The Economy and Monetary Policy in Our Challenging Times

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Keynote Session
2020 Liberal Arts Macroeconomics Conference
Pomona College
Claremont, CA
(via videoconference)

August 5, 2020

Introduction

I thank Dean Croushore and the organizers of the 2020 Liberal Arts Macroeconomics Conference for inviting me to present in the keynote session. I also want to acknowledge the important role that the participants in this conference play in our economy and in society. In recent years, some have questioned whether a liberal arts education offers the same value as it once did, and point to other types of programs that, in their view, better prepare students for the job market. I take the opposite view: to me the value of a liberal arts education has never been clearer. The current pandemic underscores the fact that the future is uncertain. A year ago, I certainly wasn't imagining we would be in the place we find ourselves today. If we want students to be prepared for the future, then we must give them the tools they will need to successfully stand up to future challenges, think critically through possible approaches and solutions to those challenges, be resilient in the face of adversity, and question the status quo. A broad-based liberal arts education, which encompasses the study of history, literature, and the arts, as well as mathematics and the natural and social sciences, holds the best promise to prepare students for the future, whatever it may bring. I applaud the professors taking part in this conference. Not only do you have to be inspirational teachers, but you also have to be excellent researchers who are pushing the boundaries of knowledge in economics forward. Both roles have become more challenging during the pandemic, with the sudden need to move to remote teaching and the difficulty in keeping ongoing research on track. I appreciate your efforts and ask that you persevere in these very important roles.

Today, before we open it up to questions, I'll give you an update on the economy and on the Federal Reserve's policy response. As always, the views I'll present are my own and not necessarily those of the Federal Reserve System or of my colleagues on the Federal Open Market Committee.

The Economy

The coronavirus pandemic is a global public health crisis that has inflicted pain and hardship on people all over the world. This is an unprecedented situation and unprecedented actions have been taken in response.

In thinking about the economic impact of the pandemic, it helps to think in terms of phases: the shutdown phase, the reopening phase, and a more traditional economic recovery phase. The shutdown phase began in March when the country took aggressive social distancing measures to limit the spread of the virus and to buy some time for the healthcare system to increase its capacity to care for the sick, learn more about the virus itself, and develop testing and treatments. The shutdown had swift and severe effects on the economy.

The economy entered the reopening phase in May, as the public health statistics began to improve in some parts of the country. Many states began to relax some of their stay-at-home restrictions, with some states doing so more quickly and more broadly than others. We began to see some welcome rebound in the economic data in May and June. But it is good to keep in mind that growth rates after a shutdown are going to look good as activity resumes. Given the deep hole we are digging out of, it is more informative to look at levels when gauging the economy and assessing the outlook.

The reopening phase has proved to be challenging. In late June, virus cases in many parts of the country began rising again and, in response, some states have hit the pause button on their reopening plans, while other states have reimposed some restrictions on activities. Although we don't yet see the effects of the pause in many of the official economic statistics, the higher-frequency data and discussions with regional contacts do indicate that economic activity has slowed in recent weeks. Thus, the reopening phase may be more protracted than many had anticipated when it started.

[FIGURE 1] At this point, the most dated of our official statistics are the GDP data. These statistics show that economic activity peaked in February and the U.S. economy entered a recession. After declining at a 5 percent annual pace in the first quarter, real GDP plunged at a record 33 percent annual pace in the second quarter, with nonresidential business fixed investment down 27 percent, and personal consumption down almost 35 percent, at an annual rate. I expect that the second quarter will be the trough in economic activity. Consumer spending rebounded in May and June, with June's spending on goods higher than it was in February, before the shutdown. But while spending on services, which includes dining at restaurants, air travel, and hotel stays, moved up in May and June, it remains well below pre-pandemic levels.

[FIGURE 2] The decline in activity has put downward pressure on inflation. Both headline and core inflation readings moved down in March and April and remained low in May and June. It is true that supply disruptions have caused the prices of certain goods and services to rise, but this upward pressure has been more than offset by the downward pressure driven by the pullback in demand. And I expect inflation to remain low for some time to come.

[FIGURE 3] The shutdown of the economy earlier this year led to an unprecedented rise in unemployment and loss of jobs. While many people can work from home, many others cannot. As reopening began, we started to see some improvement in labor markets. Both the unemployment rate and payroll employment have improved over the past two months. Recall that in February, the unemployment rate was 3.5 percent, its 50-year low. In April, the unemployment rate surged to 14.7 percent. As reopening commenced in May, people on temporary furlough began to be rehired. As of June, the unemployment rate is down to 11.1 percent. The fact that the unemployment rate is coming down is good news. But we also need to put this into perspective. The current level is still above its peak in the aftermath of the Great Recession. And there are still almost 18 million unemployed workers in the U.S., compared with 6 million in February. This means one in 15 Americans over the age of 16 is unemployed, about the same as at the height after the Great Recession.

[FIGURE 4] The economy lost over 22 million jobs in March and April. This is a staggering number. It would have been literally off the charts if I hadn't changed the scale. In fact, the losses in just the two months of March and April were about the same as the number of jobs the economy added over the entire recent expansion that lasted more than 10 years. The jobs added in May and June make up only about one-third of the jobs lost.

[FIGURE 5] To get a sense of where we are, it is helpful to look at employment in levels rather than monthly changes. The current level of payroll jobs is now back to where it was in 2014. In other words, the economy is still down about 6 years' worth of job growth.

The deterioration in the labor market is even sharper than these numbers indicate. Many people left the work force at the beginning of the shutdown and consequently they do not show up in the unemployment rate, and many workers had their hours cut. Our survey of firms in the Fourth District, which includes Ohio and parts of Pennsylvania, Kentucky, and West Virginia, indicates that firms have recalled workers more slowly than they originally intended to. As of mid-July, over half of District contacts have told us they are meaningfully altering their plans in response to the rise in virus cases, including reducing employment or employee compensation or cancelling or postponing planned capital expenditures.

The deterioration in the labor market has not been evenly shared. Net job losses have been predominantly in lower-paying jobs. Nearly half of the net private-sector job losses since February have been in the leisure and hospitality and the retail trade sectors, the two sectors ranked lowest in terms of average hourly earnings. Three-quarters of the job losses are in the sectors that pay below-average wages.

[FIGURE 6] There are racial disparities as well. Unemployment rates among Blacks and Hispanics have been chronically above those of whites and Asians. Over the long expansion, we had finally seen some progress being made on that front, as the gap in unemployment rates narrowed. But the pandemic has increased the disparities. The net increase in the unemployment rate since February is higher for Blacks, Hispanics, and Asians than for whites. It is particularly distressing that much of the sacrifice over the pandemic period is being borne by the most vulnerable in our economy: lower-income and minority workers and communities, and the smaller of the small businesses.

[FIGURE 7] And it shines a bright light on long-standing economic inequality that needs to be addressed if the economy is to perform up to its potential. Education is a path to better economic outcomes for individuals, households, and the country at large. According to data from the 2016 Survey of Consumer Finances, the median income for families whose head has a college degree was over $90,000 compared with only $40,000 for families whose head has only a high school diploma. Similarly, median net worth is considerably higher for those with a college degree.[1]

[FIGURE 8] Our work force has become more educated over time. But educational attainment differs by race, as does the likelihood of completing a degree. In the Fed's survey, 39 percent of white heads of households held a college degree compared to 23 percent of Black heads of household and 17 percent of Hispanic heads of household.[2]

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[1] Information about and data from the Federal Reserve's Survey of Consumer Finances are available at https://www.federalreserve.gov/econres/scfindex.htm.

[2] See Lisa J. Dettling, Joanne W. Hsu, Lindsay Jacobs, Kevin B. Moore, and Jeffrey P. Thompson, "Recent Trends in Wealth-Holding by Race and Ethnicity: Evidence from the Survey of Consumer Finances," FED Notes, September 27, 2019 (https://www.federalreserve.gov/econres/notes/feds-notes/recent-trends-in-wealth-holding-by-race-and-ethnicity-evidence-from-the-survey-of-consumer-finances-20170927.htm).

[FIGURE 9] Graduation rates for whites, Hispanics, and Asians have all risen over time, but those of Blacks remain well below those of these other groups and have shown no progress over time. Because economic well-being rises with education, unless more is done to support those entering college so they can complete their degrees, economic inequality is likely to continue to rise.[3]

The Economic Outlook and Policy

Let me now turn to the outlook and policy. Macroeconomic forecasting has been particularly challenging during the pandemic. Higher-frequency indicators, including data on mobility, restaurant visits, debit and credit card transactions, employment in small businesses, and the weekly initial claims for unemployment insurance, all suggest that activity has begun to decelerate with the rise in virus cases. These recent developments add uncertainty to what was already an uncertain outlook. Whether the rise in cases and the deceleration in activity prove to be temporary or more persistent remains to be seen. At the very least, they suggest that the economy will be in the reopening phase for a while longer.

It is clear that the path of the economy depends on the path of the virus. But that does not mean we are helpless. The actions we take can help control the virus and thereby change the impact of the virus on the economy. Increased government and private-sector investment in expanded testing, contact tracing, and developments of therapeutics and vaccines will influence the path of the virus and our ability to re-engage in economic activity. Each individual can also influence the path of the virus: we can wear a mask that covers our noses and mouths when out and about, we can avoid social gatherings and maintain our distance from others, and we can wash our hands frequently. These simple steps have been shown to make a difference in infection rates. According to the Cleveland Clinic, the latest estimates indicate that

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[3] See Loretta J. Mester, "Community Development and Human Capital," remarks at the 2015 Policy Summit on Housing, Human Capital, and Inequality, Federal Reserve Banks of Cleveland, Philadelphia, and Richmond, Pittsburgh, PA, June 19, 2015 (https://www.clevelandfed.org/en/newsroom-and-events/speeches/sp-20150619-community-development-and-human-capital.aspx). And see Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020," May 2020 (https://www.federalreserve.gov/publications/2020-economic-well-being-of-us-households-in-2019-preface.htm).

if 95 percent of Americans wore face coverings in public, COVID-related deaths could be reduced by up to 40,000 to 50,000.[4]

In response to the increase in cases seen in Ohio, the governor recently upgraded the mask-wearing recommendation to a mandate. This is occurring in other states as well. Evidence from the Cleveland Fed's daily national survey of households shows that the vast majority of the more than 1,000 survey respondents would comply with such a mandate, with older people more likely to comply than younger people. The vast majority also thought that mask-wearing is helpful in reducing transmission of the virus, and those who believed this are more likely to wear a mask. About 70 percent of respondents also reported that they feel more comfortable shopping when they see others wearing masks.[5]

Assuming that the virus gets under control once again and people feel safe enough and businesses confident enough to re-engage in economic activity, the economy will move from the reopening phase to the recovery phase. I anticipate that the recovery will take some time because significant sectoral reallocations are going to need to occur. Changes in consumers' behavior, including their shopping, dining, and housing preferences; changes in firms' demand for office space and work arrangements; and changes in supply chains will all take time to sort out. The pandemic was a significant shock to the economy – the largest in most of our lifetimes. A significant number of firms have already declared bankruptcy. Many workers will need to be rehired; some will have to find jobs in different industries. It

[4] "COVID-19 Update: What Employers Need to Know," conversation with Steve Gordon, MD, Chair, Department of Infectious Disease, Cleveland Clinic, moderated by James Merlino, MD, Chief Clinical Transformation Officer, Cleveland Clinic, webinar, July 27, 2020 (https://youtu.be/zxFECH7ZO4w).

[5] The Cleveland Fed's website provides updates of these survey results each Wednesday on the Consumers and COVID-19 page, https://www.clevelandfed.org/our-research/indicators-and-data/consumers-and-covid-19.aspx. For a discussion of the results on mask-wearing, see Edward S. Knotek II, Raphael S. Schoenle, Alexander M. Dietrich, Gernot J. Müller, Kristian Ove R. Myrseth, and Michael Weber (2020) "Consumers and COVID-19: Survey Results on Mask-Wearing Behaviors and Beliefs," Federal Reserve Bank of Cleveland *Economic Commentary* 2020–20. https://doi.org/10.26509/frbc-ec-202020.

will take continued fiscal and monetary policy support to limit lasting damage to the economy and achieve a sustainable recovery.

Policy Actions

Both the federal government and the Federal Reserve took swift and significant actions to provide households and businesses with relief during the shutdown. Fiscal policymakers made grants to individuals, certain businesses hit hardest by the pandemic, and states and municipalities. They offered expanded unemployment benefits and loans to small businesses that turn into grants if they maintain their payrolls. It is clear that these programs made a significant difference; it is also clear that more fiscal support is needed to provide a bridge for households, small businesses, and state and local municipalities that have borne the brunt of the economic shutdown until the recovery is sustainably in place.

As one indicator of the need, I point you to recent analysis by a Brookings Institution researcher of data from the Census Bureau's Pulse Survey from the third week in June. These data show that 16.5 percent of households with children reported that sometimes or often their children were not eating enough due to a lack of resources. This is more than 5 times as high as in 2018. It translates into 14 million children, which is over 2-1/2 times the number at the peak of the Great Recession.[6]

Unlike the federal government, the Federal Reserve is not legally able to make grants, but it has taken significant actions to ensure that financial markets have enough liquidity to continue to function well and that credit can flow to households and businesses. Actions include buying Treasury and agency mortgage-backed securities to address strains in these markets, and setting up a variety of so-called 13(3) facilities. These emergency lending facilities, with the backing of the U.S. Treasury, serve as a backstop to other key credit markets and support the flow of credit to households, businesses of all sizes, and state

[6] Lauren Bauer, "About 14 Million Children in the U.S. Are Not Getting Enough to Eat," Up Front, The Brookings Institution, July 9, 2020. (https://www.brookings.edu/blog/up-front/2020/07/09/about-14-million-children-in-the-us-are-not-getting-enough-to-eat/)

and local governments. The Fed is also ensuring that our central bank counterparties abroad have access to dollar funding. Because much of the flow of credit to households and businesses relies on the banking system, the Fed has encouraged banks to use its discount window as a source of liquidity and to work with their borrowers affected by the virus. The Fed has temporarily relaxed some of the regulatory requirements and supervisory oversight so that banks have greater capacity to lend, but it has also suspended share buybacks, limited dividend distributions, and is requiring large banks to reassess their long-run capital plans to ensure they remain adequately capitalized to sustain lending through the downturn. Since March, the FOMC has set its fed funds rate target range at 0 to 1/4 percent. At our meeting last week, we reiterated that we expect to maintain this target range until we are confident that the economy has weathered recent events and is on track to achieve our maximum employment and price stability goals.

The portfolio of Fed actions has helped to relieve stress in financial markets, improve market functioning, support the flow of credit to businesses and households, and contribute to very accommodative financial conditions in support of economic activity.

As the economy emerges from the reopening phase and moves into the recovery phase, the focus of Fed policy will expand from supporting market functioning and the flow of credit to ensuring that appropriate monetary policy accommodation remains in place to support the economy's return to more normal levels of economic activity and employment and inflation's moving back up. Although our policy rate is already at its effective lower bound, the tools that we used to support the recovery from the Great Recession, including forward guidance about the future path of policy and purchases of longer-term Treasuries and agency mortgage-backed securities, can be used to provide additional accommodation. Clear communications about our policy strategy, which is part of our current review of our monetary policy framework, can also make the monetary policy actions we take more effective.[7] As Fed Chair Powell indicated in his recent press conference, we plan to wrap up the review in the near future.[8]

By the end of this year, I expect that output will still be about 6 percent below its level at the end of last year; that the unemployment rate will remain elevated, at around 9 percent or so; and that inflation will be well below our 2 percent goal. Of course, the uncertainty around this forecast is extremely high: we are in an unprecedented situation and outcomes depend not only on appropriate economic policy but also on public health considerations. The increase in virus cases that we've seen in recent weeks has raised the downside risks to the outlook and is a stark reminder that there are several different scenarios that could play out. While there are many uncertainties, there is one thing you can be certain of: the Federal Reserve is committed to using all of its policy tools to provide relief to households and businesses, to foster stability in the financial system, and to support the recovery back to maximum employment and price stability in service to the public.

[7] For information about the Federal Reserve's review of its monetary policy framework, including strategy, tools, and communications, see https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications.htm.

[8] See "Transcript of Chair Powell's Press Conference," July 29, 2020 (https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200729.pdf).

Charts for “The Economy and Monetary Policy in Our Challenging Times”

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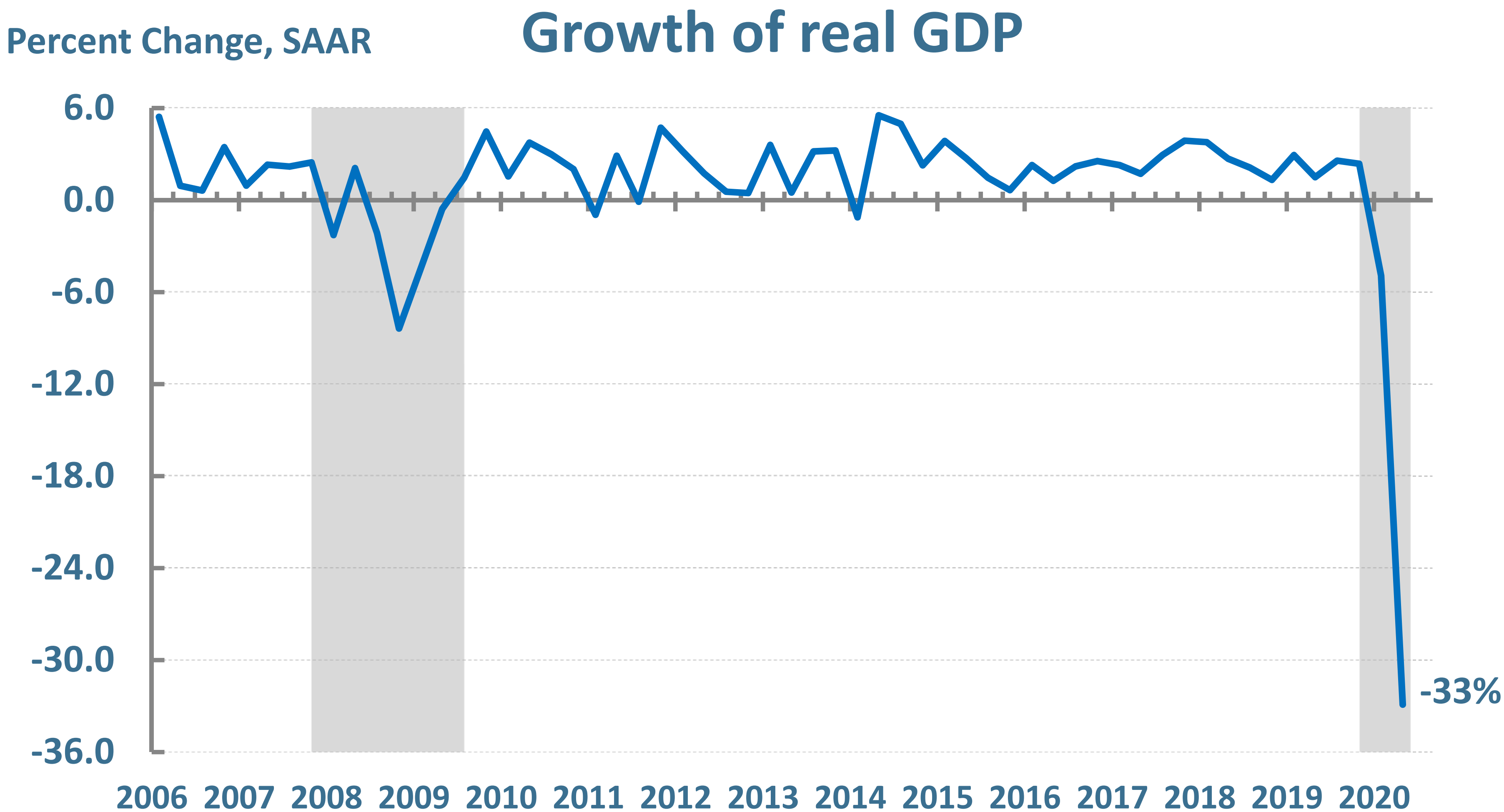
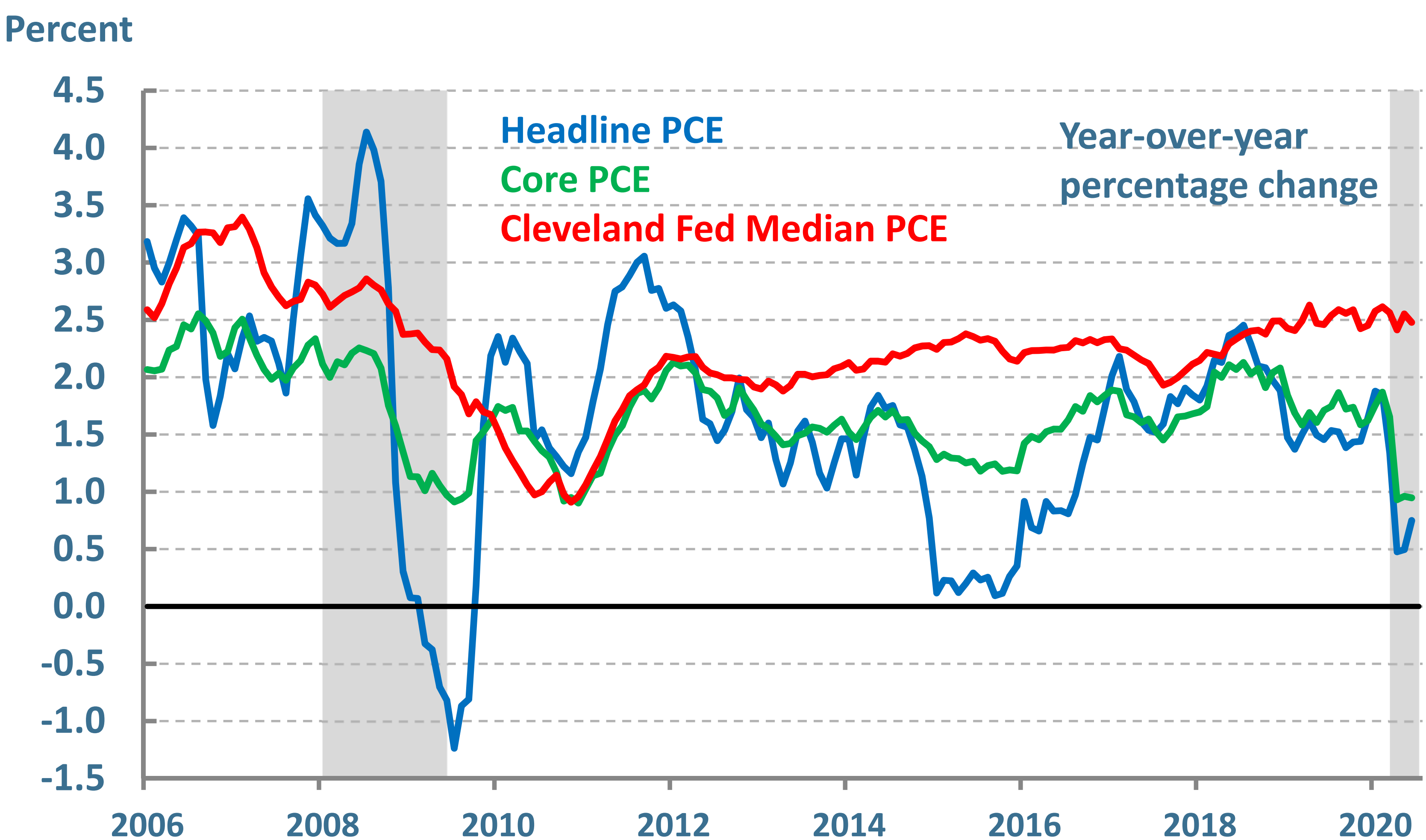
Figure 1. The economic expansion ended in February and output plunged



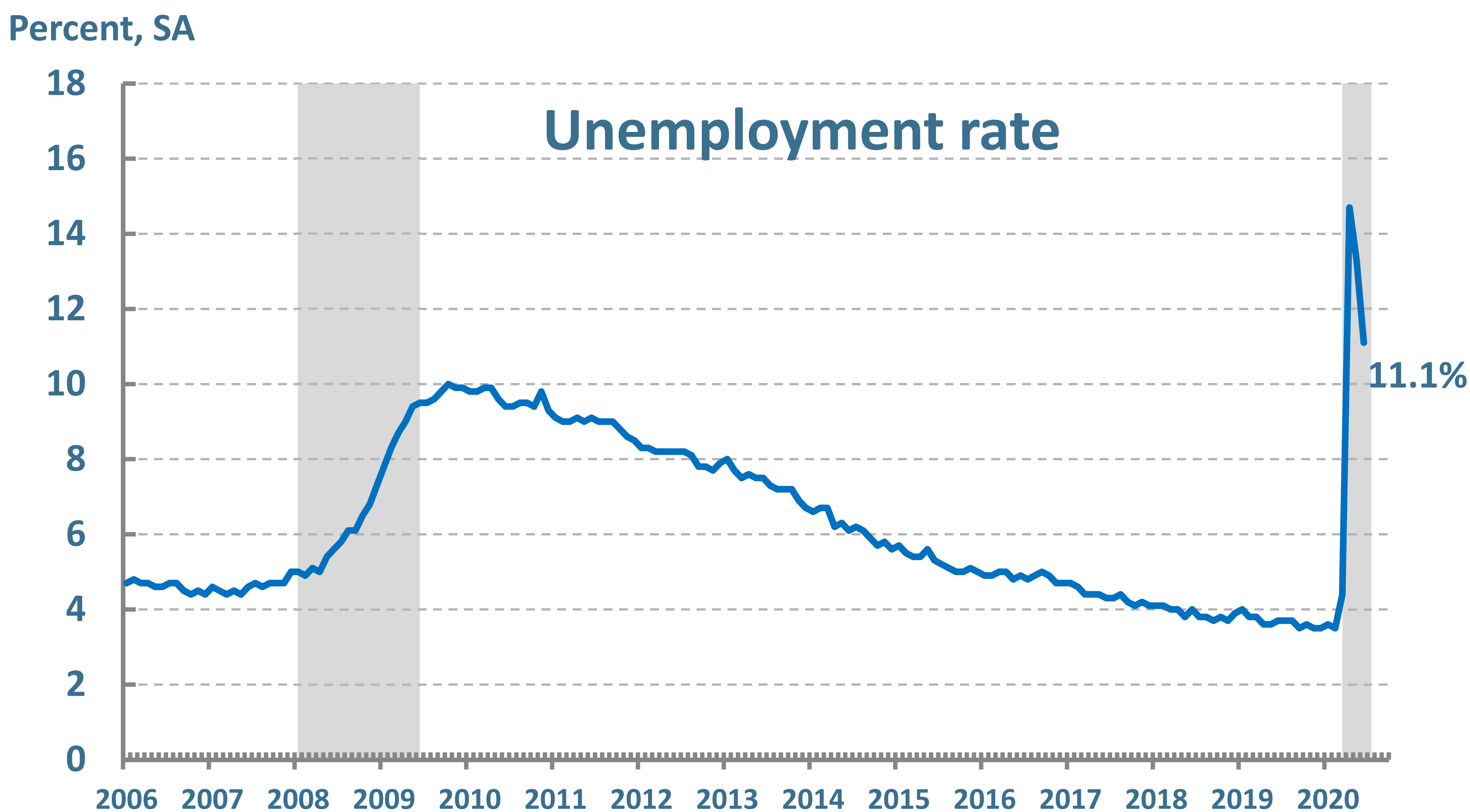
Source: Bureau of Economic Analysis via Haver Analytics
Quarterly data: Last obs. 2020Q2

Figure 2. Inflation has moved down



Source: Bureau of Economic Analysis via Haver Analytics and
Federal Reserve Bank of Cleveland
Monthly data: Last obs. June 2020

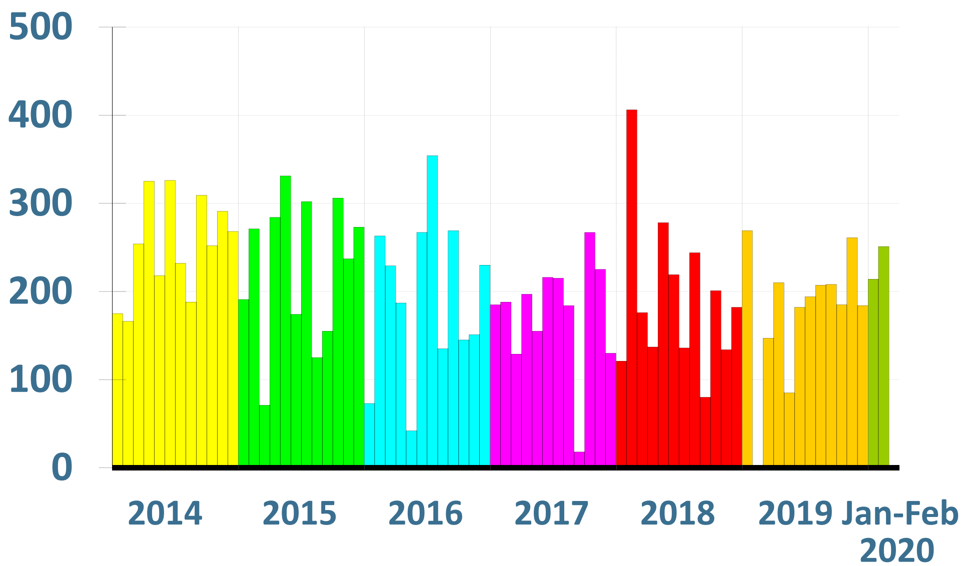
Figure 3. The unemployment rate moved down in June but remains well above its peak after the Great Recession



Source: Bureau of Labor Statistics via Haver Analytics
Monthly data: Last obs. June 2020

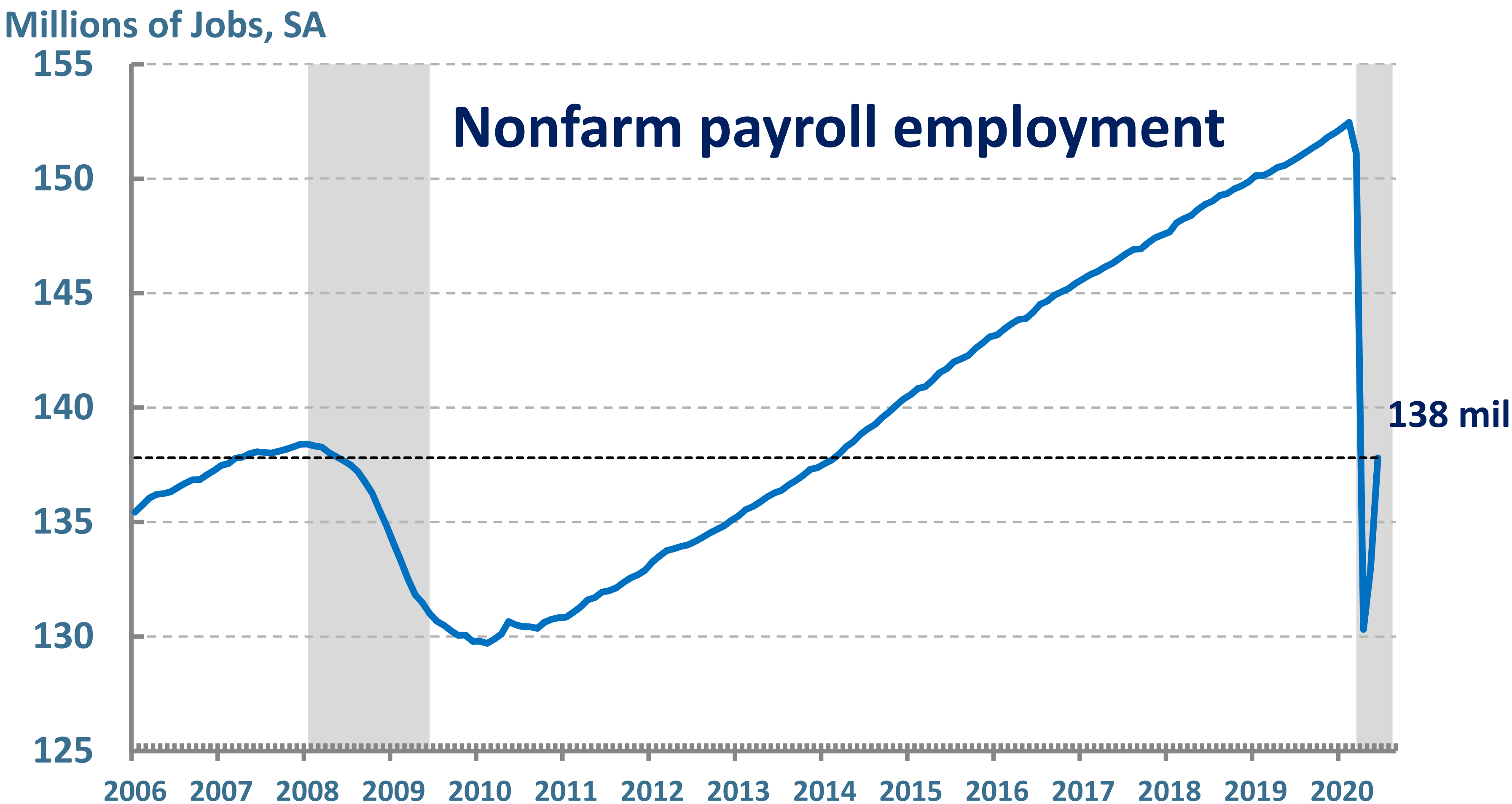
Figure 4. In May and June, the economy regained about 1/3 of the job losses in March and April

Monthly change in payroll jobs



Source: Bureau of Labor Statistics via Haver Analytics
Quarterly data: Last obs. June 2020

Figure 5. Jobs lost in March and April were nearly the same number added over the 10+ year expansion; we are still down about 6 years' worth of job growth



Source: Bureau of Labor Statistics via Haver Analytics
Monthly data: Last obs. June 2020

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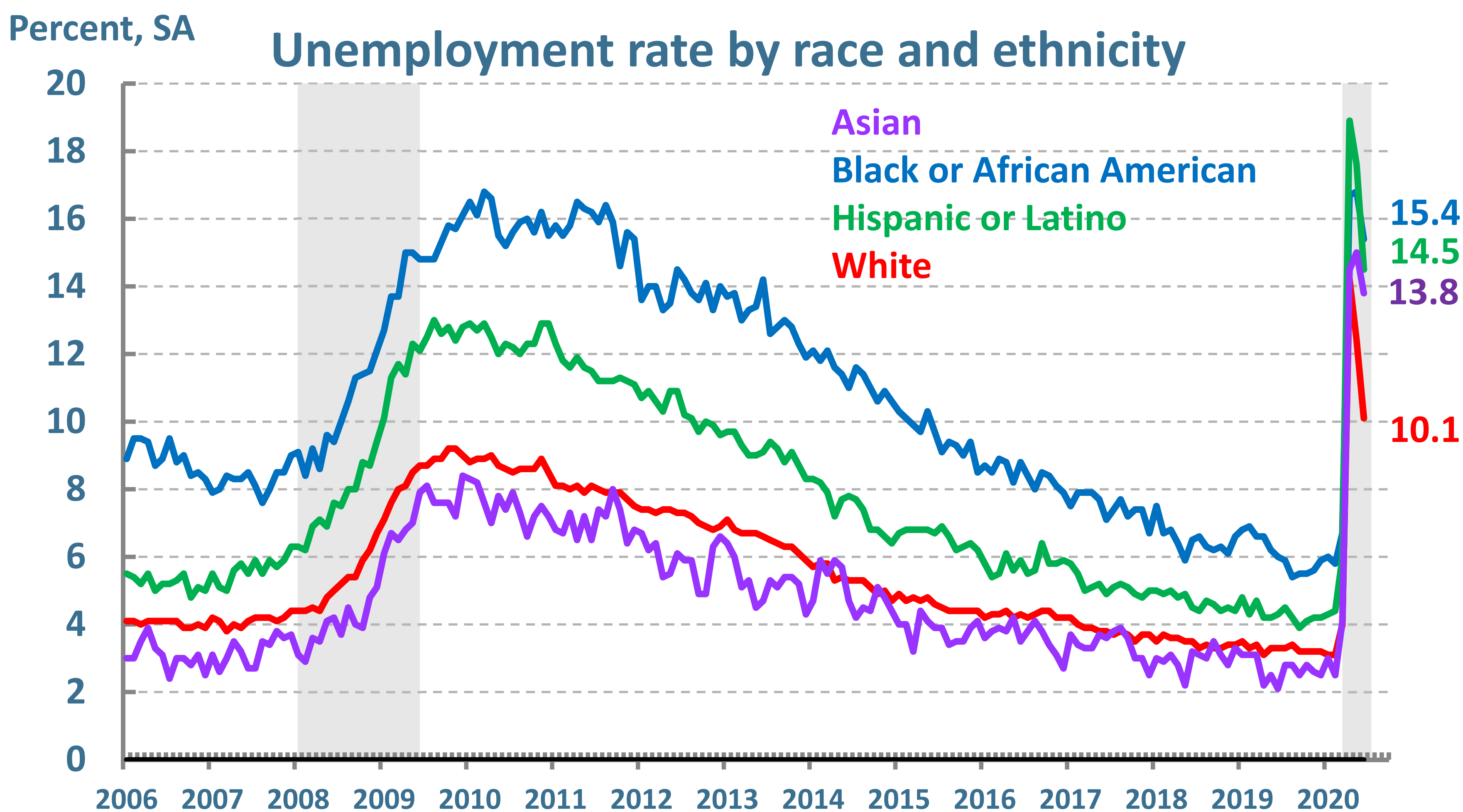
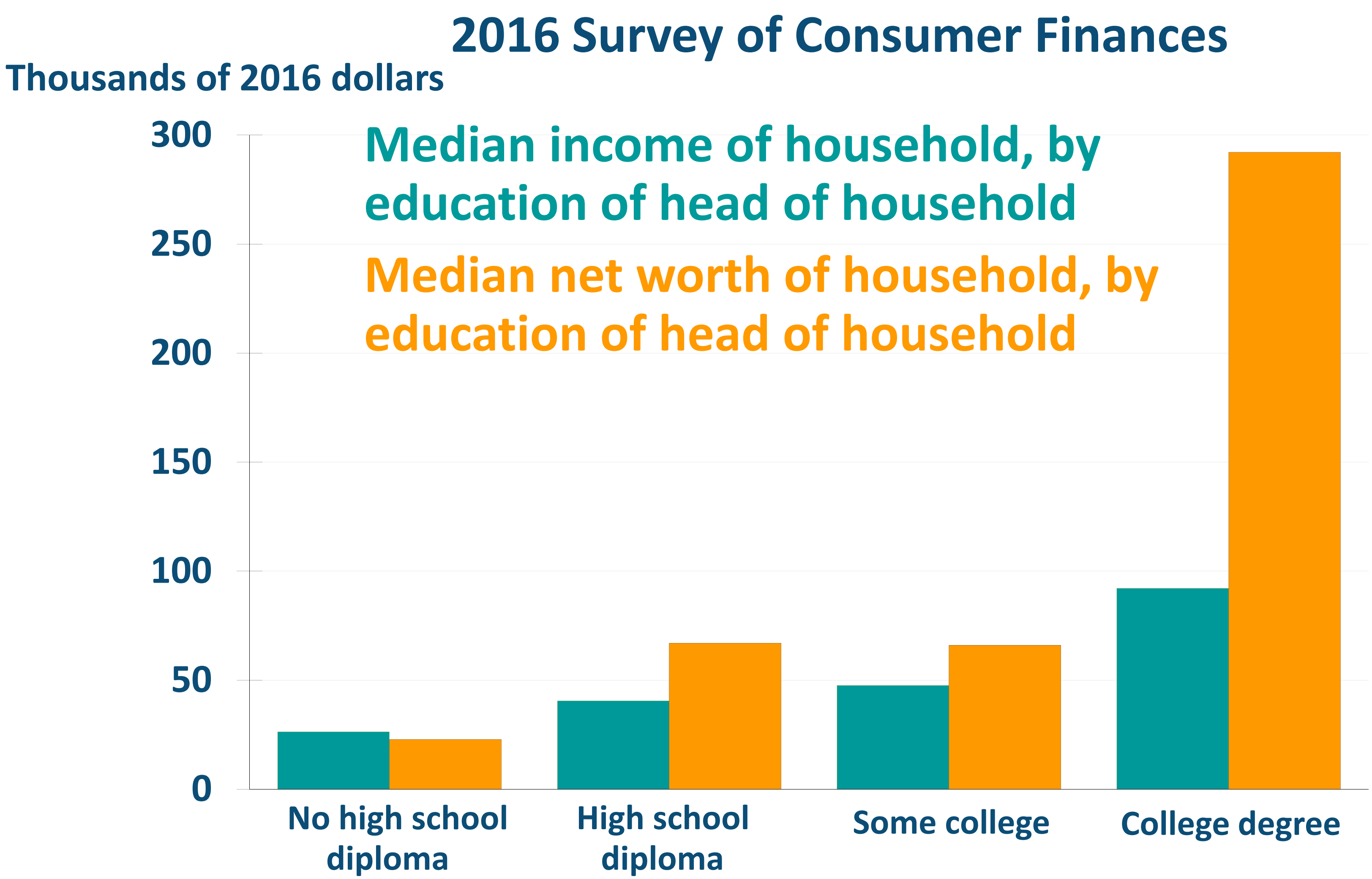
Figure 6. The net increase in the unemployment rate since February is larger for nonwhites than for whites



Source: Bureau of Labor Statistics via Haver Analytics
Monthly data: Last obs. June 2020

Figure 7. Income and net worth rise with educational attainment



Source: Federal Reserve's 2016 Survey of Consumer Finances

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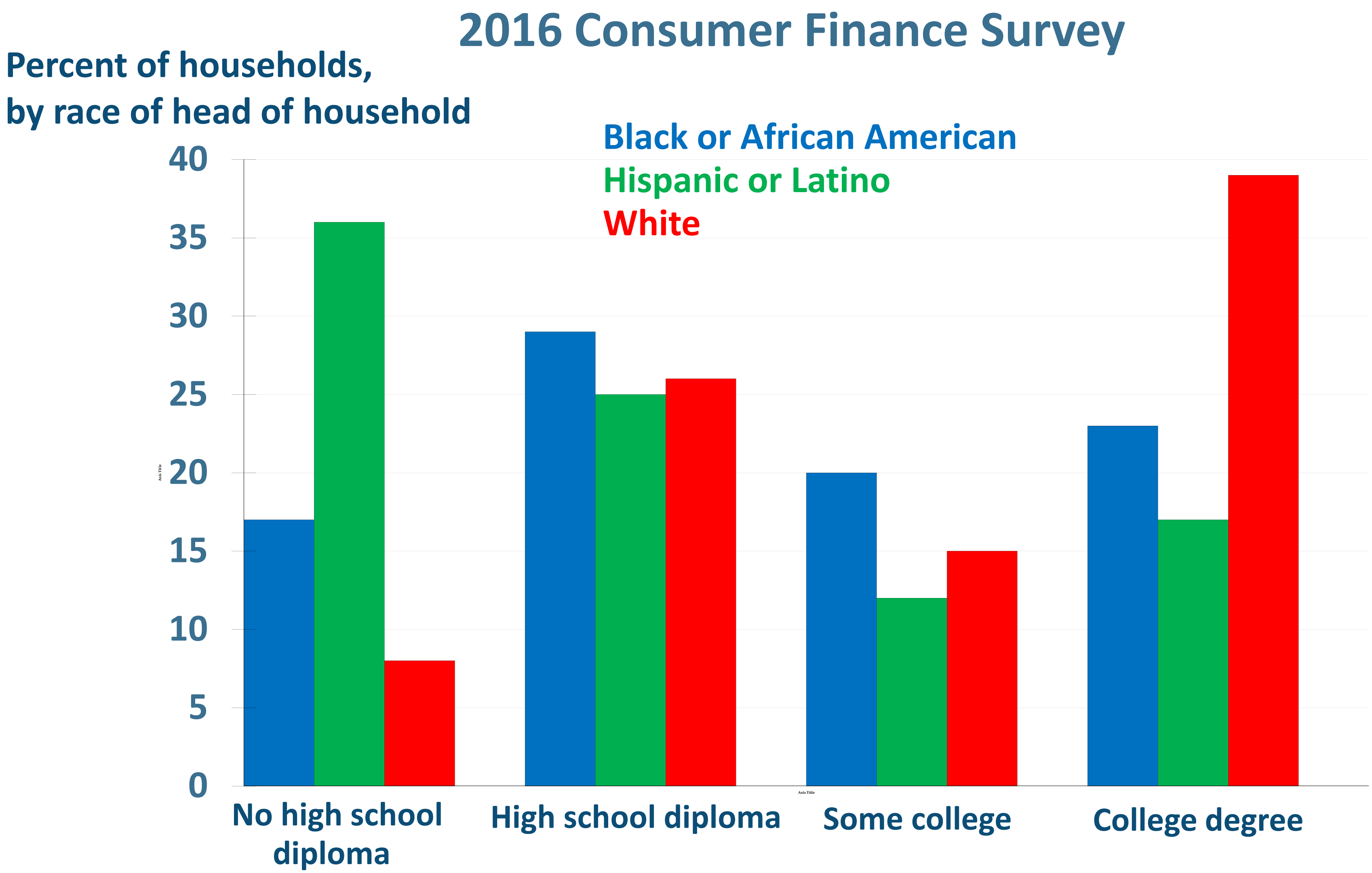
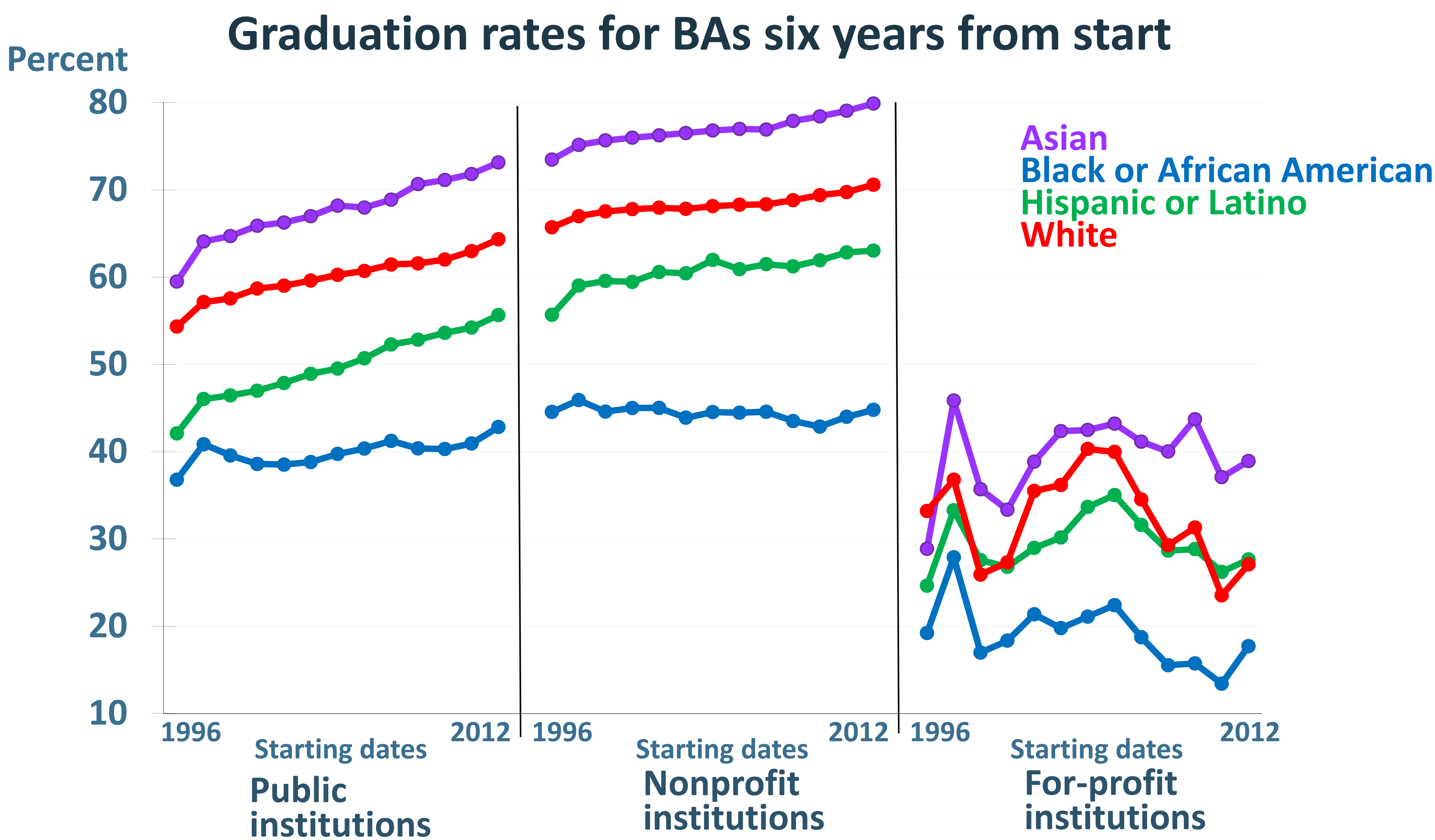
Figure 8. Educational attainment for nonwhites lags that of whites



Source: Federal Reserve's 2016 Survey of Consumer Finances

Figure 9. Graduation rates for Blacks are lower than for other groups and have not improved over time



Source: U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS), Table 326.10

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