the 2010-2017 period (see Figure 4).

Figure 4. Average Annual Gross Regional Product Change in the Largest Metros, 2010-2017 (inflation-adjusted)



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

However, there are signs that the region's job mix is becoming more favorable. In 2017, the region's growth rate increased to 2.1% ranking it 11th out of the 15 largest metropolitan areas. The improvement is attributable to both an increase in federal spending from its low point in 2013 and the continuing diversification and growth of non-federally dependent sectors that are benefitting from the continuing expansion of the national economy. While the U.S. Bureau of Economic Analysis will not release the 2018 region's growth rate until later this year, IHS Markit's 2018 is estimating that the Washington region's economy grew by 2.3% still falling well below the U.S. gain of 2.9%.

The transformation of the Washington region's economy is far from complete. The Washington region's diminishing federal spending base and the economy's in-progress transformation to higher value added, faster growing, nationally and globally competitive businesses makes it more vulnerable to global and national economic disruptions. As the threats to the U.S. economy mount, most recently the spike in energy prices due to the damage inflected on Saudi Arabia's oil production facilities, the potential for further dampening of the Washington region's economic performance increases, especially when it is already is slowing due to continuing uncertainty generated by international trade disputes, slowing job growth, and weakening consumer expectations.

The most recent U.S. economic forecast (IHS Markit, September 2019), issued before Saudi Arabia's oil production interruption and consequent energy price increase, projects GDP growing at 2.3% in 2019 and 2.1% in 2020. The current increase in tariffs on China's exports are not expected to reduce this year's forecast but have taken 0.2 percentage points out of next year's projected growth rate. In additional to these and other potential disruptions to international trade hanging over the U.S. economy, the manufacturing sector continues to weaken and is technically in recession through the first two quarters of 2019, and consumer expectations are off their peak level. Job growth in August, with 130,000 new jobs, fell below expectation and continued a slowing trend that started in 2018.

The Federal Reserve Board's vote on September 18th to reduce its federal funds rate by ¼ point, its second rate reduction in three months, represents an effort to sustain the expansion during the short term while the U.S. economy adjusts to increased international trade disruptions and continuing slowdowns in the economic growth of U.S. trading partners. There is an expectation that the Fed may consider a third interest rate reduction early in 2020. Still, the U.S. economy continues to support full employment, unemployment is at a historically low level, and inflation hovers near 2 percent, all conditions that the Federal Reserve Board considers consistent with its mandate.

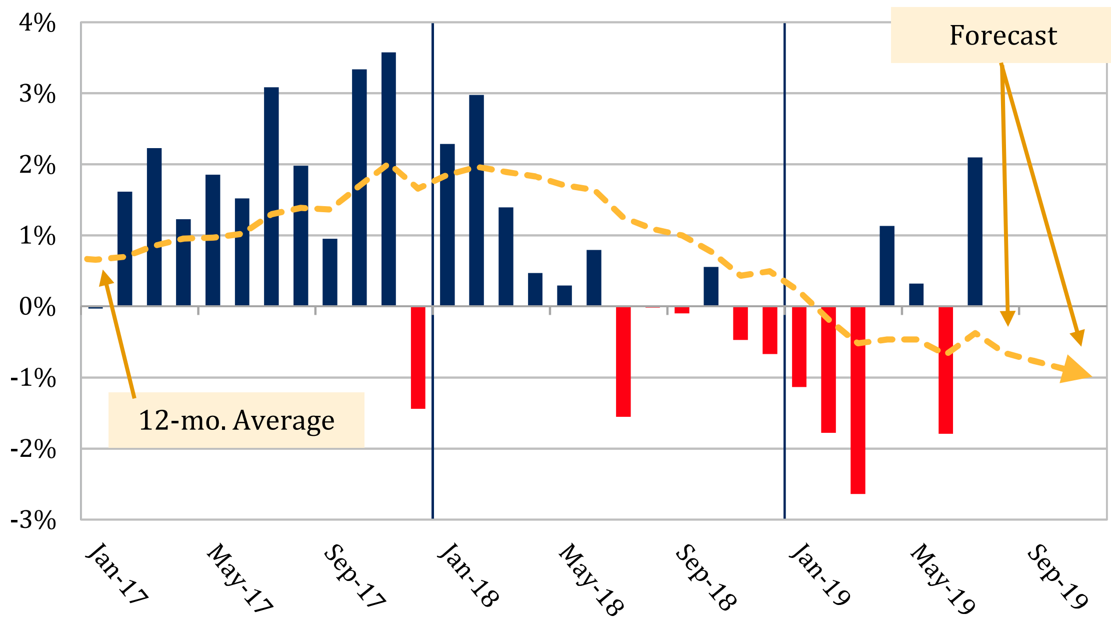
Washington Region's Near-Term Outlook

Even with the strong increase in the Leading Index in July, it continues to have a negative trajectory dating from mid-2018, as seen in Figure 5. Considering only the Leading Index's performance over the past four months would provide for a more favorable forecast. Still, the broader national and global economic context over the past year reflects the uncertainty that threatens both the U.S. economy's record expansion, now extending more than 40 quarters, and the Washington region's 64 consecutive-month long positive trajectory of its Coincident Index.

As consumer spending remains the critical driver of economic growth nationally and regionally, tracking consumer confidence provides important insight regarding possible changes in spending patterns in response to increasing uncertainty, as reflecting in the recent volatility of the equity markets, rising prices of consumer goods due to increasing tariffs imposed on Chinese imports and, more recently, increases in gasoline prices due to short-term supply interruptions stemming from lost production in Saudi Arabia.

A comparison between consumer expectations and consumer confidence (in the present) helps to clarify recent trends. Consumer expectations, as reported by the Conference Board each month, have trended down this year from their peak in 2018 while consumer confidence (in the present) continues to increase. Consumers are positive about the economy in the present. Job and wage growth continues to be strong and unemployment or the threat of unemployment is at historically low levels. Consumer confidence (in the present) has increased in ten of the last twelve months and is currently as a record level.

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



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

In contrast, consumer expectations, how consumers expect the economy to be performing in six months, peaked at the end of 2018 and have trended lower in 2019. And, even with the strong 15.5 percent increase in consumer expectations in July, this year's monthly gains have not fully compensated for the year's monthly declines. And, newly released consumer confidence data for August report a further decline in consumer expectations. With the threats of recession getting more media coverage, the continuing volatility in the equity markets possibly being interpreted by consumers as a threat to their retirement accounts, recent price increases at the pump, rate reductions by the Federal Reserve Board suggesting that it, too, is worried about the economy's future performance, these and other warning signs worry consumers and may be contributing to declining consumer expectations.

The result of this increased uncertainty, as measured by falling consumer expectations, is that consumers will change their spending patterns and they will reduce personal debt and increase their saving to protect against a future slowdown in the economy. August consumer spending data do not reflect this pull back. Even housing and auto sales data, big-ticket items for which borrowing is normal, were strong in August. However, as consumers become more concerned about their future economies, consumer spending will decline and, with this decline, the economy, too, will slow further. For now consumer expectations are off their December 2018 peak. If this trend continues, consumer spending will likely slow in the coming months and potentially undermine holiday sales in the closing months of the year further moderating the economic outlook for 2020.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Jul-19 Prelim.	Jun-19 Final	Jul-18 Final	Jun-19 to Jul-19	Jul-18 to Jul-19
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	109.6	109.2	107.8	0.42%	1.68%
Leading Index (2015 = 100)	102.8	100.8	100.7	1.98%	2.09%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,332.7	3,339.3	3,308.3	-0.20%	0.74%
Consumer Confidence (South Atlantic)[a]	174.7	168.0	161.9	3.99%	7.91%
Domestic Airport Passengers ('000)[b]	2,261.8	2,243.8	2,257.8	0.80%	0.18%
Nondurable Goods Retail Sales ($000,000)[c]	3,396.7	3,349.4	3,251.9	1.41%	4.45%
Washington Area Leading Index Components					
Total Residential Building Permitsa	2,870.0	1,945.0	2,015.0	47.56%	42.43%
Consumer Expectations (South Atlantic)[a]	115.5	104.3	100.0	10.74%	15.50%
Initial Unemployment Claims[b]	2,040.7	2,213.7	1,942.7	-7.81%	5.05%
Durable Goods Retail Sales ($000,000)[c]	3,717.0	3,584.2	3,580.3	3.70%	3.82%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,512.9	3,476.8	3,446.6	1.04%	1.92%
Employed Labor Force ('000)	3,395.8	3,359.8	3,327.0	1.07%	2.07%
Unemployed Labor Force ('000)	117.1	116.9	119.5	0.12%	-2.06%
Unemployment Rate	3.3%	3.4%	3.5%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,332.7	3,339.3	3,308.3	-0.20%	0.74%
Construction ('000)	165.5	163.2	164.2	1.41%	0.79%
Manufacturing ('000)	56.1	56.0	55.5	0.18%	1.08%
Transportation & Public Utilities ('000)	69.8	70.6	68.2	-1.13%	2.35%
Wholesale & Retail Trade ('000)	332.2	333.8	337.1	-0.48%	-1.45%
Services ('000)	2,019.1	2,012.5	1,998.4	0.33%	1.04%
Total Government ('000)	690.0	703.2	684.9	-1.88%	0.74%
Federal Government ('000)	363.7	363.0	365.1	0.19%	-0.38%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars