Transcript
FedTalk: 2021 Economic Outlook
Federal Reserve Bank of Cleveland
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Presentation

Lisa Vidacs, senior vice president, corporate communications and engagement, Federal Reserve Bank of Cleveland: Good afternoon. Welcome to FedTalk, the Cleveland Fed speaker series in which we share research that is relevant to our community and ask you to join us for a discussion. Past events have covered such subjects as the opioid epidemic, racial wealth gap, and the Paycheck Protection Program. All of our events are on the Cleveland Fed's website, clevelandfed.org, and on our YouTube channel. Before I turn things over, I want to give you a preview of our 2021 FedTalk series.

We will be hosting monthly programs that will cover a wide range of topics. 2020 provided a stark reminder that racial inequities continue to limit our growth as a nation. The Cleveland Fed is committed in word and action to racial equity and economic inclusion for all. Last year we launched our Program for Economic Inclusion, which covers topics such as the racial wealth gap, jobs and workforce, housing and redlining, minority-owned small businesses, and access to credit.

In support of our racial equity work, the FedTalk series will place special focus on the intersection of race and economics with such topics as race, ethnicity, and the financial lives of young adults, diversifying the economic pipeline, and diversity at the Federal Reserve. Additionally, we will examine the Federal Reserve's work in such areas as monetary policy, community development, and the impact of the COVID-19 pandemic. I hope you will join us.

I'm pleased to introduce to you our presenter for today's event, Ed Knotek, a senior vice president and research economist at the Cleveland Fed. Over the past year, Ed has done some interesting work surveying consumers on their beliefs and expectations related to COVID-19 as well as work on inflation. In addition to being an accomplished economist, Ed is also a really great guy. Ed, over to you.

Edward S. Knotek II, senior vice president and research economist, Federal Reserve Bank of Cleveland: Thanks, Lisa, for that introduction. My thanks to all of you for attending today's FedTalk. I plan to talk about the economic outlook as we move into 2021. I'll focus on some of the typical economic data series that economists use to keep track of the economy, some of the newer series that we've been using in this challenging time. And then I'll also talk about some of the work that we're doing at the Cleveland Fed to keep tabs on the economy during these tumultuous times. Now, as is always the case, these are going to be my views and not necessarily those of the Federal Reserve Bank of Cleveland or the Federal Reserve System.

The coronavirus pandemic has taken a terrible human toll here in the United States and around the world. And it's had a dramatic impact on the US economy. While economic activity has improved sharply since last spring, across many measures, the economy remains quite far from its pre-pandemic state.

Moreover, the resurgence of the virus starting in the fall and stretching into the winter is again weighing on economic activity, though to a lesser extent so far compared with last spring. But there's some good news, because with vaccines being distributed and with fiscal policy and monetary policy providing support to the economy, the hope and expectation across most economists is that the economy will be in a much stronger position at the end of 2021 than where we were at the end of last year.

Gross domestic product, or GDP, measures the expenditures of US households and governments, businesses investments, and our net exports to the rest of the world. Under normal conditions, economists think that the economy grows about 2 percent per year. As the pandemic spread last year, GDP growth experienced dramatic swings. GDP fell at a 5 percent annualized pace in the first quarter last year, and then at a 31 percent annualized pace in the second quarter, as people and businesses voluntarily pulled back on activities and governmental mandates and restrictions limited others.

As the economy reopened in late spring and summer, activity very quickly rebounded growing at a 33 percent annualized rate in the third quarter. However, the recovery was only partial. The level of GDP was still down by more than 3 percent as of the third quarter of last year. At the risk of using the word "unprecedented" too many times, these truly were unprecedented swings in activity.

The modern national accounts records began in 1947. We've never seen such a large decline in economic activity in a single quarter as we did last year. Similarly, the rebound in the third quarter was about twice as strong as the previous strongest quarterly growth rate in the positive direction. So, these truly are unprecedented times.

Along some dimensions, the rebound in activity so far has been stronger and faster than what had been anticipated in the middle of last year. For example, the housing market quickly strengthened in the summer and fall, as sales of new and existing single-family homes surged to the levels last seen prior to the Great Recession. Some of this recovery clearly reflects pent-up demand for home purchases. It was also aided by low mortgage rates. Anecdotal reports additionally point to a desire by some to purchase a home outside of a city center or a second home from which to work remotely. But the rapid housing recovery also highlights the ability of certain sectors to quickly adapt business models by leveraging new technologies as some aspects of the homebuying process moved online. It also helps to demonstrate the inherent resilience of the US economy.

Fiscal policy actions also helped to support incomes last year. Household incomes from wages and salaries usually decline during recessions as unemployment rises, a pattern that was repeated in 2020. Disposable personal income provides a broader look at income sources including not only asset income and income from businesses, but also transfers from the federal government, such as unemployment insurance benefits, economic impact payments, and Paycheck Protection Program loans to businesses that were part of the CARES Act from last year.

Overall, helped by fiscal policy, disposable personal income rose last year, helping to offset the loss of wage and salary income in the aggregate. But clearly this was not universally true at the individual household level. The combination of large fiscal transfers and reduced opportunities to spend money caused the personal saving rate to rise sharply. At its peak, the personal saving rate was 34 percent last April as the economic impact payments from the CARES Act were being dispersed and many activities were shut down. It has since fallen to 13 percent. But this rate is still almost twice its pre-pandemic level. The savings that some households were able to build up in 2020 are likely to be one support for growth in 2021. However, this has been an uneven and unequal recession and recovery thus far. The split in how consumers spend their money helps to highlight this phenomenon.

Spending on goods—things like toys, cars, exercise equipment, and food to eat at home—quickly rebounded and is now above its pre-pandemic level, as this type of spending can be done online in many cases or enjoyed in one's own home. Spending on services, including restaurant meals, hotel accommodations, and travel, remains below its pre-pandemic level, as many of these experiences require more interpersonal contact. As the vaccine rollout proceeds and people feel more comfortable engaging in these types of activities once again, spending on services will likely rise. In the meantime, rising new virus case counts pose a headwind to economic activity.

Since last March, the Cleveland Fed has been surveying consumers each day about their beliefs related to the coronavirus outbreak. We post results from this survey every Wednesday on the Consumers and COVID-19 page on the Bank's website. Over the last several months, there has been a clear upward trend in the percentage of respondents expressing concern over current conditions. In particular, consumers recently have been more likely to report refraining from large purchases. They've also been more likely to report that they fear the loss of a job than was the case last summer when new case counts were markedly lower.

Some other high-frequency indicators that have become popular during the pandemic paint a similar picture of slowing activity as consumers voluntarily pull back and state and local governments have set new limitations on activities to stem the further spread of cases. Mobility reports based on cell phone location data show that time spent outside the home has been trending down since the end of summer. Restaurant traffic has also declined over the same period. In spite of a spike on December 31, perhaps as people were happy to ring out the old year, the number of seated diners recently has been only around one-third of its year earlier level. Nevertheless, it's worth noting that in all of these cases, the slowdown in activity to this point is not as sharp as it had been last spring even though the new restaurant case count is much higher. This suggests that the economy is finding ways to adapt to the existence of the virus.

Turning to the labor market, we see a similar slowing in activity of late. Job gains show tremendous losses in March and April of 2020 when the economy lost more than 22 million jobs. Job growth rebounded beginning in May and it was strong last summer. However it has subsequently stepped down in each month since then. Job growth stalled in December as the economy lost 140,000 jobs on net. There are a large number of job losses in the leisure and hospitality industry as restrictions on in-person dining weighed on the sector as governments have attempted to subdue the spread of the virus. By contrast, most other sectors continue to add jobs.

There were about as many job losses last spring as the total number of jobs that were created during the entire last expansion. We've gained back about 12 million jobs since then, but this still means that the number of jobs in the economy is down by more than 6 percent compared with its pre-pandemic peak. This puts the number of jobs back to its 2015 level.

These tremendous job losses translated into a massive spike in the unemployment rate. Last April, the overall unemployment rate peaked at 14.8 percent, its highest level since estimates of the unemployment rate from the Great Depression. As economic activity has picked up, unemployment has declined. The unemployment rate moved down to 6.7 percent in November and it remained at that level in December as the labor market slowed. The increases in unemployment have been widespread across demographic groups. However, it is the case that the net increases in the unemployment rate so far have been larger for Black or African American workers and for Hispanic or Latino workers than they have been for white workers. In additional signs of the unequal nature of the recession and recovery, job losses have been greater for lower-wage workers than for higher-wage workers, and job losses have been greater for workers with relatively lower levels of education than for workers with college degrees.

Moreover, the unemployment rate understates some of the damage that's taken place in the labor force because many workers have dropped out due to the pandemic and its economic consequences, and they are not being counted as unemployed. Labor force participation, which had been trending up in the latter half of the last expansion due to the improving economy, suffered a very sharp decline last spring, falling to its lowest levels since the early 1980s when fewer women were in the labor force. We've seen a modest rebound in participation as activity has recovered, but participation remains near the lows from the last expansion. Jobs have disappeared or entire industries, in some cases, remain shut down, and many people have left the labor force due to health concerns or to care for children because of disruptions to schooling from the pandemic.

Turning to inflation, the weakness in economic activity—especially for services that require interpersonal interactions—has caused inflation to be subdued. Inflation rates were not far from the Federal Open Market Committee's, or FOMC's, 2 percent goal prior to the pandemic, but as demand for many goods and services turned down in the spring, so, too, did prices. For example, gasoline prices last spring fell sharply with fewer people driving. This caused headline inflation to fall to about 1/2 percent, while core inflation, which excludes food and energy prices in an effort to pick up inflation trends, fell to about 1 percent.

The Cleveland Fed's Center for Inflation Research produces a number of inflation-related statistics. One of these measures published by the Cleveland Fed is called Median PCE Inflation. This looks at the middle of the distribution of price changes. This inflation measure has also softened compared with its pre-pandemic reading.

Turning to monetary policy, the Federal Reserve took aggressive actions in 2020 to cushion the fallout from the pandemic and to stimulate the recovery by reducing interest rates, setting up emergency lending programs, expanding the size of its balance sheet, and enacting regulatory changes. Following its December meeting, the FOMC statement highlighted two key elements of its current monetary policy approach.

First, the FOMC decided to keep its primary monetary policy instrument, that target range for the federal funds rate, at zero to 1/4 percent, a rate that it set in March. It provided forward guidance around the funds rate by indicating its belief that it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the committee's assessments of maximum employment, and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time.

Second, the committee indicated that the Fed would continue its purchases of Treasury and agency mortgage-backed securities. To help clarify its future intentions regarding these asset purchases, the statement had new language to indicate that such purchases will continue until substantial further progress has been made toward the committee's maximum employment and price stability goals. Taken together, these statements suggest that monetary policy is likely to remain highly accommodative with low interest rates for some time to promote a strong labor market and inflation rates that are above 2 percent for a period. Let me turn to what these factors are likely to mean for the economy in 2021.

First and foremost, the virus and the distribution of the vaccines will continue to play a central role in the outlook. As noted earlier, the resurgence of the virus is weighing on economic activity and is likely to continue to do so in the near term. But as the vaccine rollout continues and it becomes safer for people to reengage in a wider variety of activities, economic activity should pick up markedly.

Second, fiscal policy will continue to support the economy, especially in the first half of this year as the recently passed relief package from December kicks in and savings from fiscal policy actions last year are spent.

Third, accommodative monetary policy is likely to keep interest rates relatively low to stimulate borrowing and spending. Together, these factors should lead to a strong rebound in consumer spending as the year progresses, especially on services that have languished thus far.

There's considerable uncertainty around the timing of such a rebound. This broadening recovery should encourage firms to pick up hiring, helping to reduce the unemployment rate and thereby helping support further spending in a so-called virtuous circle. This summary broadly describes the consensus view among professional forecasters. Since research suggests that looking across forecasters is more efficient than looking at a single forecast, I'll talk about the consensus among professionals.

The most recent survey from Blue Chip Economic Indicators shows growth stepping down in the first quarter of this year as the surge in new virus cases weighs on activity. But as more of the population is vaccinated, restrictions on activity are likely to ease and consumers will grow more confident resuming old activities. These factors will lead GDP to accelerate to a relatively strong pace of growth late in the year. With the economy growing at a rapid clip, payroll growth picks up and the unemployment rate falls to end the year at about 5-1/2 percent. The strengthening of demand puts upward pressure on prices as the year goes on, which helps in turn to lift the inflation rate to about 1-3/4 percent.

There's a lot of uncertainty around this outlook and much has to go right for this forecast to be realized. But it does suggest that there is at least some light that's growing brighter at the end of the proverbial tunnel.

Now this high-level forecast abstracts from many important details. To conclude my talk, let me speculate for a moment on what the post-pandemic landscape might look like.

Economic research finds that people can often carry lasting lessons from key events in their lifetimes. For example, the Great Depression had a large impact on future saving behavior, and new drivers around the time of the energy price spikes in the 1970s were more attuned to jumps in gasoline prices later in life. Since April of last year, the Cleveland Fed's Consumers and COVID-19 survey has been asking respondents about their post-pandemic plans to use or attend a few activities that have been hard hit by the pandemic, including such hospitality services as bars, restaurants, and hotels, and attending crowded venues such as concerts and amusement parks.

To answer these questions, respondents move a slider on a scale from zero to 100, whereas zero indicates that they expect much less usage than before the pandemic; 50 is the same level of usage; and 100 indicates that they expect much more usage than before the pandemic. You can think to yourself how you might've responded to this type of question since April of last year. Now interestingly, 50 has been the most common answer throughout. In other words, the typical or immediate respondent has consistently indicated plans to resume their old habits after the pandemic, in terms of going to restaurants, hotels and bars. But the shape of the distribution has changed in interesting ways.

Early on, the expected intensity of usage was roughly balanced between those expecting more versus less usage. As new virus cases surged in parts of the country during the summer, interquartile range shifted down, consistent with the view that consumers at that point were somewhat more pessimistic about their longer-term spending plans in the hospitality industry. But more recently, the pattern has reversed course. By October, the distribution of responses was once again roughly symmetric. And by last month, we were starting to see signs that consumers on net anticipated somewhat more usage of hospitality services once the pandemic had run its course.

The pattern was extremely similar for the question regarding crowded venues. Early on, consumers were skewed toward expecting less attendance at venues like concerts, amusement parks, and sporting events. This pessimism grew during the summer. But by the end of the year, interquartile range had shifted up to reflect somewhat greater expected attendance at these venues than in the past. These shifts over time highlighted difficulties in trying to predict whether the pandemic will have a longer-term effect on the economy or not. All events are still unfolding. Only time will tell what lasting effects the pandemic may have on the economic landscape. With luck, the recovery will continue to progress this year and it will be closer to that post-pandemic landscape, whatever it might be.

Regardless, I hope you find the products and research coming out of the Cleveland Fed useful to keep tabs on the economy. Thank you for joining us today. I look forward to your questions.

Q&A

Lisa: Thank you Ed. That was very informative and lots for people to think about. And I know we've got many questions, some that came in ahead of time. I'm going to start with one that came in ahead of time. "My wife and I run a small food bank out of our church. Many of our guests have lost their jobs and are living on unemployment, odd jobs, and assistance program like ours to survive. Based on that experience I'm keenly aware of the need to continue offering assistance to those who are deeply suffering physically, emotionally, and economically from the pandemic and ongoing economic disruptions. My question is, what is the balance between the federal government providing ongoing assistance programs to those in need versus the government's limited ability to continue paying for such programs?"

Ed: So this is a great question and obviously the needs out there are extremely acute at this point in time, so it's incredibly timely. The basic idea behind the fiscal policy actions that have been put in place is kind of textbook econ 101 to conduct what's called 'counter cyclical fiscal policy,' and to provide support for the economy when the economy is weak. This has a lot of benefits to individuals, to households, physically, emotionally, economically as was indicated, but certainly at an aggregate level, it helps to support demand in the economy. It's meant to make up for the loss of demand that would take place without that support. In this case, not only is there a strong case for fiscal policy to provide this stabilizing role, but it's also an investment in public health because without that support, if people try to carry on as normal, first off, it's not clear that they could and, secondly, that can help to worsen the spread of the virus. I think that fiscal policy's playing a few roles, and that means that it's taking on an even larger role than just as normal counter cyclical role. It's also helpful to think a little bit about the counterfactual. If fiscal policy hadn't stepped in, what would the economy have looked like? We know that these actions are not costless; they are adding to the deficit, they are adding to the debt. But had fiscal policy not done this, you most likely would have had a much weaker economy.

Tax revenues would have declined anyway endogenously, just as people had less income. Automatic stabilizer policies would have kicked in to a greater extent. You would have had even more unemployment insurance benefits being paid out and the deficit would have gone up regardless. Maybe not as much, but it would have gone up. And yet at the same time, you probably would have had a much weaker economy. You would have had more permanent job losses, more businesses shutting down, and that could have led to a longer and slower recovery and higher unemployment.

So, for a lot of these reasons, it makes a lot of sense for the government to step in and to try and build a proverbial bridge over these troubled waters to when the virus would be under better control, more vaccines would be in place, and then people can start re-engaging in activities.

At the same time, I'm very sympathetic to this question because I also believe that we don't have an infinite opportunity to borrow. At some point in time, if you borrow too much, interest rates are likely to rise. There could be questions about fiscal sustainability. This is compounded by the fact that we have the retirement of a large baby boom generation that in turn will put some stresses on things like Social Security and Medicare payments, which will necessitate funding from the federal government as well. I do think that you want to find the right balance, you want to support the economy in the near term. We've seen just in the last expansion that if fiscal policy pulls back too soon, that does weigh on economic activity; it slows the recovery in its early stages. You need to balance the pros of fiscal policy with the fact that at some point in time, you may need to pull back. And honestly, that's one of the reasons why this is an extremely tough choice and it's best for elected officials to make those tough trade-offs.

Lisa: Thanks Ed. No easy answers. I have a question about labor force participation. "To what degree do you believe the decline in labor participation is due to school and daycare closures, and do you think this will reverse once we return to normal operations?"

Ed: Good question Lisa. And so that's actually something that we've looked at a little bit in our Consumers and COVID-19 survey. It's worth pointing out that some of the school closures, the disruptions that we've seen related to the pandemic, they can take a variety of forms. On the one hand you can certainly have people who are no longer working because of school closures, but there's a lot of other margins that are at play, too. You might have people who are working less hours or they're working less hours during the normal day and working more hours at night. At least in our survey work, we had found that it's not just people dropping out of the labor force, which is a real phenomenon, but they're really flexing hours or they're working less. So there's a lot of different margins along which people are adjusting.

The decline in labor force participation has been a little bit larger for women than it has been for men. The decline has been large for both groups to be honest. My best guess is that part, maybe half, of that decline has been related to childcare but there's a lot of other factors going on. We have the fact that some people have voluntarily taken themselves out of the labor force for health reasons. We have the fact that some industries have just shut down. And so instead of looking for work, people are waiting for an industry to reopen. In other cases, people have become discouraged and have left the labor force because they've lost their jobs. So childcare is an issue. This is one of the reasons why prioritizing schools, getting schools back online, or, off of online and back in person is one of the priorities that has been emphasized. That would help people to kind of be able to go back to work in some cases. I think that that is an important consideration for the recovery.

Lisa: Great, thanks Ed. I want to move to some questions related to inflation now and I know that's one of the areas that you have done a lot of work on. "Why has inflation remained so low when monetary policy has been so expansionary for such a long time. And then a related question, how will inflation help debt service?"

Ed: Okay. So good questions. The first question, just about why has inflation been so low for so long? It's worth pointing out that before the pandemic, inflation was not far from 2 percent. The Federal Reserve, the Federal Open Market Committee, has a longer run objective of keeping inflation close to 2 percent. And so before the pandemic, inflation was close to 2 percent. It was a little bit short of 2 percent, but fairly close. There's a lot of factors at play in terms of determining inflation. The strength of the economy is one factor. What people think inflation will be in the future is another factor. There are many, many of these so-called shocks that impact the economy. Whether it's pressures from abroad, domestic pressures, technological innovations, the price of oil, there are many, many factors that are affecting inflation.

There is a general belief that perhaps now the so-called Phillips curve is relatively flat, which means that in order for inflation to be very, very high, the economy needs to be really, really, really overheating. So that is certainly a possibility. And it's possible that during the last expansion, even though times were very, very good, that maybe they weren't so good that it was generating a lot of inflationary pressures.

The question about why is it the case that monetary policy hasn't generated more inflation, so that kind of goes back ... There is a sense over long time periods that tremendous monetary excess can generate a lot of inflationary pressures. And you've seen that historically, you've seen that especially in some hyperinflationary scenarios where tremendous monetary growth, tremendous expansions of central bank balance sheets have led to inflation. But oftentimes there have been other factors at play too, where fiscal policy has been working basically in tandem with monetary policy to running large deficits that are going to be financed by monetary financing. And that's been leading to very, very tremendous increases in prices. And we're very far from that here.

In some sense, some of these issues of access of monetary creation haven't really been at play that are putting in a lot of upward pressure on inflation. And so therefore, with an expected inflation close to 2 percent, the economy in a good spot, inflation was around 2 percent. The hope and the expectation are that as conditions improve once again, inflation will gradually rise.

As I had shown earlier, the Blue Chip professional forecasters think that by the end of this year, inflation will be back to around 1-3/4 percent. There's a lot of uncertainty around that but as the economy gradually improves, that will help to boost inflation gradually and eventually, inflation should return toward 2 percent.

So that was a long-winded answer for that first question, but that gives a sense of there are lots of factors at play; the improving economy should help to get inflation back up. And the fact that inflation wasn't kind of out of control earlier, I think, is consistent with the fact that the economy was in a pretty good spot. In terms of the second question. Lisa, you might have to repeat it for me because I spent a while on that first one.

Lisa: Yep, no it's not fair to give you two at once. "How will inflation help debt service?"

Ed: Good question. So when you take out a loan, you're paying a nominal interest rate for that. So right now, mortgage rates let's just say are in the ballpark of 2-1/2 or 3 percent. When you take out that mortgage, usually anticipate that there's going to be a certain amount of inflation over the course of that mortgage. So that means that the real interest rate then is the nominal interest rate minus expected inflation. If inflation turns out to be higher than what you expected, then in real terms you're basically paying less to pay back that mortgage than what you had anticipated. That means that over time the dollars that you're paying back are not worth as much as you had anticipated that they would be. What that means is anticipated inflation, it can impact the transfers that occur between debtors and the owners of the debt. If inflation is too low, then that is basically too low or lower than expected, that's not transferring, that's making real transfers going from the person who borrowed to the person who owns the loan. And if inflation becomes too high, it goes in the other direction.

This is one of the reasons why the Federal Reserve wants inflation to be relatively stable. If people are expecting inflation to be about 2 percent, and there's a fair amount of evidence to suggest that inflation expectations are relatively well anchored in the vicinity of that 2 percent objective, you want inflation to actually deliver on that objective to assure that you don't have any of these unexpected transfers between savers and borrowers. That's one of the mechanisms in which inflation is working through the economy, and one of the reasons why you want to have inflation being relatively low but also stable. That way you can plan accordingly, and you have kind of the right expectations when you're making these financial decisions and you're borrowing.

Lisa: Thank you for that Ed, I appreciate the explanation. You talked about savings, and so there is a question about savings. "Can you speak to the savings rate increase while there are looming evictions? It seems that the ideas conflict."

Ed: Sure. And so that's an excellent point. And that savings rate that I [referred to] was certainly in the aggregate. So that is the economy-wide personal savings rate, which is really a measure of the income that households get and you subtract how much they're spending, what you're left with is what they're saving. And so certainly it's absolutely true that in the aggregate, the savings rate was very, very high, but at the household level, that was not universally true. And it certainly was the case last year as I had mentioned, also with like the labor market.

We've seen a lot of unevenness and inequities in the labor market in terms of how the pandemic recession has affected different segments of the labor market. We've seen much greater job losses among lower-income workers than among higher-income workers, for example. While the aggregate savings rate jumped up, certainly that doesn't mean that the savings rate was high for everybody at an individual level. And as we think about fiscal policy, unfortunately oftentimes fiscal policy can be a rather blunt tool. We make the same critique about monetary policy. If you aren't giving the funds exactly to offset income losses for example, then even distributing a lot of money in the aggregate, it might not go everywhere that it could to perfectly offset those income losses. And so you could certainly have cases in which there's a lot of savings in the aggregate, but at an individual level for people who have lost jobs and they haven't been made whole, they could be facing things like evictions.

Lisa: Great. Thank you Ed. I'm going to go to a question around small business that came in prior to today's event. "What does the small-business reset look like after COVID and what will the long-term impact be, especially to underserved communities?"

Ed: Yeah, it's a great question. Some of the survey work that we've been doing here at the Cleveland Fed helps to illustrate just the intense uncertainty around the longer-term picture. We do know that the picture for small businesses currently is not very good. Look at the tracktherecovery.org website, which is a popular website to look at some higher frequency data that researchers have been using and updating to highlight some of what's been going on with the pandemic in the early phases of the recovery.

I think the number of small businesses is down somewhere in the ballpark of 30 percent based on their calculations. Small-business revenue is down around 30 percent. We know that many restaurants or small businesses have been heavily impacted by the pandemic. You see a lot of restaurant closures, you see that nationwide, locally, everywhere you look.

Certainly, I think for the small businesses, one of the keys here, is really about near-term survival, that the new round of Paycheck Protection Program loans will hopefully help some of those small businesses. And the timing note, the vaccine rollout can't come soon enough to support some of those small businesses. It's interesting though because on the flip side, on the other side of things, small-business startups also surged last year.

I think in the third quarter or so, John Haltiwanger is an economist who does a lot of work on small businesses, and I believe I remember him saying that the third quarter of last year was the most small-business startups that he'd seen in like the 16 years of data that he has. So ideally, it'd be great if small-business startups would be able to quickly reenter to make up for exits across communities, especially in some of the underserved communities. But certainly, it's also possible that the reality could be that some of those small-business startups are going to be focused on particular opportunities or locations. And if they aren't in the underserved communities, that could certainly lengthen the recovery in those underserved communities.

But I guess just kind of going back full circle to the survey results that I mentioned at the beginning: It's very, very difficult now to predict with much accuracy kind of what Main Street is going to look like in one or even two years' time. Because we've seen big swings and kind of how consumers are thinking about their post-pandemic plans and those can change very quickly.

Lisa: Yeah, thanks. There is a question here related to the COVID survey that you've been doing that I think is pretty interesting. "How does the dispersion of restaurant and crowded revenue responses differ by age? Did older people respond more cautiously than younger people?"

Ed: Ooh, that is a great question. And I am embarrassed to say that I don't know the answer to that one. And so that's something that we are going to have to look at. We have that data, but we just have not sliced it that way as of yet. That's a great suggestion, so thank you. We plan to write up some of those results into an *Economic Commentary*. We will make sure that we include that answer in that *Commentary* when it comes out, hopefully in the next few months.

Lisa: Great. All right. Well, thank you to whoever asked that question. Gave us an idea of something we could really do to give some additional information in the research that we're doing. I'm going to switch back to an issue related to forecasts. "Has the methodology for generating forecasts changed in any way due to the pandemic, such as using different markers, determinants, or shifting weights given to components for forecasting?"

Ed: So the short answer is yes, there have been changes, and yes, we're using new data. And so actually it was kind of interwoven into the presentation. Some of the data series that I presented were not on economist radar screens prior to the pandemic. Economists have been adding new data indicators to their suite of models. For example, based on some of the work that we've done internally, including initial claims for unemployment insurance can be quite noisy and so sometimes you don't know whether to include them or not. But it turns out that they were very helpful to pick up the initial downturn last spring. And it is the case that it's not just economists but even the statistical agencies are looking at some of these new and different data series as well, looking at the higher frequency data, looking at credit card transaction-level data. It's a great time to be an economist. That's even a better time if you have access to a newer, novel data set that you can use.

In addition, it is the case that some of the statistical models that we use have been changing. So there was kind of an open question of how do we treat this massive decrease in GDP in the second quarter and the massive increase in the third quarter. At the time, in real time, we struggled with this and so now it's kind of a question of, well, do we treat these as outliers? Do we try to extract just a little bit of data and a little bit of signal as opposed to a lot of signal from them? There's some evidence to suggest that that could be the right approach. This is far from being settled. It'll take economists and researchers years, if not decades, to think about the "right way" to handle these extreme movements. But yes, so it was a very active part of our research and that's why this is an interesting time for doing research because that research becomes very, very relevant toward the real world in real time no less.

Lisa: Yeah. So let's talk a little bit about how can we get some growth? So there's a question. "How President-elect Biden seeks to reinvigorate the Midwest, what policies would you recommend to him?"

Ed: Yeah, it's a great question, also a very tough question. I mean this is something that the region has been working on for most of my lifetime and I anticipate that it will continue. If we look back at the history of the Midwest, historically the focus or the emphasis on manufacturing was an asset for the region for a long time. And this ties in turn to the outlook for international trade because much manufacturing ultimately is trainable, which means that it's a highly competitive industry.

If I think about international trade, there are pros and cons. Many people gain a little bit from international trade but some sustain very large losses. And so there's a key question in here of how to reallocate some of the gains to those who suffer the losses. And there, you get into things like retraining and upskilling.

I guess my first answer to this type of a question is going to be retraining, upskilling, and education are going to be some ways that you can try to get your workforce ready for the demands of the 21st century. There's also in my mind an issue of economic diversification.

So financial planners often talk about diversification of your portfolio as a way to balance strengths and weaknesses in different parts of your portfolio. And I think here, one of the lessons for the Midwest is just the importance of economic diversification.

So, somewhat of an emphasis on manufacturing is not necessarily a bad thing, but you want to diversify your portfolio of manufacturing a bit [by] thinking about next-generation manufacturing or combinations that can leverage high-tech incubators with the manufacturing sector. Some of the particularly bright spots in the Midwest and the work we've done at the Cleveland Fed also highlights the role for broadening out and thinking about diversifying the portfolio, the role of like the meds and eds. So, the medicine field, education, because education can open up many doors and prepare your workforce in many different ways for the future. And these are areas where there's been a lot of progress and there's probably some further progress that can still be had. So those would be, I think some of the high-level things that I would focus on personally.

Lisa: Great, thank you. And thanks everybody for all the really good questions that we have. I'm trying to do a mix of different topics. So I'm going to move to housing now. And this one came in ahead of time. "I'm wondering about broad demand for housing, especially housing for sale and for rental, for low- and moderate-income households. Interest rates are still very low for those who own, but these groups have been impacted by job loss and changes in income that the eviction moratorium and other supports may have tempered in 2020 and which could be gone in 2021. Demand for for-sale housing has been increasing for those with income but I'm not sure what will be happening for those in the rental housing market, especially those with very low incomes or new households entering poverty as a result of income loss. Could there be an investment in rental housing and rents that remain stable or decrease? In markets like Cleveland, much of the affordable rental housing is owned by smaller landlords, not large companies. Could

2021 result in shifts or changes in this so-called naturally occurring affordable rental housing market?" There's a lot in that for you, Ed.

Ed: Yeah, there's a lot there. So let me take a step back and think about the big picture and then try and zero in a little bit on the last question. As I indicated earlier, the purchasing housing market really boomed in the second half of 2020. And so we've seen a runup to an increase in house prices, stronger house price inflation. There's been a combination of limited supply: Builders can only build so much so quickly. And there's also been a shift in purchases to more expensive homes. We've seen that in the data as well. And this really lines up with this bifurcated nature of the recovery.

We've seen the greater job losses among those with lower incomes, which certainly raises as the question pointed out the potential for evictions if these moratoria end. And again, low mortgage rates; they're very helpful for buyers who are in a position to buy a home, have the income to afford house payments. They're less helpful on the rental side of things. If we think about builders, certainly given the strength that we've been seeing, the natural economic response would suggest that we should probably see some response among builders. Now, the question is, where will that response be concentrated? I don't think it's unreasonable to think that builders will be concentrating on that higher price point to take advantage of the surge in demand that's occurred kind of at that level. So that does suggest that there could be some concerns about building for low- and moderate-income households.

Now on the rental side, the issues that they were discussing in this question in terms of the housing market are not too dissimilar from issues on the commercial side of things, right? Where if businesses are struggling to pay their rents, that's creating some stresses in commercial real estate. And you could see very similar things in the rental market. If renters can't pay their rents, you could see some stresses among smaller landlords and among the companies that own rental properties. And again, that can translate to the potential for less investment in those types of properties.

I think that overall, the concerns that were raised in this question about what types of investment are we going to see in rental housing seems to be pretty well founded, though it could take some time to play out. And I guess that an open question would be what policy offsets could there be? Something potentially through like, the Community Reinvestment Act or will there be some tax incentives to support the affordable rental housing market? Those would be some important offsets to offset some of the economic forces that are likely going to be at play over the medium term here.

Lisa: Yeah, thank you again Ed. All right, I'm going to try to get a few more questions and I know we're coming up on time. "If you have not done so, do you plan to conduct a similar survey on how private firms would change their ways of doing business? Given that the pandemic has made some seek other alternatives probably equally effective and certainly more cost-effective?"

Ed: Yeah, good question. And so honestly, we've been more focused on the consumer side of things in part because there's some tie-ins to our interests in inflation for the Center for Inflation Research. This Consumers and COVID survey actually started in the Center for Inflation Research and we were thinking about how do consumers form their expectations for inflation and then very quickly, the pandemic started to happen as we kind of shifted gears. A lot of the survey has been focused on the consumer side of things, but I think it's a great suggestion.

Lisa: Yeah, and I do want to put a plug in. It's not quite exactly what this question was suggesting, but we do survey businesses pretty regularly through the Beige Book to see kind of what is occurring in their business. If you haven't seen that, the Beige Book is also on our website. There was a question about fintech. "What sort of fintech tools can the Bank deploy to more effectively evaluate creditworthiness of small businesses in order to help them receive the lowest possible rates on loans?"

Ed: Hm, good question. And honestly, a little bit afield from my normal wheelhouse. I'll be a little bit careful in terms of what I say. It's a great time to be working with big data nowadays. And so certainly, machine learning, artificial intelligence with big data sets, it really opens up lots and lots of opportunities. There's tons and tons of data out there. And so it's really a question of how do you work with these big data sets and how do you leverage them to answer important questions and important issues that are related to the outlook and to policy. I guess that would be my starting point—how can you leverage big data techniques to try and address these types of questions? But honestly, I would have to defer to the experts on fintech and people more on the finance side of things than I am.

Lisa: All right, thank you Ed. Thank you for your presentation, it was very informative. And thank you for taking so many different questions and giving us your best responses.

I know there's a lot of interest in the *Economic Commentary* that you mentioned related to the survey that you're doing. We can certainly provide that information when it becomes available and we can include it in information that we put on our website.

If there's any other information that we referenced today that we think would be useful, we'll also include that in the follow-up to the session today. I do want to thank everybody for participating today and for joining us.

Thank you for the good questions that we had. I hope that you felt that you got some good information that you can take away. And I will refer everybody to the clevelandfed.org website. There's lots of really good information about lots of work that we're doing, particularly with the work we're doing on the response to the COVID-19 pandemic. [We have] more information on the survey that Ed referenced as well as our work on the Program on Economic Inclusion that I mentioned at the beginning. I hope that everybody has a wonderful day. Thank you.