

The Opportunities of a Tight Labor Market

Economic Forecast 2020
The Main Line Chamber of Commerce
Malvern, PA

February 12, 2020

Patrick T. Harker
President and Chief Executive Officer
Federal Reserve Bank of Philadelphia



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OF PHILADELPHIA

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Note: President Harker presented similar remarks on February 10, 2020, in Delaware.

Good morning. It is a pleasure to be back here on the Main Line to share with all of you a cup of coffee and my views on the economy. First, let me dispense with the usual 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 the Federal Reserve System.

With that out of the way, let me outline my remarks today. I will start with my outlook for the economy — which I know takes on greater significance since I am a voting member this year on the FOMC. My outlook for the economy — specifically for the labor market — ties into the final section of my speech: workforce development. In my view, with the labor market the tightest it has been in decades, now is the time to create new approaches to how companies hire, train, and retain employees and how the U.S. can create career paths for all of its workers.

Economic Outlook

Let's start with the economy. Overall, I think the economy is in good shape.

We are in the longest economic expansion on record, and I see growth returning to trend of about 2 percent this year, a view that is widely shared.

Friday's employment report showed the labor market began 2020 on the same positive trend it showed through 2019. We added 225,000 net new jobs in January — better than the monthly average of

175,000 for all of 2019. Hourly wages increased 3.1 percent from last January and the unemployment rate edged up to a still-low 3.6 percent.

At some point, we'll return to a trend of creating about 100,000 net new jobs per month. That number sounds disappointing — compared with the stronger monthly gains we've seen in recent years. But it's important to recognize that 100,000 jobs per month is more than enough to keep pace with the expected growth in the U.S. labor force. That's one reason why I expect that the unemployment rate will stay below 4 percent for the next couple of years.

The health of the labor market, especially when it comes to paychecks, is key to my economic outlook since consumer spending accounts for about 70 percent of the U.S. economy. The news in general continues to be good for the consumer sector. Thanks to the lowest unemployment rate in 50 years and growth in wages, consumers are upbeat about the economy. Consumer confidence is high, and the optimism should support household spending this year.

Another support to consumer spending this year is the prospect of more homeowners refinancing their mortgages. Research done at the Philadelphia Fed's Consumer Finance Institute¹ shows that lower rates in 2019 resulted in a large number of borrowers who are in a position to refinance their residential mortgages. Mortgage refinancing fuels consumption in two ways: First, homeowners are able to lower their monthly house payment, freeing up money that can be spent elsewhere. Second, homeowners may choose to extract some home equity by using a cash-out refinance. This also provides money for other consumer spending.

Our research shows that in September 2019 — when the 30-year fixed mortgage rate averaged 3.61 percent — about 19 percent of all active mortgages were refi candidates. The Bank's research — supported by industry analysis — suggests that with no change in mortgage rates, about 60 percent of borrowers will probably refinance this year, and over the next two years, we would expect an estimated \$11.2 billion in added consumption from this refi activity. On an individual level, an average homeowner would have about \$2,000 to spend in extra consumption within the first year after refinancing — a nice lift to almost any budget.

My positive view about the consumer contrasts with concerns about business investment. Spending on new plant and equipment and intellectual property is lagging, and the uncertainty attached to fiscal and

¹ The analysis is based on Black Knight McDash data and Equifax Credit Risk Insight Servicing data.

other policies has continued to hold spending back. So, too, have international developments, including the global slowdown, trade uncertainty, and geopolitical tensions.

It's too early to say what impact the spread of the coronavirus will have on the global economy, but the negative effects on the Chinese economy and international travel are something to watch.

That's my view on the labor markets and economic growth. Now let me talk about the other side of the Fed's dual mandate: inflation. We haven't quite met our 2 percent inflation target, but we're on track to get there. While the process has been a slow one, I still believe that the inflation rate will rise to meet our goal.

Against this backdrop of a generally positive economic outlook and expectations that inflation will eventually hit the Fed's target, I come to the part that everyone really cares about: rates. As you know, at the January FOMC meeting, the Committee decided unanimously to hold the federal funds rate target stable at the range of 1½ to 1¾ percent.

My own view right now is that we should hold steady for a while and watch how developments and the data unfold before taking any more action.

The Regional Economy

Turning to the Philadelphia region and Pennsylvania, the economic outlook is more mixed than the national one.

In the Philadelphia metro area, which encompasses parts of Delaware, Pennsylvania, New Jersey, and Maryland, job growth had been running around 1.5 percent, but a few years ago, it slowed to 1 percent annually. In general, the Philadelphia metro area's job growth since the last recession has outpaced that of the Pennsylvania average, but has been below that of the nation during the same period.

As for the jobless rate, the Philadelphia metro area's rate stood at 4.2 percent in December. This is lower than the state rate but is higher than the national average. In recent months, we have seen a slight uptick in the region's and the state's unemployment rates. This is likely due to an increase in the labor force participation rate at the state level during the same period. As more people enter the labor force, the unemployment rate will temporarily increase until they find jobs.

Pennsylvania's economy has not done as well as the Philadelphia area. Job growth over recent years has been about 0.5 percent annually, lower than the Philly area and lower than the nation. The state

unemployment rate is currently 4.5 percent — higher than the U.S. average. Again, we might attribute this to the increase in Pennsylvanians who are now back in the labor force but haven't found a job yet. The state's labor force participation rate is 63.6 percent, which is above the national rate of 63.1 percent in 2019.

As in the Philadelphia region, the state job gains have been particularly strong in the service-providing sectors, like "Eds and Meds," and professional and business services. The state labor market is also feeling the direct impact of e-commerce versus brick-and-mortar stores. In the past years, we have seen a decline in retail employment, but we are seeing continuous growth in transportation and warehousing employment, particularly in the northeast region of the state.

On the housing front, Philadelphia is doing better than the state as a whole. Home prices in Philadelphia county are up 4 percent over the past year, and in nearby Delaware county, home prices are up a strong 5.9 percent. Good news for those of you looking to sell your homes; maybe not good news for those of you looking to buy.

For Pennsylvania, home prices are up about 3.5 percent — roughly the same as the nation's growth. The state's home price gains are being held back by weakness in the central part of the state.

Tight Labor Market Could Be a Workforce Development Opportunity

The very tight labor markets we are seeing locally and across the nation have put employers in a challenging position that was not evident in the years following the Great Recession. Companies report difficulty filling open positions, and many of those slots stay vacant for a long time. The difficult recruiting environment is also one that is likely to stay with us for some time as demographic trends indicate that the workforce will continue to age, and the labor force relative to the population will continue to decline.

This challenge may also be viewed as an opportunity, and those that successfully invent new ways to attract workers will enhance their chances of success. Now is a chance to rethink the same-old, same-old ways of building a productive workforce. This can perhaps be done by rethinking job requirements or additional ways of training.

One such innovative program has begun in Philadelphia. It is a public-private partnership to train workers in Philadelphia. This project was developed by the Bank's Economic Growth & Mobility Project in concert with Philadelphia Works and Comcast. It seeks to gain a better understanding of what

programs and strategies expand opportunities for individuals who live in low- and moderate-income communities.

The pilot program, announced last fall, has Philadelphia Works providing the upfront investment for training workers to master the skills needed by Comcast. As part of this new financial model, Comcast is committed to paying for outcomes once they are achieved, such as staying on the job for over six months. Philadelphia Works provides the training. The model also creates a better feedback loop between employers and the workforce board to make the program more effective and responsive to changing employer and employee needs.

The program is helping Comcast find workers in a tight labor market and let me assure you: The tight labor market we hear about from most of you is not imagined. Economists at the Philadelphia Fed have been looking into the amount of time needed to fill positions in metro areas across the U.S. In our region, it took 41 days, on average, to fill a position. That was longer than the national average of 37 days, and put Philadelphia 47th out of the 50 largest metro areas.

It is hard to say exactly why it takes longer in Philly than in other places, but one thing our researchers noted is that job ads in the Philadelphia metro area tend to list slightly higher education requirements than other metro areas. This underscores a need to switch gears and investigate if programs such as the one I just mentioned could be adapted to the challenges you face.

But here's another finding of the study that I found very interesting: The skills in highest demand in the Philadelphia region, and across the U.S., are not those dependent on acquiring a four-year degree, but instead are soft skills, such as communication, customer service, and teamwork. That could indicate that a rethinking of job requirements could help counter the tight labor market conditions that are a prevalent feature of the current economy. Sometimes that means a college or graduate degree is needed, but sometimes it doesn't.

That leads to another issue about workforce development, an issue I have championed for a few years now. And it might be strange to hear this from me — a former president of the University of Delaware — but not every high school graduate needs to go to college. And that would be even truer if there were greater innovation in recruiting and training. To reiterate, the difficulty of finding new employees is likely to be a feature of the labor market for some time to come because demographic trends are not short-run fluctuations. Innovation in attracting and retaining workers is likely to be one of the key

aspects governing success. It expands the pool of workers, helping to create better matches and a more productive workforce. And importantly, it opens pathways for workers.

Opportunity Occupations

Of course, workers without a college degree still need to find well-paying jobs. As I mentioned earlier, my positive outlook for the U.S. economy rests on the consumer sector. We need everyone who wants a job to be able to find a well-paying and sustainable career path. Researchers within our Community Development and Regional Outreach Department have identified several employment categories that pay above the national annual median wage but do not require a four-year college degree. We call these opportunity occupations.

My colleague Keith Wardrip worked with researchers from the Cleveland Fed to catalogue these occupations by looking at education requirements in job postings and hourly wage data from the Labor Department. The list of opportunity occupations vary from registered nurses to truck drivers, retail sales supervisors, carpenters, and patrol officers. So whether a person likes dealing with people or working with their hands, and whether they are interested in a career in health care, construction, transportation, or sales, one of the many opportunity occupations may fit their idea of a good job.

To be clear, many of these jobs require on-the-job experience or some type of training after high school, and some positions advertised online required a college degree. But nationally Keith and his colleagues calculated that 21.6 percent of jobs in 2017 could be classified as opportunity occupations. In the Philadelphia–Camden–Wilmington metro area, the share was a slightly lower 20.1 percent.

These occupations offer workers without college degrees the chance to be part of our growing economy and to become financially secure. Giving more people the opportunity to participate in the economy strengthens our economy because more paychecks support increased consumer spending. It's a win–win situation for all of us.

Indeed, emphasizing skills rather than degrees might help to reverse a troubling longer-run trend in the U.S. economy, and that is the high number of adults who are not in in the labor force. The share of working-age adults who are participating in the labor force — which includes those who are employed and those who are unemployed but actively looking for work — came in at just 63.1 percent in 2019, down from 65.4 percent 10 years ago. What this says to me is that the U.S. is missing out on the

potential these adults could bring to the economy. This will, no doubt, require innovative thinking and new ways of investing in the workforce, but the payoffs are likely to be substantial.

I know the popular notion is that artificial intelligence and robots will make workforce development unnecessary. But let me return to our study about the time needed to fill job openings and mention that the occupations that are hardest to fill include registered nurses, retail store managers, and physicians. These are jobs that are least at risk for automation. They require uniquely human skills and can't easily be done by robots. Employers can't expect these jobs to disappear any time soon, and that is why it is imperative for employers to invest in those unique humans who can develop the communication, teamwork, and service skills that will get the job done.

Thank you, and now I think we have time for some questions.