

Building a Healthy Long-Term Economy

2016 World Class Summit: 10 Years to 2026

Economy League of Greater Philadelphia

Philadelphia, PA

July 13, 2016

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President and CEO
Federal Reserve Bank of Philadelphia



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OF PHILADELPHIA

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Introduction

Good evening. It is a pleasure and a privilege to have the opportunity to engage with the distinguished gathering of professionals and leaders represented here at tonight's 2016 World Class Summit.

Thank you, Steve Wray and Chris Chepel, for the invitation. And thank you, Bill Rhodes, for that generous introduction.

Tonight I am here as both a Federal Reserve Bank president and a lifelong member of this community. I was born and raised in New Jersey; spent many years at the University of Pennsylvania as a student, an academic, and an administrator; headed to Newark to serve as president of the University of Delaware; and now I am back in Philadelphia at the Fed.

I drive home every day to South Jersey and plan to remain in the area long after the year 2026. So, when I am asked to speak about how we can best ensure a bright economic future for this region 10 years from now, not only do I think about this question professionally, but I also think about it on a very personal level. I am always looking for answers to this question. I look for answers in the data I pore over every day. And, I look for answers in the stories I hear from the people I meet throughout the District.

I often reflect on a visit I made last October to the YouthBuild Charter School, where I met a number of young people who had previously dropped out of school. Through this program, they were earning their high school diplomas while training for jobs in construction and retail. In the hours we spent together, these young people shared stories about their hopes for the future. They were remarkably clear about the barriers and hard work they faced to get back on track. They were also very aware of how they were benefiting from this fantastic program as well as the passionate teachers and administrators who were there to keep their focus on the long term.

There is no doubt that these students embody a quintessential Philadelphia quality that I think is undervalued but incredibly important — grit. University of Pennsylvania Professor Angela Duckworth defines “grit” as perseverance and passion for long-term goals. Her research says the smartest of us aren't necessarily the best at our jobs, the best students, the greatest innovators, or even the most successful professionally. People with grit are those who

stay focused on the long term even when things aren't going perfectly in the "right now." They achieve difficult goals. They don't necessarily learn quickly or easily. They work really hard and consider life a marathon rather than a sprint.

In August, the YouthBuild students who I met last fall will be graduating. Some will go on to college, and others will find jobs in the industries for which they have trained. They will become an important part of our economy in the next 10 years. The path they have taken, and the character they have shown, will be assets that our economy needs and can use to grow.

The people of the Greater Philadelphia region embody grit — this is who we are. But how do we translate the grit that defines us into a stronger workforce that will be the foundation for a stronger economy?

My talk tonight will focus on this topic as it relates to our region's long-term health. But before we get there, I think it best to start with a look at our current economic landscape. I must offer the following disclosure: My remarks today reflect my own views and not necessarily those of my colleagues on the Federal Open Market Committee (FOMC) or in the Federal Reserve System.

Economic Overview

For the most part, economic fundamentals appear to be solid, personal income growth has been healthy, job growth continues — albeit with some volatility — at a healthy pace, and there has been a modest increase in equity prices and continued steady growth in home prices.

Additionally, consumers appear fairly confident as measured by various indices of consumer sentiment, and household balance sheets are in good shape. These solid fundamentals have contributed to a healthy pickup in consumption with a growth rate that is likely to accelerate to a bit above 4.0 percent in the second quarter. As a result, it appears that GDP is growing above its trend rate, reversing what was a weak first quarter in which GDP grew at a mere 1.1 percent.

However, I believe that part of the first quarter weakness was largely due to seasonal adjustment problems with measured GDP. An alternative measure of economic activity produced at our Bank, called GDPplus, indicates that the economy grew at 2.3 percent in the first quarter. Using that measure as my guide, the U.S. economy appears to be on fairly firm footing this year.

Based on recent data, I anticipate that we will see growth of about 2.0 percent in 2016, increasing to roughly 2.3 percent in both 2017 and 2018. However, there are some risks to my fairly optimistic forecast.

Some of those risks are reflected in the recent volatility in job growth. The latest employment report largely arrests the concerns that arose from the exceptionally weak job numbers in May, but it remains to be seen which of the latest two reports better represents the true state of the labor market.

I think the best way to view the recent data is to average through it, which implies a gradual tapering in employment growth to a rate that is still considerably above that which would imply no change in the

unemployment rate. Given the maturity of the recovery, I anticipate that employment growth will gradually slow to a more sustainable pace consistent with maintaining our low level of unemployment.

Viewing the jobs data in this way is consistent with other labor market evidence. Job openings remain at historic highs, and the high level of the quits rate indicates that workers feel fairly confident in their ability to change jobs.

Further, wage growth has been increasing steadily. Over the past three months, average hourly earnings have increased at a 2.5 percent annualized rate. Also, contacts in our region indicate that they continue to search for workers but that finding those workers with sufficient skills is getting increasingly more difficult. Nevertheless, the disconnect between the labor market and economic activity is puzzling.

The first quarter saw strong employment growth and perhaps fairly weak output growth, while the current quarter is witnessing a weakening in employment growth just as economic activity is accelerating. That behavior is creating uncertainty for both forecasters and policymakers, myself included.

Other areas of concern are the manufacturing and energy sectors, which continue to struggle, although there have been some signs of recent improvement. Regional contacts appear a bit more upbeat than they were a few months ago, but the durable goods part of the market is still having a rough time. The data on core orders in April and May also do not point to any near-term strength in investment. Finally, there is the uncertainty surrounding Brexit, which may provide additional headwinds to an already struggling manufacturing sector, and further appreciation of the dollar could result in declining net exports.

That said, Brexit is low on my list of risks, and I do not anticipate more than a transitory couple of 10ths of a percentage point slowdown in growth.

On the inflation front, there are signs of firming as the dollar has stabilized, and oil and gas prices have risen substantially. Consumer price inflation continued to firm this quarter with core measures approaching the FOMC's target of 2 percent. Given these observations, I believe that inflation will return to target sometime next year. Considering the economic projections, I anticipate that it may be appropriate for up to two additional rate hikes this year and that the funds rate will approach 3.0 percent by the end of 2018.

Growing Our Human Capital

Now, let's look a little closer to home. Philadelphia's economy is heating up. Job growth in the metropolitan area began outpacing U.S. job growth this year, which is not the norm. More important, Philadelphia's growth is beginning to keep pace with that of other comparably sized U.S. metropolitan areas.

Employment is up in nearly every sector, and the jobless rate has risen somewhat in recent months, which reflects, in part, that more people are joining the labor force due to greater job opportunities. Still, the average over the past five months is comparable with that of the nation's. Moreover, we anticipate that the recent rise will soon reverse and that much of the rise will be smoothed away with next year's revisions.

While housing remains sluggish in Pennsylvania as a whole and in outlying areas of the Philadelphia metropolitan area, growth has been dramatic within the City of Philadelphia. As in other large cities, the surge in development

and redevelopment of housing, plus the growth of new office space, has been accompanied by commercial and mixed-use projects, which are especially appealing to millennial workers. We know that in order for us to continue on this path, productivity growth is essential.

There are two general ways productivity growth can be achieved:

1. Through the development of better technologies that improve our ability to produce existing products or entirely new products, and
2. By improving the skills of our workforce. Doing so will lead to workers earning more (and spending more) as well as producing more.

Both tactics highlight the necessity of building human capital.

Keeping this momentum will require us to make some targeted human capital investments and explore new ways to meet old challenges. In the time we have, I would like to highlight a few areas where I think we have some work to do as well as some of the promising strategies that are in play.

I'm sure it is no surprise to you that I believe one of the answers lies in securing a solid education system that begins with pre-K for all children. The Economy League of Greater Philadelphia and other organizations across the state worked diligently to make the case for Pre-K for PA. And our economy will reap the benefits of this work down the road.

Having spent most of my career engaged in academics, I have found that it has become even more apparent over the past year working at the Fed that the foundation for a well-trained workforce begins in these early days of school. These are critical times where character, self-esteem, and work ethic — the foundations of grit — are developed.

A solid education system, which includes pre-K, is something we must continue to work toward. Not only will it produce a pipeline of future Philadelphians with the grit to take on the hard work ahead, but it will also make us a more desirable place for skilled people to live.

Our researchers have studied the connection between having a solid school system in place and the positive economic impact this has on cities like Philadelphia, where young, educated people choose to build their careers and raise their families.

As a former college president, my next point may sound controversial. Not everyone is going to be college-bound, and that's OK. College is not for everyone. But what is not OK is that our region has 106,000 disconnected youths, young people who are not in school or not working.

This growing figure points to the critical need for a training system in our region that is more agile, one that meets the needs of those at various skill levels. That is how we will give more of our young people a path toward success.

In addition to these disconnected youths, there are many young people who start and never finish college. Why is this?

It could be that the average high school curriculum is not rigorous enough to prepare youths for college. Or maybe it's that many students who pursue college do not feel — rightly or wrongly — that the average curriculum is helpful for future employment.

I pondered this daily as an academic leader and now as a Fed president because this college completion rate decline leaves our economy with young people saddled with school loan debt, without a degree, and no higher paying job to pay off this debt.

As an economist, I see a growing mismatch between what our education sector offers to students and the skills and training our business sector increasingly needs. This disparity — if left unattended — will have a *significant* impact. So, what can we do?

As a region, we must focus on creating a training system that is more agile, one that works in real time for our industries in need, our disconnected young people, and our long-term economy.

I had the pleasure of taking Federal Reserve Chair Janet Yellen on a tour of Philadelphia a few weeks ago. She was interested in hearing more about employment efforts that are working here in the city. On our drive through West Philadelphia, we had the opportunity to visit clients at the West Philadelphia Skills Initiative (WPSI).

In this program, anchor institutions work with and through a local nonprofit organization to identify future job openings and train local residents to fill these positions. I believe the partnerships that help to build these kinds of collaborative, innovative programs create a more agile labor market. These programs benefit the individual jobseeker, the employer, and ultimately, the economy.

We are also exploring other areas including apprenticeship programs. These programs combine study with on-the-job training and have been shown to have a sizable impact on the lives of workers and the economy in other parts of the world. So far in the U.S., we have had some limited experience, but there are huge opportunities to expand these programs.

In an assessment and cost-benefit analysis of the Registered Apprenticeship program in 10 states, Mathematica Policy Research estimated that, on average, those who complete one of these registered programs can expect to be compensated nearly \$300,000 more over their lifetimes — including benefits — than those who do not. We can and should find ways to expand these programs in our region.

The Delaware Valley chapter of the National Tooling and Machining Association plans to develop an apprenticeship program in precision machining. In May, the Fed's Community Development Studies & Education Department organized a meeting in which the program was introduced to workforce and manufacturing leaders in Philadelphia.

Attendees included representatives from Philadelphia Works, Inc.; the Community College of Philadelphia; the School District of Philadelphia; and three local manufacturing organizations. What came out of this meeting was a genuine interest in working together. Our partners are now exploring ways in which we can work with a local high school to possibly use their facilities to grow these programs.

Here again is a training system that meets the needs of manufacturers in our region who can't find skilled employees. And for the unemployed and underemployed, it provides good-paying jobs and long-term careers. We need to be creative and look for ways to boost this model in the areas of technology and other sectors to capture the imagination of young workers and to provide the training and skills they need.

Collaborative Leadership Is Key

The late John W. Gardner once said, "When an institution, organization, or nation loses its capacity to inspire high individual performance, its great days are over."

Our efforts to strengthen the region's human capital are important ways for us to ensure that our great days are ahead. It is through collaborative leadership — like that demonstrated by the Economy League and its World Class Greater Philadelphia Agenda — that our region can think critically and act decisively on behalf of our region's economic future.

The Economy League — and nearly 2,000 regional businesses, nonprofits, government, labor, and community leaders — are improving education and talent outcomes in our region, boosting business growth, and making our infrastructure more effective and reliable. It is through such efforts that we will make sure there are skilled people to hire when our region's projected 3 million square feet of new office and mixed-use space is ready. *We must* deliver on the challenge of having the resources, vision, and leadership to make full use of our District's potential.

The Philadelphia Fed stands ready to partner with you in this effort. This year, we created a new council, made up of both for-profit and nonprofit leadership, with the purpose of working collaboratively to address the critical issues impacting our region. Over the next year, we will be working with the council on key issues, including human capital, to identify ways in which the Fed can better leverage its research and facilitation resources to strengthen our economy.

We are ready to work toward our shared goal of fostering human capital needed to build this region today and tomorrow. My expectation is that this collaboration will yield impacts for the region for years to come.

When I think about all we are discussing today, I picture myself opening up the *Philadelphia Inquirer* in 2026 and flipping to the business section — and, yes, I believe I will still be reading a paper publication in 2026. I also believe that, if we stay focused, I will be reading about the fruits of our labor.

And please, let there be a big Carson Wentz profile on the cover of the sports section about his early retirement after multiple Super Bowl wins for the Eagles. Or even just one!

But seriously, what will get us through tough and unpredictable times — with limited fallout — is the grit and agility we start producing today. The investment we make in human capital will position us for a healthy tomorrow.

Thank you for your time.