Economic Outlook for Delaware and the Nation

Delaware State Chamber of Commerce
Philadelphia, PA (virtual)

April 6, 2022

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President and Chief Executive Officer
Federal Reserve Bank of Philadelphia

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Hello! It's great to be here again for what is becoming an annual tradition. I'm very much looking forward to today's conversation. I plan to discuss the economic outlook, monetary policy, and a bit of research on housing from the Philadelphia Fed. And then we can have an open discussion.

And now for another tradition: the 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 Economy

When I addressed this group almost exactly a year ago, I called the economic recovery, both nationally and here in Delaware, a "work in progress."

I think that still holds. Economic growth and employment are robust, but I'm very concerned about inflation.

Let's begin on the positive side of the ledger.

In the fourth quarter of last year — coinciding, at least in part, with the Omicron surge — national GDP grew at an annualized rate of 7 percent, with strong inventory investment and healthy demand for capital goods. For the totality of 2021, U.S. GDP growth was a very healthy 5.7 percent. That this occurred in the midst of a deadly pandemic is quite a testament to the underlying strength of our economy.

Job growth, a key component of the Fed's mandate, remains robust. For 11 straight months, new job creation has topped 400,000. But if you think that has led to a decline in Help Wanted signs, you're wrong. Even with all this job creation, vacancy rates remain elevated, at a near record.

Nominal wage growth — as one would guess given these conditions — has been strong, though lately it has not been keeping up with inflation. Labor participation rates are edging up as well, though they remain below where they were before the pandemic. I suspect that the waning of the virus — at least here in the United States — as well as uncertain equity markets and even inflation may lure people back into the workforce and persuade others to delay retirement. The unemployment rate, which is below 4 percent, should continue to fall this year.

In Delaware, the recovery continues apace.

The unemployment rate is nearing pre-pandemic levels, overall gains in payroll employment have been steady, labor market conditions are tight, and the housing market remains hot. Consumer traffic to workplaces and other nonresidential locations has increased substantially, though transit use remains almost 40 percent below where it was prior to the pandemic.

Total employment in Delaware is now about 14,000 jobs below where it was when the pandemic struck. Job openings were at a historic high in January, the quits rate remains elevated, and layoffs are very low. Employment in financial services is where it was prior to COVID-19's arrival, while leisure and hospitality employment remain somewhat depressed.

A persistent problem in getting more people back into the labor force is the high cost and low availability of child care. The problems are acute here. To cite just one statistic, Delaware families spend about 20 percent of the median household's income to care for one child, an unsustainable burden.

Many of you are probably aware of the work that the Philadelphia Fed and the Delaware Chamber have been doing on this important issue, and I'd be happy to discuss this further during our Q&A.

Inflation

Inflation is running far too high, and I am acutely concerned about this. The consumer price index (CPI) was up 10 percent annualized in February, led by another significant increase in energy prices. Over the past year, CPI is up 7.9 percent.

Core CPI, stripping out energy and other volatile indicators, remains very high as well, with 6.2 percent annualized growth in February. Russia's invasion of Ukraine will add to inflation pressure, not only hiking oil and gas prices but other commodities, like wheat and fertilizer, as well.

Delivery times remain elevated, and while there are some signs in the data, and in what we hear from our contacts, that supply chain constraints are finally easing, we are not out of the woods yet. In response to a new COVID-19 wave, China is instituting hard lockdowns in major manufacturing hubs, further choking supply.

Inflation is widespread. It is showing up throughout a vast array of goods that comprise the CPI "basket" — and among some of those that aren't in the basket.

The bottom line is that generous fiscal policies, supply chain disruptions, and accommodative monetary policy have pushed inflation far higher than I — and my colleagues on the FOMC — are comfortable with. I'm also worried that inflation expectations could become unmoored.

That is why last month we announced we were raising the federal funds rate for the first time since 2018. We raised our target by 25 basis points, and I expect a series of deliberate, methodical hikes as the year continues and the data evolve. I also anticipate that we will begin to reduce our holdings of Treasury securities, agency debt, and mortgage-backed securities soon.

With the runoff of pandemic support, tightening monetary conditions, and the war in Ukraine pressuring commodity prices, I think growth will moderate this year. We can probably expect 3 percent to 3.5 percent GDP growth this year before falling to trend growth of 2 percent to 2.5 percent during the next couple of years.

I do see the potential for a significant uptick in the service sector in many large cities that are only now waking up after a two-year pandemic-induced hibernation. Central business districts in cities like New York, San Francisco, and Philadelphia should get a boost as more workers return to their offices — the staff of the Philadelphia Fed included. The rise of hybrid work may moderate the potential for a huge boom, however. There is a big question mark hanging over the future of commercial real estate.

Inflation should begin to taper this year too — but remain elevated, probably around 4 percent for 2022. The following two years should bring it back to our target of 2 percent.

All of these forecasts, of course, are freighted with uncertainty.

Housing

Now, before we move to the open discussion, I'd like to turn to housing, which comprises a huge and vitally important sector of the U.S. economy. With a fairly weak public social safety net, for Americans, houses are not only their shelters — they are a significant source of their household wealth and retirement savings as well.

In general, the housing market is largely healthy; if anything, it's not keeping up with demand.

Housing starts are robust, but inventories are low and price growth is strong. Policies that make construction arduous in certain states and municipalities continue to impede efforts to meet demand. That degrades overall economic performance, because in many places, people cannot afford to live where the jobs are.

Now I'd like to turn specifically to mortgage forbearance, a subject of important research from the staff of the Philadelphia Fed.

As many of you will recall, at the outset of the pandemic, the CARES Act mandated that borrowers of federally insured mortgages be granted forbearances. To ensure widespread take-up, the law said borrowers could be granted forbearances by simply requesting it; they did not even need to prove hardship. The upshot was that homeowners could temporarily pause their mortgage payments without penalty and stay in their homes, without negatively affecting their credit scores.

The CARES Act also put into place a foreclosure moratorium, followed by temporary protections against foreclosure. Private sector lenders adopted the same practices.

Perhaps not surprisingly, as the pandemic began and the economy was shut down, Americans took this opportunity in droves. More than 8.5 million borrowers entered forbearance at some point during the pandemic — more than 15 percent of the total mortgage market.

That was then, though.

As of last month, the number of loans in forbearance had declined by more than 90 percent, down to around 680,000 mortgages.

So, what has become of the nearly 8 million households that entered forbearance and have since come out of it? Our researchers at the Philadelphia Fed have been tracking this and have made some important findings.

I'll begin with the positive news.

Nearly three-quarters of those who have exited forbearance have voluntarily paid off or are current, many making use of payment deferrals or loan modifications.

For borrowers able to resume timely payments, a deferral creates a no-interest subordinated lien out of their missed payments not due until loan payoff. Meanwhile, loan modifications offer lower interest rates and extend loan terms up to 40 years while offering payment reductions of 20 percent or more.

Moreover, our exceptionally strong housing market has kept home prices elevated.

While this has had undeniably negative impacts on those seeking to enter the housing market, it does ensure that borrowers can avoid losing their homes and that banks won't suffer losses large enough to meaningfully affect their capital positions. Homeowners are sitting on more than $10 trillion of tappable equity — a record. The contrast with the Great Recession is remarkable; you'll recall back then that nearly half of all distressed borrowers were "underwater."

Still, nearly 1 million mortgages are seriously delinquent, split evenly between those classified by servicers in loss mitigation and those not in loss mitigation. Most borrowers who remain seriously delinquent and not in loss mitigation never entered forbearance at all. Many were in nonpayment before the pandemic struck.

And of the borrowers classified as being in loss mitigation, three-quarters are still in process and have not, as of yet, resumed timely payments on their mortgages. Black and Hispanic borrowers have much higher shares of nonpayment — either being in forbearance or delinquency. Interestingly, just as the unemployment rate has returned to pre-pandemic levels, the number of delinquent mortgages has also returned to pre-pandemic rates.

Lenders may want to consider solutions that limit the costs of modification while providing more payment relief to borrowers. One such solution is for the Federal Housing Administration to offer 40-year modifications. This will lower the cost relative to the 30-year option and provide more relief to borrowers. The U.S. Department of Housing and Urban Development has proposed a 40-year mortgage modification for FHA loans, and we are currently in the midst of a 60-day comment period.

It's worth noting now that protections against foreclosure expired on December 31, 2021, and foreclosure starts are back to their pre-pandemic levels too.

I would like to say a couple of words about some research on mortgage refinances as well.

Refinance mortgage originations grew remarkably in 2020 in Delaware, New Jersey, and Pennsylvania — in fact, they vastly outpaced the growth in mortgages for new home purchases. A lot of that we owe, of course, to the extraordinary circumstances we found ourselves in that year: Mortgage interest rates fell to historic lows as the economy was shuttered, keeping people where they were.

But my colleagues at the Philadelphia Fed have found, while refinances were popular during this period, the growth rate for refinanced mortgages for Black and low- and moderate-income borrowers was only about half to three-quarters of the growth rate for borrowers overall.

What's instructive is that the lower rate of refinances was not solely because of higher denial rates, though historically those communities have been denied at higher rates.

Rather, our Bank researchers found refinance *applications* from Black and low- and moderate-income borrowers grew at a much slower rate than applicants overall. That suggests a need for improved communication from banks to Black and low- and moderate-income households. Unfortunately, many homeowners missed out on some significant savings they could have enjoyed if they had refinanced. We should think of ways to make sure these communication breakdowns do not happen again.

So, thanks again for having me. I'm sure the next time we convene, more progress will have been made. Now let's open things up for discussion.