The Outlook for 2021 Nationally and Locally

Philadelphia Business Journal Economic Forecast
Philadelphia, PA (virtual)

January 7, 2021

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Good morning! It's great to be here … at least in some form. I'm hopeful that the next time we convene it will be in 3D.

And happy new year! After the year we just had — filled with tremendous loss, pain, and dislocation and disunity in our nation — I and my colleagues at the Fed recommit our efforts to serve the Third District and the country in order to build a strong and inclusive economy, an economy that works for all Americans.

My plan for this morning is to share a few thoughts on where the national economy is now and where it's headed. Given that this is a Philadelphia audience, I'll then offer some thoughts on the outlook for our region. After that, we'll open things up for a Q&A, which I'm really looking forward to. I will especially welcome the hard questions, such as "What became of our Eagles this year?"

But before we proceed, I need to give you my standard Fed disclaimer: The views I express today are my own and do not necessarily reflect those of anyone else on the Federal Open Market Committee or in the Federal Reserve System.

The State of the Virus

Now, it's no secret that the economy has been profoundly affected by the same scourge that has kept us physically apart today: COVID-19.

When you're looking for a house, a realtor will tell you what the three most important things are: location, location, and location. And when you're talking to a Fed president, he or she will tell you that the three most important things affecting the economy are: the virus, the virus, the virus.

So, let's begin with where we are with COVID-19, given that the virus itself — more than anything else — is determining the trajectory of the economy.

In the space of about a year, the virus has infected more than 85 million people around the world and killed more than 1.8 million. In the U.S., the death toll has now surpassed 350,000. The math is stark: With 4 percent of the world's population, we've suffered 20 percent of the world's fatalities. Certain communities have borne the brunt of the virus more than others, with racial minorities both becoming infected with the coronavirus and dying at higher rates than White Americans.

While the number of infections and deaths fell during the warmer months, cases have been on the rise since September. And deaths, a lagging indicator, are tragically now even more voluminous than they were during the first wave of COVID-19 last spring.

It's truly impressive that several pharmaceutical companies were able to develop highly effective vaccines for COVID-19 at warp speed — a real tribute to modern ingenuity. But what matters more than vaccines is *vaccinations* — that is, getting needles in people's arms.

There, our country's performance has been incredibly disappointing so far. Fewer than 5 million people have received their first dose of the vaccine — less than 2 percent of our total population. In Israel, by contrast, they've managed to distribute the first dose to more than 15 percent of the country's population.

The State of the National Economy

COVID-19 has been utterly determinative of the U.S. economy's performance, both as local governments impose measures to curtail the spread, which depress economic activity, and as consumers change their behavior to protect themselves and their loved ones. The latter is a crucial point that sometimes gets lost.

But the bottom line is this: If people don't feel safe, they won't engage in the broader economy.

And so, even before state and local governments took action last spring, many Americans had stopped dining out, getting on airplanes, and boarding public transit. That's a trend that has continued throughout the pandemic. Many local governments have introduced measures to curtail indoor restaurant dining. But even before that, data that we look at here at the Fed showed that people had begun dining out less.

It isn't surprising then that the economy has largely tracked the spread of the virus. In the second quarter of last year, as the U.S. endured its first wave of COVID-19 and as state and local governments implemented various shutdown measures, the U.S. experienced its worst quarterly GDP drop in recorded history. The economy contracted at an annualized rate of nearly 32 percent; 22 million jobs evaporated. Those with low-wage jobs, particularly racial and ethnic minorities, were the hardest hit.

Following that contraction, the economy rebounded quite nicely. Stay-at-home orders were lifted, and millions of Americans returned to their jobs. Indeed, a little more than half of those 22 million residents who were suddenly out of work earlier in 2020 are now back, enough to nudge the unemployment rate down from 14.7 percent in April to 6.7 percent today, which is still far too high, especially because the headline number masks the millions of Americans who have simply dropped out of the labor force. It's also troubling that the ranks of the long-term unemployed have swelled.

Our country's economic tribulations, tracking the path of the virus, have wreaked havoc on people's lives. Since the onset of the pandemic, the Philadelphia Fed's Consumer Finance Institute has conducted several nationwide surveys of consumers about their financial situation.

Not surprisingly, last spring saw a huge surge in Americans facing financial hardship. But then, as cases declined in the warmer months and the economy reopened, things looked up. Between April and July 2020, respondents to the survey reported steady improvements. Increasingly fewer of those responding to the survey reported losing their job, experiencing declines in income, and having trouble making ends meet.

With the resurgence of the virus, those trends have turned sharply negative once again. While the latest survey found fewer respondents reporting job losses, they did report more income declines and increased concerns about their financial futures.

The hard times will be with us for a little while longer. On the national level, for now, I'm expecting the fourth quarter of last year to show modest growth, before a significant slowing in the first quarter of this year — possibly even negative growth. In other words, "happy new year" has a caveat.

The good news is that the weakness should stay relatively short lived — as we all hope COVID-19 vaccinations become more widely available. The recently passed $900 billion of fiscal support — while we can quibble over the details — should also help buoy the economy. I am optimistic that in the second half of 2021, the economy — and frankly, life — should begin to look much more normal. GDP growth should be strong in the second half of the year, and through 2022, before a light tapering in 2023.

The State of the Local Economy

Here in our area, the situation should look similar to the national picture, with slow to negative growth in the beginning of the year and a much healthier — in all senses of the word — second half of 2021.

Our region, for better or worse, tends to be roughly a middle-of-the-pack player when it comes to economic trends. We don't boom like some areas, but we don't bust like them either.

Local employment figures show that this trend has remained true during the COVID-19 pandemic. As of late last year, in Pennsylvania, year-over-year employment was down 7.8 percent, which is roughly in the middle of the pack among the states. In New York State, for instance, employment was down 11.2 percent, whereas it was down only 4.5 percent in Texas.

But of course those numbers mask vast gaps across different sectors of the economy within our region.

In the Philadelphia area, like in the rest of the country, the hardest hit sectors have been leisure and hospitality and education and health services. In leisure and hospitality alone, nearly 100,000 jobs have been lost in the Philadelphia MSA since March. The upshot is that year over year, about 30 percent of total employment in that sector has evaporated — a stunning decline. In education and health services, meanwhile, nearly 30,000 jobs have been eliminated since the onset of the pandemic.

Manufacturing, by contrast, has held up relatively well, with employment down less than 5 percent. Output in manufacturing has remained strong as well, with activity at or above pre-pandemic levels. And given that employment has declined slightly in manufacturing and output has not, this means the sector has figured out ways of being more productive during the pandemic.

The Coming Recovery

I expect that, as we recover, the economic picture will remain uneven, with wildly unequal outcomes across sectors of the economy. There's a strong chance that consumer habits will have changed long term, even when we've finally rid ourselves of COVID-19. That will have significant impacts.

With the boom in videoconferencing, for instance, business travel could remain depressed indefinitely, placing stress on hotels and restaurants. Americans may have become even more addicted to online shopping, harming the physical retail industry. And higher education — my old industry — faces major threats not only from changes brought on by the pandemic, but also from the country's demographics. The traditional college-age population has actually begun to decline.

All of these changes would in turn have knock-on effects to other sectors of the economy, like commercial real estate. And a downturn in commercial real estate would, of course, affect the financial industry … et cetera, et cetera.

Automation represents another challenge. Researchers at the Philadelphia Fed have found that many of the jobs that the pandemic eliminated may never return — even after the virus has passed. They will instead be automated. To take an example near and dear to all of our hearts, the Pennsylvania Turnpike has switched permanently to automatic tolling — a change that was initially spurred by the onset of the pandemic and the need to promote social distancing.

Today, I'd like to challenge all of us to think hard about ways to make sure the coming recovery is not only strong, but equitable.

And that's a subject I would be happy to address more during the Q&A, as the Philadelphia Fed is working on a number of important projects. It's my firm belief that, as we emerge from this tragic period, we can seize many opportunities to build the society we all want.

So, thank you, and happy new year once again. Now let's open this up for discussion.