



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



# 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.*

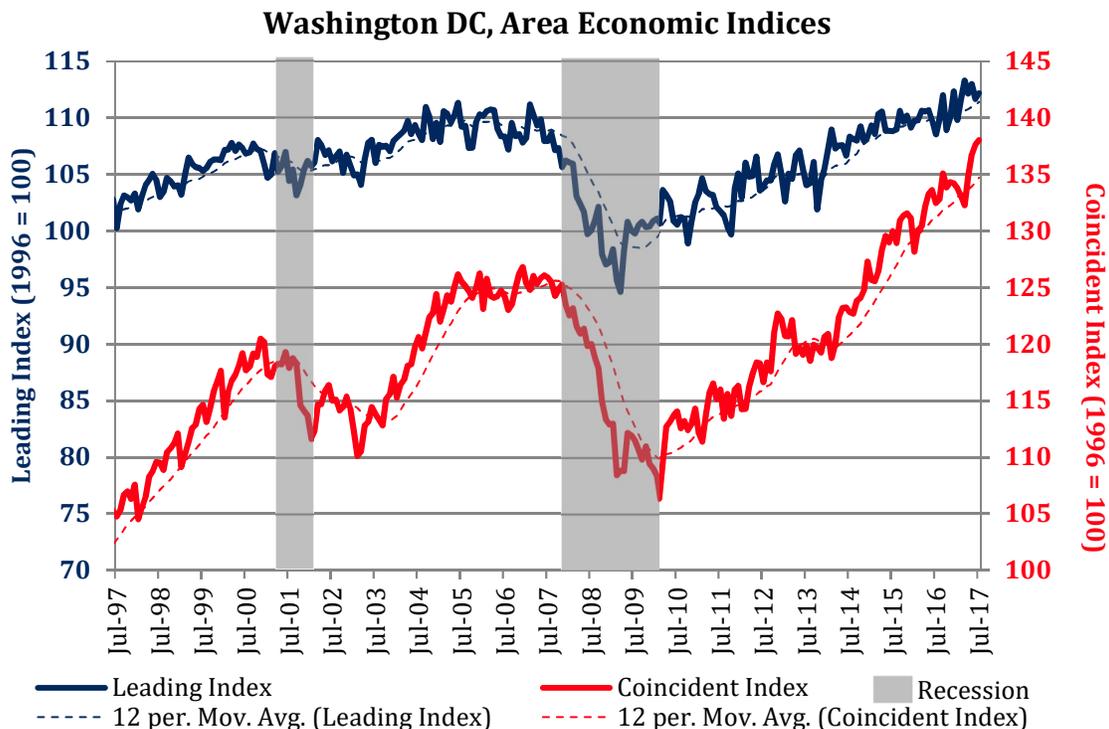
# Washington Economy Watch

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## The Washington Region's Economy Starts The Third Quarter With Sharp Gains

The Washington Leading and Coincident Indices were stronger in July than in June and continue pointing to a stronger performance in 2017 than in 2016. While the region's economy encountered some unevenness early in the year, its performance has improved each month since March and registered its strongest gains to date in July. The Coincident Index has increased each of the last four months with all of the Index's four components contributing to its gains. The Leading Index has registered strong gains in 2017 with July's monthly over-the-year increase being its largest gain in 32 months. This momentum is expected to continue through 2017 into next year with the region's economy on track to achieving its strongest performance since 2010.



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

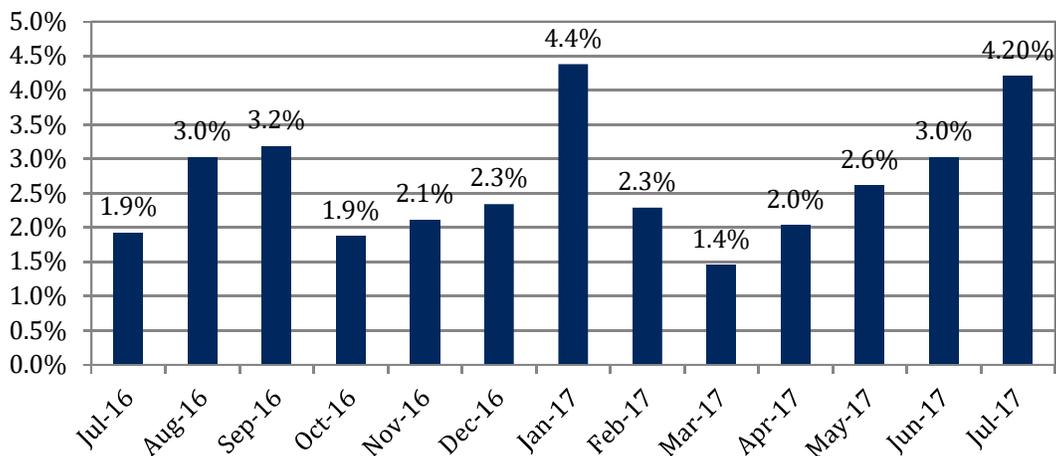
The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, increased for a fourth consecutive month in July registering a 0.3 percent gain from June 2017 with two of the Index's four components increasing on a month-to-month basis, one showing no gain, and one (nondurable goods sales) declining following two monthly gains. Prior to April, the Index had declined in five of the previous six months on a month-to-month basis.

The Index's fourth month-to-month gain in July reflects its positive long-term trend extending back to April 2014 (totaling 40 months). July's gain of 4.20 percent from July 2016 represents its strongest monthly over-the-year gain since January (4.4%) and its second strongest performance in 20 months, since November 2015. The Coincident Index has now registered consecutively stronger performances four months in a row following March's weak performance (the weakest in 40 months).

For the fifth month this year, all four of the Coincident Index's components were positive on a monthly over-the-year basis.

- *Wage and salary employment* growth in the Washington region increased 2.6% between July 2016 and July 2017;
- *Consumer confidence (in the present)* continued its positive trend, increasing by a record setting 43.3% from July 2016;
- *Domestic passenger volume at Reagan National and Dulles Airports* increased 3.3% in July compared to July 2016 and has now increased in six of this year's first seven months on a monthly over-the-year basis; and,
- *Non-durable goods retail sales* increased 1.1% from July 2016, growing for the fifth consecutive month after declining in February.

**Washington Coincident Index, Monthly Over-the-Year Changes**



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

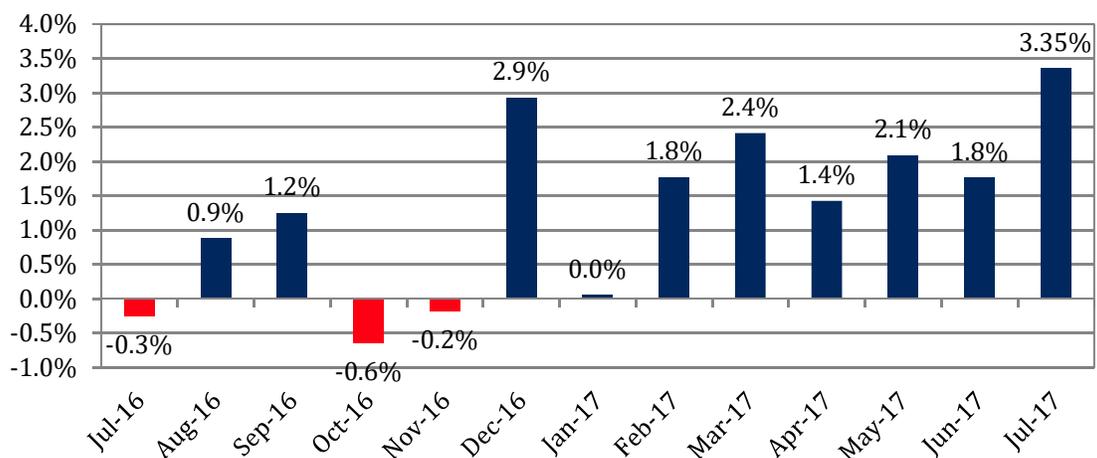
The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy six to eight months in advance, increased in July, gaining 3.35 percent from July 2016, its strongest increase since November 2014. The Leading Index has now registered solid gains for six consecutive months in 2017 after registering no gain (0.05%) in January. This upward trend represents the strongest sustained performance for the Leading Index since 2014.

This year's continuing strong performance points to further economic growth during the remainder of 2017 and through at least the first quarter of 2018. This growth path contrasts with the Index's pattern of gains and losses during 2016 that net out to zero during the year's first half.

In July, three of the Leading Index's four components contributed to its gain from July 2016.

- *Durable goods retail sales* increased 5.8% in July from July 2016 continuing its positive trend from 2016 when durable goods sales increased every month;
- *Consumer expectations (consumer confidence six months hence)* extended its upward trend for a tenth month gaining 30.1% and registering double-digit gains for an eighth consecutive month; and,
- *Total residential building permits* rebounded sharply from two monthly declines gaining 48.6% from July 2016; while
- *Initial claims for unemployment insurance* increased (worsened) following June's improvement and now has increased in eight of the last nine months.

**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 July extended its growth trajectory to a 40<sup>th</sup> month and started the year's second half with a strong gain. While the first half of 2017 showed some unevenness, especially with March's relative small gain, the region's economy has gained strength each month since. Each of the four components of the Coincident Index were stronger in July than when the year began confirming the positive direction and breadth of the region's current economic performance.

The performance of the region's forward-looking indicators continues to suggest stronger growth six to eight months ahead. Six strong monthly gains since January present a clear signal that the region's economy should registered a stronger year overall in 2017 than in 2016 and that this upward trend will be carried into 2018. Last month's concern regarding residential investment trends seems to have been answered by the sharp increase in residential building permits in July, up 48.6% from July 2016. As noted last month, the region's housing market conditions remain favorable: consumer confidence continues to increase with double-digit gains, mortgage interest rates remain low, and consumer spending has continued to grow along with jobs and personal earnings.

As has been noted previously in *Washington Economy Watch*, the Leading Index cannot project the impacts of external disruptions to the region's economy that could dampen or even possibly accelerate its future performance. While the near-term economy looks well positioned to grow at an accelerating rate in 2017 and 2018, its actual performance over this period will depend on the continued flow of federal spending in the region (and nation). The federal budget for FY 2018 remains to be finalized, but at least the debt ceiling and budget deadlines have been resolved until December. Still, uncertainty is not good for economic growth and could dampen performance in early 2018 in the absence of passage of both authorization and appropriations legislation before the end of December.

## **Current Performance**

By most measures, the Washington region's economy has recovered its momentum from its relatively weak performance during 2016 (GRP growth at 1.1%) as well as from any disruption that resulted from the change in Administrations in January. This year's job growth through August has exceeded projection averaging 59,050 jobs on an annualized basis. While these job estimates will be subject to revision after the end of the year and reissued in March 2018, and should be expected to be lowered, they still are consistent with other indicators that point to the region's improving economic conditions building from 2013 when the economy (GRP) declined by 0.8% due to cutbacks in federal spending—the Sequester—while the national economy expanded 1.7% and continued its recovery following the Great Recession.

Job growth in August (compared to August 2016) totaled 67,600 jobs, well ahead of the beginning-of-the-year forecast; it also exceeded the year-to-date average job growth. While August's job increase was one of the region's largest going back to April 2016 (only exceeded by July's 85,000), its 2.1% gain was not extraordinary when compared to other major metropolitan areas. Of the nation's 15 largest metropolitan areas, of which the Washington region ranks fifth by size of its economy, the Washington region ranked 8<sup>th</sup> in terms of percentage job growth; that is, seven metropolitan areas had greater job growth rates.

As has been pointed up in previous reports, it isn't only the number of the jobs that is important, but it is also the types of jobs; that is, their value added or contribution to the economy and the salaries that they support. The restructuring of the region's economy during the last decade is illustrated by comparing the value added of the jobs that were lost in the Washington region during the recession to the jobs that have been added since the recession. For this comparison, only the private sector jobs are included as it is these jobs that the region will need to drive its future growth in place of the federal jobs that historically had been this driver.

The Washington region lost 180,300 private sector jobs during the Great Recession and has added 411,500 jobs beginning in 2010 through August 2017. However, the average contribution of the jobs lost to the region's economy was \$160,233 while the jobs added since the recession had an average value added of only \$109,916. Quite simply, the job mix of the new jobs has fewer higher-value added occupations and a greater proportion of lower-value added occupations than the region's pre-recession job mix.

This pattern continues. Of the 67,600 new jobs reported of the year ending in August, 24.4% were in the professional and business services sector, with an average value added per job of \$157,969 (in 2014\$s) while the educational and health services, leisure and hospitality services, and retail trade sectors combined accounted for 55.9% of these new jobs (with an average value added per job of \$63,390). These four sectors accounted for 80.3% of the total job gain. With two-thirds of these jobs generating less than one-half (47.9%) of the total value added, this mix resulted in a lower growth rate than a mix favoring higher-value jobs.

Additionally, the continuing concentration of the region's job growth in these lower-value added sectors (the other seven sectors accounted for only 13.5% of the new jobs with three of these seven sectors actually reporting job losses) further reduces the economy's ability to grow at a greater rate. And, the \$271,167 per job average value added of these seven underperforming private sectors makes their weak performance a significant opportunity cost to the region's economic vitality and reduces the economy's ability to compensate for future reductions in federal spending.

## Near-Term Outlook

The 40 consecutive monthly over-the-year gains in the Coincident Index and the continuing strong positive performance of the Washington region's forward-looking indicators comprising the Leading Index are pointing to continuing economic gains extending through the first quarter of 2018. These gains will be measured in continuing greater-than-expected job growth, even if the mix is not as favorable as preferred, low unemployment and rising labor force participation rates, and continuing personal income growth.

The Washington region's current economic growth trajectory has its gross regional product (GRP) growing for the full year in 2017 at double the rate it did in 2016, increasing to 2.2% from 1.1%. If the region is to achieve this rate of growth (this assumes that federal spending during 2017 will not be interrupted or seriously threatened), the region's economy would outperform the U.S. economy (projected to grow 2.1% in IHS Markit's September U.S. Executive Summary) for the first time since 2010. Of course these forecasts will likely change as the initial impacts of Hurricanes Irma and Harvey are assessed; the U.S. GDP is expected to be slightly less than forecast and the GDP forecast for 2018 could be greater than currently forecast.

The U.S. Bureau of Economic Analysis (BEA) released its annual 2016 GRP estimates as well as GRP revisions back to 2001 on September 20<sup>th</sup>. The Washington region's economic performance in 2016 (1.1%) ranked 11<sup>th</sup> among the 15 largest metropolitan areas in the U.S. but retained its 5<sup>th</sup> place in total GRP value with Dallas moving from 6<sup>th</sup> to 4<sup>th</sup> place and Houston dropping from 4<sup>th</sup> to 6<sup>th</sup>. This slowdown in the Houston metropolitan area economy predates Irma (this will impact 2017) and is largely attributable to the impacts of global energy prices and shifts in demand. Houston is still too dependent on the energy sector; there is a lesson here for the Washington region with its continuing dependence on the government sector. Among all metropolitan areas in the U.S., the Washington region's 2016 growth rate placed it in 203<sup>rd</sup> place.

While BEA's historic revisions were generally small and largely reflected definitional changes, they did have a pattern. The Washington region's GRP growth rates prior to the Great Recession were revised slightly lower—the region's economy was not quite as expansive in 2005 and 2006 as had been previously reported—and its recovery was slightly stronger than had been previously reported.

There were several notable exceptions. Economic growth in 2015 had been reported at 1.3%; revised GRP estimates placed its growth at 2.4%, a difference of \$4.8 billion (2009 \$s). About 60 percent of the upward revision to growth in 2015 reflects a weaker performance in 2014 than previously estimated. The remaining \$2 billion increase was a result of stronger economic growth in 2015 than initially reported. The backstory of this upward revision is not apparent beyond the substantial job gain in the private sector from 2014; this was not directly linked to

changes in federal procurement spending in 2015, as it was unchanged from its 2014 level. Possibly, the longer-term impacts of the Sequester could have been over-estimated. Whatever the cause of this extra growth in 2015, it did not carry over into 2016, even though job growth in 2016 was almost as strong as it was in 2015; 55,600 new jobs and 57,700 new jobs, respectively.

Still, the one-year cost of the Sequester in 2013 is not to be downplayed. In fact, the GRP loss in 2013, previously estimated at 0.5% was revised upward (a greater loss) to 0.8%; a loss of \$3.27 billion instead of \$2.38 billion. And, the region's 2014 growth rate was reduced from 1.0% to 0.5%, a gain of only \$2.17 billion instead of a gain of \$4.17 billion. For future reference, this is the measure of what a 15% reduction in federal procurement spending and a 4% reduction in federal employment (approximately 14,000 jobs from the peak in 2010 through 2013) can do to the Washington region's economy if it does not succeed in reducing its dependency on federal spending to drive its growth.

In the short-term, looking forward, the Washington region's economy is projected to accelerate from a 2.2% gain in 2017 to a 2.9% gain in 2018. This gain will reflect a stronger performance of the U.S. economy, currently projected to grow 2.8% (this September forecast does was not adjusted for the reconstruction impacts from Irma and Harvey that could boosted short-term growth next year), and from continuing relatively strong job growth (45,900) plus some favorable fiscal stimulus although the magnitude of this fiscal stimulus is yet to be determined and might not even occur. Still, all of the signs at this time are pointing to continuing economic growth in the Washington region equal to or slightly stronger than what is projected for the U.S. economy.

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

Economic Indicator	Estimates			Percent Change	
	Jul-17 Prelim.	Jun-17 Final	Jul-16 Final	Jun-17 to Jul-17	Jul-16 to Jul-17
<b>Washington Area Business Cycle Indicators</b>					
Coincident Index (1996 = 100)	138.0	137.6	132.5	0.29%	4.20%
Leading Index (1996 = 100)	112.2	111.7	108.5	0.44%	3.35%
<b>Washington Area Coincident Index Components</b>					
Total Wage & Salary Employment ('000) <sup>a</sup>	3,323.4	3,312.6	3,238.4	0.33%	2.62%
Consumer Confidence (South Atlantic) <sup>a</sup>	161.4	152.2	112.6	6.04%	43.34%
Domestic Airport Passengers ('000) <sup>b</sup>	2,240.1	2,239.1	2,168.4	0.05%	3.31%
Nondurable Goods Retail Sales (\$000,000) <sup>c</sup>	3,137.6	3,178.3	3,102.7	-1.28%	1.13%
<b>Washington Area Leading Index Components</b>					
Total Residential Building Permits <sup>a</sup>	2,314.0	2,432.0	1,557.0	-4.85%	48.62%
Consumer Expectations (South Atlantic) <sup>a</sup>	113.7	106.6	87.4	6.66%	30.09%
Initial Unemployment Claims <sup>b</sup>	1,452.4	1,765.8	1,413.5	-17.75%	2.75%
Durable Goods Retail Sales (\$000,000) <sup>c</sup>	3,489.5	3,552.6	3,297.0	-1.78%	5.84%
<b>Washington Area Labor Force<sup>a</sup></b>					
Total Labor Force ( 000)	3,455.7	3,426.1	3,335.8	0.86%	3.60%
Employed Labor Force ( 000)	3,321.3	3,294.0	3,204.4	0.83%	3.65%
Unemployed Labor Force ( 000)	134.4	132.1	131.4	1.73%	2.31%
Unemployment Rate	3.9%	3.9%	3.9%	--	--
<b>Washington Area Wage and Salary Employment<sup>a</sup></b>					
Total ( 000)	3,323.4	3,312.6	3,238.4	0.33%	2.62%
Construction ( 000)	163.9	159.8	159.1	2.57%	3.02%
Manufacturing ( 000)	54.4	54.3	54.2	0.18%	0.37%
Transportation & Public Utilities ( 000)	66.8	68.2	64.9	-2.05%	2.93%
Wholesale & Retail Trade ( 000)	346.4	346.3	341.3	0.03%	1.49%
Services ( 000)	1,991.2	1,977.8	1,936.0	0.68%	2.85%
Total Government ( 000)	700.7	706.2	682.9	-0.78%	2.61%
Federal Government ( 000)	368.4	368.7	367.9	-0.08%	0.14%

<sup>a</sup>Unadjusted data

<sup>b</sup>Seasonally adjusted data

<sup>c</sup>Seasonally adjusted constant (1996) dollars