



The
STEPHEN S. FULLER INSTITUTE
for Research on the Washington Region's Economic Future



Washington Economy Watch

Vol. II, No. 7
July 2018

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.

Washington Economy Watch

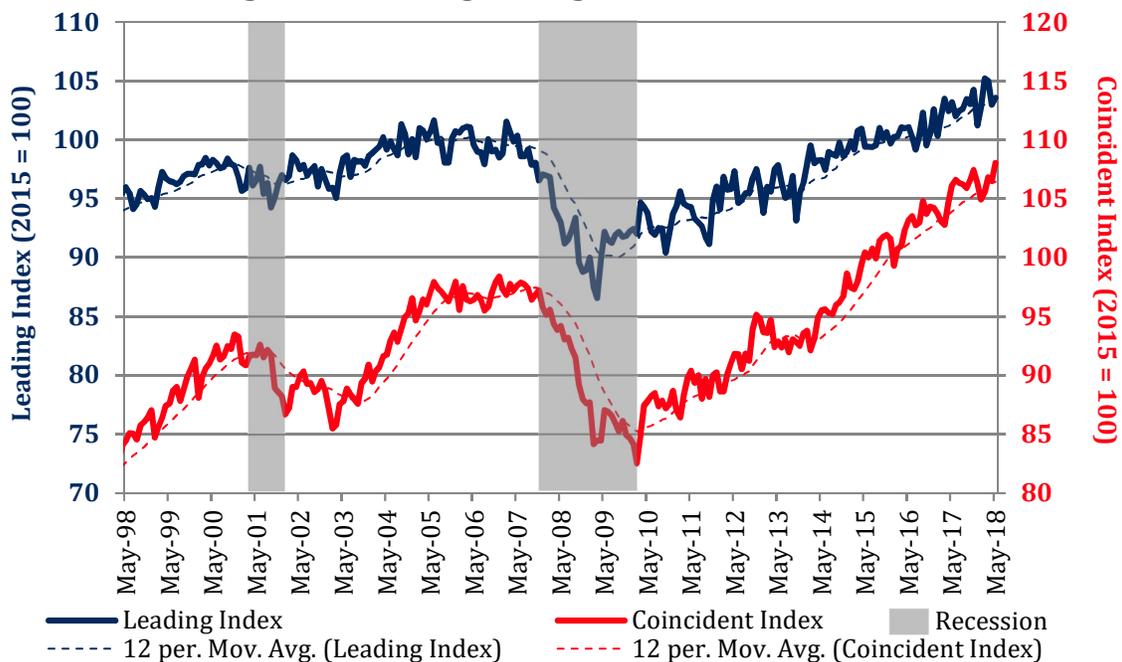
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The Washington Region's Economy Continues to Expand But Its Outlook Shows Signs of Moderation

The May 2018 performances of the Washington region's Coincident and Leading Indices, while continuing their respective positive trends from 2017, appear to have stabilized at a somewhat more moderate growth rate than registered over the previous year. The economy's current performance, as measured by the Coincident Index, while still growing, has not grown as rapidly during the second quarter as it had during the past three quarters. Even at this more moderate growth rate, the Coincident Index has extended its positive trajectory to a 50th month. The Leading Index's small gain in May was similar in magnitude to its April gain; both of these were substantially smaller than achieved during the year's first quarter. Still, the Leading Index's positive trajectory points to the region's economic growth continuing into the fourth quarter of 2018. Other forecasts for the Washington region's economy are pointing to these gains accelerating over the second half of 2018 and peaking in 2019 before slowing for several years beginning in 2020.

Figure 1. Washington Region Economic Indices



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

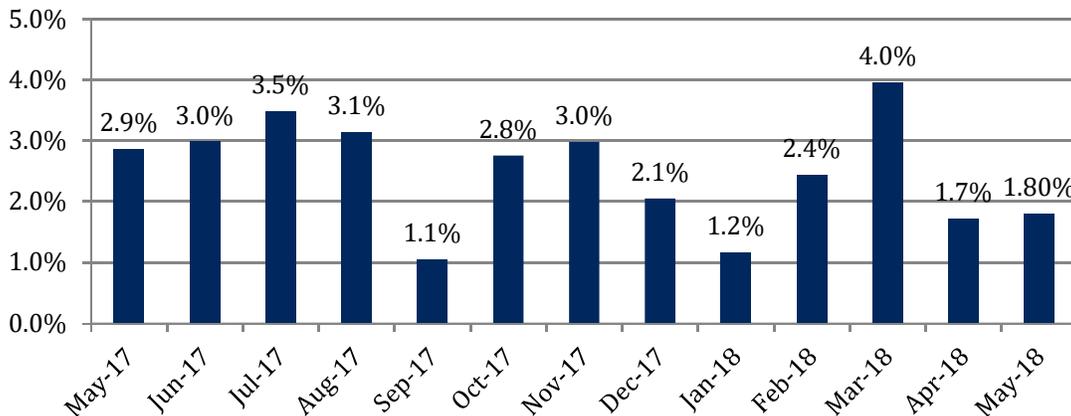
The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, increased 1.46 percent in May from April after having decreased slightly from March to April. On a month-to-month basis, the Coincident Index has increased three times in the year's first five months. In May, three of the Index's four components increased on a month-to-month basis. Total wage and salary employment, domestic airport passenger volume and nondurable goods sales increased from their April levels while consumer confidence declined. Consumer confidence has now declined for three consecutive months.

On a monthly over-the-year basis, May's Coincident Index registered an increase of 1.80 percent from May 2017 extending its upward trend to 50 consecutive months, dating from April 2014. May's Index performance paralleled its performance in April, when it gained 1.7% reflecting a more moderate and more stabilized growth rate compared to its 4.0% gain in March.

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

- *Wage and salary employment* in the Washington region increased 1.3% between May 2017 and May 2018;
- *Consumer confidence (in the present)* continued its positive trend, increasing 11.1% from May 2017 extending its pattern of double-digit increases experienced in all but one month over the past year; and,
- *Non-durable goods retail sales* registered a strong gain of 3.3% from May 2017; while,
- *Domestic passenger volume at Reagan National and Dulles Airports* declined for the second consecutive month by 1.2 on a monthly over-the-year basis.

Figure 2. Washington Coincident Index, Monthly Over-the-Year Changes



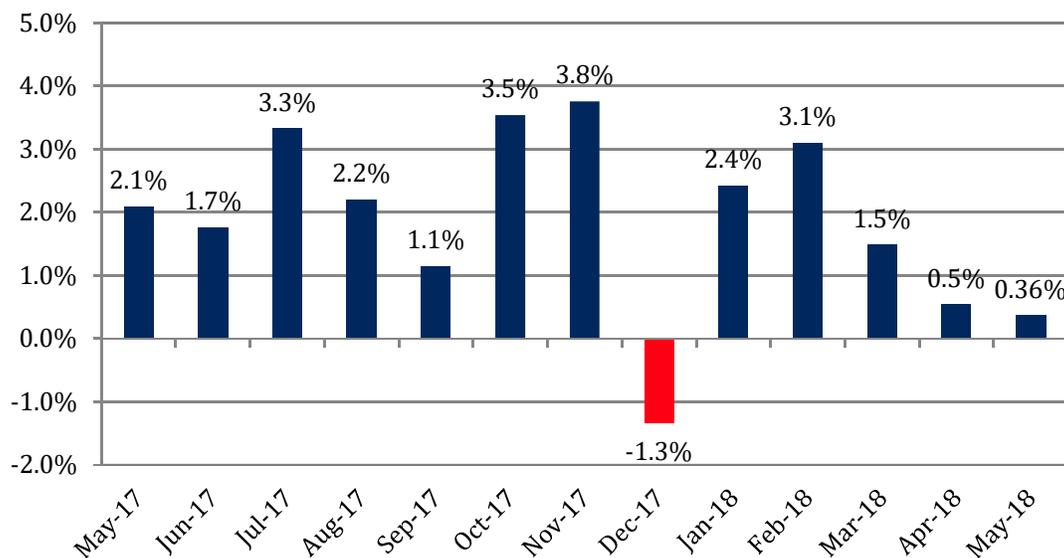
Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy six to eight months in advance, registered a small increase for the second consecutive month, gaining 0.36 percent from May 2017 after having increased only 0.5% in April. These small gains in April and May are the smallest for the Leading Index since it was negative last December. For both months, their performances were dampened by double-digit declines in residential building permits; these have been volatile over the past several years frequently ranging from a double-digit gain to a double-digit decline in consecutive months. In spite of this volatility in this one indicator, the Leading Index's positive long-term performance continues pointing to the region's economic expansion extending at least into the fourth quarter of 2018.

In May, three of the Leading Index's four components contributed to its gain from May 2017:

- *Durable goods retail sales* increased 6.5% between May 2017 and May 2018 continuing its positive trend from 2017;
- *Initial claims for unemployment insurance* decreased 6.4% (improved) extending its favorable trend to a fifth month; and,
- *Consumer expectations (consumer confidence six months hence)* increased 4.0% from its May 2017 level reversing its decline in April; while,
- *Total residential building permits* declined 30.8% in May after having declined 14.4% in April.

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 continues to expand and has largely recovered from its Sequester-induced downturn in 2013. And, forecasts for 2018 and 2019 point to continued expansion and possible acceleration over the next eighteen months. However, longer-term forecasts call for a substantially more moderate growth trajectory into the early years of the next decade.

The economy's performance during the first six months of 2018 provides a new baseline from which to project this future. With the release of June employment data for the Washington region by BLS on June 20th it is possible to assess the year's job growth performance at mid-year relative to 2017 as well as measure it against the beginning-of-the-year job growth projection. While jobs data for the year's first six months can only provide a partial measure of the full year's performance, they may identify: (1) changes in historic trends relative to the current number of jobs being created by the region's economy, (2) changes in the regional distribution of these new jobs, and (3) changes in the economy's sectoral mix of jobs. These new trends can be helpful in refining the expectations for the region's economy for the remainder of this year and reset the baseline for economy's future performance.

The key measures of this mid-year assessment are shown in Table 1. For the region as a whole, job growth in 2018 was expected to slow from 50,100 in 2017 to a projected 47,400 in 2018. Based on mid-year job growth data, the region's job growth has slowed more than expected to 41,300; if this trend continues for the full year, the region's job growth in 2018 will be 18.9 percent less than its 2017 level rather than the 12.9 percent reduction projected at the beginning of the year.

Table 1. Employment Change by Sub-State Area, 2017-2018¹
(jobs and dollars in thousands)

Sub-State Area	Actual			Forecast (from beginning of the year)	
	2017	YTD 2018*	% Change (2017 to YTD 2018)	2018	% Change (Forc. 2018 to YTD 2018)
D.C.	8.9	6.8	-23.6	5.9	15.3
Suburban MD	15.2	2.6	-82.9	13.1	-80.2
Northern VA	26.8	31.9	19.0	28.4	12.3
Region	50.9	41.3	-18.9	47.4	-12.9
GRP/Job**	\$161.5	\$141.2	-12.6	\$166.9	-15.4

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

*annual estimate based on first-half year employment data. **average GRP value of new jobs to the region's economy in current year dollars.

Beyond this faster-than-expected slowdown in the region's generation of new jobs, there are two other important trends that are identified in these jobs data, as presented in Table 1. Both of these trends have continued from 2017 into 2018 and therefore may reflect structural changes in the region's economy, conditions not tied to the evolution of the business cycle or to some other short-term condition.

The first of these trends is the change in distribution of job growth across the region's sub-state areas. In recent years, Northern Virginia has accounted for approximately 50 percent of the region's job growth with the District of Columbia generating in the range of from 15-20 percent and Suburban Maryland's economy generating from between 30-35 percent. Over the past several decades these percentages have varied slightly from year to year however since mid-2017 there has been a significant reduction in the share of the region's jobs being generated in Suburban Maryland. As has been reported previously by the Stephen S. Fuller Institute, job growth in Suburban Maryland declined to almost zero during the third quarter in 2017 and actually went negative during the fourth quarter. So far in 2018, Suburban Maryland's economy has accounted for 2,600 new jobs or 6.3 percent of the region's new jobs. This weak job growth performance in the Suburban Maryland economy appears to be concentrated in Prince George's, Calvert and Charles Counties—these counties together have averaged job losses of 3,500 during this year's first six months, while Montgomery and Frederick Counties have averaged gains of 5,600 jobs for the same period.

The second trend traces back to the structural changes experienced by the Washington region's economy as a result of the Great Recession that were deepened by the Sequester's impacts on the region's economy in 2013. Simply stated this trend is the shift of job growth activity away from higher-value added economic activities to lower-value added economic activities. This shift is most apparent in the decline of federal government jobs and the accelerated job growth experienced in the Leisure and Hospitality Services and Education and Health Services sectors although other smaller shifts away from higher-value added sectors have compounded the consequences of this long-term change in the region's job mix.

The economic impacts of these job shifts are seen in the region's slower economic growth rate since 2010. The accelerating growth of lower-value added jobs—their contribution to the region's gross regional product (GRP)—is seen in the changes in average GRP per job value in Table 1. In 2017, the average per job contribution to the Washington region's economy of its total employment base was \$161,470, as measured in 2017 dollars. For 2018, the projected average contribution of all jobs in Washington region (IHS Markit, 2018) is \$166,907 in 2018 dollars. However, the average GRP contribution per job for the mix for the region's new jobs, reported through six months in 2018, is only \$141,196. This is well below both the projected annual 2018 value and the 2017 actual average GRP contribution per job. The mix of jobs created through mid-year in the Washington regional economy has continued to be a drag on the Washington region's economic expansion and explains why it is no longer among the fastest growing large metropolitan areas nationally.

The region's most recent jobs report, for June 2018 compared to June 2017, showed both greater strength and a better geographic distribution than had been recorded during the year's first five months. Job gains for the region total 51,500 with Suburban Maryland accounting for 12.2 percent. While this is still below its long-term average share, it is a clear improvement from recent months. The District's recorded a 20.4 share of June's job gains while Northern Virginia's share was 67.4 percent. In order to achieve the region's full growth potential in 2018, the economy will need to perform during second half more like it did in June than it has during the year's first five months.

Near-Term Outlook

The U.S. economy is expected to accelerate in 2018 and remain strong through 2019. The most recent forecast (IHS Markit, July 2018) for the U.S. economy incorporates an assessment of the magnitudes and timing of the fiscal impacts of recent federal initiatives—the 2017 Tax Cuts and Jobs Act and the Bipartisan Budget Act of 2018. These updated GDP forecasts also reflect higher energy costs in 2018 and 2019 resulting in part from the suspension of the Iranian nuclear agreement, the effects of higher import tariffs imposed by the Trump Administration and the retaliation by U.S. trading partners, and higher sales tax collections now that internet sales can be taxed resulting in a slight reduction in consumer spending and a corollary increase in state tax revenues (these impacts are expected to begin showing up in the data during the 4th quarter of 2018). The result of this most recent forecast is that GDP growth is now projected to reach 3.0% in 2018 but slip to 2.7% in 2019.

The performance of the U.S. economy establishes the foundation for the performance of the Washington region's economy although, with its continuing dependency on federal spending to accelerate its grow, federal spending levels will remain an important variable in determining the region's future economic growth rate. With federal employment down by 6,400 jobs in the year's first six months (compared to the federal employment level during the first six months of 2017), federal procurement contracting expenditures will be the differentiating force in the region's economic performance in 2018 and 2019 but may also magnify intra-regional performance differences.

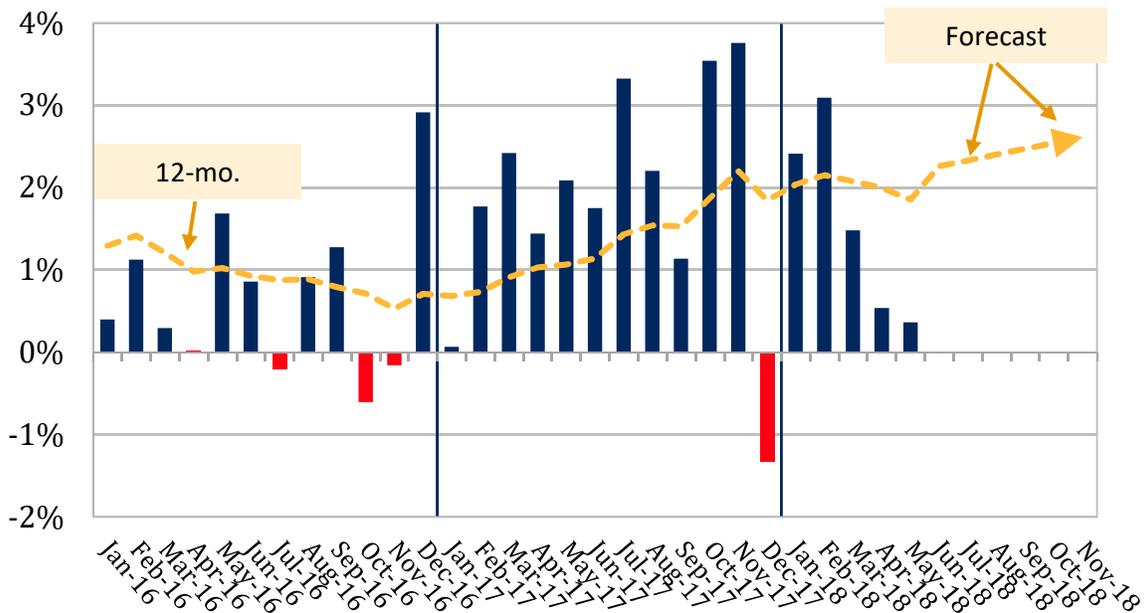
With the federal budget agreement in place, affecting both defense and non-defense spending, there are expectations that end-of-the-fiscal-year spending will provide a measurable boost to the Washington region's economy during the third quarter (Fiscal Year 2018 ends September 30th). Similarly, federal spending during FY 2019 is expected to remain strong and have regional benefits that will also boost the economy's performance next year even though other federal fiscal stimuli are not expected to be as strong. With continuing favorable national economic conditions and expected increases in federal procurement spending in both FY 2018 and FY

2019 this combination is expected to drive the region's economic growth over the next eighteen months at its fastest rate since 2010.

The Washington Leading Index projects this positive trajectory over the first half of this longer forecast period. By design, the leading indicators in combination have their strongest correlation with the Coincident Index—in projecting the performance of the region's economic performance—six to eight months into the future. While the Leading Index has moderated in April and May, it continues to track positively. This recent slowdown in the Leading Index may be pointing to moderation in the performance of the current economy later in the year during the period when Congress is in recess during the run up to the mid-term election simultaneously with slower federal spending at the beginning of the new fiscal year. Perhaps this moderation is temporary and next month the regional economy will rebound fueled by year-end (fiscal) increases in federal spending and new policy pronouncements by the Trump Administration.

Uncertainty continues to shadow both the U.S. and the Washington region's economies. The effects of changing federal policies impacting international trade and the size and functions of federal agencies, their employment levels and procurement spending patterns, will determine whether the 2018 economy realizes its full growth potential or ends the year looking more like its first six months.

**Figure 4. Washington Region Leading Index
Monthly Over-the-Year Percent Change**



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

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

Economic Indicator	Estimates			Percent Change	
	May-18 Prelim.	Apr-18 Final	May-17 Final	Apr-18 to May-18	May-17 to May-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	108.1	106.5	106.1	1.46%	1.80%
Leading Index (2015 = 100)	103.6	103.0	103.2	0.57%	0.36%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000) ^a	3,328.2	3,303.0	3,286.9	0.76%	1.26%
Consumer Confidence (South Atlantic) ^a	163.6	164.0	147.2	-0.24%	11.14%
Domestic Airport Passengers ('000) ^b	2,227.7	2,142.4	2,255.5	3.98%	-1.23%
Nondurable Goods Retail Sales (\$000,000) ^c	3,264.5	3,173.6	3,160.7	2.86%	3.29%
Washington Area Leading Index Components					
Total Residential Building Permits ^a	1,664.0	1,579.0	2,406.0	5.38%	-30.84%
Consumer Expectations (South Atlantic) ^a	118.4	111.1	113.8	6.57%	4.04%
Initial Unemployment Claims ^b	1,503.9	1,362.6	1,606.4	10.37%	-6.38%
Durable Goods Retail Sales (\$000,000) ^c	3,829.6	3,642.9	3,597.0	5.13%	6.47%
Washington Area Labor Force^a					
Total Labor Force ('000)	3,425.9	3,410.2	3,387.2	0.46%	1.14%
Employed Labor Force ('000)	3,315.4	3,303.3	3,265.0	0.37%	1.54%
Unemployed Labor Force ('000)	110.5	106.9	122.3	3.41%	-9.59%
Unemployment Rate	3.2%	3.1%	3.6%	--	--
Washington Area Wage and Salary Employment^a					
Total ('000)	3,328.2	3,303.0	3,286.9	0.76%	1.26%
Construction ('000)	162.4	161.3	160.3	0.68%	1.31%
Manufacturing ('000)	55.7	55.0	54.8	1.27%	1.64%
Transportation & Public Utilities ('000)	69.3	68.6	66.1	1.02%	4.84%
Wholesale & Retail Trade ('000)	343.5	338.4	339.1	1.51%	1.30%
Services ('000)	1,991.7	1,974.5	1,957.2	0.87%	1.76%
Total Government ('000)	705.6	705.2	709.4	0.06%	-0.54%
Federal Government ('000)	361.8	363.1	369.0	-0.36%	-1.95%

^aUnadjusted data

^bSeasonally adjusted data

^cSeasonally adjusted constant (1996) dollars