The Economy, Inflation, and Housing

Economic Club of New York

New York, NY (virtual)

November 8, 2021

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President and Chief Executive Officer
Federal Reserve Bank of Philadelphia

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Hello! It's an honor to be here today to talk a little bit about our country's economic outlook, Federal Reserve policy, and some recent research on housing that I think will be of particular interest to this group. I've long wanted to have a conversation with all of you at the Economic Club of New York, though I must admit that when I used to envision it, I thought we'd be doing it in 3D. Soon enough, I hope.

I'm really looking forward to our dialogue — especially the fireside chat and Q&A after my prepared remarks — but before I begin, 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 (FOMC) or in the Federal Reserve System.

The State of the Recovery

At the beginning of the pandemic, I was often asked what "shape" the recovery would take. Would it be a "V?" An "L?" A "U"? More often than not, I liked to say it would look a little bit like a "Nike swoosh" — a sharp decline followed by a gradual upward climb.

If I could amend that prediction today, I would put it this way: Our recovery looks like a Nike swoosh drawn by somebody who has had one too many cups of coffee — i.e., me on many workdays. We're climbing undeniably upward, but it's a jagged path. And our turbulent recovery has been shaped largely, as so much has, by the path of COVID-19.

Consider this: The second quarter of 2020 saw our economy's sharpest contraction on record as COVID-19 reached our shores. This, of course, was largely *intentional* as states shuttered businesses and schools and ordered citizens to stay home in a bid to contain the virus. We put our economy, effectively, into a medical coma.

The economy jolted quickly awake that summer as states reopened and a large dose of fiscal relief was injected into American households and businesses. But then last winter's tragic COVID-19 surge ensured the economy went sideways. This was followed by another growth spurt earlier this year as vaccines were introduced and COVID-19 rates plummeted. And then the Delta variant showed up and, once again, growth slowed markedly.

So in 2021, GDP growth in the first half of the year was around 6½ percent, while the second half will be significantly slower. I expect the full year to come in around 5½ percent. Next year, if another major COVID-19 wave can be avoided — and I think it can, given widespread vaccinations and natural immunity among those who've recovered from the virus — we should see another growth spurt to more than 4 percent before the economy returns to something approaching trend growth of 2 percent to 3 percent in 2023.

The economy is continuing to recover, in other words. But it is doing so under constraints.

Constraints

The first constraint is a lack of *people* — labor. Despite very robust jobs gains in October, the U.S. economy has still created many millions of jobs in recent months that haven't been filled.

Job openings, sitting around 10 million, are at near-record highs, running at double their long-term average. So is the rate at which Americans are quitting their jobs.

Layoff rates, meanwhile, are at series lows. And those people who *are* working are putting in longer hours and commanding higher wages; average hourly earnings are up more than 4½ percent from 2020.

It seems that a combination of factors — trouble accessing childcare or eldercare, lingering fears about the virus, the rise in equities and home values spurring people to retire, and perhaps a general revaluation of life choices — is persuading many Americans to stay on the sidelines even as the economy has reopened. And notably, the elimination of extra federal unemployment benefits has not — at least not yet — appeared to nudge people back into the workforce. I do expect that will change eventually and especially as other forbearance programs run out. There is also a spatial-geographic component to unfilled jobs, which I will discuss further when we get to housing issues.

The other constraint hampering economic growth is a lack of *stuff*. Supply chains are badly hobbled, leading to shortages of everything from new vehicles to home appliances to chicken wings.

Manufacturers curtailed production as the pandemic set in and are now working furiously to ramp up — but it's taking time. And this is occurring as demand is very strong because household balance sheets are in such good shape.

The result of this equation — a lack of goods coupled with high demand — is, of course, inflation. And indeed, inflation readings are now at 30-year highs; core inflation was up more than 3½ percent from a year ago in September, and headline inflation was up nearly 5½ percent.

Moreover, inflation is more widespread across products and services than it was earlier this year. In the third quarter, nearly three-quarters of spending on goods and services in the CPI "basket" was on goods that displayed annualized inflation of more than 4 percent; in the second quarter, that was true for only a little more than a third of the goods and services that comprise the basket.

I am acutely aware that this period of rising prices is painful for many Americans. But I do expect inflation to moderate next year as supply chains come back online and bottlenecks ease.

With economic growth chugging along and job creation — if not job *filling* — so robust, the FOMC announced last week that we will begin tapering our purchases of mortgage-backed securities and Treasury bills by $15 billion a month. I don't expect that the federal funds rate will rise before the tapering is complete, but we are monitoring inflation very closely and are prepared to take action, should circumstances warrant it.

Renters

One thing I've noticed in my travels is that when you're in Los Angeles, you always end up talking about the traffic — how it was bumper to bumper on the 405 or the 101. When you're in Philadelphia, meanwhile, you always end up talking about the Eagles — although, let's please not do that today … it's too painful.

And I've also found that whenever you're in New York, you end up discussing housing, and specifically housing *costs*. Which is why I'm delighted to share some recent research from the Philadelphia Federal Reserve about this most important topic. One of the pleasures of my job as a Reserve Bank president is talking about all of the pathbreaking research we do *besides* that which is directly related to monetary policy.

I'd like to begin with renters, who often get short shrift in our national political conversation, despite making up more than 35 percent of all Americans — and disproportionately higher numbers in big cities like Philadelphia and New York.

At the beginning of the pandemic, Congress passed a moratorium on evictions. This, in a way, functioned like mortgage forbearance; with evictions no longer a risk, many Americans who were struggling stopped paying their rent either partially or in full. And while the eviction moratorium did, thankfully, prevent people from losing their homes, those rent payments didn't go away — they became debt owed by the tenants.

Researchers at the Philadelphia Fed have been tracking rental debt to understand which households are burdened and how significantly. This is especially urgent now that the eviction moratorium has expired.

This month, our economists project, roughly 1.9 million households carry COVID-19–related rental debt, or about 6 percent of all renter households. And they carry an average debt of nearly $9,000 — a severe burden for unemployed or underemployed households.

Congress has made aid available to many renters who are struggling, but there have been persistent problems throughout the pandemic in getting that vital support into the hands of those who need it the most.

As part of our understanding of how the pandemic is affecting people on the ground, the Philadelphia Fed has been conducting a series called the *CFI COVID-19 Survey of Consumers*. And those surveys have consistently found that many renters are, unfortunately, simply unaware of the aid that they qualify for or how to go about obtaining it. As of last month, roughly 43 percent of renters who say they require assistance had not applied for it. Clearly, this is a problem: No matter how well intentioned or well designed a program is, it can hardly be judged a triumph if nearly half the people who would benefit from it are not partaking in it.

As we emerge from the pandemic, I would also urge policymakers to not only make sure indebted households have access to the funds intended for them, but also to think creatively about ways to reduce rents, including reforming zoning regulations to induce more residential construction.

There is evidence, in fact, that high rents may be affecting the labor market and hindering efforts to get us back to full employment. That's because many workers can't afford to live where jobs are. It's tough to ask somebody to work in a restaurant in San Francisco, for instance, when the nearest place with affordable housing may be in, say, Fresno. This not only hinders attempts to fill jobs, but, ultimately, it degrades the economic performance of areas with expensive housing. Expensive metro areas are not achieving their full economic potential because millions of would-be participants simply can't afford to be there.

Homeowners

Now, I'd like to turn to homeowners. As I'm sure this audience is aware, the CARES Act provided for mortgage forbearance, allowing borrowers to stop paying on their houses for up to a year and a half.

Earlier this year, my colleagues at the Philadelphia Fed set out to answer two central questions about this program. First: What is the extent of racial and income disparities among mortgage borrowers in nonpayment on their mortgages, and how has the pandemic affected these disparities? Then, they wanted to find out who took up forbearance on their mortgages and who missed this important opportunity.

Because the CARES Act mandates that borrowers in forbearance who aren't paying on their mortgages still be reported to credit bureaus as if they are paying, these turned out to be surprisingly tricky questions to answer. But through some quite clever methods — my Philadelphia Fed colleagues are nothing if not ingenious — the researchers were able to suss out the data.

Here is what they found: Between April and November 2020, an acute phase of the COVID-19 crisis, minorities' and lower-income borrowers' nonpayment rates were twice as high as for higher-income and White borrowers.

Even if we compare borrowers with the same credit score and the same loan type, Black and Hispanic borrowers have more than 30 percent higher rates of nonpayment, and lower-income borrowers, 50 percent higher. Moreover, and importantly, these disparities largely *did not* exist pre-COVID-19.

In a sign that the CARES Act was effective, my colleagues found that minority and lower-income borrowers took up forbearances at significantly higher rates than other groups.

The rub, of course, is that under the CARES Act and subsequent extension from the Biden administration, forbearance lasts only up to 18 months, meaning many borrowers will be coming off of it by the end of the year, which is also when temporary protections against foreclosure are set to expire.

That's concerning, given that as of mid-October, about 15 percent of people who went into forbearance in the first place are still in it — an estimated 1.1 million borrowers. And as with rental debt, those missed payments just didn't go away. They are now additional debt burdening households who went into forbearance.

The good news is that most of the 8 million or so households that took forbearance during the crisis have fully recovered. Due in part to the booming housing market, which has seen a 20 percent gain in house prices nationally since the onset of the pandemic, more than two-thirds of households came out of forbearance and are either current on their mortgages or have paid off or refinanced them. Borrowers still unable to resume full payments are being offered payment reductions to the tune of 20 to 25 percent. While it is still early, some borrowers in need of assistance have started to take advantage of these home-retention programs.

Still, about 20 percent of borrowers are either still in forbearance or are now delinquent. Banks, meanwhile, report being unable to contact many borrowers who have stopped paying to work out new terms.

That presents a challenge to borrowers first and foremost, of course, but also to lenders given the expense and hassle involved in foreclosure.

Keeping people in their homes isn't only vital because of the first order issue of shelter — it's also crucial to wealth building. A person's house may be their castle. But in many cases, it is also their savings account. This is, in part, because homeowners can borrow against their home's value to boost their lifetime earnings and capital gains. Here, there is a silver lining to the current economic environment; whereas during the Great Recession, nearly half of distressed borrowers were "underwater," meaning their mortgage was larger than their home's actual value; today, only around 2 percent are.

The nation's racial wealth gap owes much to both unequal rates of homeownership among groups and among disparate housing values — often a legacy of direct government policy. Using a series of geospatial maps, Philadelphia Fed researchers have found that properties with covenants within the city of Philadelphia from 1920 to 1932 formed an invisible barrier to less densely populated areas sought after by White residents and around predominantly White neighborhoods throughout the city — and that those effects are still visible a century later. This too is an issue that will require deliberate policy action to redress.

Ultimately, we must all work to make sure that all Americans can build wealth and participate fully in the U.S. economy — and housing policy is a big part of that.

I'm eager to discuss this and much else besides during our fireside chat. And for more information on this and other research, please do check out our recently redesigned website: philadelphiafed.org.

Thank you again so much for having me. And now let's move on to the discussion.