The Stephen S. Fuller Institute for Research on the Washington Region's Economic Future
Schar School of Policy and Government
George Mason University

Washington Economy Watch

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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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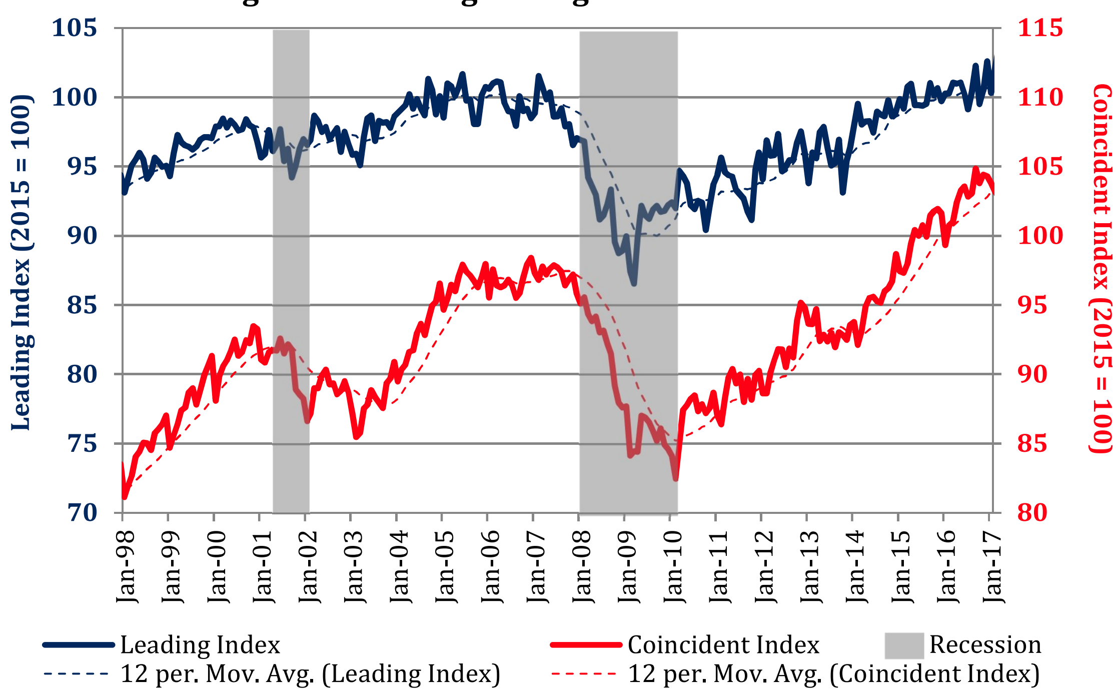
The Washington Region's Economy Resumes Its Positive Growth Trajectory into 2018

The January 2018 performances of Washington region's Coincident and Leading Indices extended their respective positive trends from 2017. While the Coincident Index registered only a modest gain in January compared to its Presidential Inauguration-distorted gain in January 2017, this extended the economy's long-term positive growth trajectory to a 46th month. The Leading Index's January gain erased its December weather-impacted and federal shutdown-threatened decline continuing its strong performance from 2017. This continuing positive trend points to the region's economic growth continuing at least through the third quarter of 2018. Overall, the Washington region's economy outperformed its beginning of the year forecast in 2017 adding 50,900 new jobs for the year and achieving a growth rate that closely paralleled the national GDP gain. January's performance indicators suggest these positive trends will continue and could accelerate in 2018.

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 1.24 percent in January from December, after having also decreased in December on a month-to-month basis. Similar multi-month, monthly decreases occurred previously during the first and third quarters of 2017. Such patterns often reflect seasonal factors or one-time events. Two of the Index's four components decreased on a month-to-month basis with consumer confidence and nondurable goods sales registering small gains.

In spite of the Coincident Index's month-to-month decline in January, it continued its upward trend on a monthly over-the-year basis increasing 1.20 percent from January 2016. This gain extended the Index's upward trend to 46 consecutive months, dating from April 2014. However, the Index's January increase was the smallest since September 2017 and fell far below its 4.5 percent gain in January 2017 that had benefited from the Inauguration's economic impacts.

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

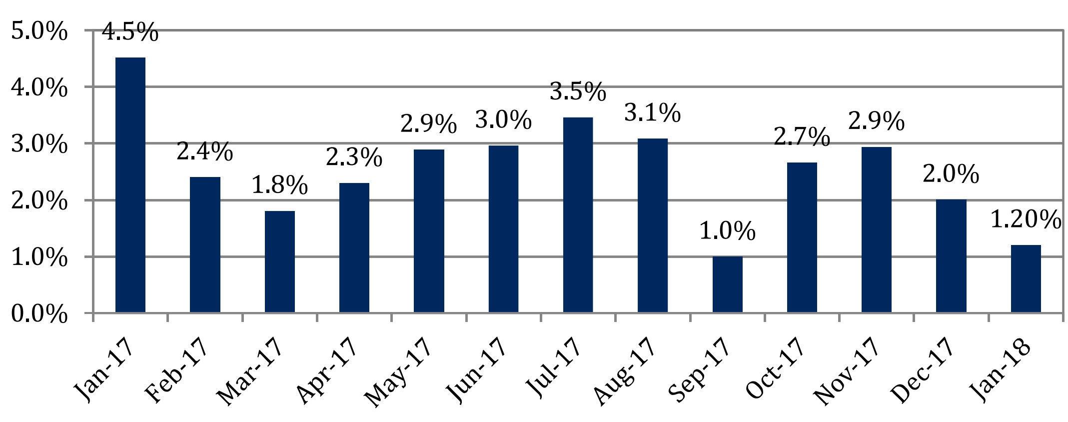
- *Wage and salary employment* growth in the Washington region increased 1.4% between January 2017 and January 2018;

- *Consumer confidence (in the present)* continued its positive trend, increasing by 9.4% from January 2017 slowing its growth following eight months of double-digit increases; and,

- *Non-durable goods retail sales* increased 2.9% from January 2017; while,

- *Domestic passenger volume at Reagan National and Dulles Airports* decreased 5.3 percent in January compared to January 2017, which had benefited from travel demand generated by the Presidential Inauguration.

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 in January gaining 2.39 percent from January 2017, regaining its positive trend following its one-month decline in December. With the exception of the Index's December's decline, which could be linked to severe weather effects and the continuing budget impasse that threaten a federal government shutdown, its overall performance in 2017 was the strongest since 2014 pointing to the region's continued economic expansion in 2018.

The Index's positive performance in January was broad-based with three of its four components contributing to its gain with an especially strong performance for initial unemployment claims that declined (improved) 19.4 percent; in contrast initial unemployment claims had increased (worsened) by 54.8 percent in January 2017:

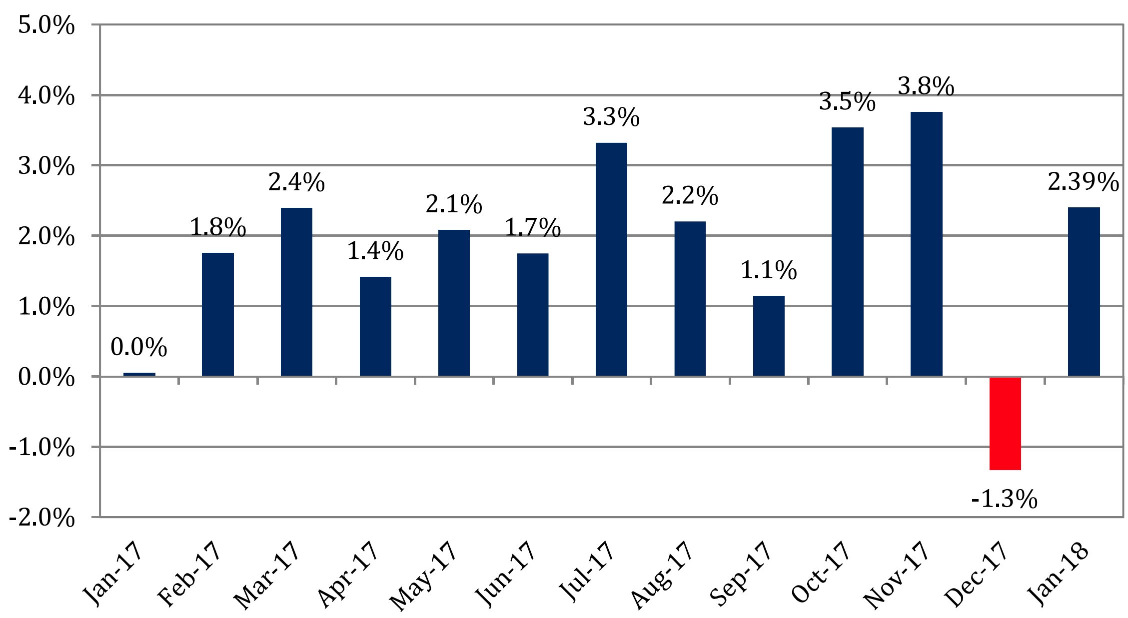
- *Durable goods retail sales* increased 6.4% between January 2017 and January 2018 continuing its positive trend from 2017;

- *Consumer expectations (consumer confidence six months hence)* bounced back from its December decline registering a 15.5% gain in January; and,

- *Initial claims for unemployment insurance* decreased 19.4% (improved); while,

- *Total residential building permits* registered a 1.8% decline in January after declining 37.4% in December 2017.

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



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

The Washington region's economic performance in January continued its long recovery from the negative effects of the Sequester in 2013. The Coincident Index has now increased for 46 consecutive months tracking the region's economic recovery from the Sequester beginning in April 2014. During this period, the region's economy has been buffeted by decreases in federal employment, threatened federal government shutdowns, and the uneven performance of the national economy. In spite of these and other uncertainties, the Washington region's economy has generated approximately 178,100 net new jobs since April 2014 and its annual growth rate now only lags the national GDP annual growth rate by an estimated two-tenths of a percentage point. This economic recovery and continuing expansion has been achieved in the absence of rapidly increasing federal spending levels driving this growth as they did over the past thirty years.

Whether the Washington region's economy can sustain growth rates that exceed U.S. GDP growth going forward, as it had regularly done between 1980 and 2010, will depend on the economy's continuing diversification into non-federal markets in combination with federal spending that at least maintains its current trajectory of small annual increases. With the possibility of larger annual federal spending levels under the newly approved federal spending plans for 2018 and 2019, the Washington region's economy likely could outperform the U.S. GDP growth rate.

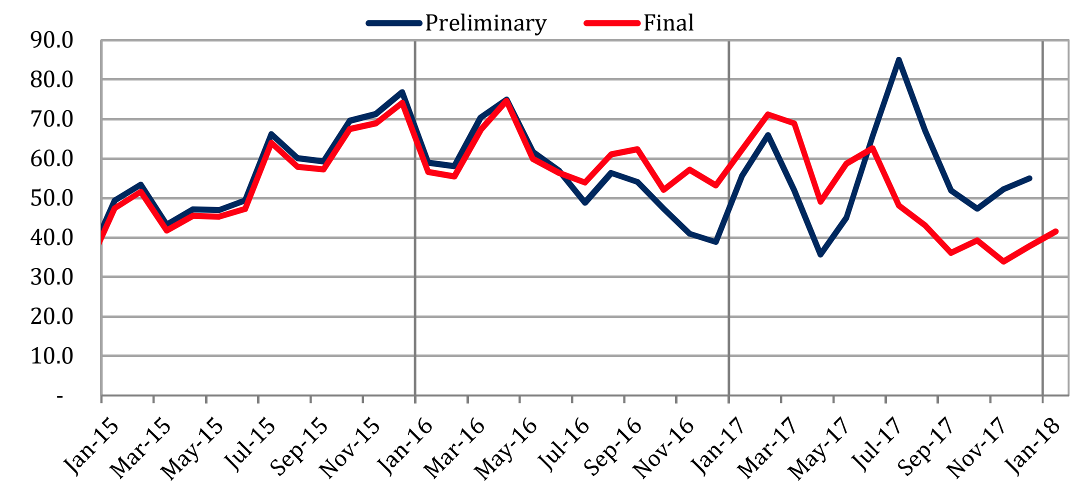
Current Performance

The Washington region's economy generated 50,900 net new jobs in 2017, 5,600 fewer jobs than initially estimated during the year by the Bureau of Labor Statistics (BLS). BLS released its annual employment revisions on March 12th as reported by the Fuller Institute.[1] These revisions for 2017 provide further insight into the region's economic health as well as remind us that the monthly jobs data that BLS releases over the course of the year are preliminary and conclusions drawn from these data releases may be incorrect. For example, the total monthly over-the-year job gain reported initially for July 2017 was 85,000. However, the revised July job gain totaled only 48,100, a downward revision of 36,900 jobs. The actual job gain in July, rather than being the largest for the year, fell below the year's average gain.

These revisions can be generally attributable to methodological challenges associated with small-area estimates and sample size limitations. These methodological problems can be magnified by a directional change in the trend line over the course of the year. This year's BLS revisions extended back to earlier year job totals, including adding 3,600 more jobs to the 2016 gain. As a result, 2017 started off stronger than had been initially estimated with approximately 70,000 jobs added in February and March (monthly over-the-year gains) and then slowed over the following months to a low of 33,900 new jobs in November.

[1] "The Washington Region Added 50,900 Jobs in 2017" at http://sfullerinstitute.gmu.edu/2018/03/12/jobs-2017/

Figure 4. Preliminary and Final BLS Job Estimates For the Washington Region Monthly Over-the-Year Change, 2015-2017 (Thousands)



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

The magnitude of these revisions varied by sub-state portion of the region and by sector. The BLS-revised total new jobs added in the District of Columbia in 2017 were 2,000 fewer than cited in the preliminary estimates; Suburban Maryland's total job gain for 2017 was reduced from 22,400 to 12,800, a downward revision of 9,600 jobs or 42.9 percent; while, Northern Virginia's job gain was revised upward slightly (+1,000).

The sectors that experienced the greatest downward revisions were the region's largest non-government sectors. The downward revisions for professional and business services (-36.2%); education and health services (-39.2%) and leisure and hospitality services (-40.0%) accounted for a downward adjustment of 16,100 jobs or almost three times the total downward job adjustment for the year. These three sectors are the region's most important private sectors accounting for 1.51 million jobs and 46.2% of the region's total employment base.

The federal government sector was slightly negative for the year (down 100 jobs) and the state and local government sector gained 5,600 jobs, 100 more than the preliminary estimate. While the federal sector, the region's third largest, was basically flat in 2017, this annualized performance masked its monthly growth pattern; it added jobs in the first half of the year and lost jobs in the second half of the year. The January 2018 employment report showed 6,600 fewer federal jobs in the region than reported in January 2017.

The sectors that experienced upward revisions to their preliminary estimates included: financial activities, up by 3,400 rather than by 700 jobs and other services, up by 11,400 rather than by the 2,300 gain initially reported. This category accounted for the most significant revision that offset the large reductions in the three largest private sectors.

The other services sector is a diverse sector composed of private and non-profit businesses, consumer services including workers in private households and membership associations and organizations. This mix of services makes it more difficult to estimate job changes in this sector due to the small sizes of these firms and their abilities to expand (or contract) quickly in response to changing market or political conditions. The larger-than-estimated job growth in other services could be a response to the Trump Administration with the growth of political action or special interest groups. It may also reflect the creation or expansion of new small businesses fueled by new technologies and changing consumer tastes and market opportunities. All of these dynamics present real-time estimating challenges for BLS. This unexpected job growth in a sector that has 207,400 jobs (6.3% of the region's jobs) may be pointing to an emerging competitive growth opportunity in the Washington region that should be closely monitored going forward.

The Washington region started 2018 adding 41,500 jobs in January, compared to January 2017. This monthly over-the-year gain was slightly stronger than the average monthly gains for the last four months in 2017. Still, this gain fell well below the January 2017 gain of 62,300 jobs (compared to January 2016) confirming the pattern of slowing job growth over the full year and its continuation in 2018.

The mix of January's job gains reflected the continuing dominance of the region's three private sectors: professional and business services, up 10,400 jobs, education and health services, up 10,700, and leisure and hospitality services, up 11,600, for a total gain of 32,700 jobs. Combined, these three sectors accounted for 76.9 percent of the total job gain. The other major source of new jobs in the private sector was other services that added 3,600 jobs for a 1.8 percent gain (the total job gain in the region was 1.3%). The region's most historically important sector, federal government, had 6,600 fewer jobs in January 2018 than it had in January 2017 as the Trump Administration began its term. In summary, 2018 began with slower job growth than at the outset of 2017 and with a job mix favoring lower-value added sectors.

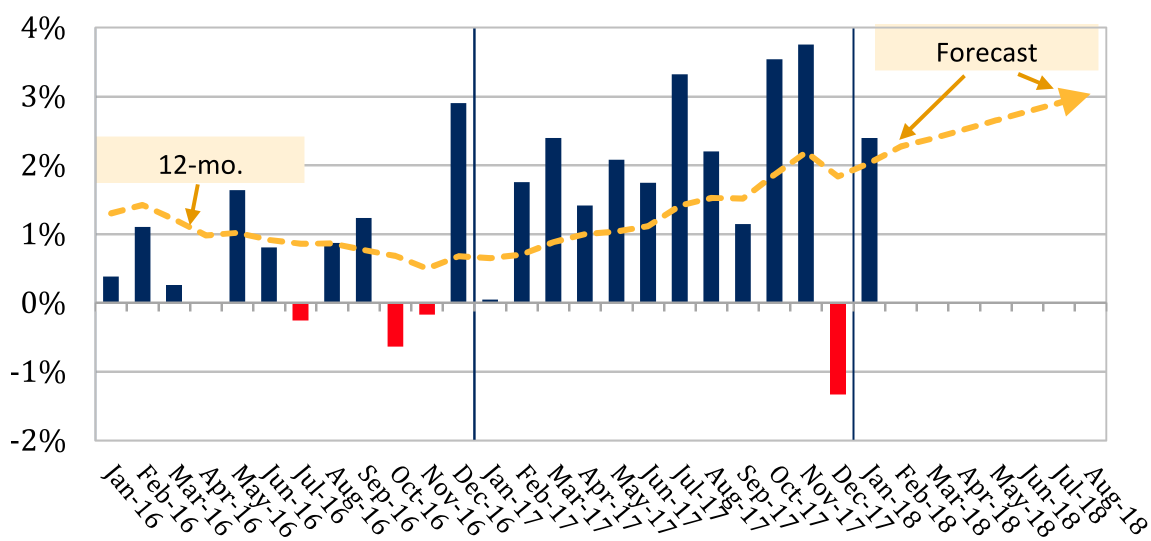
Near-Term Outlook

The most recent forecast for the U.S. economy in 2018 and 2019 is for stronger than previously expected growth. This upward revision, prepared by IHS Markit (March 2018), was based on several positive considerations—the improved performance of the world economy, the federal tax revisions enacted last December, continuing strong job growth in the U.S., and the fiscal stimulus that will be provided by the two-year budget passed in February and the increased appropriations programmed for each of the next two years. This latter economic stimulus has been calculated to add 0.4 of a percentage point to GDP in 2018, increase GDP by 0.2 of a percentage point in 2019 and add 0.1 of a percentage point to GDP in 2020. The new tax law has already added an estimated 0.3 of a percentage point to GDP spread over 2018 and 2019. The results of these fiscal stimuli will be to increase the GDP forecast for 2018 to 2.7%, for 2019 to 3.0% and for 2020 to 2.2%.

These positive growth forces at the national level can be expected to stimulate faster economic growth within the Washington region. Federal fiscal stimuli in the forms lower taxes and increased spending will increase the rates of consumer spending locally and are expected to increase the rates of corporate capital investment. Increased federal spending at the national level will have a corollary benefit on the regional economy to the extent that this increased spending translates into increased federal hiring and/or increased federal procurement from local federal contractors. Even if little or none of this federal spending is captured directly to the benefit of the region's economy, local federal contractors are also providing sub-contracting services and could realize increased revenues in this manner and, of course, a stronger national economy will generate increased spending that may indirectly benefit local businesses (e.g., increased tourism spending).

Without assuming that the just-signed federal spending plan for FY 2018 will increase federal spending within the region's economy, the Leading Index, based on its forward looking indicators, projects the region's economy will continue to grow in 2018 and is likely to accelerate its growth rate from 2017. With both faster national economic growth and increased federal spending, the Washington region's economy would be expected to out-performance GDP and continue to outpace the national economy's growth trend as long as federal spending in the region continued to grow—it is the annual increase in federal spending that drives annual gains beyond the regional growth linked to GDP performance.

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



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

These positive national and regional growth forces in 2018 could be undermined by externalities that are not reflected in the Leading Index. The uncertainty generated by dramatic fluctuation in the stock market, the potential for an international trade war, and unpredictable political leadership could result in undermining business and consumer confidence with resultant reductions in business investment and consumer spending. If this were to occur, the optimistic forecasts for U.S. and regional economies for 2018 and 2019 would have to be reconsidered.

Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Jan-18 Prelim.	Dec-17 Final	Jan-17 Final	Dec-17 to Jan-18	Jan-17 to Jan-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	105.1	106.4	103.8	-1.24%	1.20%
Leading Index (2015 = 100)	102.7	101.2	100.3	1.46%	2.39%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,258.5	3,310.2	3,214.7	-1.56%	1.36%
Consumer Confidence (South Atlantic)[a]	150.0	149.1	137.1	0.60%	9.41%
Domestic Airport Passengers ('000)[b]	2,142.3	2,242.0	2,262.6	-4.45%	-5.32%
Nondurable Goods Retail Sales ($000,000)[c]	3,168.3	3,117.9	3,079.8	1.62%	2.87%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	1,529.0	1,106.0	1,557.0	38.25%	-1.80%
Consumer Expectations (South Atlantic)[a]	127.0	103.3	110.0	22.94%	15.45%
Initial Unemployment Claims[b]	1,638.1	1,490.5	2,031.9	9.90%	-19.38%
Durable Goods Retail Sales ($000,000)[c]	3,718.6	3,723.5	3,493.7	-0.13%	6.44%
Washington Area Labor Force[a]					
Total Labor Force (000)	3,390.5	3,364.9	3,341.6	0.76%	1.46%
Employed Labor Force (000)	3,263.2	3,253.7	3,212.4	0.29%	1.58%
Unemployed Labor Force (000)	127.2	111.2	129.2	14.39%	-1.52%
Unemployment Rate	3.8%	3.3%	3.9%	--	--
Washington Area Wage and Salary Employment[a]					
Total (000)	3,258.5	3,310.2	3,214.7	-1.56%	1.36%
Construction (000)	156.6	159.5	153.5	-1.82%	2.02%
Manufacturing (000)	54.5	54.7	54.2	-0.37%	0.55%
Transportation & Public Utilities (000)	68.0	71.8	65.0	-5.29%	4.62%
Wholesale & Retail Trade (000)	338.0	349.2	339.8	-3.21%	-0.53%
Services (000)	1,948.9	1,968.5	1,906.8	-1.00%	2.21%
Total Government (000)	692.5	706.5	695.4	-1.98%	-0.42%
Federal Government (000)	363.9	365.9	370.5	-0.55%	-1.78%

[a]Unadjusted data

[b]Seasonally adjusted data

[c]Seasonally adjusted constant (1996) dollars