The Washington Region's Current Economic Performance and Near-Term Outlook

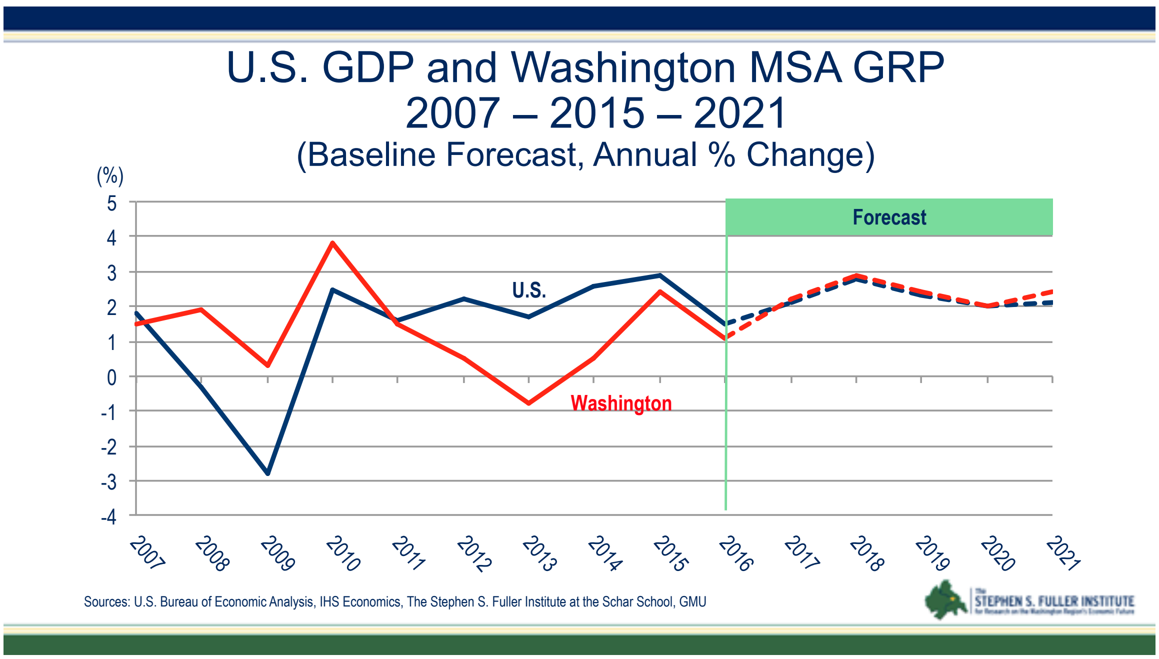
Stephen S. Fuller, Ph.D.
Dwight Schar Faculty Chair and University Professor
Director, The Stephen S. Fuller Institute for
Research on the Washington Region's Economic Future
Schar School of Policy and Government
George Mason University

October 4, 2017

The Washington Region's Current Economic Performance and Near-Term Outlook

The Washington region's economy is outperforming its beginning-of-the-year forecast through eight months and its forward looking indicators are pointing to the full year's performance substantially exceeding last year's 1.1 percent gain with this improved performance accelerating in 2018. Still, this year's recovery from last year's slower growth only parallels the expected gain for the U.S. economy's performance into 2018, as shown in Figure 1.

Figure 1

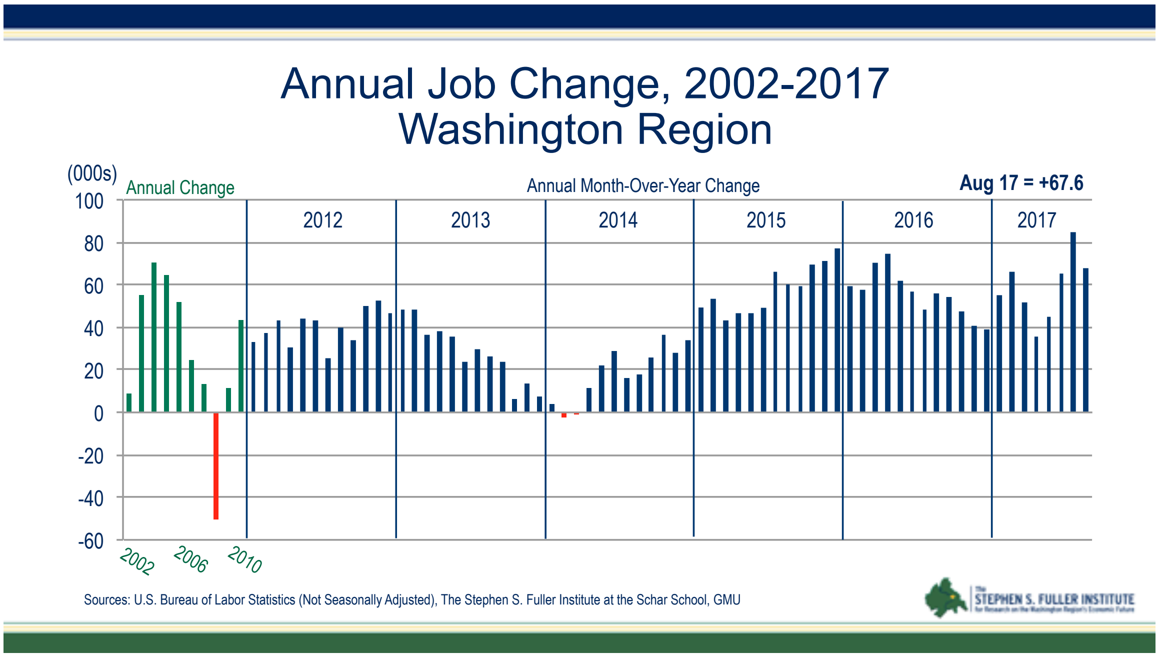


The Washington Region's Current Performance

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 averaged 59,050 jobs on an annualized basis. This continuing strong job growth is 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 started the year off with gains greater than those experienced during the last quarter of 2016, then slowed significantly in April but has rebounded sharply over the June-August period (see Figure 2). While these job growth rates appear strong when compared to the region's recent history dating back to the Great Recession, they are not outpacing most of the other major metropolitan areas; the Washington region's job growth rate ranked 8th in August compared to the largest 15 metropolitan areas among which the Washington region ranks 5th by size of its economy, it gross regional product (GRP).

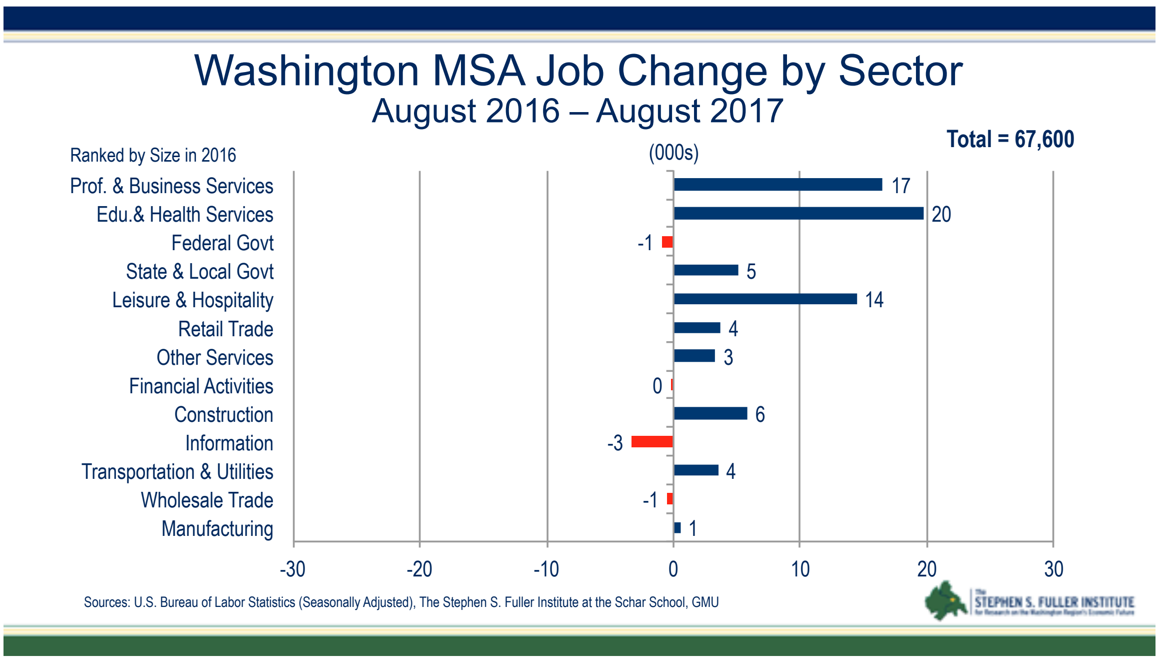
Figure 2



As has been pointed out in previous Fuller Institute 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 these jobs support. 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 from the region's economy was $160,233 while the jobs added since the recession had an average value added of $109,916. Quite simply, the job mix of the new jobs had fewer higher-value added positions and a greater proportion of lower-value added positions than the region's pre-recession job mix.

This pattern is reflected in the Washington region's most recent jobs data. The sectoral distribution of the region's August jobs is shown in Figure 3. Of the 67,600 new jobs reported for the year ending in August, 24.4 percent were in the professional and business services sector, with an average value added per job of $157,969 (in 2014 $s) while the education and health services, leisure and hospitality services, and retail trade sectors together accounted for 55.9 percent of these new jobs (with an average value added per job of $63,390). These four sectors accounted for 80.3 percent of the region's total job gain for this 12-month period. With two-thirds of these jobs generating less than one-half (47.9%) of the total value added, this mix resulted in a lower economic growth rate than a job mix favoring higher-value jobs. The continuing concentration of the region's job growth in these lower-value added sectors further reduces the economy's ability to grow at a higher rate.

Figure 3



The other seven sectors shown in Figure 3 accounted for only 13.4 percent of the new jobs with three of these seven sectors actually reporting job losses. The $271,167 per job average value added of these seven underperforming private sectors makes their weak performance a significant opportunity cost for the region's economy and reduces its ability to compensate for future reductions in federal spending.

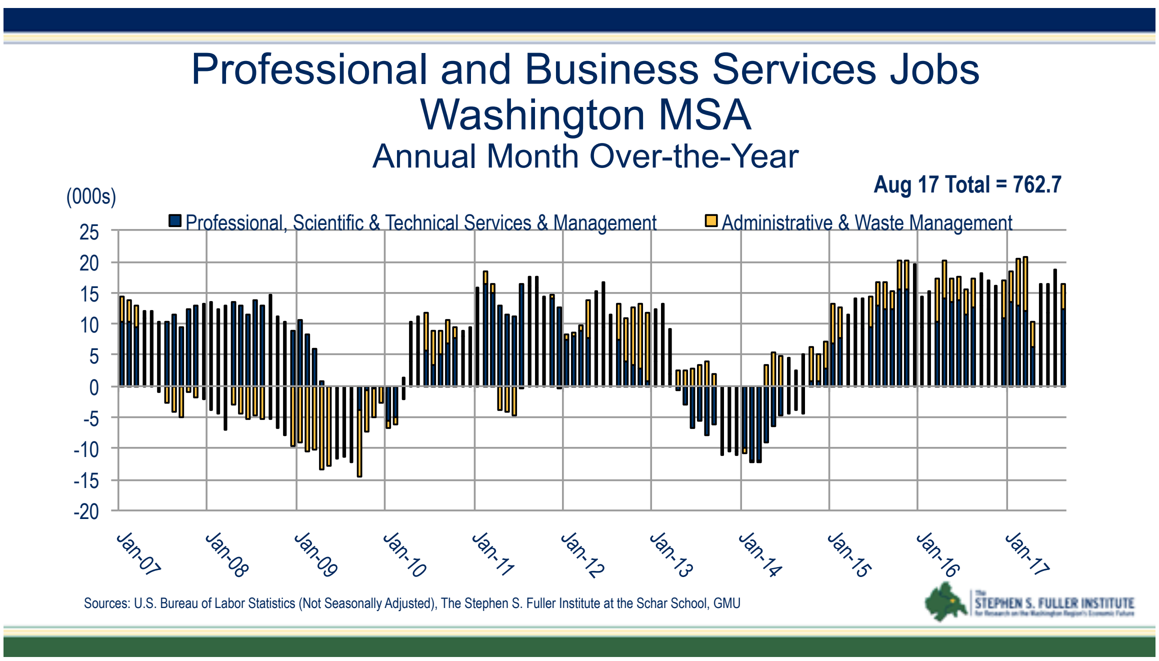
The two key sectors that have been responsible historically for driving the region's economic growth are professional and business services, with to total of 762,700 jobs as of August 2017 and the sector accommodating most of the federal contractor jobs, and the federal government sector, with its 365,900 jobs as of August 2017. Together, these two sectors account for 34.2 percent of the region's job base and both can be directly affected by changes in federal policy.

The professional and business services sector comprises approximately 23.1 percent of the region's employment base but has been outpacing this historic percentage share since its recovery following substantial job losses during the

Sequester in response to reduced federal procurement spending (see Figure 4). On average, jobs in this sector each contribute an estimated $157,969 (in 2014 $s) to the region's gross regional product. These are the jobs that have the greatest potential for compensating for the loss of federal jobs or reductions in federal procurement spending as the Washington region continues to adjust to its changing sectoral structure.

As can be seen in Figure 4, the pace of job growth in this sector appears to have slowed since the beginning of the year. This apparent slowing may be attributable to a slowdown in federal contracting at the beginning of the new Administration as it was slow to get its new management team in place. Regardless of the reason, any slowdown in the growth of this sector is a threat to the long-term health of the Washington region's economy.

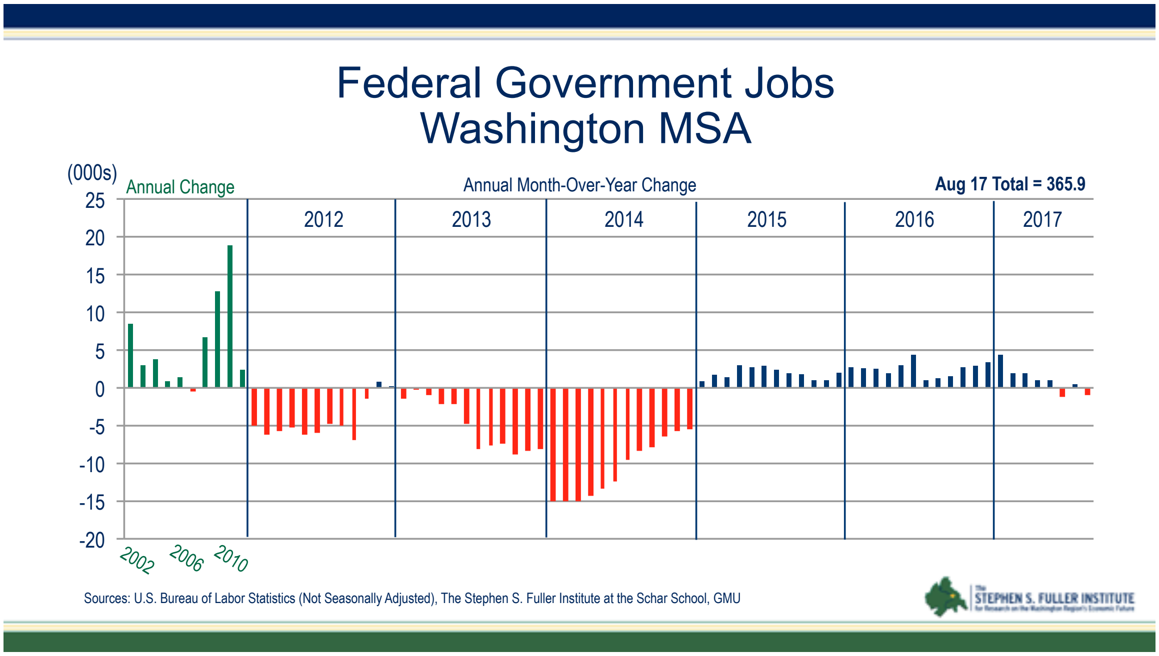
Figure 4



Federal government employment and its payroll have historically been an important growth stimulus for the region's economy. Federal workers generate an estimated $185,804 (in 2014 $s) in total value added per worker to the region's gross regional product. However, since 2010, total federal employment has been in general decline and is now down a total of 21,500 jobs from its peak seven years ago. As shown in Figure 5, most of these losses took place during the period leading up to and during the Sequester.

This year's federal job growth pattern appears to be one of slow erosion with job gains at the beginning of the year turning into losses at mid-year. Whether this is a pattern that can be linked to the Administration's policies regarding the federal workforce in the National Capital Region, one that reflects accelerating voluntary separations from the federal civil service, or a temporary lull in hiring, is too early to determine. What is clear from this pattern of declining federal employment is that the federal employment sector will not drive the region's economic growth in the near-term and to achieve higher rates of economic growth will require a stronger performance in the private sector and, in particular, by those locally based businesses marketing their services in national and global markets.

Figure 5



The Washington Region's Near-Term Economic Outlook

As reported in the Fuller Institute's September issue of *Washington Economy Watch*, 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. 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 were 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 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 currently forecast in 2017 and its forecast for 2018 could be greater as a result of increased reconstruction spending in the coming months.

Job growth forecasts for the next five years are presented in Table 1 by sub-state area. This forecast represents a 21.7 percent increase for the 2017-2021 period over the beginning-if-the-year forecast; that is, 209,500 total jobs rather than 172,200 jobs. The forecast has been increased for each year, building on this year's continuing strong performance and the stronger forecast for the national economy for 2017 and 2018. The distribution of the projected job growth among the sub-state portions of the Washington region reflects their respective GRP growth rates as presented in Figure 6 and the mix of jobs that is driving the respective sub-state economies.

Table 1

Employment Change by Sub-State Area
Baseline Forecast (000s)

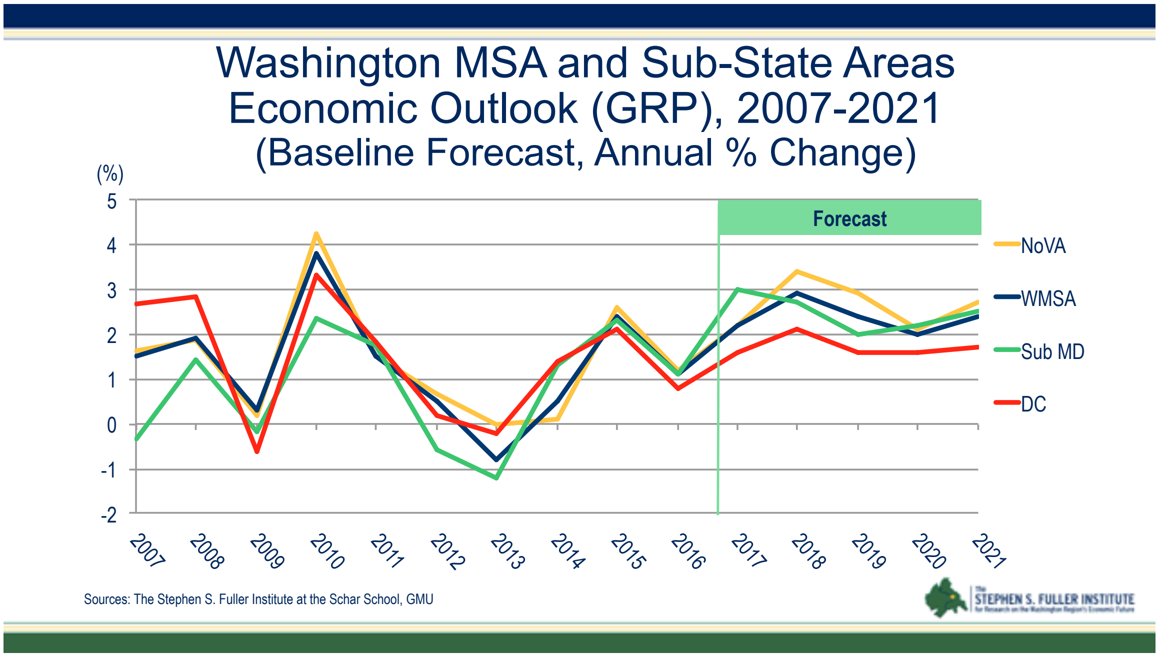
	2014	2015	2016	2017	2018	2019	2020	2021
D.C.	5.2	15.9	13.0	10.4	9.2	8.1	6.2	5.5
Sub. MD	10.2	12.5	14.4	22.8	16.6	16.2	13.1	12.3
No. VA	0.8	29.8	31.0	19.8	20.4	20.8	15.1	13.0
REGION	18.6	57.7	55.6	53.0	46.2	45.1	34.4	30.8

Average Annual Change 1990-2010 = 36,300

Source: BLS, IHS Economics, The Stephen S. Fuller Institute at the Schar School, GMU (forecast as of September 2017)
NOTE: The regional totals include Jefferson, WV.

It should be noted that Suburban Maryland's job growth share is projected to increase at the expense of Northern Virginia's share in the out-years of the forecast. This is more a result of Northern Virginia's economy slowing down and paralleling Suburban Maryland's growth path than that Suburban Maryland's economy is growing faster than Northern Virginia's. The assumption underpinning this evolving growth pattern is the continuing slowdown in federal procurement spending in the coming years with this slowdown having a disproportional impact on the Northern Virginia economy as a consequence of it having the largest share of federal procurement spending taking place in the Washington region.

Figure 6



Looking Forward

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