

An Economic Outlook

Jewish Business Network Luncheon
Federal Reserve Bank of Philadelphia
Philadelphia, PA

February 13, 2019

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The views expressed today are my own and not necessarily those of the Federal Reserve System or the Federal Open Market Committee (FOMC).

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Good afternoon, welcome, and shalom. It's a pleasure to have everyone here. Given the unpredictability of February weather in Philadelphia, it's an even bigger pleasure to have such a short commute — so we're particularly happy to be hosting you today.

I'm going to start this afternoon with an economic outlook — where we are, where we're likely headed, and what I'm watching as we make our way there — and then discuss something that's a focus of ours here at the Federal Reserve Bank of Philadelphia: the labor market, skills, and the future of work.

Before I start, let me issue the standard disclaimer that the views I express today are mine alone and do not necessarily reflect those of anyone else in the Federal Reserve System.

Growth

Starting with GDP, I see growth a bit above 2 percent for this year, returning to trend of around 2 percent some time in 2020. While some may view that growth rate as disappointing, it reflects structural, slow-moving forces — like demographics, muted growth in the labor force, and lower productivity growth — rather than any temporary headwind. So I still see the outlook as positive: The U.S. economy continues to grow in what is on pace to be the longest economic expansion in our history.

I should also deliver the caveat that those projections are for the year as a whole. I expect Q1 of this year to come in closer to 1.5 percent; there are multiple contributing factors here, not least being that first quarters have seen low or negative growth for several years running, enough to have essentially become the norm. That should balance out as growth picks up in the following quarters.

PCE remains the primary driver of real GDP growth, and household spending continues at a strong, sustained pace.

Businesses, on the other hand, have reported an increase in uncertainty and a decrease in confidence. Coupled with tighter financial conditions, the investment outlook is not quite as rosy as last year. It's certainly not a dire one, but the specter of uncertainty does cast a shadow, and the ambiguity of the current climate appears to be having a dampening effect.

I am also monitoring international influences, including the outlook for growth abroad and trade developments.

On balance, the potential risks tilt very slightly to the downside, but I emphasize the word "slight." It's a gradient measured by a protractor rather than one apparent to the naked eye.

Overall, the economy remains in good shape.

Employment

One clear example is the continued strength of the labor market. Employment data continue to show remarkable health and, in fact, have surprised many of the experts. Job creation continues at a strong pace, quits are still high, and the slight upticks in the unemployment rate over the past couple of months reflect more people coming off the sidelines to join the labor market.

In fact, the primary concern we're hearing anecdotally is not the lack of jobs but the dearth of skilled workers.

Inflation

Inflation is running around our preferred 2 percent target. For several years, it was persistently low, finally moving up to our goal last year. I see inflation running slightly higher than 2 percent for this year and next.

As Fed watchers well know, when we say our goal is 2 percent inflation, we don't mean the sweet spot is exactly 2 percent all the time; it's our medium-term average. While I would be concerned if it rose significantly above that marker, running slightly above, as I predict we will this year and next, is not something that provokes concern, particularly after a sustained period of underperformance.

Importantly, I'm focused on core inflation, which strips out volatile elements like food and energy, giving a better understanding of the fundamentals. Headline inflation is likely to suffer with fluctuations in energy prices, but those are transient and do not have a marked effect on the underlying measure.

What I'm watching most closely is inflation's trajectory: what direction it's headed and how fast. Right now, we're not seeing significant upward pressure, and it's not on an accelerated path; if anything, it's edging slightly downward. If that scenario changes, the data will guide my views.

Rates

With a temperate climate for inflation; continued strength in the labor market; very slight downside risks; solid, but moderate growth projections for the next couple of years; and, of course, a climate of uncertainty, I continue to be in wait-and-see mode. Or, to use the word of the moment, I see patience as a virtue. My own view is that one rate hike for 2019 and one for 2020 are appropriate.

As ever, that's my current stance, and my views will be guided by data as they come in and events as they unfold. I know some people wish that Fed officials would retire the metaphorical pencil we use in our forecasts and be more forceful in our estimates. And I'm happy to use a pen ... so long as it's filled with erasable ink. We have to make policy decisions in context, and I've shared my outlook given the landscape on February 13, 2019. If we had a perfectly functioning crystal ball, those predictions would be infallible – and I'd be playing the lottery a lot more.

Skills and the Workforce

Of course, while we can't prognosticate with absolute certainty, we can make educated guesses about a host of issues.

One that's of particular interest here at the Philadelphia Fed is the future of work, and how cities and regions across the country are preparing for the changes that are already well underway.

There have been two discussions about the labor market that have taken center stage of late, the first being the skills shortage and the difficulty employers report in finding qualified workers.

The other is the effect of artificial intelligence and automation on the current and future employment landscape. The two obviously go hand in hand.

While both have received an abundance of attention, the discussions are decidedly nuanced, and it's important to understand both the risks and the opportunities these issues present.

The opportunity is that we can see change coming and not only prepare for it, but rise to meet it. This is in the economic interests of both individual businesses and the cities and regions in which they operate. The risk, of course, is in ignoring the change and failing to prepare for it.

Automation is coming; in fact, it's already here. But much of the popular conversation veers from practicalities. Rather than look at the jobs that have already been, or are on the precipice of being, automated, speculation runs to the entirety of human capabilities somehow being mechanized.

What the current trend in automation has actually done is thrown into stark relief the importance of uniquely human attributes, what we tend to refer to as "soft skills." These are as in demand among employers as technical skills, if not more so.

The truth is that the scope of artificial intelligence is limited to our input; that is, machines are only as smart as we make them. The important conversation, in my view, is not whether robots may someday write the great American novel but what the current capabilities of automation mean for the people in our workforce now and how it will shape the near future.

We recently published research on the likely effect of automation, both within the Federal Reserve's Third District and in the U.S. We not only identified jobs that are in danger of automating, we assigned degrees of likelihood to their eventual demise. We also looked at who's doing those jobs, who would be hardest hit, and whether and where new jobs might be created.

We concluded that almost one in five jobs in our District have a 95 percent or better chance of becoming automated and that the people doing them are some of the economy's most vulnerable workers. While some people will be absorbed into new jobs, others won't.

Instead of leaving the disruption of various industries to fate, we have an opportunity to think about how to train the workers whose jobs will likely disappear to do jobs that are more secure from the ones that have yet to be created to the ones that are standing empty right now.

As I mentioned, one of the most frequent complaints we've heard from business is the shortage of skilled workers. While there has been some debate about the skills shortage, our research certainly points to a gap and the JOLTS data in particular support it.

We also have research underway. Our economists took a very large data set — more than 90 percent of all online postings — to analyze what factors impact the length of time a job stays open or, in their parlance, the “time to fill.” They looked over a two-year span, from 2015 to 2017, for the 50 largest metropolitan statistical areas to see, among other things, what factors influenced the time-to-fill stretch and whether requirements for certain levels of experience and educational attainment affect that metric.

Their preliminary findings confirm what we've been hearing anecdotally and what we've seen in other research — that there is a gap between the skills employers want and need and those in the available workforce.

They found that the easiest jobs to fill are those that are generally routine, manual positions — the same ones that are at the highest risk of automation.

The most difficult to fill are those that require specific cognitive, and uniquely human, skills: teachers, for instance, or psychologists.

The more skill required, the longer a job takes to fill; likewise, the higher the bar for educational attainment and years' experience, the more time the position will remain open.

While the research is as yet unpublished, the early findings pose questions for the labor market.

Should, for instance, employers consider hiring candidates who are good, rather than ideal, and focus on in-house training to make up the difference? Considering the combined losses associated with unfilled positions and the expense of a candidate search, it is likely more cost-effective for many organizations.

This is something we've been discussing with employers across the region. In fact, the Philadelphia Fed has formed a partnership with Philadelphia Works, Social Finance, and a local company to change the way we prepare the local workforce for the future of work. The pilot is a unique public-private partnership, in which the public sector will provide customized training and the employer will repay the cost of that training once the outcomes are realized.

The reality of the tight labor market means that employers have to start thinking creatively and long term about how they're going to address the gap between the skills they want and need and those available in the labor pool. What makes this project stand out is just that: The employer isn't funding it through their foundation; it's coming right out of the HR budget. It's a business decision. And not only will they get an agile, trained workforce, but it adds to the city's labor pool overall.

It's my hope that more businesses in the region — and across the country — will begin to take another look at how they're approaching training and hiring. This will be especially important as the baby boom generation continues its march into retirement and the importance of succession planning takes on new urgency across the professional spectrum.

Conclusion

To sum up: The economy continues to do well. I continue to be happily patient in my outlook on raising rates and will monitor the data as they come in. And importantly, I hope that this point in the labor market's history will prove to be the catalyst for employers to reconsider their approach to training, and what role they can play in arming people with the skills both employers and employees need.

Thank you.