An Update on the Effects of the Pandemic on the Economy

Loretta J. Mester[*]
President and Chief Executive Officer
Federal Reserve Bank of Cleveland

Greater Cleveland Partnership Annual Meeting
(videotaped October 6, 2020)

October 14, 2020

[*] The views expressed are my own and not necessarily those of the Federal Reserve System or of my colleagues on the Federal Open Market Committee.

It is a pleasure to be with you today. Let me start by congratulating Joe Roman on his upcoming retirement as president and CEO of the Greater Cleveland Partnership. Joe was one of the first civic leaders I met when I moved to Cleveland in 2014. From our very first conversation, it was clear that Joe was passionate about Cleveland. Over his entire career, he has been a strong advocate for our region and a strong adherent to the view that by working together, business, civic, and community leaders can get important things done. I am sure that Joe will show that same dedication and optimism in his new endeavors and I wish him well.

Wishing someone well has taken on new meaning this year. The coronavirus pandemic is a global public health crisis that has inflicted pain and hardship on people all over the world. The pandemic was an unprecedented shock to the economy – the largest in most of our lifetimes.

In March, all but essential economic activity shut down 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.

[FIGURE 1. Output and Employment through Q2] In the second quarter of the year, real output declined at a rate of about 31 percent measured on an annual basis. In just the two months of March and April, payroll jobs dropped by 22 million. That is about the same number of jobs that the economy had added over the entire recent expansion that lasted over 10 years. The unemployment rate, which had been at a fifty-year low of 3.5 percent in February, spiked to 14.7 percent in April. And despite supply disruptions, inflation moved down with the drop in demand.

In May, as public health statistics began to improve, many parts of the country began to relax some of their stay-at-home restrictions, and the economy began to reopen. Activity, hiring, and inflation picked up – all good news. But there is quite a bit of difference across sectors.

Interest-rate-sensitive sectors, like housing and autos, have seen the sharpest rebounds. Other sectors, especially service sectors like travel, hospitality, and leisure, are still very depressed.

[Figure 2. Employment and Unemployment] September's jobs report shows a continued pickup in hiring, although at a slower pace than in the summer. We have made up a little over half of the jobs lost in March and April as people returned to work from temporary furlough. But that still means we are down almost 11 million jobs from February's level. The unemployment rate fell to just under 8 percent (7.9 percent) in September, better than expected. But part of that drop reflects a drop in labor force participation, which remains well below February's level.

[Figure 3. Re-employment Rates by Income] It is clear that the adverse effects of the pandemic have not been evenly distributed. They have been borne by the most vulnerable in our economy: lower-income and minority workers and communities; those who do not have the opportunity to work from home; those who do not live in areas with reliable telecommunications and internet services or access to adequate healthcare; and the smaller of small businesses.

Rehiring by employers has been slower for lower-income workers than for higher-income workers – at the national level and in Cuyahoga county.

[Figure 4. Progress on Unemployment by Race/Ethnicity and Educational Attainment] Over the course of the reopening, there has been less progress on reducing the unemployment rate for minorities than for whites and for those with lower levels of education compared with those with higher levels.

So while the economy is recovering, it is still in a deep hole. Employment is about where it was in the middle of 2015 – so we've lost more than five years of job growth. Even if growth rebounds in the third quarter at the same pace at which it contracted in the second quarter, the level of output will be about where it was at the end of 2017, so the economy will have lost almost three years of output growth.

Both monetary policy and fiscal policy reacted swiftly and strongly to support the economy thus far. We have in place very accommodative monetary policy: the fed funds rate is at its effective lower bound, we are purchasing Treasury and agency mortgage-backed securities, we have a number of liquidity and lending facilities in place to ensure that markets continue to function and that credit continues to flow to businesses and households, and we have temporarily relaxed some of the regulatory requirements on banks so they have greater capacity to lend.

Fiscal policy actions have included grants to individuals, certain businesses hit hardest by the pandemic, and states and municipalities; expanded unemployment benefits; and the Paycheck Protection Program, which offered loans to small businesses that became grants for firms maintaining their payrolls.

It will take some time to move from the somewhat fragile, disparate recovery we have now to a more sustainable, broader recovery. The path of the recovery is likely to be bumpy, with some fits and starts and uneven progress. It will take time for workers who have lost jobs to find new ones, either at another firm in their current industry or in a new industry after they retrain. The commercial real estate market has been particularly hard hit. There was already a trend toward online shopping and remote work; the pandemic has greatly accelerated that trend. The structural changes in the commercial real estate market will take some time to sort out.

Provided we continue to make progress on controlling the virus, activity and hiring will continue to expand. By the end of this year, I expect that output will still be somewhat below its level at the end of last year; that the unemployment rate will remain in the high single digits; and that inflation will be well below our longer-run 2 percent goal. The recovery should continue over the next couple of years provided it is supported by very accommodative monetary policy and further fiscal policy actions. Fiscal policy in the form of aid to households and small businesses most affected by the pandemic and to states and municipal governments, and increased investment in testing, contract tracing, treatment, and vaccine development would provide important support for the recovery.

Of course, there is a lot of uncertainty around the forecast. It is highly dependent on the virus and our actions to control its spread. It is easy to think of downside scenarios. Many of our contacts in the region, across all sectors, tell us that uncertainty about the course of the virus and about whether there is going to be additional fiscal support is clouding their outlook and holding back larger investments.

But there are upside scenarios as well. Development of a safe and effective vaccine that people have confidence in and that can be widely distributed fairly quickly would be very positive for the outlook. In addition, we should not discount the fact that the pickup in activity we have seen so far has exceeded expectations. It is a good reminder that we should never count out the resiliency of the U.S. economy and the American people.

Charts for “An Update on the Effects of the Pandemic on the Economy”

Loretta J. Mester*
President and Chief Executive Officer
Federal Reserve Bank of Cleveland

Greater Cleveland Partnership Annual Meeting
(videotaped October 6, 2020)
October 14, 2020

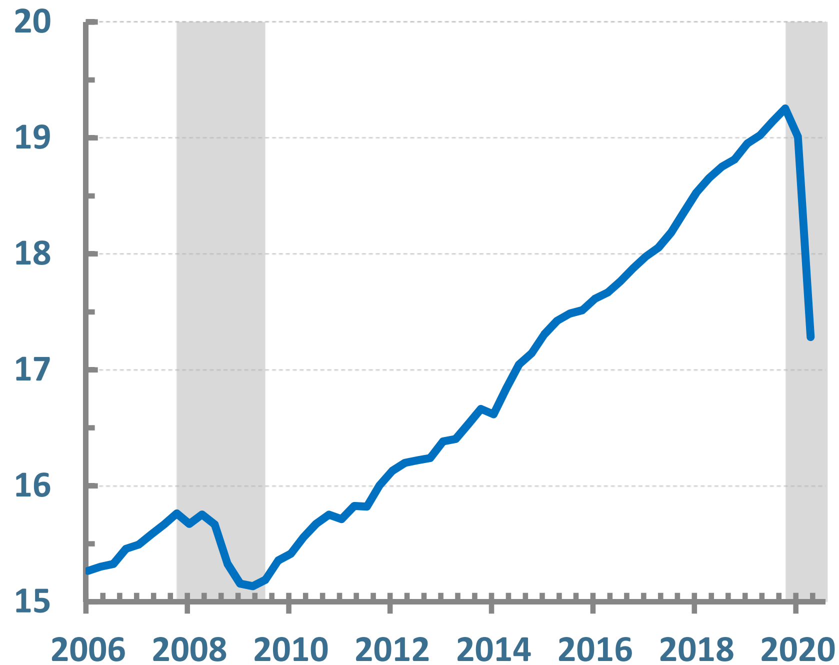
*** The views expressed here are my own and not necessarily those of the Federal Reserve System or my colleagues on the Federal Open Market Committee.**

FEDERAL RESERVE BANK *of* CLEVELAND

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

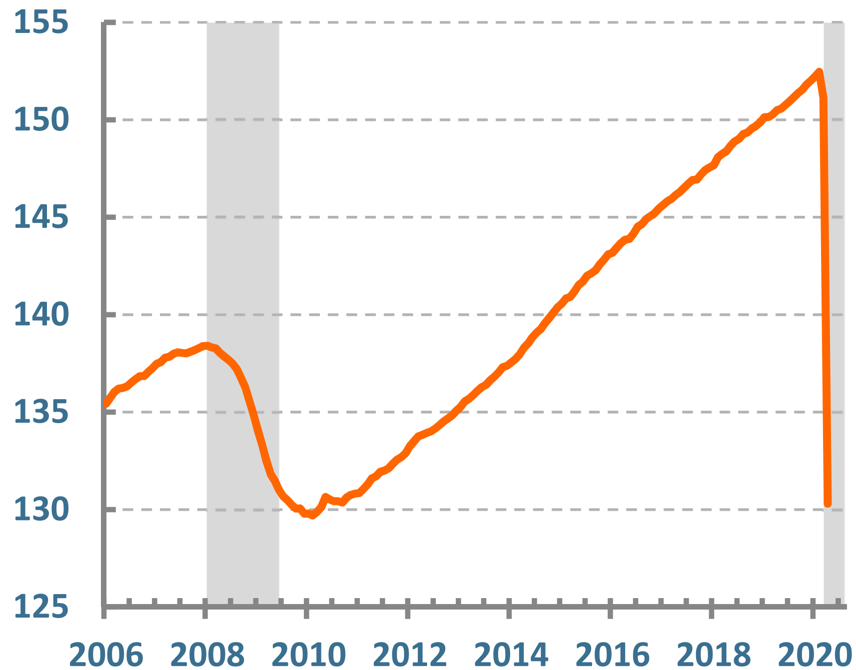
Level of real GDP through the second quarter of 2020

Trillions of chain-weighted 2012 $



Level of payroll employment through April 2020

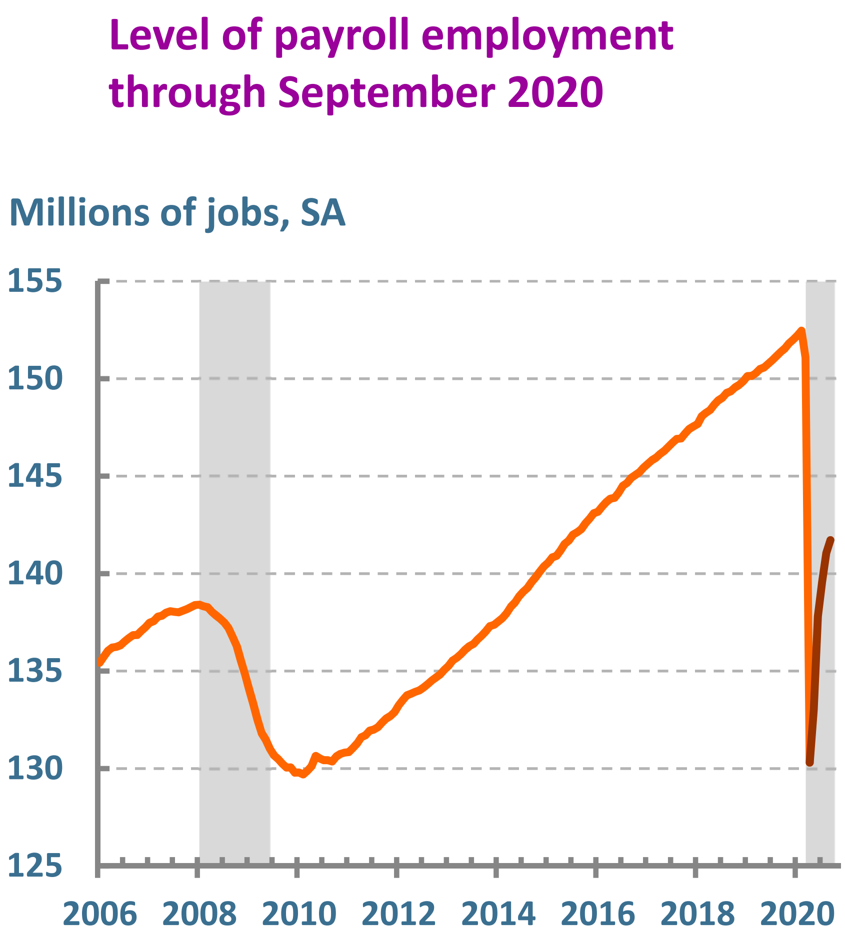
Millions of jobs, SA

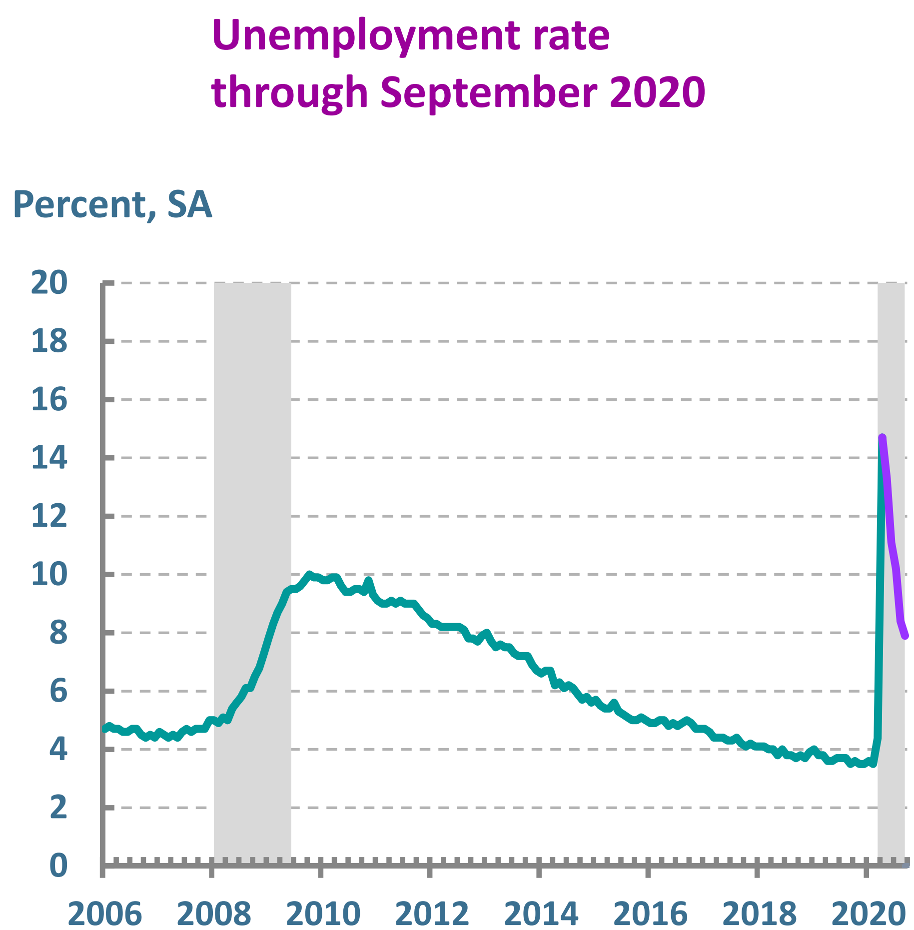


Source for GDP: Bureau of Economic Analysis via Haver Analytics, quarterly data

Source for Employment: Bureau of Labor Statistics via Haver Analytics, monthly data

Figure 2. Labor market conditions have improved since April



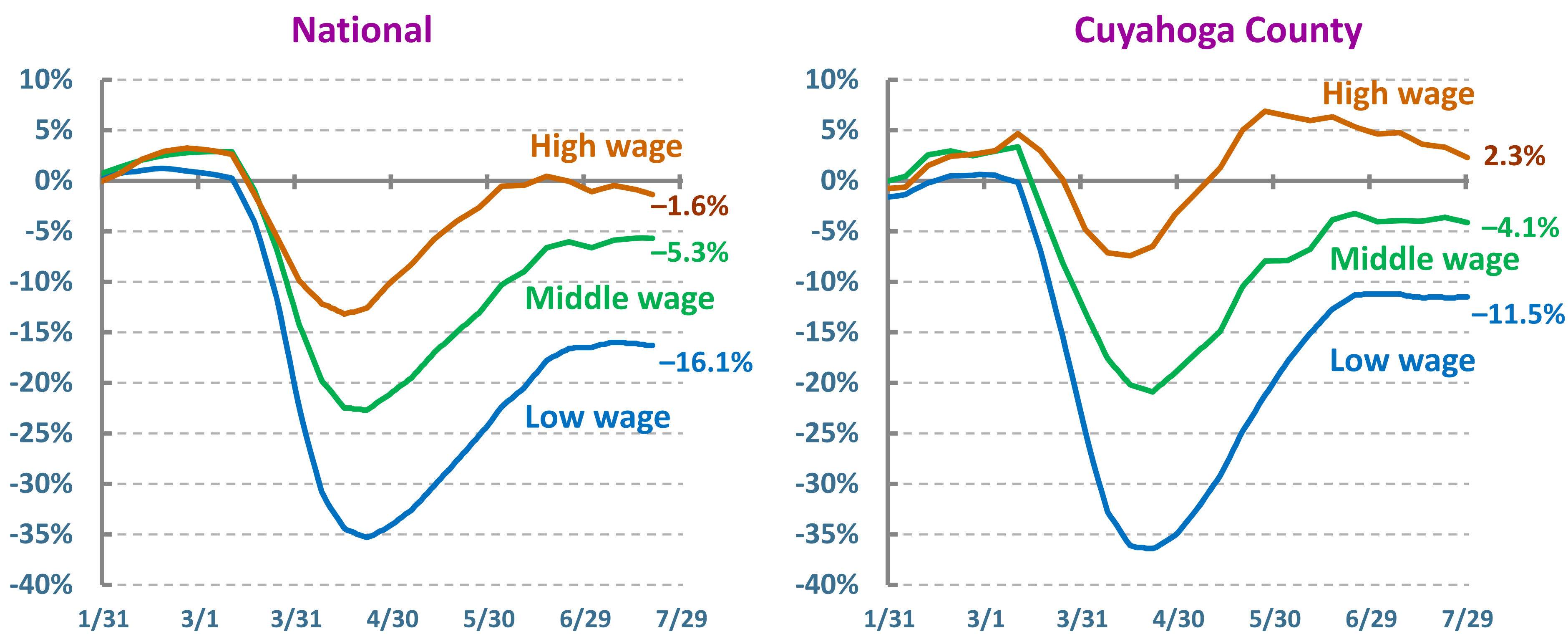


Source: Bureau of Labor Statistics via Haver Analytics, monthly data

Figure 3. Employment of low-income workers remains well below its level in January

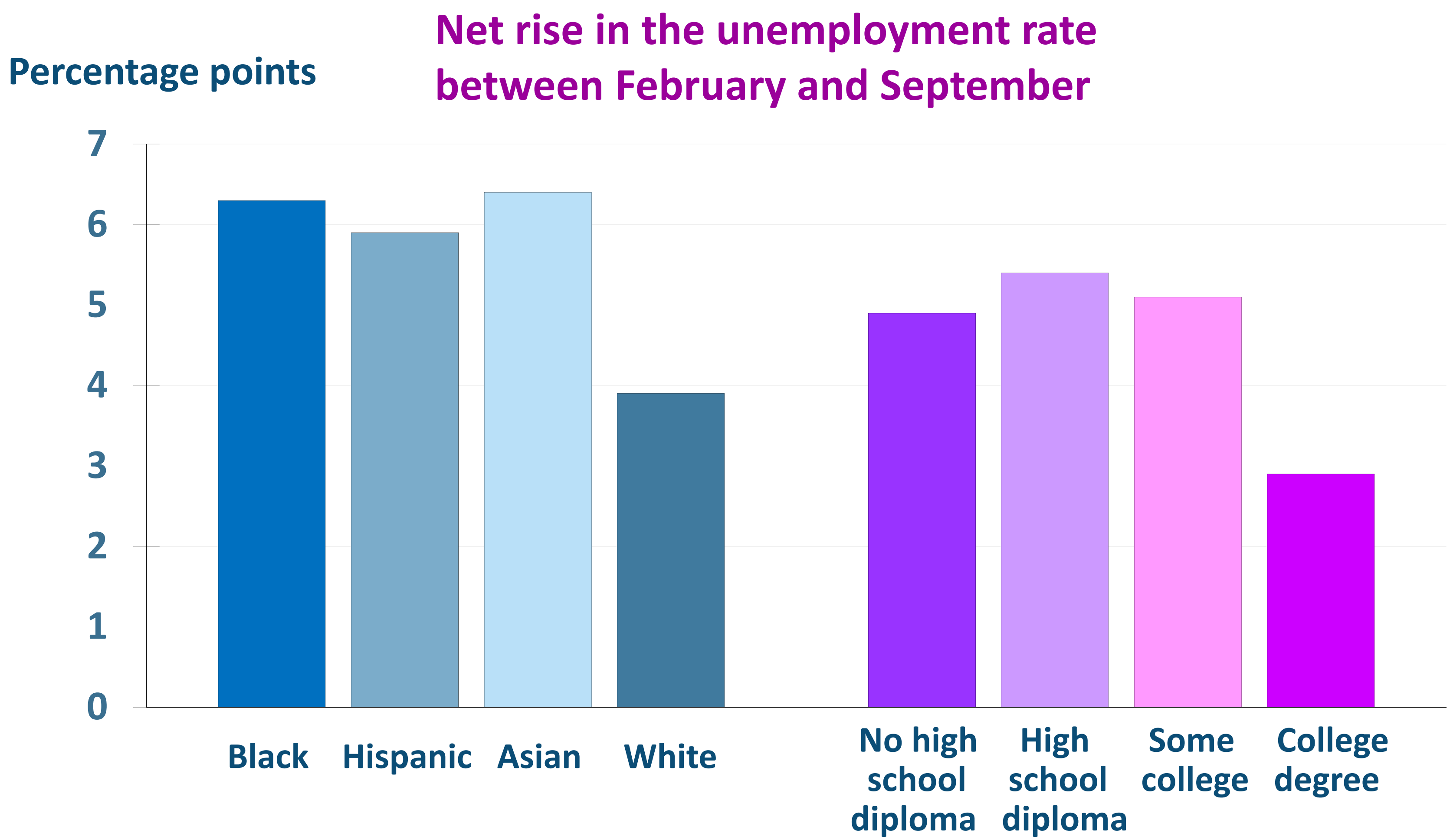
Employment level compared to January, by wage quartile:

Low wage: bottom quartile, Middle wage: middle two quartiles, High wage: top quartile



Source: Opportunity Insights, TracktheRecovery.org
based on data from Paychex, Intuit, Earnin, and Kronos, daily data through 7/29/2020
Low wage is approx. < $13/hour, Middle wage is approx. $13-$29/hour,
High wage is approx. > 29/hour

Figure 4. Unemployment rates remain elevated, especially for minorities and those with less education



Source: Bureau of Labor Statistics via Haver Analytics