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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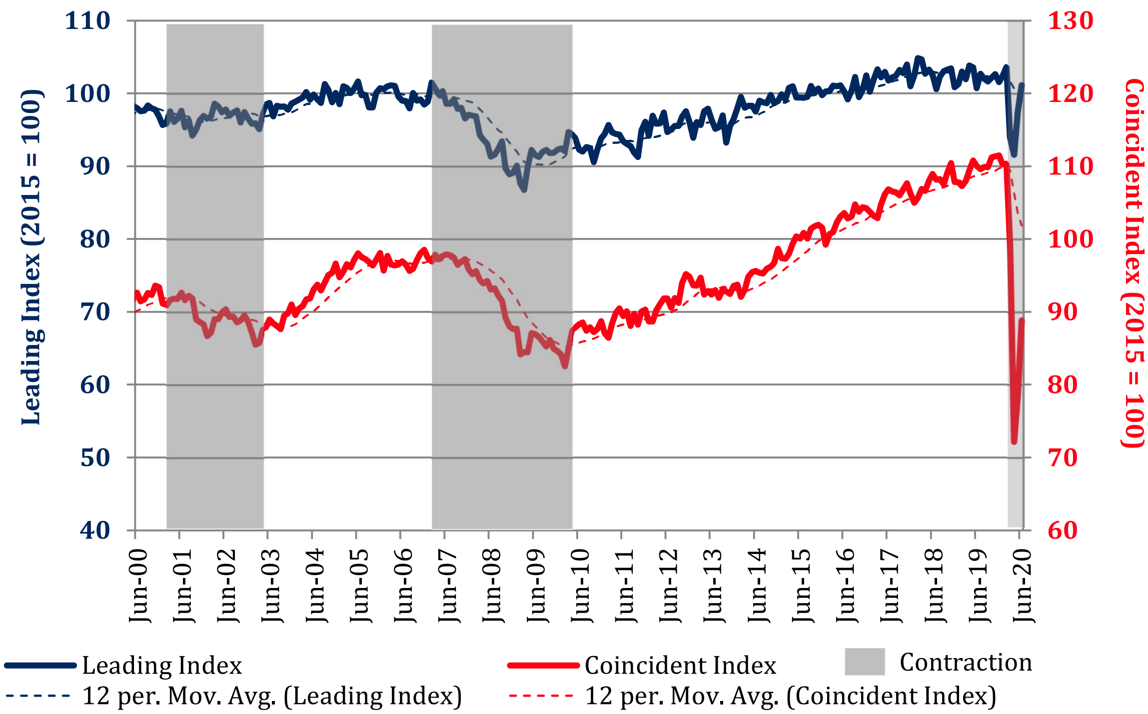
Economic Conditions Improved in the Washington Region in June

In June 2020, Washington region's Coincident Index and Leading Index improved, and both have had two consecutive increases on a month-to-month basis. Even with this improvement, the economic contraction recorded by the Coincident Index remains larger than the peak-to-trough contraction during the 2008 Recession. In June, the Leading Index increased 0.45 percent on a monthly over-the-year basis. This increase is likely temporary and two of the four components with gains in June had declines in July. Employment data also suggest that the rate of recovery slowed in July, and the region had 7.3 percent fewer jobs compared to last July; in June the regional jobs losses were 7.7 percent on a monthly over-the-year basis. In upcoming months, weakening consumer expectations and constraints affecting business operations, including changes to allow for physical distancing and the availability of protective equipment, are likely to further subdue the rate of recovery.

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 13.2 percent between May 2020 and June 2020. This is the second consecutive increase and each of the four components had month-to-month gains: domestic airport passengers (+93.1%), consumer confidence (+55.9%), non-durable goods sales (+5.1%), and wage and salary employment (+2.7%). These gains reflect a broader economic recovery compared to May but, even with this improvement, economic conditions remained weaker than during the troughs in prior recessions.

The Coincident Index decreased 19.18 percent between June 2019 and June 2020 and 19.4 percent between February 2020, prior to the pandemic, and June 2020. For comparison, the peak-to-trough decline during the 2008 Recession was 16.2 percent and the current contraction in economic conditions remains larger. Still, June continued to reflect improvement compared to April and the losses moderated on a monthly over-the-year basis. Three of the four components decreased on a monthly over-the-year basis:

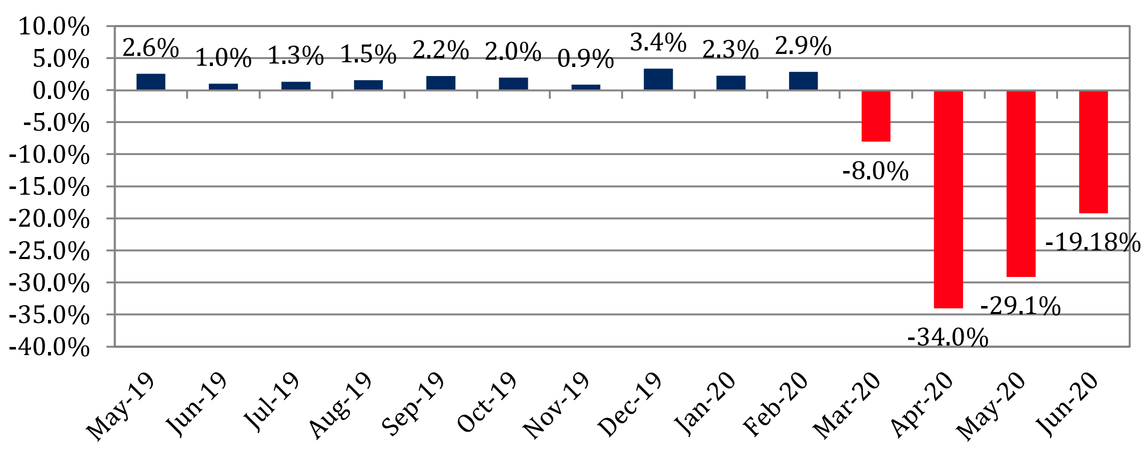
- *Non-durable goods retail sales* increased 1.1% from last June for its first gain since February 2020; while

- *Wage and salary employment* in the Washington region decreased 7.7% between June 2019 and June 2020 and the losses moderated compared to May;

- *Consumer confidence (in the present)* decreased 39.2% from last year, after decreasing 64.2 percent in May; and

- *Domestic passenger volume at Reagan National and Dulles Airports* decreased 83.6% from June 2019 and continues to be the least recovered component.

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 in six to eight months, increased 3.7 percent between May 2020 and June 2020, after increasing 6.5 percent in May on a month-to-month basis. For the second consecutive month, each of the four components contributed to this improvement: initial unemployment insurance claims (-45.4%), residential building permits (+39.5%), durable goods retail sales (+10.0%), and consumer expectations (+4.6%).

Compared to June 2019, the Leading Index increased 0.45 percent. The Index has not yet returned to its pre-pandemic level and was 2.3 percent lower than in February 2020. The improvement in the Index compared to last year was small and will likely be temporary, based on preliminary July data. Nationally, the pandemic appeared more contained in June, resulting in a rebound in several leading indicators that later reversed. In particular, consumer expectations improved in June before deteriorating in July. In June, three of the four components contributed to this improvement on a monthly over-the-year basis:

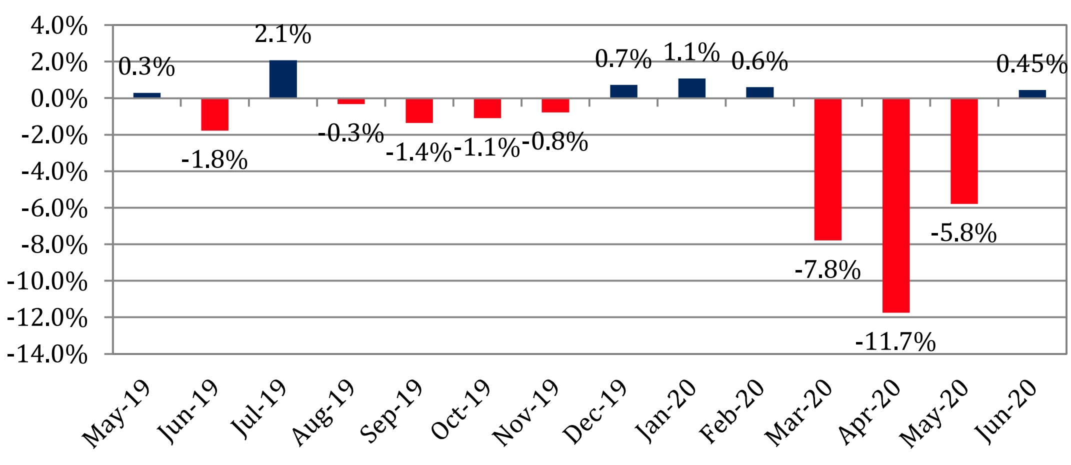
- *Total residential building permits* increased 25.0 percent, driven entirely by gains in multi-family permits (+83.6%);

- *Durable goods retail sales* increased 13.1%, marking the largest increase since 2013;

- *Consumer expectations (consumer confidence six months hence)* increased 5.2% compared to last June but decreased 9.0% compared to February 2020; while

- *Initial claims for unemployment insurance* increased 479.8% (worsened), a gain that was about one-half the size of the monthly over-the-year gains in May.

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

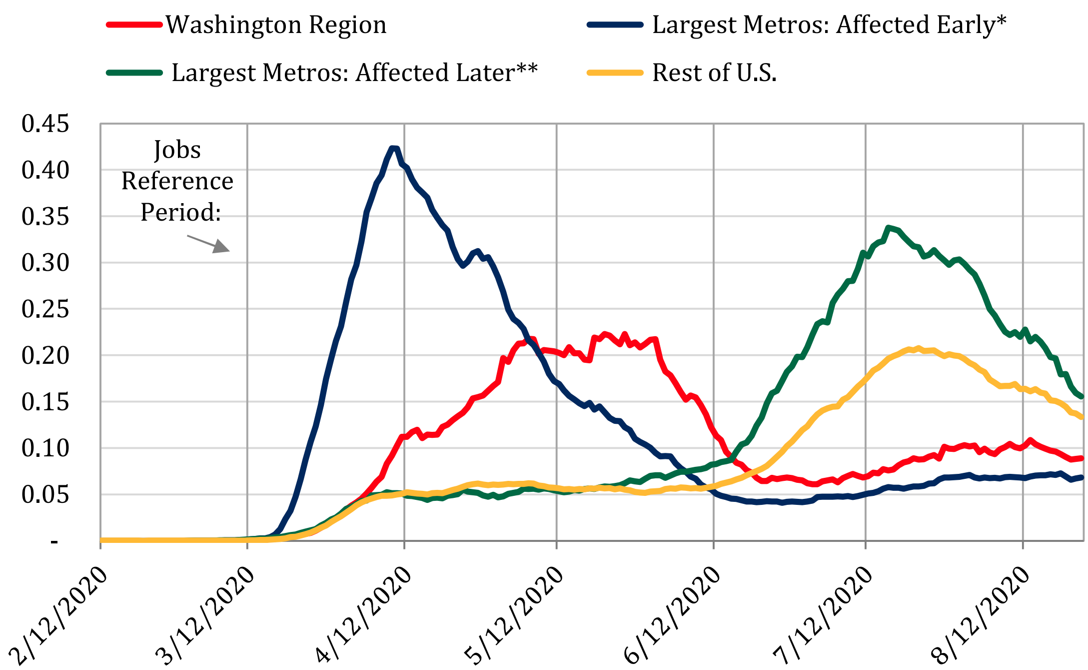


Source: The Stephen S. Fuller Institute at the Schar School, GMU

Current Performance

The pandemic resulted in an economic contraction that reached a trough in late April or early May. During May and June, economic conditions have modestly and steadily improved. On a month-to-month basis, the Coincident Index increased in both May and June, with gains in all four components in June. This indicates that a broader economic recovery occurred in June after the initial limited gains in May. However, even with this improvement, economic conditions remained weaker than at the most severe point in prior recessions. In July, employment data reflect a slower rate of recovery, mirroring the trend of the national health crisis.

Figure 4. New Daily COVID-19 Cases per 1,000 Residents,
Largest 15* Employment Metros & Rest of the U.S., 7-Day Average, 2/12/20 – 8/29/20

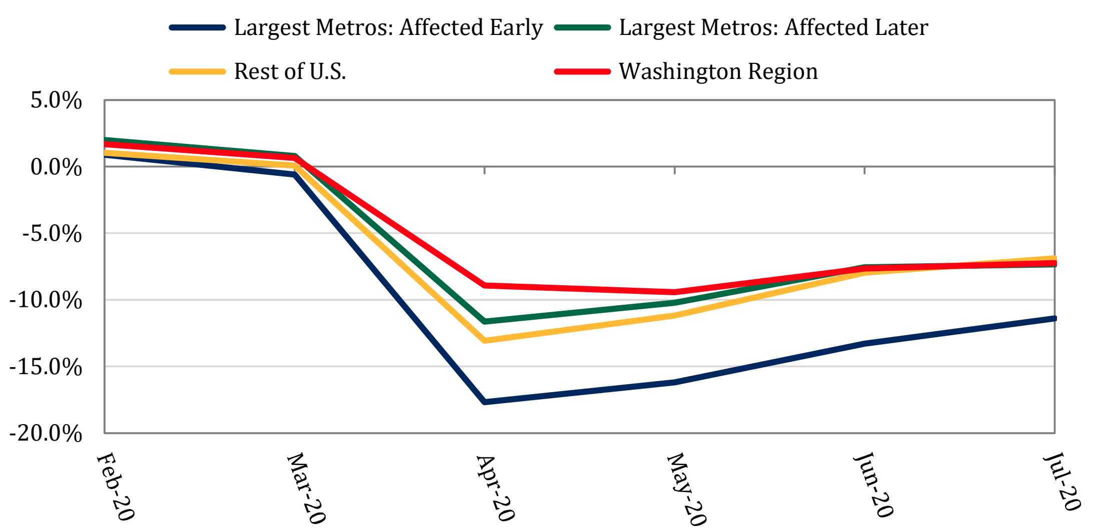


Sources: Johns Hopkins University Center for Systems Science and Engineering; U.S. Census Bureau (v2019 Population Estimates); The Stephen S. Fuller Institute at the Schar School, GMU
*Excludes the Boston metro due to reporting change **Excludes the Dallas metro due to backlog of laboratory reporting that cannot be properly allocated to August data

As in past months, health conditions are the key determinant in the economic recovery. In mid-June, the confirmed COVID-19 cases per capita were small in nearly every geography (Figure 4). This bolstered consumer sentiment and increased some types of consumer activities. These health conditions were not sustained and in late June many metropolitan statistical areas (metros) had rising case rates. In turn, this slowed or reversed some of the initial gains in economic activity. Of the 15 largest employment metros, nine were most affected by the pandemic in July. Four of these metros also had larger jobs losses in July than in June, reversing the gains from earlier in their recovery: Phoenix, Miami, Houston, and Dallas. The remaining five metros that had a deterioration in health conditions did not have a reversal in jobs gains, but the recovery slowed significantly (Figure 5).

Of the 15 largest metros, the five metros that were most affected by the pandemic in April (New York, Boston, Chicago, Detroit, and Philadelphia) continued to recover jobs at the same rate between May and July. The Washington region, which had elevated case rates through the end of May, had smaller initial losses and a slower recovery: between July 2019 and July 2020, jobs in the region decreased 7.3 percent. While this marks an improvement compared to the May monthly over-the-year loss of 9.4 percent, the regional job market has not improved at the same rate as most parts of the U.S. As a result of this slower recovery, the Washington region is no longer significantly outperforming the national average in terms of jobs losses. Nationally, the number of jobs decreased 7.6 percent in July on a monthly over-the-year basis, a loss that was 0.3 percentage points sharper than the Washington region's. At the beginning of the pandemic, the Washington region had a loss that was 4.5 percentage points milder.

Figure 5. Jobs in the Largest 15 Employment Metros & Rest of the U.S.
Monthly Over-the-Year Percent Change



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

In most parts of the U.S., the case rates peaked by July and improved significantly by late August. The case rate in the Washington region and in other metros that had an earlier first wave remained minimally higher than in late June but stable and well below peak levels. The health metrics, both in the Washington region and nationally, suggest a stronger economic recovery in August compared to July. The main mitigating factor is how permanent consumers and businesses think the current health trends will be. After the temporary improvement that occurred in late June and the concerns over a worsening health crisis in the fall, it is likely that the consumers and businesses are more cautious in August and the relatively slow pace of recovery will continue.

Washington Region's Near-Term Outlook

The Washington region's Leading Index projects economic performance six to eight months in advance based on business cycle indicators. Because this economic contraction is the result of a health crisis, traditional leading indicators primarily reflect the anticipated end to the crisis. In June, the national health metrics were promising and the Leading Index increased 0.45 percent compared to June 2019, driven by gains in three of its four components. The gains of the two of these components, consumer expectations and residential building permits, were temporary and reversed in July, as health conditions worsened for many parts of the U.S.

Consumer expectations continued to decline in August in the South Atlantic region and decreased 27.4 percent compared to August 2019. This is the largest monthly over-the-year decrease since 2009 and brings consumer expectations to its lowest level since 2014. The large, consecutive decreases in July and August indicate that consumers will likely be more cautious in the upcoming months, which will further subdue the economic recovery. Similarly, a substantial share of households (29%) in the Washington region continued to anticipate further employment losses as of the week ending July 21.[1] This decline in consumer expectations and anticipated economic conditions likely reflects, at least in part, the concerns about a resurgence of COVID-19 in the fall and will continue to fluctuate in response to the health crisis.

In addition to weakening consumer expectations that will moderate consumer demand, business operations have faced additional constraints that are unrelated to changes in demand. The main limitations according to a U.S. Census survey of small business in the Washington region as of Aug. 16-22, 2020 are shown in Figure 6. Of the small business in the survey, 41.0 percent reported that their ability to provide goods or services was constrained; that is, these businesses could increase operations and sales once these bottlenecks or limitations were resolved. The largest limitation was physical and 19.6 percent of small businesses in the Washington region reported that physical distancing needs for customers limited their operations in August. About one-tenth (11.1%) also reported that physical distancing needs for employees also limited their operations. These responses suggest that there is demand from businesses for additional space, but the current configuration, location, and/or cost of that space does not align with the underlying demand.

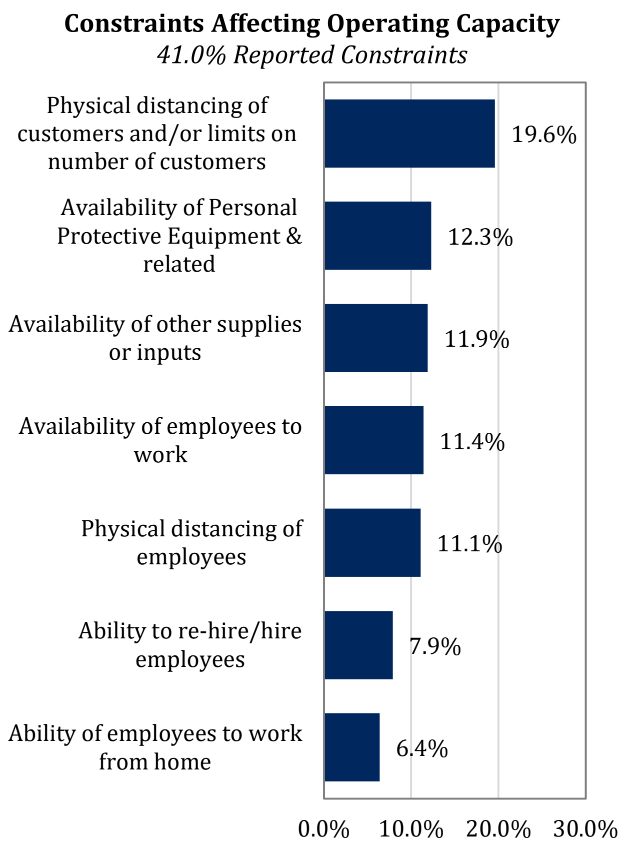
The second largest limitation for small businesses in the Washington region is the availability of personal protective equipment and related equipment and 12.3 percent reported this to be an issue. The question does not specify the type or the user (customer or employee), but a larger share of local businesses report this as a key limitation than in the U.S., overall, as only 8.4 percent of national respondents cited this as a problem. Conversely, a smaller share of small businesses reported a

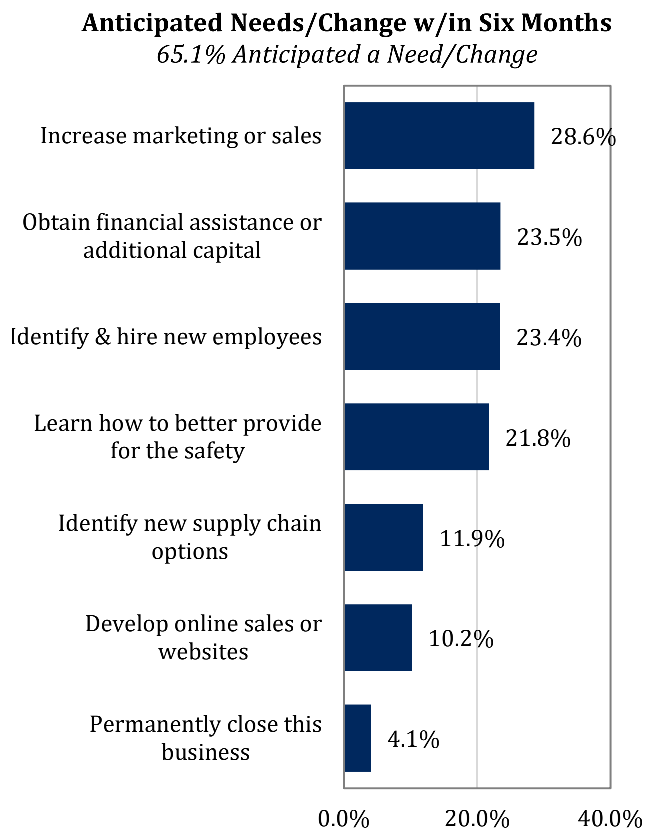
[1] Data are from the U.S. Census Household Pulse Survey.

limitation due to other supplies and inputs (14.4%) compared to the U.S. (11.9%), which likely reflects the region's lack of manufacturing and other production.

The final set of factors limiting small business operations are more generally related to employees, either their availability to work (11.4%), the ability to re-hire or hire new employees (7.9%), or the ability of employees to work from home (6.4%). These responses suggest that some businesses would expand operations if they had better access to labor; the ability of these firms to obtain employees may also be due to limits on the firm's ability to increase wages as well as the inability to replicate what were previously in-person activities like training.

Figures 6 & 7. Small Business Pulse Survey
Washington Region, Aug. 16-22, 2020





Sources: U.S. Census Bureau; The Stephen S. Fuller Institute at the Schar School, GMU
NOTE: More than one response allowed for both questions. Respondents only includes single-location employer businesses with 1-499 employees and receipts of $1,000+.

As shown in Figure 7, 65.1 percent of small businesses in the Washington region also anticipate changing to their business operations in the next six months. The most common change is related to increasing demand and 28.6 percent report that they will increase marketing or sales and 10.2 percent reporting the need to focus on online sales. The second largest anticipated need is for capital and 23.5 percent reported that in the next six months they would need either financial assistance or capital from a market source. A nearly equal share (23.4%) of small business reported that they would hire new employees in the next six months.

Notably, 21.8 percent of small businesses reported that they anticipated needing to learn how to better provide for the safety of customers and employees in the next six months, indicating that these small businesses may continue to limit operations in upcoming months unless they think that the safety measures they have put in place are sufficient to protect both customers and employees. Nationally, the share of businesses anticipating this change was smaller, at 17.8 percent, and the ability to disseminate information on the best safety practices appears to be a larger issue in the Washington region than elsewhere.

Finally, 11.9 percent of small businesses anticipate needing new supply chain options and 4.1 percent anticipate closing permanently. The share of businesses that anticipate closing permanently was similar to the national share of 4.9 percent. Nationally, the sectors that reported the highest likelihood of closure among small businesses were Accommodation and Food Services (12.3%), Educational Services (9.5%), Arts, Entertainment and Recreation (8.9%), and Other Services (7.0%).

Overall, economic conditions in the Washington region continued to improve in July. The rate of improvement appears to have slowed in July and August, and a weakening in the return of consumer demand and capacity constraints on business operations will likely result in a slower recovery in upcoming months, even in absence of a resurgence in the pandemic. It is also likely that many households and businesses will not make large changes to their habits or plans until after the onset of fall, once more is known about the trajectory of the health crisis.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Jun-20 Prelim.	May-20 Final	Jun-19 Final	May-20 to Jun-20	Jun-19 to Jun-20
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	88.9	78.5	110.0	13.25%	-19.18%
Leading Index (2015 = 100)	101.2	97.6	100.7	3.70%	0.45%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,119.2	3,038.1	3,378.0	2.67%	-7.66%
Consumer Confidence (South Atlantic)[a]	102.1	65.5	168.0	55.88%	-39.23%
Domestic Airport Passengers ('000)[b]	367.9	190.6	2,243.8	93.05%	-83.60%
Nondurable Goods Retail Sales ($000,000)[c]	3,394.2	3,229.1	3,355.8	5.11%	1.14%
Washington Area Leading Index Components					
Total Residential Building Permitsa	2,432.0	1,743.0	1,945.0	39.53%	25.04%
Consumer Expectations (South Atlantic)[a]	109.7	104.9	104.3	4.58%	5.18%
Initial Unemployment Claims[b]	12,836.3	23,509.7	2,213.7	-45.40%	479.85%
Durable Goods Retail Sales ($000,000)[c]	4,044.4	3,676.3	3,574.5	10.01%	13.15%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,437.7	3,358.4	3,476.8	2.36%	-1.12%
Employed Labor Force ('000)	3,149.5	3,059.3	3,359.8	2.95%	-6.26%
Unemployed Labor Force ('000)	288.1	299.1	116.9	-3.67%	146.37%
Unemployment Rate	8.4%	8.9%	3.4%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,119.2	3,038.1	3,378.0	2.67%	-7.66%
Construction ('000)	162.4	157.5	163.2	3.11%	-0.49%
Manufacturing ('000)	54.2	53.8	56.0	0.74%	-3.21%
Transportation & Public Utilities ('000)	66.6	65.7	70.6	1.37%	-5.67%
Wholesale & Retail Trade ('000)	307.1	297.3	333.8	3.30%	-8.00%
Services ('000)	1,821.2	1,769.2	2,012.5	2.94%	-9.51%
Total Government ('000)	695.6	694.6	703.2	0.14%	-1.08%
Federal Government ('000)	369.3	366.7	363.0	0.71%	1.74%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars