



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

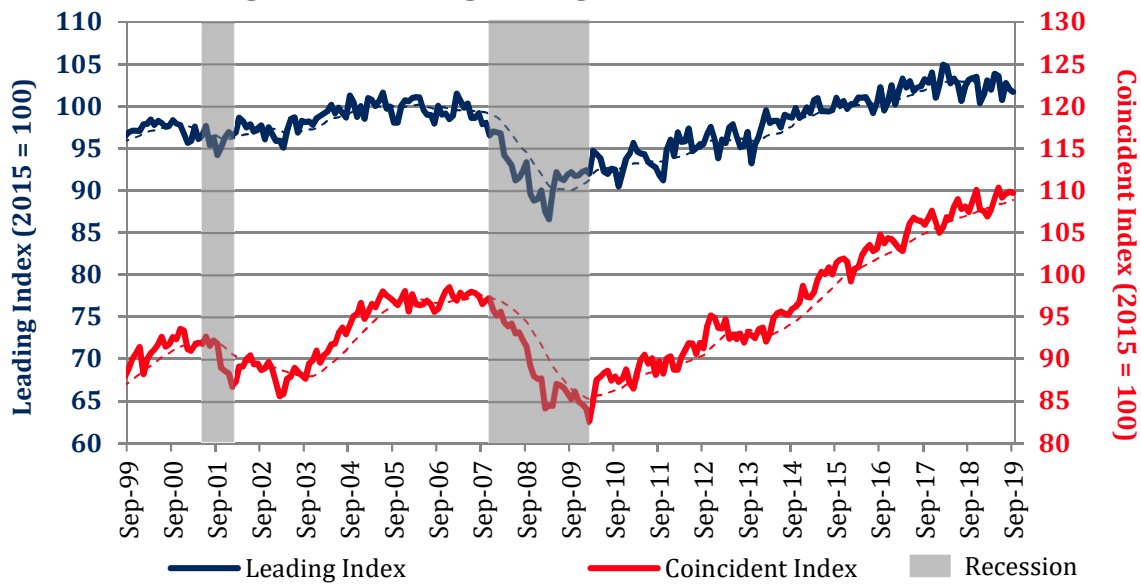
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The Washington Region's Economy Accelerated in September But Its Outlook Weakens

In September, the Washington region's Coincident Index registered a third consecutive strong gain while the Leading Index declined for the eighth time in the last twelve months. For the Coincident Index, this gain extended its consecutive monthly over-the-year increase to a 66th month. For the Leading Index, its September decline continues a pattern of softening consumer expectations that may be spilling over into the homebuilding industry that continues to underperform this year's projections. Still, job growth has accelerated since mid-year and consumers continue to spend with both durable and non-durable goods sales continuing to increase. With FY 2020 appropriations bills affecting twelve federal agencies still waiting for Congressional approval and the possibility of a shutdown now pushed to December 20th, the region's economy remains vulnerable to further uncertainty going forward. Even with approval of these agencies' appropriations, their contract spending has been curtailed for at least the year's first quarter further dampening the region's economic performance in 2019.

Figure 1. Washington Region Economic Indices



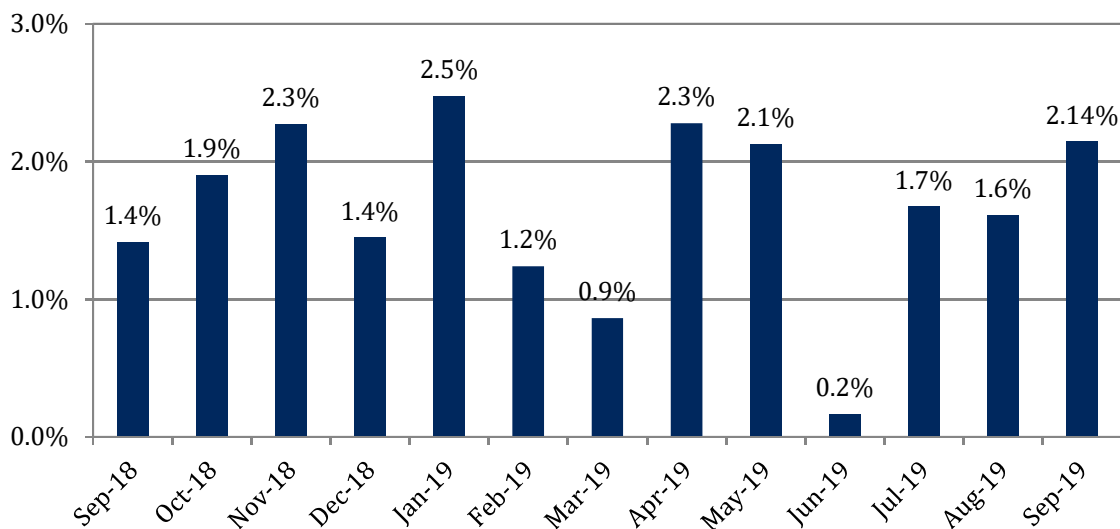
Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Coincident Index**, which represents the current state of the metropolitan area economy, decreased 0.08 percent in September on a month-to-month basis. The Index had been positive in July and August following its 1.1 percent month-to-month decline in June. This growth pattern is largely attributable to the peaking all of the Index's four components. In September, consumer confidence, domestic passenger volume at Reagan National and Dulles Airports, and non-durable goods sales were all off their previous peak values while wage and salary employment growth was flat.

On a monthly over-the-year basis, September's Coincident Index registered its strongest gain in five months, up 2.14 percent from September 2018. September's gain extended the Index's upward trend to 66 consecutive months, dating from April 2014. This strong performance reflected increases in all four the Index's indicators for the third consecutive month.

- *Wage and salary employment* in the Washington region increased 1.1% between September 2018 and September 2019;
- *Non-durable goods retail sales* were up 4.0% from September 2018 gaining for a 31th consecutive month on a monthly over-the-year basis;
- *Consumer confidence (in the present)* increased by 5.5% from September 2018; and,
- *Domestic passenger volume at Reagan National and Dulles Airports* increased 3.5% from September 2018.

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



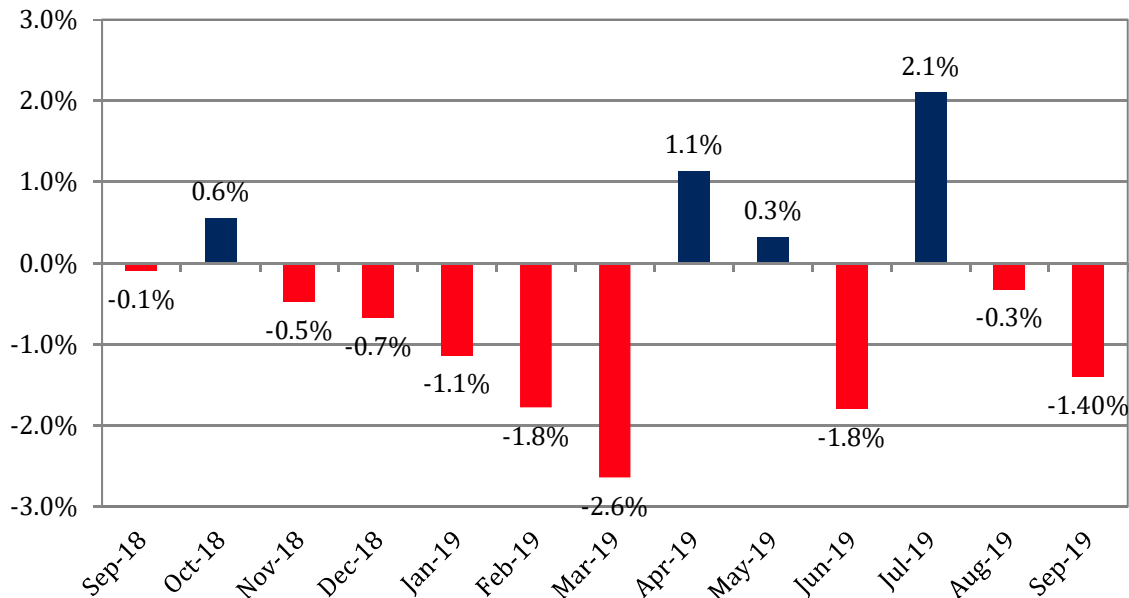
Source: The Stephen S. Fuller Institute at the Schar School, GMU

The **Washington Leading Index**, which is designed to forecast the performance of the metropolitan area economy by six to eight months, decreased by 1.40 percent in September on a monthly over-the-year basis, adding to its year-long downward trend; the Leading Index has been positive in only four of the last twelve months. This negative trend reflects continuing weaknesses in consumer expectations and the residential building industry as well as unevenness and uncertainty in several segments of the labor market. The divergent patterns of the Leading Index, which is pointing to slower future growth and possible contraction, and the Coincident Index, which has registered accelerated growth since mid-year, should be considered a warning of possible performance changes in the region's economy going forward.

In September, three of the Leading Index's four components contributed to its decrease.

- *Consumer expectations (consumer confidence six months hence)* decreased 16.6% from September 2018, its largest decline since January;
- *Total residential building permits* decreased 6.7% in September following its 8.1 percent decrease in August on a monthly over-the-year basis; and,
- *Initial claims for unemployment insurance* increased 11.8% (worsened) extending its upward trend to a sixteenth consecutive month; while,
- *Durable goods retail sales* increased 2.4% from their September 2018 level and have now gained in six out of this year's first nine 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 economic growth has accelerated since mid-year, at least as measured by job growth. October's job increase, from October 2018, was estimated to total 52,300 jobs, the greatest 12-month increase since June 2017. This gain, along with strong increases reported for August and September, has raised the region's year-to-date job growth average to 32,700. At mid-year, this year-to-date average was 26,100 jobs. Still, this job growth trend lags the 35,300 jobs added in 2018 and the beginning-of-the-year projected gain of 38,200 jobs for 2019.

These stronger job gains since mid-year reflect several differences from the year's first-half performance. Job growth across the region's sub-state areas has become more balanced in recent months. During the year's first half, job growth in Suburban Maryland was slightly negative while gains in the District of Columbia were below its normal share and job growth in Northern Virginia was accounting for more than 90 percent of the region's total. In October, Northern Virginia's share of the region's job growth was 62.5 percent (still above normal), job gains in Suburban Maryland accounted for almost 20 percent of the total and the District's share was near normal at 18 percent. While job growth in Northern Virginia has also increased in number since mid-year, it is the gains in Suburban Maryland (compared to losses) and in the District that explain the overall increases of the monthly job gains.

The types of jobs that are increasing are also important in understanding the region's job growth acceleration. At mid-year, two of the region's three largest and fastest growing private sectors were under-performing: educational and health services and leisure and hospitality services. The third fast growing and largest sector, professional and business services, representing 23.0 percent of all existing jobs generated almost 52 percent of the new jobs through the year's first half. Job growth in the education and health services sector through the year's first six months averaged 5,300; in October, this sector added 9,900 jobs compared to October 2018. For the leisure and hospitality services sector, these comparative job gains were 13,200 at mid-year and 17,200 jobs added in October's report. These sectors were underperforming earlier in the year and appear to have now returned to their previous growth trajectories. In addition, several smaller sectors have reversed their growth trends from negative to positive (financial activities and information services) and other sectors have accelerated (construction and transportation and utilities). Through ten months, the federal government sector has continued to experience small job losses while moderate job gains are reported for the state and local government sector.

There is no clear explanation for the job growth differences reported during the year's first half in comparison to the four months. One clue is that job growth patterns in the past several years have shown larger gains in the summer months only to have these gains reduced when by BLS's annual revisions were released in March of the following year. So, it is likely that some downward revisions in these

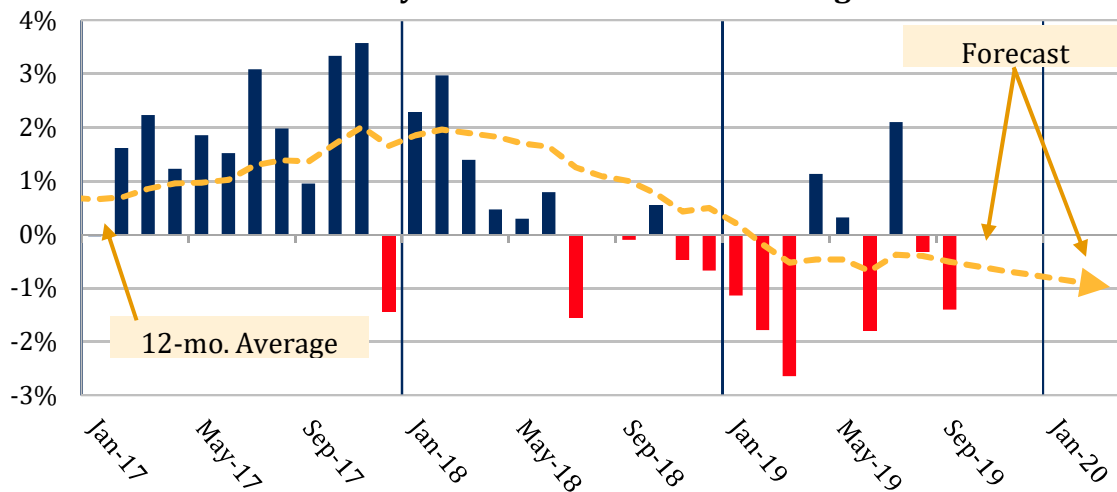
job counts will occur next March. It is also possible that the 35-day partial federal shutdown at the beginning of 2019 had a greater impact on the region's economic performance than was attributed initially to the shutdown. The uncertainty surrounding the federal shutdown may have had a much greater impact on business decisions that have long-term effects on the bottom line; this may explain why hiring was weaker over an extended period. These uncertainties and the unusually wet spring help to explain the slowdown in the homebuilding industry. The good news is that the region's economy appears to be adding jobs in all three of its sub-state areas at levels more closely paralleling their historic shares suggesting that the region's economy is more fully benefiting from its broad base of assets than it was earlier in the year.

Washington Region's Near-Term Outlook

The Leading Index is designed to forecast directional changes in the region's economy. In past recessions, the Leading Index has turned negative in advance of the Coincident Index turning negative. Similarly, the Leading Index has forecast recoveries; it has turned positive in advance of the Coincident turning positive. The Leading Index forecasts the trend of the Coincident forecast best six to eight months in advance.

At present, the Leading Index has been trending downward for more than twelve months (see Figure 4) but the Coincident Index has continued to grow on a monthly over-the-year basis, registering its 66th consecutive gain dating back to the April 2014 and the end of the Sequester. So what are the takeaways from this apparent disconnect between the Leading Index's signal for the economy to slow (and possibly decline) and the Coincident Index's continued growth?

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



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

The Washington Leading and Coincident Indices were developed in late 1990 at the request of the Greater Washington Research Center (no longer in existence) with funding support provided by the Greater Washington Board of Trade. The Washington region was experiencing the effects of the 1990-1991 recession and local business leaders were asking “couldn’t recessions be anticipated or wasn’t there a methodology that could be employed to signal the approach of a recession, giving some warning so that local businesses and governments could prepare?”

I was retained to develop such a methodology in September of 1990. With the assistance of John L. Preston, a long-time colleague with a strong background in statistical analysis, we determined that the appropriate methodology was to replicate the National Leading and Coincident Indices using locally available monthly data for which there was a fifteen-year history and that were released within six weeks of the month that they represented.

The results of this analysis were first released in February 1991 and they showed that the Washington region’s economy was on the verge of escaping the grips of the current recession. The Washington Economic Index has now been calculated and reported out each month since February 1991. Although some other metropolitan areas and states have had similar indices for short periods, no other region in the U.S. has had a continuous, real-time analysis of its economy for anything close to the 28-year run of the Washington Economic Index and now this analysis and reporting will continue under new authorship.

Besides the detailed tracking of the region’s economic performance and the insights that this monthly examination has provided, the principal take away from these analyses is that the Washington region’s economy is not recession proof as once touted by local business and public officials. As can be seen in Figure 1, the Washington region has experienced two recessions since the year 2000. It also experienced downturns in 1980 and 1981-1982 and 1990-1991. These downturns were not as severe as experienced at the national level and their timing was often slightly different and shorter. The fact is (and was) that the significant contribution that federal spending makes to the Washington region’s economy (almost 40% in 2010 and now closer to 31%) has cushioned the region’s economy from the full force of past national recessions. Federal spending is often counter-cyclical and does not contract during a downturn in the national economy. Rather, federal spending typically increases in response to a recession thereby benefiting an economy with an overdependence on federal spending.

What we have learned more recently is that while this federal dependency may be beneficial during a recession, it also can have negative consequences on the region’s economy when federal spending is disrupted, as it was during the Sequester in response to the Budget Control Act of 2011. The Washington region’s economy contracted in 2013 due to rapid and significant decreases in federal spending, as seen in Figure 1, while the national economy (GDP) continued its expansion.

The Washington region's economy suffered in early 2019 from the 35-day partial shutdown. While the Coincident Index remained positive, it did register two of the year's smallest gains in February and March as the impacts of the shutdown cycled through the local economy. Similarly, the Leading Index became increasingly negative over a five-month period before registering two, weak increases in April and May.

The Washington Leading Index is designed to measure how changing national and global conditions impact the region's economy. But it can also respond to the impacts of more localized conditions such as threatened or actual changes in federal spending patterns. So, it is certainly possible that what the Leading Index is currently tracking is the consequences of the region's continued economic dependency on federal spending rather than measuring the potential for a national recession that has receded in recent months. Disruptions to federal procurement spending, uncertainty regarding the budget and expected contract awards, and declining federal employment and payroll, individually or in combination, can flatten the region's economic growth curve or take it negative as the Sequester did in 2013 when the region's GRP contracted by 0.8% while U.S. GDP was increasing by 1.8%.

Washington is a Company Town and its economy remains dependent on this dominant source of spending and high-value added employment in spite of the diversification that is slowly transforming the economy. Consequently, while seeking further economic diversification, it is important to acknowledge that the Washington region's economic performance remains dependent on federal spending and, that while this can cushion the effects of national recessions, it can also cause economic performance differences from those being experienced by its peer regions. This is the Washington region's uniqueness and its competitive advantage or disadvantage. Since 2010, this federal dependence has been a drag on the region's economic performance and, if the federal government is shutdown on December 20th, or even if it continues to operate under another Continuing Resolution, the consequences will further diminish the region's economic outlook for 2020 and possibly beyond. With a strong national economy and increasing federal spending, the Washington region is positioned for above-trend growth. However, the Washington region's economy is vulnerable to declining, interrupted or uncertain federal spending. So far in 2019, this is what has caused its performance to lag behind its peers.

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

| Economic Indicator | Estimates | | | Percent Change | |
|---|-------------------|-----------------|-----------------|------------------------|------------------------|
| | Sep-19 Prelim. | Aug-19 Final | Sep-18 Final | Aug-19 to Sep-19 | Sep-18 to Sep-19 |
| Washington Area Business Cycle Indicators | | | | | |
| Coincident Index (2015 = 100) | 109.7 | 109.8 | 107.4 | -0.08% | 2.14% |
| Leading Index (2015 = 100) | 101.7 | 102.0 | 103.1 | -0.36% | -1.40% |
| Washington Area Coincident Index Components | | | | | |
| Total Wage & Salary Employment ('000) ^a | 3,338.7 | 3,339.5 | 3,301.4 | -0.02% | 1.13% |
| Consumer Confidence (South Atlantic) ^a | 172.6 | 180.4 | 163.6 | -4.32% | 5.50% |
| Domestic Airport Passengers ('000) ^b | 2,304.4 | 2,230.5 | 2,227.1 | 3.31% | 3.47% |
| Nondurable Goods Retail Sales (\$000,000) ^c | 3,365.7 | 3,409.1 | 3,234.9 | -1.27% | 4.04% |
| Washington Area Leading Index Components | | | | | |
| Total Residential Building Permits ^a | 1,972.0 | 1,698.0 | 2,114.0 | 16.14% | -6.72% |
| Consumer Expectations (South Atlantic) ^a | 96.3 | 112.0 | 115.4 | -14.02% | -16.55% |
| Initial Unemployment Claims ^b | 2,004.6 | 1,905.7 | 1,792.8 | 5.19% | 11.81% |
| Durable Goods Retail Sales (\$000,000) ^c | 3,749.5 | 3,766.9 | 3,659.9 | -0.46% | 2.45% |
| Washington Area Labor Force^a | | | | | |
| Total Labor Force ('000) | 3,461.7 | 3,468.4 | 3,381.1 | -0.19% | 2.38% |
| Employed Labor Force ('000) | 3,361.5 | 3,358.9 | 3,275.6 | 0.08% | 2.62% |
| Unemployed Labor Force ('000) | 100.1 | 109.5 | 105.5 | -8.52% | -5.11% |
| Unemployment Rate | 2.9% | 3.2% | 3.1% | -- | -- |
| Washington Area Wage and Salary Employment^a | | | | | |
| Total ('000) | 3,338.7 | 3,339.5 | 3,301.4 | -0.02% | 1.13% |
| Construction ('000) | 168.3 | 167.3 | 163.1 | 0.60% | 3.19% |
| Manufacturing ('000) | 55.0 | 55.8 | 55.5 | -1.43% | -0.90% |
| Transportation & Public Utilities ('000) | 70.3 | 69.4 | 68.5 | 1.30% | 2.63% |
| Wholesale & Retail Trade ('000) | 329.5 | 332.9 | 336.3 | -1.02% | -2.02% |
| Services ('000) | 2,017.7 | 2,034.3 | 1,979.4 | -0.82% | 1.93% |
| Total Government ('000) | 700.6 | 679.9 | 698.6 | 3.04% | 0.29% |
| Federal Government ('000) | 362.8 | 364.9 | 362.9 | -0.58% | -0.03% |

^aUnadjusted data

^bSeasonally adjusted data

^cSeasonally adjusted constant (1996) dollars