On the Flight Path to the Soft Landing

Philadelphia Business Journal's State of the Economy
Philadelphia, PA

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Good morning, everyone, and thank you, Sandy, for that welcome and introduction.

My thanks to the *Philadelphia Business Journal* for bringing us together, and I must give recognition in absentia to Editor-in-Chief Ryan Sharrow for reaching out and inviting me to be with you.

I also must give thanks to City Winery for hosting us this morning. I do note with some disappointment that it is only 8:00 a.m., and we're at a winery. I know while technically it may be 5:00 somewhere, this may be a bit of a stretch.

And I also thank you all for coming out this morning. It is always a pleasure to not only see so many familiar faces but also to get to know new ones.

And no matter whether we are meeting today for the first time or just the latest of many, what excites me is that we're all here for the same key reason. We care about Philadelphia. With its diversity of peoples and opportunities, Philadelphia remains an economic driver and leader.

So, I am happy to be here to give you my sense of where we are and where I see us heading, as well as to highlight a few things we have going on down Arch Street at the Philadelphia Fed, which you may find of interest.

Before I go any further, allow me to get a piece of business out of the way at the outset — and that's the regular 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.

Or, in simple English, you can always say, "Pat said." You just can't say, "the Fed said."

Now, this year I sit as a voting member of the FOMC. At our meeting two weeks ago, I joined my colleagues on the Committee in voting to raise the policy rate another 25 basis points, to a range of 5¼ to 5½ percent — the 11th policy rate increase in the span of 12 meetings.

But you knew that. I bet what you want to know is what we are going to do next. Unfortunately, I do not know — it depends on what the data will tell us from now to our next meeting in September.

What I can tell you is where we stand now given past actions, what I expect to see in the data going forward, and whether I believe that we need to do more, or not.

Ten days ago, the latest PCE inflation report showed continued disinflation year over year on the headline measure and promise on the core measure. We are making progress against inflation. It has been slow progress, and I am watchful of any reemerging price pressures. We remain unwavering in our commitment to bring inflation back to target.

And this is indeed what I expect will happen. I expect core PCE inflation to decline to a rate perhaps just below 4 percent year over year by the end of 2023, before falling below 3 percent next year and leveling out at our 2 percent target in 2025.

While this economy may not be hewing to traditional modeling and seems to bend some rules in one place and make up its own in another, it continues to move along. I forecast unemployment to tick up slightly and better align with the natural unemployment rate as labor tightness continues to ease. And when it comes to GDP, I expect the rate of growth to be slightly lower than what we have seen so far this year.

In sum, I expect only a modest slowdown in economic activity to go along with a slow but sure disinflation. In other words, I do see us on the flight path to the soft landing we all hope for and that has proved quite elusive in the past.

Now that you know what I expect, I can tell you what I believe: Absent any alarming new data between now and mid-September, I believe we may be at the point where we can be patient and hold rates steady and let the monetary policy actions we have taken do their work.

I take my role seriously in achieving the Fed’s dual mandate of price stability and maximum employment. And I remain focused on seeing us achieve these goals to support our long-term economic success.

Allow me to be clear about one thing, however. Should we be at that point where we can hold steady, we will need to be there for a while. The pandemic taught us to never say never, but I do not foresee any likely circumstance for an immediate easing of the policy rate.

Before the Committee meets again, we will have a slew of new economic data to consider, with another PCE report, one more employment report, and two CPI reports among them. And I will continue to talk and listen to people from throughout the Third District. Together, these will provide the guidance I will need in considering my ultimate stance heading into September’s Committee meeting.

This slew of data is not just national in scope. I also closely consider what I see going on right here in the Philadelphia region. So, allow me to take a couple of minutes to share with you my more localized view.

Overall, the area's economy reflects weakened conditions in business and interest-rate sensitive areas such as housing, but maintains strengths, particularly in the labor market. While survey responses from both manufacturing and nonmanufacturing businesses reflect currently weakened business activity across the region, responses have moved positive for future expectations. Inflationary pressures in the region have also waned somewhat though — as it is across the nation — inflation generally remains above target and wage pressures remain elevated.

That's the snapshot. But let's look a little deeper.

Pennsylvania's Coincident Index, the Philadelphia Fed's summary metric of economic activity, increased 1.4 percent in the second quarter and 0.6 percent from May to June, reflecting positive conditions. There was a rise in payroll employment, the unemployment rate fell during the three-month period, and there was an increase in average hours worked in manufacturing. Overall, year to year, the index has risen 3.6 percent.

Another positive indicator is business formation, which in Pennsylvania continues well above prepandemic levels, with more than 12,500 business applications as of June 2023, compared with roughly 8,600 in February 2020, seasonally adjusted.

On the jobs front, the Philadelphia MSA has not only fully recovered its pandemic-era losses but is currently running 96,000 jobs above February 2020. Notably, this includes the hospitality sector, which is at full recovery.

And, speaking of hospitality, we know that restaurants and hotels are good indicators of consumer spending and local economic health. One of the data sets we look at in the Philadelphia Fed is the trend data for seated diners, which currently shows restaurant activity more than 4.5 percent above this time last year.

The hotel sector, however, remains slightly below where it was prepandemic, despite Taylor Swift's best efforts.

When it comes to housing, Philadelphia Fed researchers also recently looked at current, real-time asking rents region-wide. Like many areas of the country over the past three years, Philadelphia experienced significant rent inflation, but the data now show that tapering off, as asking rents on average slightly decreased 0.14 percent from April to May and basically have not changed across a three-month span.

Looking at residential sales, current market tightness continues. As mortgage rates have risen, it is understandable that current homeowners don't want to put their houses on the market and step away from their current low-rate mortgages, diminishing inventory. And, certainly, a lack of inventory keeps prices elevated, which further impacts the depth of the potential buyer pool. Both are understandable outcomes.

I am also very sensitive to the state of the commercial real estate (CRE) sector, especially here in Center City. And I am glad that part of the discussion that will follow me will be specifically dedicated to CRE.

First, I recognize the potential impact on financial institutions heavily invested in CRE, should they get pressed into ownership in the event of a loan default. But on a more street level, I have concerns about the health of the businesses traditionally supported by now-remote workers or those only in their offices intermittently, especially in the restaurant and services industries.

As the *Philadelphia Business Journal* itself reported just a few weeks ago, it will take many months, perhaps a couple of years, for the commercial real estate market to shake itself out and rightsize, given the shifts in working environments. We will be watching this carefully, I assure you.

Looking ahead, I am also focused, as many are, on the potential impact of the October 1 resumption of federal student loan payments. Even with new income-based payment plans set to reduce payments for many borrowers, our contacts have expressed concern about their capacity to reintegrate these borrowers into the repayment system.

So, how this system is implemented, and how prepared borrowers are and where their repayment funds will come from — whether from paychecks or savings — will be something we will be keeping a close eye on.

As we've been tracking, credit card balances and loan delinquency rates have both been increasing in recent months. Coinciding with this has been a decrease in bank balances, as consumers have drawn more from their savings to pay their bills, even if this drawdown is of pandemic-era supports they've held on to. This is not the ideal consumer finance backdrop in which one would necessarily want to add potentially hundreds of dollars in new monthly student loan payments.

But, overall, I believe that the resilience we've seen in our economy will continue, and I do believe we are poised to come out from under the pressure of inflation in good condition, both nationally and right here in Philadelphia and the region.

But what the economy on the other side will look like is not set in stone and is something that we at the Philadelphia Fed are working hard to help decipher. So, please allow me a couple of minutes to highlight two ongoing initiatives: the Anchor Economy Initiative and the Worker Voices Project.

The Philadelphia Fed established the Anchor Economy Initiative to dive deep into the economic impacts that hospitals and institutions of higher education have on their home regions. While it's long been assumed that there's been a positive benefit, we lacked the data to capture the economic impacts of "eds and meds."

Over the course of a year, the team at the Philadelphia Fed pulled together data from all 524 regions of the United States to create the [Anchor Economy Dashboard](), which measures the direct, indirect, and induced economic impacts these institutions have on their communities.

The dashboard also includes a *reliance index* to indicate how dependent a region is on higher eds and hospitals for economic activity. With 1 as a baseline average, Philadelphia came in at an index of 1.4.

While an increased reliance on eds and meds can be a concern in places where institutions are vulnerable from challenges in health care and declining college enrollments, in Philadelphia, our eds and meds are more likely a strength. In fact, if you break down the data, these anchor institutions support nearly 496,000 jobs and nearly $34 billion in employment income and benefits up and down the chain. Further, they add more than $51 billion to our regional GDP — roughly 11.4 percent of the region's total. Moreover, each job created in the anchor economy has a multiplier effect of creating roughly one other job elsewhere in our area.

Ultimately, the power of having data is the power to make positive change in communities. The dashboard is a tool for communities to use in their economic development planning. For instance, St. Louis and Chicago are both using the regional data as context for some deeper dives they're doing on impacts at the neighborhood level. And, here in Philadelphia, I recently sat down with institutional leaders to begin discussions of how we may all be able to augment each other's efforts.

The basic recognition is that each institution comes with its own sets of priorities, opportunities, and challenges. But if we pull back the layers, we'll find the points from which collective strengths can be leveraged and strong partnerships can emerge for an even larger impact.

The Anchor Economy Initiative is just getting started, so there will be much more to report as time goes on.

The Worker Voices Project is a more than year-long partnership between our colleagues at the Atlanta Fed — and other Fed Banks — focused on meeting with and listening to workers in low-wage jobs and those with a college degree to understand more fully what truly matters to them when deciding where, when, and whether to work, especially in this post-pandemic job market.

I know we've all heard — and some have maybe even said — the phrase, "No one wants to work anymore." But that's an overly simplistic view. What we've learned is that there are a multitude of reasons why a worker may have exited the labor market at the onset of the pandemic only to reenter from an entirely different door on the other side of it or quit jobs at such a high rate.

Yes, workers want to be paid what they believe they are worth and bring to the table, but it's not only about wages. And, yes, they want to be somewhere they can be productive and contributing employees, but not if they don't believe their contributions are appreciated, let alone rewarded.

What we increasingly heard is that workers want something for which economists don't yet have a metric: to be treated with dignity.

The factors going into the decisions of where to work, or whether to go in an entirely different direction, are increasingly complex. And these complexities may make us rethink what we thought we knew about labor markets.

Allow me to provide two examples from earlier this summer, when I had the opportunity at the Philadelphia Fed to engage with workers as part of the Worker Voices Project. One young woman, a single working mother, told me that she changed jobs because she needed a manager who understood how last-minute schedule changes impacted her ability to find childcare. And we heard from a young man who left a job that required him to be on the road; yet, when diagnosed with a condition that left him prone to severe seizures, his manager still wanted him spending his days driving, as opposed to similar work that could be done from a stationary location.

As one participant summed it up, "We're looking for a place where we belong."

For us as policymakers and employers, those words can point us in the direction for creating a strong, growing, and more inclusive economy.

Which, after all, is what we all want and is the reason why we're all here today. We at the Federal Reserve Bank of Philadelphia are just as committed to the economic health of our region and our residents as you are. And we remain at the ready with the data and insights necessary to help you make the decisions that will lead to your success.

With all that said — and I know it's a lot — I'd be happy to step back and take some questions.