Economic Outlook: The More Things Change

Mid-Size Bank Coalition of America
Philadelphia, PA (virtual)

May 18, 2022

Patrick T. Harker

President and Chief Executive Officer
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Hello, everyone! It's great to be back with this group that I last addressed about a year and a half ago. A lot has changed since we were last together, I will say! I'm looking forward to talking a little bit about the economic outlook, inflation, and monetary policy, and some recent Philadelphia Fed research on the job market. Then I will be glad to field some of your questions.

One thing that has *not* changed since last we met is 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.

While I was preparing for this meeting, I took a look at my notes from our last discussion. When I say things have changed a lot since January 2021, I think you'll see what I mean.

Then, 2 percent of the U.S. population was fully vaccinated against COVID-19. Today, 67 percent are, and highly effective new treatments for the disease have been developed as well.

Then, the national unemployment rate was 6.4 percent. Today, it is 3.6 percent, and there are 11.5 million unfilled jobs.

Then, we had just concluded a year in which inflation came in at 1.2 percent, well below the Fed's target of 2 percent. Today, we are dealing with annualized inflation of 8.3 percent.

Inflation

High inflation is a scourge, punishing low- and moderate-income families the most. Even though wages are rising, they are not keeping up with the pace of gains in the cost of living. This is an urgent problem.

Inflation is a result of two factors: supply and demand.

On the supply side, COVID-19 lockdowns — still ongoing in parts of China as we speak — have badly damaged supply chains. Semiconductors, present in everything from automobiles to washing machines, are hard to come by as factories have shuttered for extended periods and international ports have clogged. The unavoidable result of shortages? Higher prices.

Government policies — and I evince no position on whether these are wise on balance — have undeniably contributed to price gains. The U.S. government slaps tariffs on everything from Chinese-made televisions to Canadian lumber, spiking prices. Sanctions imposed on Russia after its tragic and outrageous invasion of Ukraine have reduced energy and commodity supplies. Unfortunately, I think elevated energy prices could be with us for a while. A two year “pause” in legal immigration has contributed to labor shortages. And housing costs are up, not just because of pricier materials and labor, but also because we are not building enough houses to keep up with demand. This is often a result of local government policies that stymie construction.

On the demand side, Americans have money to spend. Nominal wages are rising, thanks to our tight labor market. Fiscal policy pumped trillions of dollars into households during the worst periods of the pandemic. And accommodative monetary policy — that’s us — has kept the cost of capital low. Throughout the acute phase of the COVID-19 pandemic, we kept rates near zero and embarked on a major asset-buying program.

It should go without saying that, as a central bank, there is little the Federal Reserve can do to affect the supply constraints pushing up inflation. But we can affect demand — and that is what we have begun to do.

The tightening, at least as the market interpreted it, began last September, even before we began to move the federal funds rate or taper our asset purchases. My colleague Fed Governor Chris Waller pointed out in a recent speech that, after the FOMC’s September 2021 statement, which indicated as forward guidance that we would soon begin tapering our asset purchases, two-year Treasury yields

began to rise. Again, this was before we had actually taken any action; it was simply a result of our forward guidance.

The taper began in earnest last November and is now complete. We have also raised the federal funds rate 75 basis points since the start of the new year. Beginning on June 1, we will start to reduce our balance sheet.

Going forward, if there are no significant changes in the data in the coming weeks, I expect two additional 50 basis point rate hikes in June and July. After that, I anticipate a sequence of increases in the funds rate at a measured pace until we are confident that inflation is moving toward the Committee's inflation target. This will be dependent on where the data are. Because I can tell you this: One thing that has *not* changed since last January is the generally elevated level of uncertainty about our current economic path. Reality has a way of interceding — and at no time has that been more apparent than over the past two years.

Overall, despite a contraction in the first quarter, I expect growth of about 3 percent this year. Underlying demand growth remains strong, and the job market should stay tight through 2022.

The Job Market for Non-College Workers

Now I'd like to turn to the labor market and share some recent research from the Philadelphia Fed.

I'd like to begin by asking you to think back to what things were like before the pandemic. I know this can be a challenge — it certainly is for me.

In general, the economy was quite healthy before COVID-19 struck, with solid GDP growth and low unemployment. But those headline numbers masked serious problems, most notably in the labor market. Many prime age workers, particularly men, and especially men without college degrees, had dropped out of the labor force altogether — so they didn't show up in the unemployment data. Many more Americans were essentially "stuck" — they may have been working, but they had jobs with stagnant wages and minimal opportunities for advancement.

A big focus of ours at the Philadelphia Fed has been working to get more of these workers into what we call *opportunity occupations* — jobs that don't require a college degree and that pay above the median wage. We even developed an interactive tool called the Occupational Mobility Explorer, which demonstrates that many workers in lower-wage employment already possess the skills they need to transition to a higher-paying job with just a little bit of training. You simply input your job and your

metro area into the tool, and the Explorer suggests available career paths. A bill collector, for instance, could become a credit counselor and enjoy a significant bump in wages. I urge you to delve into the Occupational Mobility Explorer at Philadelphiafed.org.

In recent months, my colleagues at the Philadelphia Fed set out to answer another important question: How did the pandemic affect workers without college degrees?

Initially, of course, it was those workers who suffered the worst effects of the pandemic-induced recession. Workers without college degrees were less likely to be able to work from home and were more likely to work in industries that were shut down either by government order or because of COVID-19 outbreaks. The huge spike in unemployment we experienced in 2020 — at its peak, the unemployment nearly quadrupled — was disproportionately concentrated among those without college degrees and those in lower-wage work.

But what happened to those workers when the economy reopened?

By June 2021, job openings were at record highs as a variety of factors kept workers on the sidelines, even as consumer demand surged. Employers deployed all kinds of methods to lure workers. They, for instance, offered increased flexibility and training and bumped up starting salaries. These were favorable trends for workers.

Examining a data set of job postings, Philadelphia Fed researchers identified another trend favorable to workers without a college degree, in particular: The minimum level of education required in the online job market fell modestly, even after controlling for the postings' broad occupation and sector classifications. In other words, some job postings that before the pandemic might have required a college degree no longer did.

All told, compared with the five quarters preceding the pandemic, the five quarters following its onset included an additional 2.3 million "opportunity employment" job postings. You'll recall that these are jobs that don't require a four-year college degree and that pay at least the median wage. These additional postings can be attributed to both the greater volume of job postings for these types of jobs at 62 percent and the lower educational requirements, at 38 percent of the increase. Which is to say, a lot of job openings that might have been previously off-limits to someone without a college degree became viable options after the start of the pandemic.

This is clearly a salutary trend, and we should all be thinking of ways to build on it. Uncertainty, if nothing else, can breed opportunities to build a better economy that works for all Americans.

So, thanks again for having me back. And now let’s get to some questions.