In the Wake of an Unprecedented Year

Remarks by
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Thank you for inviting me to participate in your event today. I appreciate the opportunity to speak with you about my outlook for the nation's economy and look forward to our discussion. As we turn the calendar to a new year, the opportunity to reflect on the past and to look ahead to the future is a time-honored tradition. Today I will do a little of both.

Last year was one for the record books. The year had both the largest decline in quarterly GDP on record as well as the largest increase. The unemployment rate hit a 50-year low before climbing to levels not seen since the Great Depression. The equity market set record highs, while the price of oil dropped below zero for the first time ever, if only for a moment. The year saw the largest fiscal policy reaction and the most rapid increase in government debt, even as the yield on government securities fell to new lows. The Federal Reserve, for its part, broke new ground in policy accommodation, while expanding its balance sheet to record size. Suffice to say, 2020 was not a typical year.

I am hopeful, as I believe many of us are, that 2021 will mark the beginning of a return to something more like normal. Just two weeks in, we are off to a rocky start. However, I am generally optimistic that the year will be one of continued economic recovery, though not without bumps and potholes, particularly in the first part of the year as the virus continues to exact a terrible human and economic toll.

In my remarks today, I will offer my outlook for the economy, noting my growing confidence in the recovery, notwithstanding near-term turbulence. Underlying this outlook are my expectations about a path to resolving the pandemic, renewed fiscal support and the continued accommodative stance of monetary policy. Even as the economy recovers, the events of the last year are likely to leave an imprint on the economic outlook for years to come. There is no going back to where we started, and I'll highlight my own thoughts on some of the longer-term consequences of the pandemic. Finally, I will turn to what this all means for the path of monetary policy.

The Economic Outlook

Starting with the outlook, economic activity appears to have stalled at the end of last year. Consumer spending edged down broadly, not just in the contact-intensive service sectors most sensitive to the path of the virus, but also for durable goods, which have been quite strong up to now. The widespread nature of this pullback suggests that fading fiscal support along with uncertainty about the timing of any new government transfers likely weighed on activity, as did the resurgence of the virus across the country.

With the virus still impeding the resumption of many activities, employment growth also has stalled, with the economy shedding 140,000 jobs in December. Given that we ended the year still 10 million jobs short relative to before the pandemic, there remains quite a large gap to close. About a third of the jobs that have yet to come back are in the high-contact leisure and hospitality industry, making it likely that the pace of employment growth will remain lackluster until widespread vaccination is achieved and the virus diminishes as an everyday concern.

Overall, much of the optimism for eventual recovery this year is tied to a successful and widespread vaccination program. One of the most substantial risks to the outlook is a significant delay or disruption in the administration of the vaccine. Already, a slower-than-expected roll out has led many analysts to push back their estimates for when the United States might achieve broad-based immunity. It is difficult to imagine a sustained and robust recovery until the virus no longer interferes with the public's day-to-day decision-making.

That said, there is reason to be optimistic about the economy's growth prospects post-vaccination. One signal has come from equity markets, which have responded favorably to positive vaccine news. Sectors that have been particularly hard hit by the virus, including air travel and leisure and hospitality, have seen some of the largest price gains, suggesting that investors, at least, are optimistic that demand could bounce back strongly for these still-depressed services. Inventories are another dynamic that could support strong growth later this year. Businesses, and particularly retail establishments, ran down their inventories during the early stages of the pandemic, unsure of future sales prospects. A sustained recovery in demand could prompt businesses to restock, boosting production and growth, even if perhaps also straining some supply chains.

The additional fiscal support passed at the end of last year also sets the stage for a strong recovery. A renewed Paycheck Protection Program offers the prospect of sustaining small businesses until demand picks up, avoiding the significant cost and disruption of bankruptcy or closure. Transfer payments in the CARES Act had boosted aggregate personal income to an all-time high in the spring, even as wage income fell off steeply, providing a key support to consumption and the economy. In recent months, personal income had been trending down, as the payments faded and wage income has yet to fully recover. The new fiscal package, with enhanced unemployment benefits and household stimulus payments, should once again push up personal income, maintaining support for spending and growth.

As with the earlier government transfers, there is a high likelihood that a large portion of the renewed fiscal support will end up being saved by households rather than spent. In April, the personal saving rate shot up to a record 34 percent, as transfer payments boosted income and Covid restrictions and concerns limited consumption. Although the saving rate has come down since, it remains almost twice as high as the average prior to the pandemic. Of course, fiscal support that is saved has less of an immediate impact on growth than that which is spent, but it also is true that transfers that strengthen household balance sheets can prevent a pullback in spending that might otherwise occur as households demand higher precautionary buffers in an uncertain environment. Also, once concern for the virus ebbs, relatively healthy household balance sheets should allow for a quick rebound in demand and a resumption of activity. To the extent such dynamics prevail, the economy might avoid the experience of the Global Financial Crisis, when even after the recession ended there was a prolonged period of household deleveraging that contributed to a lackluster pace of growth for years.

Long-Term Implications of the Pandemic

When thinking about the long-term consequences of 2020, I find it helpful to group the potential factors into three broad categories. First, despite the best efforts of policymakers, there are likely to be scars from the crisis that will take time to heal. Businesses and workers have suffered a tremendous disruption, and while there is some optimism for a quick bounce-back, it would not be unexpected for some of the negative effects to persist. Second, the crisis will leave a lasting impact on business and public sector balance sheets, with governments taking on notably more debt, central bank balance sheets swelling around the world, and corporate borrowing soaring, even as household balance sheets, in the aggregate, have improved. Third, the crisis will likely have a lasting effect on the structure of the economy, both by changing the way that people work as well as what and how they consume.

Starting with the first of these three broad categories, there could be economic scarring that eventually heals, but only after some time. For example, as mentioned earlier, 10 million fewer individuals are working now relative to before the pandemic. Given the notable decline in labor force participation over the same period, it would appear that about half of those workers that lost jobs dropped out of the labor force altogether. Traditionally, it has taken some time to bring individuals back into the labor force, and it has often taken a fairly hot labor market to do so.

An additional dynamic with this crisis has been the disproportionate decline in labor force participation among woman. In particular, about half of the decline in women's participation is attributable to caregiving, likely reflecting disruptions in child care. While this could suggest a quicker bounce-back once the virus is checked and normal child care options return, it is important to note that even after returning to the job, these workers could suffer interruptions in human capital development and career progression, with unfortunate long-term effects.

Turning to the second broad category, 2020 has scrambled balance sheets across the economy. While household balance sheets are generally in good shape, this has come at the expense of government finances. The federal government increased its liabilities to fund transfers that, in many cases, have turned into household assets. Again, it must be noted that the relative strength of household balance sheets is in the aggregate. Certainly, the pandemic has led to significant economic hardship for many, as a large number of households struggle to pay bills and purchase necessities. One of the defining features of the pandemic has been the unevenness of its economic impact. There has been substantial variation in how different industries, professions and geographies have been affected, with some sectors reporting record activity even as others have seen demand collapse.

On the business side, non-financial corporations have further increased borrowing from already elevated levels, in part to cover pandemic-related holes in revenue but also, for larger corporations, to take advantage of near-zero interest rates and favorable borrowing conditions. These shifts in balance sheets can have long-run impacts. For example, the large increase in government debt could limit a fiscal policy response during some future crisis. Higher levels of business debt could threaten financial stability, increasing the fragility of the financial system to prospective shocks.

Finally, looking at the third broad category, the pandemic has likely unleashed, or at least accelerated, structural and technological changes that will continue to play out over years or even decades. These include a shift to remote work, as well as online retail and entertainment. While these changes could ultimately result in increased economic productivity, there will likely be near- and medium-term disruptions as resources shift between sectors. These changes also increase the risks around the value of capital in certain sectors—for example, commercial and retail real estate—which could in turn raise important financial stability considerations.

Monetary Policy

An exceptionally uncertain economic outlook, with the chance of both downside and upside surprises, creates a complicated and difficult environment for monetary policy. While the vaccine promises an eventual end to the virus's hold on the economy, there remains a substantial gap to be bridged before we get there. With the most recent fiscal package, the economy could get the necessary momentum to bridge this gap and prevent standard recessionary dynamics from taking hold before we reach the safety of widespread vaccination.

Monetary policy is also playing an important role in supporting the economy, as it has since the start of the pandemic. In March, the Federal Open Market Committee (FOMC) cut its policy interest rate to near zero and launched an aggressive balance sheet expansion program, purchasing large quantities of Treasuries and Mortgage-Backed Securities (MBS). While these purchases were initially directed towards smoothing market functioning, the expansion of the Fed's balance sheet also supports accommodative financial conditions, to the benefit of the overall economy. In September, the FOMC provided forward guidance, consistent with the Fed's new monetary policy framework, that interest rates would remain near zero until the labor market reached levels consistent with maximum employment and inflation had both risen to 2 percent and was on track to exceed 2 percent for some time. In December, the Committee further extended its forward guidance to cover its asset purchases, stating that it will continue to increase its holding of Treasuries and MBS by at least the current pace until substantial further progress has been made on its employment and inflation goals. Overall, the outlook is for monetary policy to remain accommodative for some time.

Clearly, in the current environment where the economy continues to heal, an accommodative policy stance is appropriate. It is too soon to speculate about the timing of any change in this stance. The Committee has agreed that further substantial progress in achieving high employment and average inflation at its 2 percent target is necessary before making adjustments. This wait-and-see approach will guide the trajectory of monetary policy. As the data come in, and the economy evolves, the public and markets should be able to adjust their expectations regarding the policy path. This feature of forward guidance is especially useful now given the heightened uncertainty around the outlook, stemming in large part from the path of the virus. In the near-term, the risks are predominately negative, but once the pandemic is behind us, there is considerable scope for a snapback in activity.

However, as the economy recovers and the Committee judges progress toward its mandate for employment and inflation, policymakers will necessarily wrestle with judgments about the appropriate stance of its policy settings. With longer-term implications of the pandemic noted earlier unfolding over time, these deliberations are likely to be challenging. For example, how long-lasting will the effects of the pandemic on the labor market be? Should we expect employment to return to its lows of early 2020? Or will changes in the structure of the economy and labor markets shift employment's long-run equilibrium?

Will inflation continue to fall short of central bankers' desired 2 percent long-run average, or will other dynamics take hold and shift inflation impulses? For example, although aggregate inflation, as measured by the PCE index, remains muted, a few hard-hit services prices have played a disproportionate role in depressing the aggregate index. To the extent that a post-vaccine bounce-back boosts demand and prices in these sectors, including airfares and hotel accommodation, inflation could move up quickly. Other large contributors to the decline in inflation are a bit idiosyncratic, including owner-occupied housing and financial services. In contrast to these sectors, price inflation for many other categories of consumption (particularly goods) has moved up, sometimes quite sharply. Such a scenario does not suggest higher inflation is a near-term threat, but rather that inflation could approach the Committee's average inflation objective more quickly than some might expect.

Finally, will highly accommodative monetary policy seed imbalances in the economy that increase the fragility of the economy to the next inevitable shock? Will other mechanisms effectively mitigate and balance any destabilizing elements of a low-for-long rate environment?

As we close the chapter on 2020, the New Year ushers in its own mix of optimism and challenges. The experience of the pandemic will undoubtedly leave its mark even as our nation's economy shows its resilience and recovers. Ultimately, the wisdom to understand this unfolding landscape and to respond with appropriate policy adjustments will set the course for achieving our objectives for financial stability, sustainable long-run growth, employment and inflation.