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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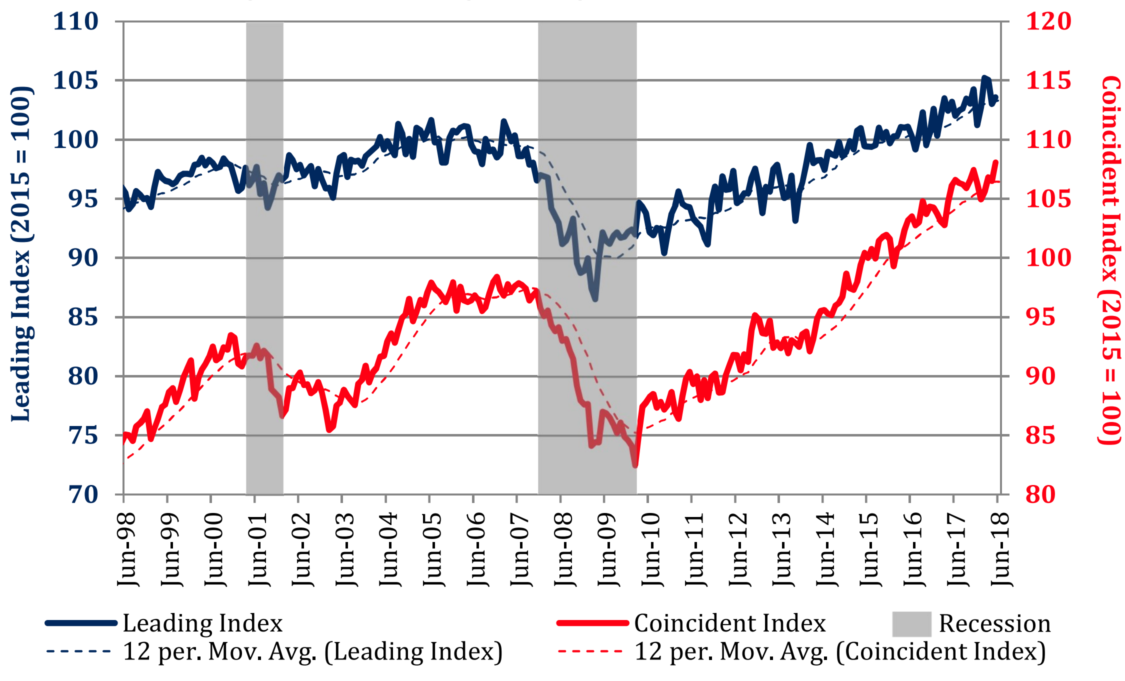
The Washington Region's Economy Accelerated in June and Its Outlook Remains Strong for 2018

The June 2018 performances of the Washington region's Coincident and Leading Indices showed the region's economy accelerating into the third quarter with the outlook remaining strong through the end of the year. The economy's current performance, as measured by the Coincident Index, experienced broad-based gains and registered its strongest job growth in June for the year-to-date. The Leading Index's gain in June was stronger than in either April or May, reaffirming its positive trajectory that points to the region's economic growth continuing at least through the fourth quarter. With the U.S. economy projected to register its strongest growth rates of the decade this year, to be followed by a strong but not as robust gain in 2019, expectations for the Washington region's economy are favorable at least through next year.

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 1.04 percent in June from May after having increased 1.4 percent from April to May. On a month-to-month basis, the Coincident Index has increased four times in the year's first six months. Consumer confidence in June, an underlying condition supporting consumer spending, turned positive in June (on a month-to-month basis) after having declined in the three previous months.

On a monthly over-the-year basis, June's Coincident Index registered an increase of 2.37 percent from June 2017 extending its upward trend to 51 consecutive months, dating from April 2014. The Index's June performance was its strongest in three months.

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

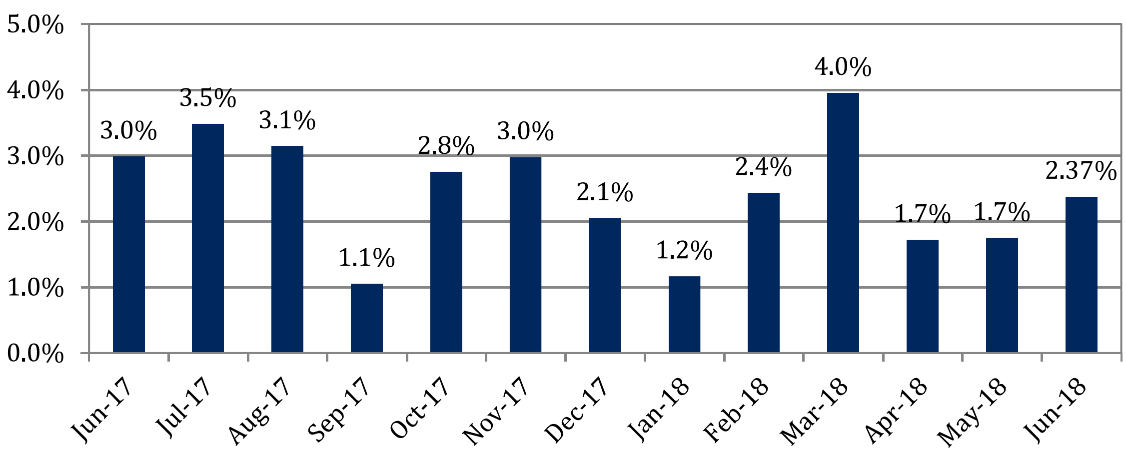
- *Wage and salary employment* in the Washington region increased 1.6% between June 2017 and June 2018;

- *Consumer confidence (in the present)* continued its positive trend, increasing 14.7% from June 2017 extending its pattern of double-digit increases experienced in all but one month over the past year;

- *Domestic passenger volume at Reagan National and Dulles Airports* increased 2.1% after having declined in the previous two months; and,

- *Non-durable goods retail sales* registered a gain of 2.2% from June 2017.

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, strengthened in June, gaining 0.78 percent from June 2017 after registering more modest gains in April and May. The principal difference in the Index's June performance was that residential building permits were positive following two months of double-digit declines. Also, consumer expectations had a strong increase following its decline in April and only modest gain in May. Partially offsetting these stronger performances was the reversal in the performance in initial claims for unemployment insurance; these had declined in each of the year's first five months but in June registered a significant increase. June's performance of the Leading Index reaffirms its positive long-term performance that now points to the region's economic expansion extending at least through the end of the year.

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

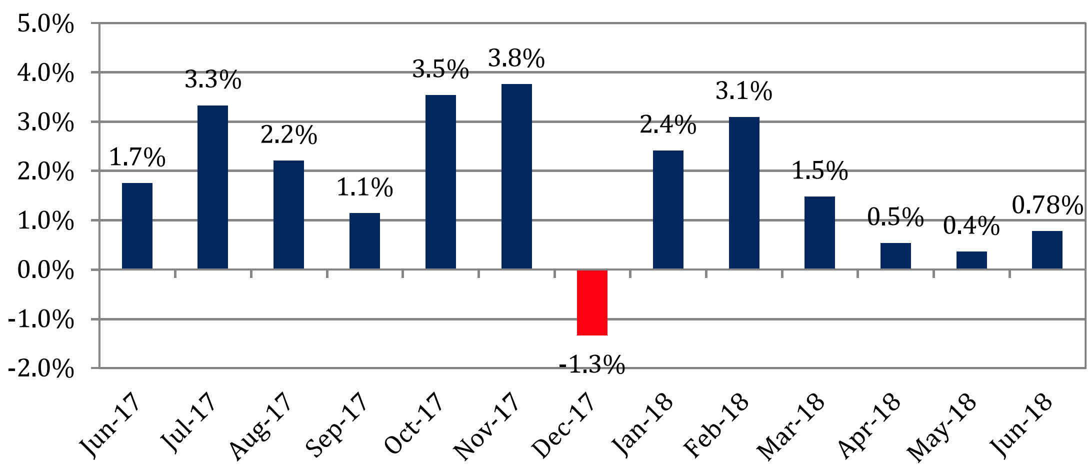
- *Durable goods retail sales* increased 4.0% between June 2017 and June 2018 continuing its positive trend from 2017;

- *Consumer expectations (consumer confidence six months hence)* increased 10.5% from its June 2017 level; and,

- *Total residential building permits* increased 6.7% in June after having declined in each of April and May on a monthly over-the-year basis, while,

- *Initial claims for unemployment insurance* increased 19.5% (worsened) after having improved (decreased) in each of the year's first five months.

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 Sequester in 2013 and into early 2014 for 51 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 through June 2018. These gains are seen in the region's gross regional product increasing from a negative 0.8 percent in 2013 (the economy actually contracted that year) to a projected growth rate of 2.8 percent in 2018, a rate closely parallel to the projected increase in U.S. GDP (2.9%, August 2018, IHS Markit).

This achievement has been accomplished by the combination of increased federal procurement spending, which has increased each year since 2013 after declining 15 percent between 2010 and 2013 while the federal workforce has now declined by 23,400 jobs from its August 2010 peak, and stronger performances of the non-federally dependent sectors (clusters) that point to the economy's continuing diversification. That the Washington region's economy has not out-performed the U.S. economy, as was the norm in recent decades, is explained in part by the underperformance of its non-federally dependent sectors (clusters) and slower gains in federal spending than had been typical during the 1980s, 1990's and 2000's.

In response to the shock of cutbacks in federal spending beginning in 2011, combined with the changes occurring naturally in the economy in response to the Great Recession (2008-2009), the structure of the Washington region's economy has changed. The Stephen S. Fuller Institute has reported on this restructuring previously. This sectoral re-balancing is most visible in the types of jobs the region has been adding as measured by their contributions to the region's economy, its gross regional product. This calculation is shown in Table 1 and compares the economic value of the jobs lost in the private sector during the recession to the jobs added since the recession, through mid-year 2018.

There can be no argument with the region's ability to generate private sector jobs, even when the federal government is reducing its employment levels. The issue isn't job generation; it is the economic value of these new jobs. The average value to the economy (gross regional product, GRP) of each job lost during the recession was $173,166 while the average GRP value of each job added since the recession was $128,405, both in 2018-dollar value.

The implications of this average value differential among the region's old and new jobs are enormous. Most simply, it means that the regional economy has to generate 1.35 new jobs for each job it lost just to maintain the same level of economic activity; that is, to not experience economic decline. In order to sustain the economic growth achieved since the recession, the private sector has had to generate 2.4 jobs for each job lost during the recession. Losses in the government sector—the total

GRP value of the federal jobs lost since 2010 was $5.1 billion and the total GRP value of the state and local government jobs added since 2010 was $3.2 billion resulting in a $1.8 billion net GRP loss—reduced the total contribution of these private sector job gains to the region's GRP since 2010. The key point here is that the Washington region's economic performance is being shaped by the types of jobs it is generating and this pattern of job growth since 2010 has resulted in a slower economic growth rate than experienced in all of the nation's other fifteen largest metropolitan areas over the 2010-2017 period.

Table 1. The GRP* Effects of Private Sector Job Change in the Washington Region, ~2007 to June 2018 (in 2018 $s)

	Job Change	Average GRP* Value	Total GRP* Value
Recession	-180,500	$173,166	-$31,256,500,000
Recovery to June 2018	+441,300	$128,405	+$56,665,000,000
Total	**+260,800**		**+$25,408,500,000**

*Gross Regional Product
Source: The Stephen S. Fuller Institute at the Schar School, GMU

This pattern of job growth continues into the present. The region's job growth total has increased in June and July compared to the year's first six-month average of 41,300 jobs as reported in Economy Watch last month. June's total has now been revised up to 57,000 jobs from the preliminary count of 51,500 jobs based largely on revisions in Suburban Maryland's June job growth. July's preliminary jobs report, issued by BLS on August 17th, estimated the region added 77,100 new jobs from July 2017, by far the greatest number of new jobs so far in 2018.

However, this number appears far too large to be true. It should be remembered that BLS estimated job growth for July 2017 at 83,100, a number that generated a lot of excitement only to be revised down to 48,100 jobs by BLS in its March 2018 re-bench marking. There appears to be something that happens during the summer months that distorts the jobs estimates. This over-estimate tends to show up predominantly in the regional-level estimates for state and local government jobs. In the July 2018, this sector is reported to have added 17,100 new jobs. State and local government jobs represent 10.5 percent of the region's total employment base so accounting for 22.2 percent of the new jobs estimated for the July 2017-July 2018 period suggests that this estimate may be too large.

Additionally, BLS reports these jobs separately by sub-state region: DC, Suburban Maryland and Northern Virginia. It is common that when the independent estimates for these three sub-state areas are totaled that they do not add up to the separately calculated regional total due to different sampling methods used by BLS to estimate the regional aggregate and sub-state area totals. When the sub-state totals are summed for the July report, they totaled 49,300. This is substantially—27,800 or 36.1 percent—fewer jobs than the 77,100 jobs reported independently for the region's total. In the three sub-state areas total (49,300), the state and local government sector is estimated to have added only 2,800 jobs representing 5.7 percent of the total new jobs added. This over-estimating of the region's job gains in July will not likely be corrected until next March so care will need to be exercised in assessing the economy's performance based on job growth as we move through the remainder of the year.

One conclusion can still be drawn from either one of BLS's job reports for July. The regional economy continues to generate a disproportional number of lower-value added jobs. Using the larger base of 77,100 jobs, while professional & business services added 22,500 jobs—these are higher-value added contributing $163,053 on average each to the economy—while the combination of educational and health services and leisure and hospitality services added 24,200 jobs—these jobs on average each added add $66,191 to the economy. During this same period, the federal sector lost 4,500 jobs each contributing $209,349 on average to the economy. It is this changing job mix across all sectors that has damped the region's economic performance since 2010 and will continue to affect its ability to regain its historic growth trajectory (pre-2010) going forward.

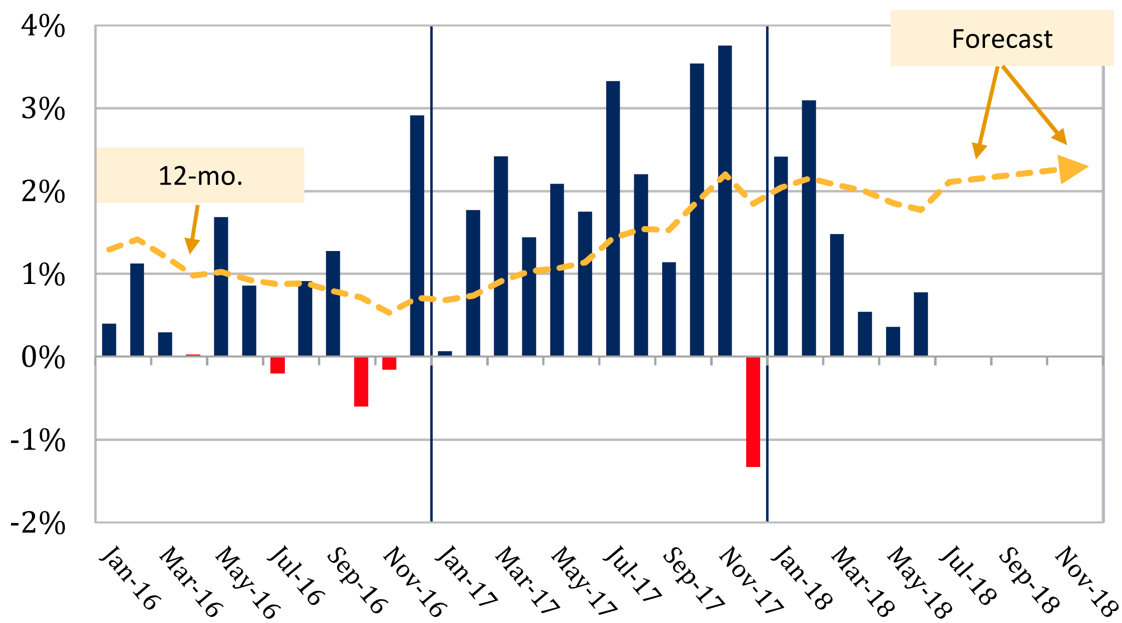
Near-Term Outlook

The most recent forecast update for the U.S. economy (IHS Markit, August 2018) projects its annual GDP growth rate at 2.9 percent for 2018 with slower (2.7%) but still healthy gains projected for 2019 followed by annual growth rates of less than 2.0 percent into the next decade. For 2018, the news is good, perhaps with the exception of slower growth forecasts for the housing sector—higher interest rates, higher production costs reflecting shortages of labor and materials contributing to price increases and slower new housing starts. The trade war is not projected to undermine this growth rate with exports even projected to grow this year. Some of this year's economic stimulus will be lost to next year's economy with higher interest rates and higher energy costs also being a drag on the growth rate in 2019. Of course, these forecasts and the economy are much more complicated than can be captured in this short summary. Most simply, the U.S. economic forecast is for strong gains this year with these continuing into 2019, although at a more moderate rate, and this will also support stronger economic growth in the Washington region.

The Washington Leading Index projects this positive trajectory over the first half of this 18-month 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 did moderate in April and May, it grew at a faster rate in June. Combining with its strong performance in the first quarter, its June performance points to the economy's positive track continuing through at least the end of the year.

Still, 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, if October 1st will bring a federal shutdown, and how the political drama will play out through the coming months including the outcome of the mid-term election, these and other variables will determine whether the 2018 economy realizes its full growth potential in 2018 and whether the region's economy is well positioned for continuing growth in 2019.

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



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

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Washington Area Economic Indicators
Current and Previous Months

Economic Indicator	Estimates			Percent Change	
	Jun-18 Prelim.	May-18 Final	Jun-17 Final	May-18 to Jun-18	Jun-17 to Jun-18
Washington Area Business Cycle Indicators					
Coincident Index (2015 = 100)	109.1	108.0	106.6	1.04%	2.37%
Leading Index (2015 = 100)	102.8	103.6	102.0	-0.74%	0.78%
Washington Area Coincident Index Components					
Total Wage & Salary Employment ('000)[a]	3,351.8	3,325.5	3,300.3	0.79%	1.56%
Consumer Confidence (South Atlantic)[a]	174.5	163.6	152.2	6.66%	14.65%
Domestic Airport Passengers ('000)[b]	2,286.0	2,227.7	2,239.1	2.62%	2.09%
Nondurable Goods Retail Sales ($000,000)[c]	3,244.2	3,264.8	3,174.0	-0.63%	2.21%
Washington Area Leading Index Components					
Total Residential Building Permits[a]	2,595.0	1,664.0	2,432.0	55.95%	6.70%
Consumer Expectations (South Atlantic)[a]	117.8	118.4	106.6	-0.51%	10.51%
Initial Unemployment Claims[b]	2,109.9	1,503.9	1,765.8	40.29%	19.49%
Durable Goods Retail Sales ($000,000)[c]	3,706.5	3,828.1	3,564.4	-3.17%	3.99%
Washington Area Labor Force[a]					
Total Labor Force ('000)	3,463.5	3,423.3	3,416.0	1.18%	1.39%
Employed Labor Force ('000)	3,335.6	3,313.0	3,282.5	0.68%	1.62%
Unemployed Labor Force ('000)	127.9	110.3	133.6	15.94%	-4.23%
Unemployment Rate	3.7%	3.2%	3.9%	--	--
Washington Area Wage and Salary Employment[a]					
Total ('000)	3,351.8	3,325.5	3,300.3	0.79%	1.56%
Construction ('000)	167.3	162.0	162.9	3.27%	2.70%
Manufacturing ('000)	56.2	55.6	55.1	1.08%	2.00%
Transportation & Public Utilities ('000)	70.4	69.2	66.9	1.73%	5.23%
Wholesale & Retail Trade ('000)	343.1	343.1	341.5	0.00%	0.47%
Services ('000)	2,011.0	1,989.7	1,967.4	1.07%	2.22%
Total Government ('000)	703.8	705.9	706.5	-0.30%	-0.38%
Federal Government ('000)	363.4	362.0	370.4	0.39%	-1.89%

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