Federal Reserve
Bank of Boston®

The Economy's Outlook, Challenges, and Way Forward

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Remarks to The New England Conference
Massachusetts Bankers Association

September 30, 2020

Recent Data Better than Expected

- States opened up from pandemic shutdowns relatively quickly
- Economic activity has reflected the benefits of increased personal mobility
- Massachusetts still has one of the higher state unemployment rates at 11.3 percent, but this is a significant improvement since July's report
  - Commonwealth is less inclined to trade higher economic activity for more COVID-19 deaths
  - Boston has yet to see most workers return to its office towers
  - Many downtown businesses and their employees have suffered greatly

New Fed Guidance on Interest Rate Policy

- FOMC forward guidance – rates expected to remain at currently low level until three conditions are met:
  - First, that the economy reaches maximum sustainable employment
  - Second, that inflation has risen to 2 percent
  - Third, that inflation is on track to moderately exceed 2 percent for some time
- Caveat:
  - As long as no risks emerge that could impede the Fed achieving its dual mandate
  - One example would be increased financial instability

Summary of Economic Projections

- Survey of all FOMC participants
  - Median forecast for the unemployment rate: drops to 7.6 percent by the end of this year, and to 5.5 percent at the end of 2021, along with inflation gradually trending toward 2 percent – a relatively rapid return to maximum employment
- My own forecast is less optimistic – my expectation is a more gradual return to maximum employment

Potential Challenges

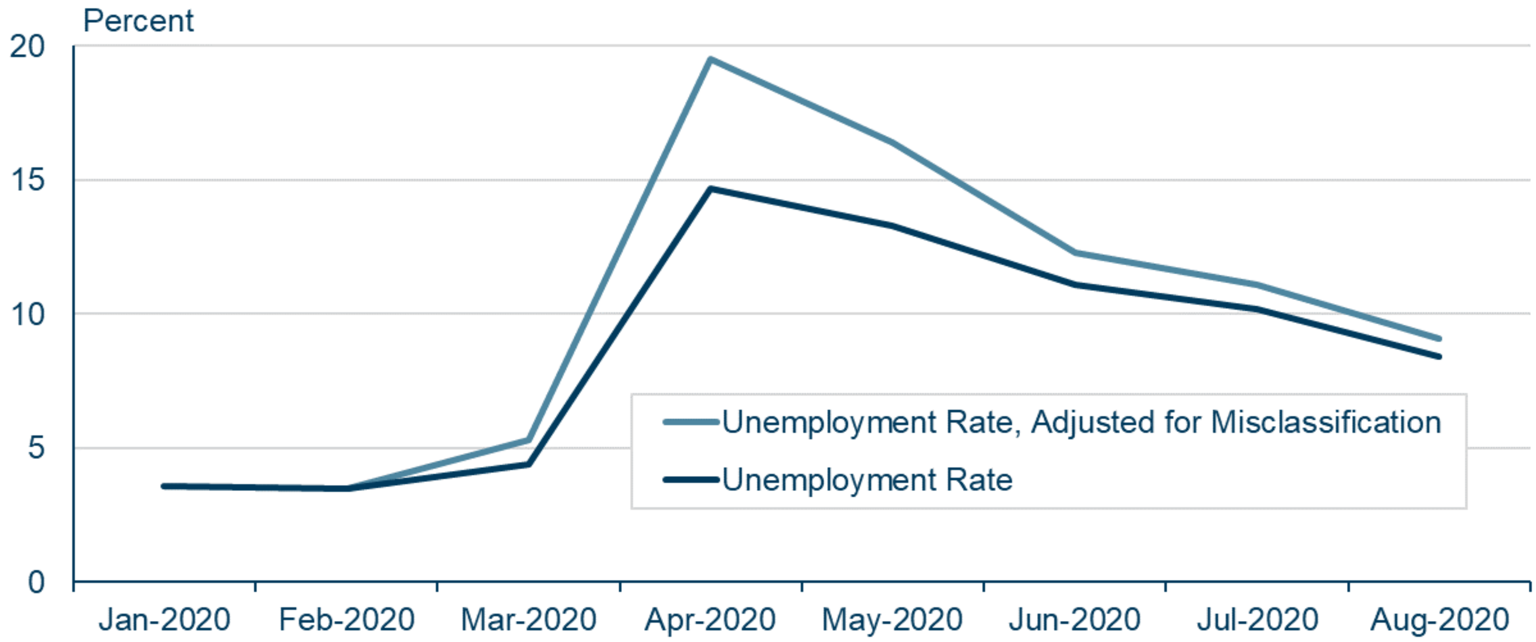
- My own view – economy could face several challenges in coming months
  - I am concerned about a possible second wave of COVID-19 infections
  - Additional support from fiscal policy, which I believe is very much needed, seems unlikely to materialize soon
  - Financial spillovers from businesses impacted by the virus will become a more significant headwind going forward
  - Workers displaced by the pandemic may find it difficult to quickly transition to new jobs, with more furloughs turning into permanent layoffs as many businesses remain troubled

My Remarks Today

- Overview of recent economic data
- Outlook from FOMC's Summary of Economic Projections
- My own view: Review the likely headwinds to a quick recovery
- Progress on Fed's Main Street Lending Program
- To preview my conclusion, my views are that the economy remains fragile, that fiscal- and monetary-policy stimulus are essential to the recovery, and that policymakers should continue to explore how to reduce economic scarring from this severe pandemic

Figure 1: Labor Market Conditions

January 2020 - August 2020

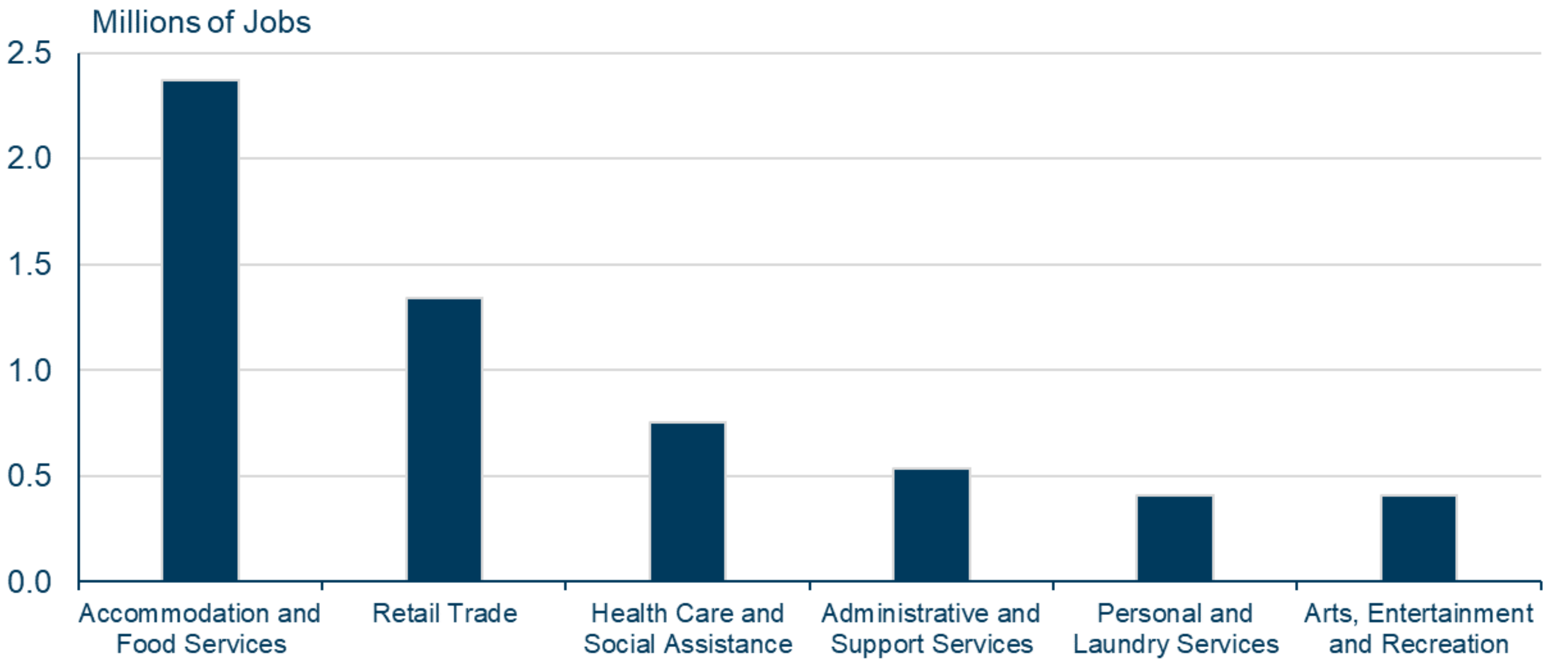


People who did not work during the reference week due to efforts to contain the spread of the coronavirus should have been classified as "unemployed on temporary layoff." However, some were classified as "employed but not at work" and were not counted as unemployed. The higher line includes the BLS estimate of that misclassification as unemployed. There are other types of misclassification not accounted for here. For example, some workers categorized as not in the labor force are workers who want a job but are not looking for work as a result of the pandemic. If they were looking for a job, they would be classified as unemployed, resulting in yet a higher unemployment rate.

Source: BLS, Haver Analytics

Figure 2: Payroll Employment Growth

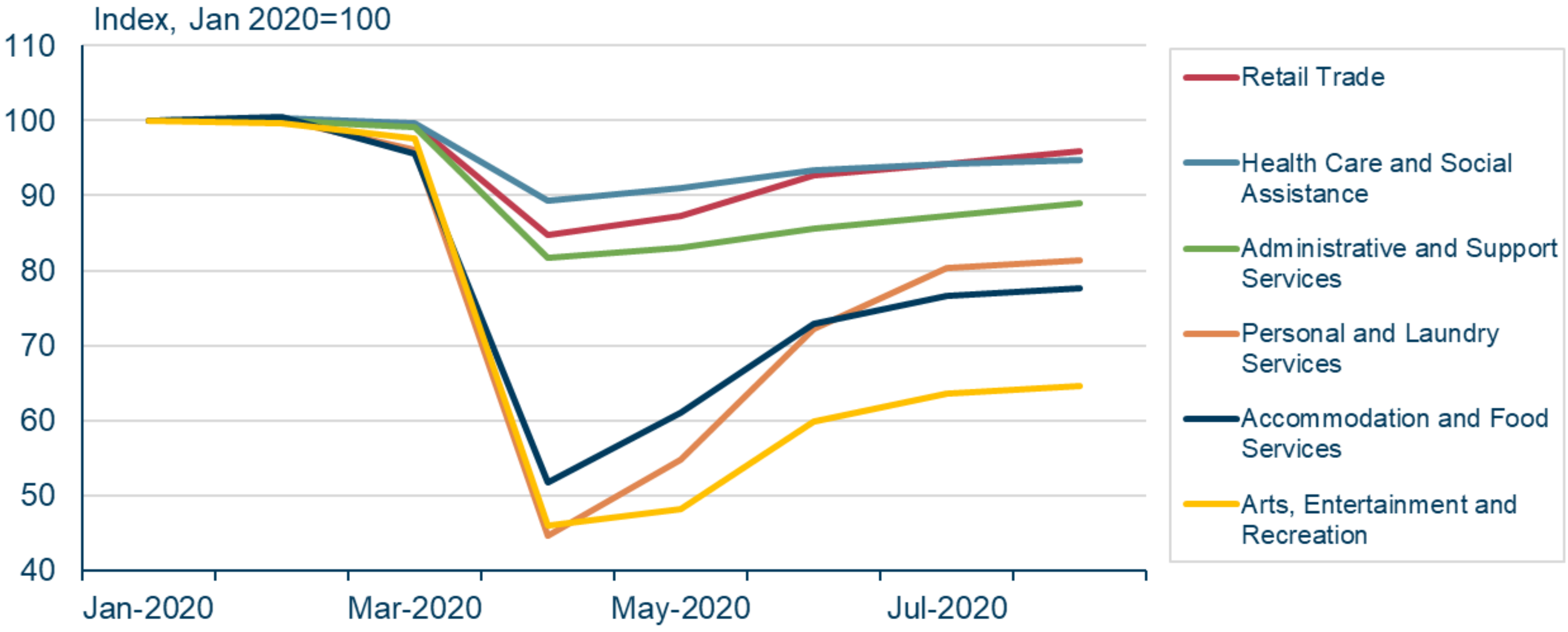
May 2020 - August 2020



Source: BLS, Haver Analytics

Figure 3: Payroll Employment Growth

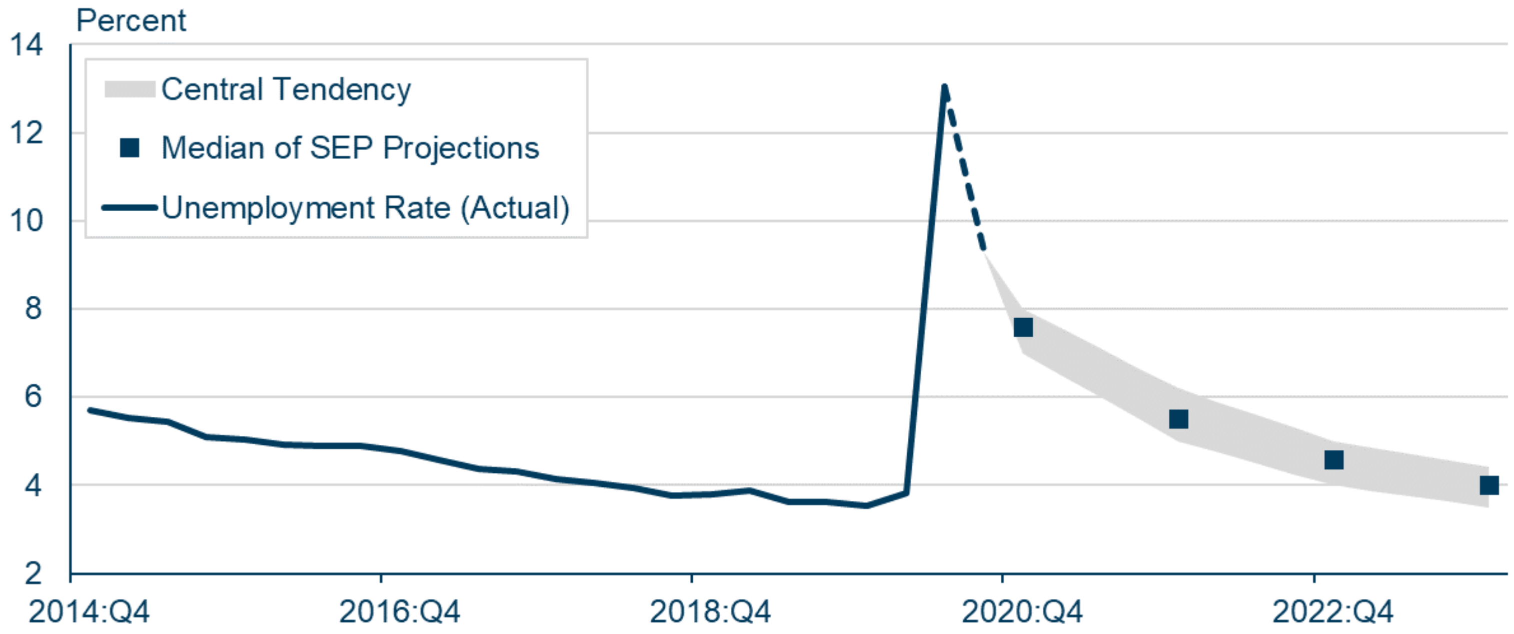
January 2020 - August 2020



Source: BLS, Haver Analytics

Figure 4: Unemployment Rate: Actual and Forecast from the Summary of Economic Projections

2014:Q4 - 2020:Q2, Actual; 2020:Q3, Estimate; 2020:Q4 - 2023:Q4, Forecast

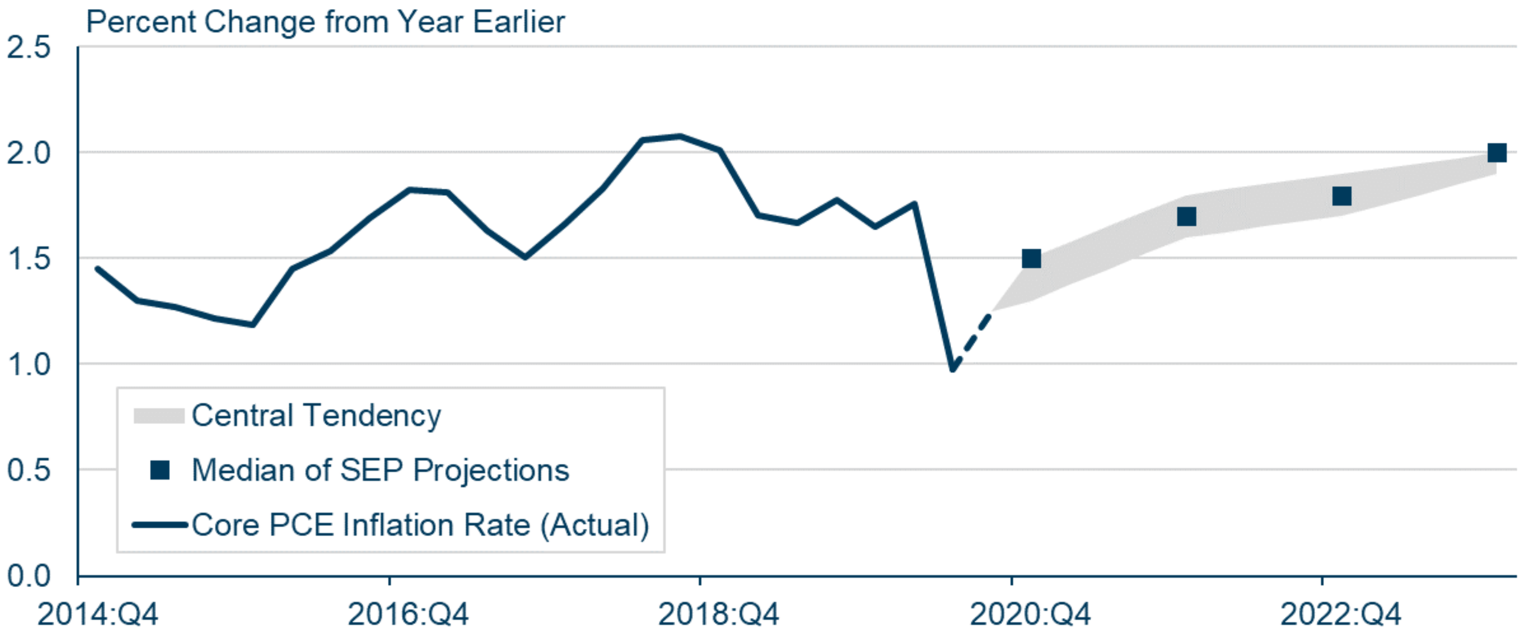


Note: The SEP unemployment rate forecast is for the unemployment rate in the fourth quarter of the year indicated, for 2020 - 2023. The figure for 2020:Q3 is an estimate, the average of the monthly figures for July and August.

Source: BLS; FOMC, Summary of Economic Projections, September 16, 2020; Haver Analytics

Figure 5: Core PCE Inflation Rate: Actual and Forecast from the Summary of Economic Projections

2014:Q4 - 2020:Q2, Actual; 2020:Q3, Estimate; 2020:Q4 - 2023:Q4, Forecast

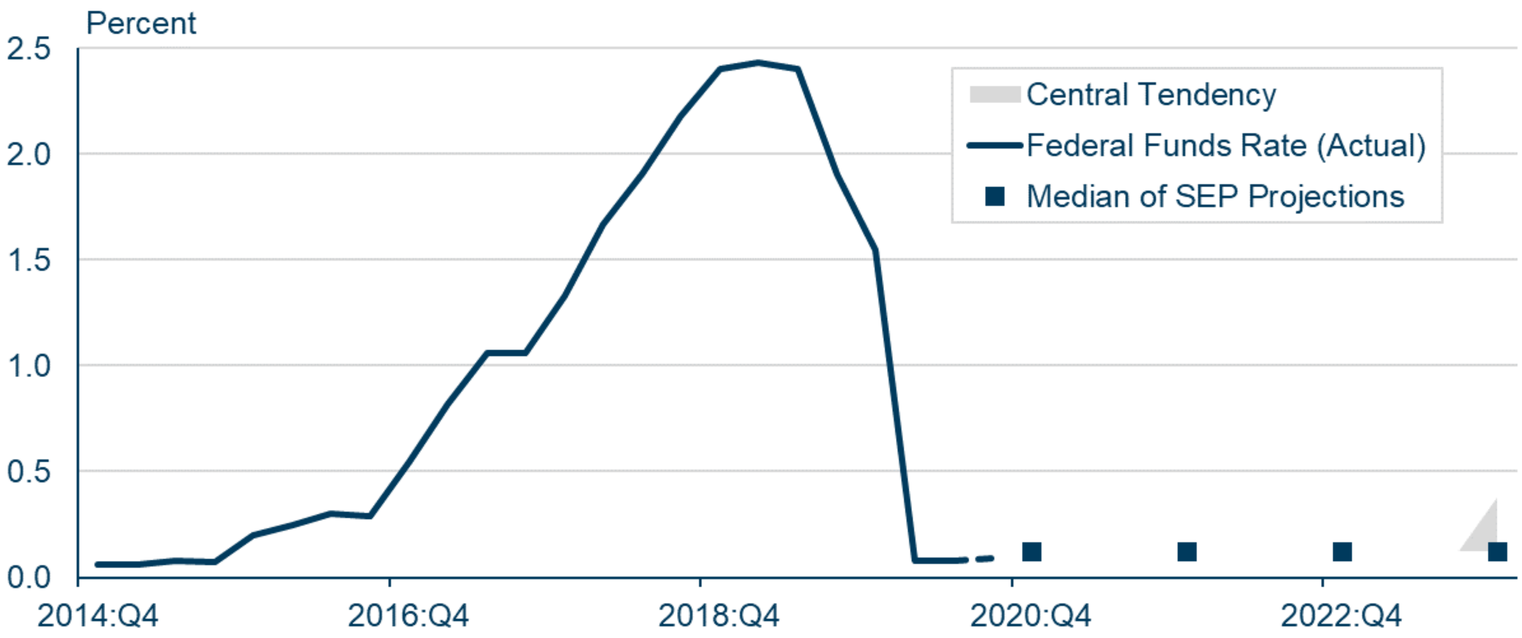


Note: Core PCE inflation excludes food and energy. The SEP core PCE inflation forecast is for the percent change in the core personal consumption expenditures (PCE) price index from the fourth quarter of the previous year to the fourth quarter of the year indicated, for 2020 - 2023. The figure for 2020:Q3 is an estimate, the most recently available figure, for the month of July.

Source: BEA; FOMC, Summary of Economic Projections, September 16, 2020; Haver Analytics

Figure 6: Federal Funds Rate: Actual and Forecast from the Summary of Economic Projections

2014:Q4 - 2020:Q2, Actual; 2020:Q3, Estimate; 2020:Q4 - 2023:Q4, Forecast

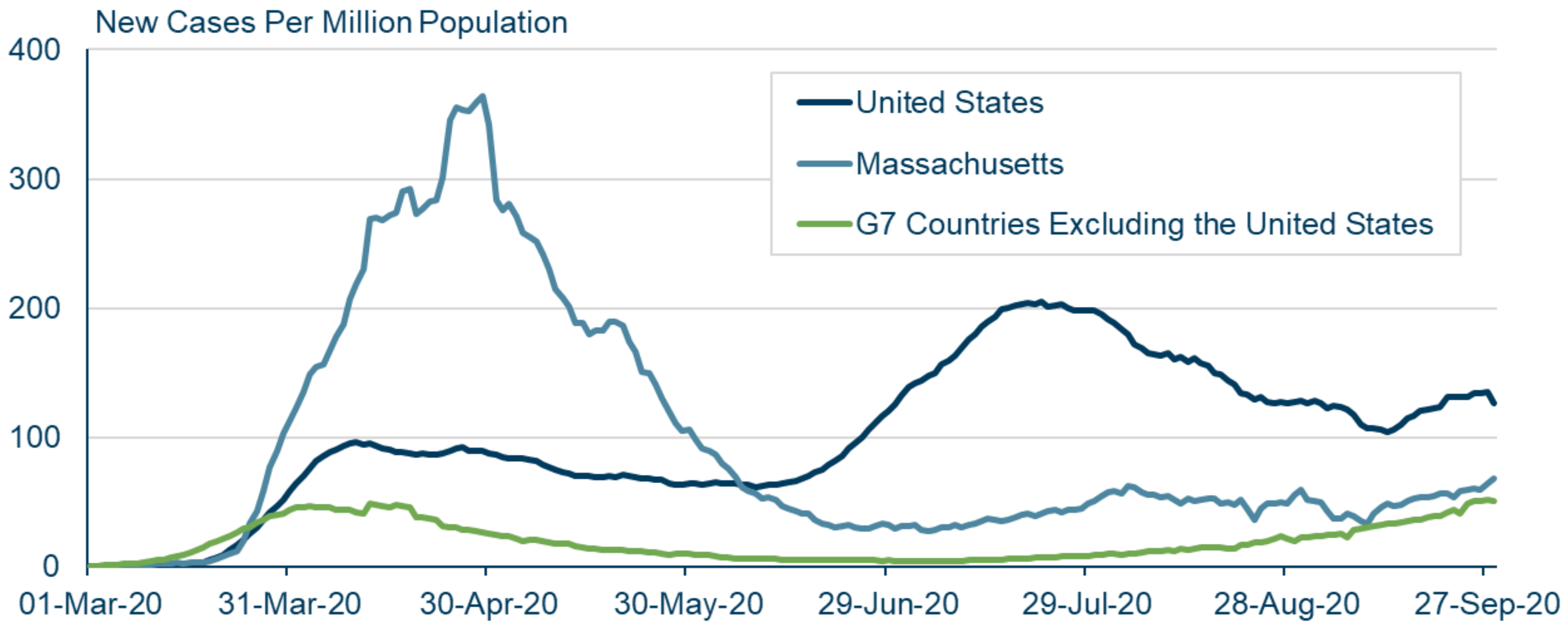


Note: Rates are as of end of period. The SEP federal funds rate projections are the midpoints of the target ranges at year-end, for 2020 - 2023. The figure for 2020:Q3 is an estimate, the most recent value for the federal funds rate, September 21, 2020.

Source: Federal Reserve Board; FOMC, Summary of Economic Projections, September 16, 2020; Haver Analytics

Figure 7: New COVID-19 Cases Per Million Population

March 1, 2020 - September 28, 2020

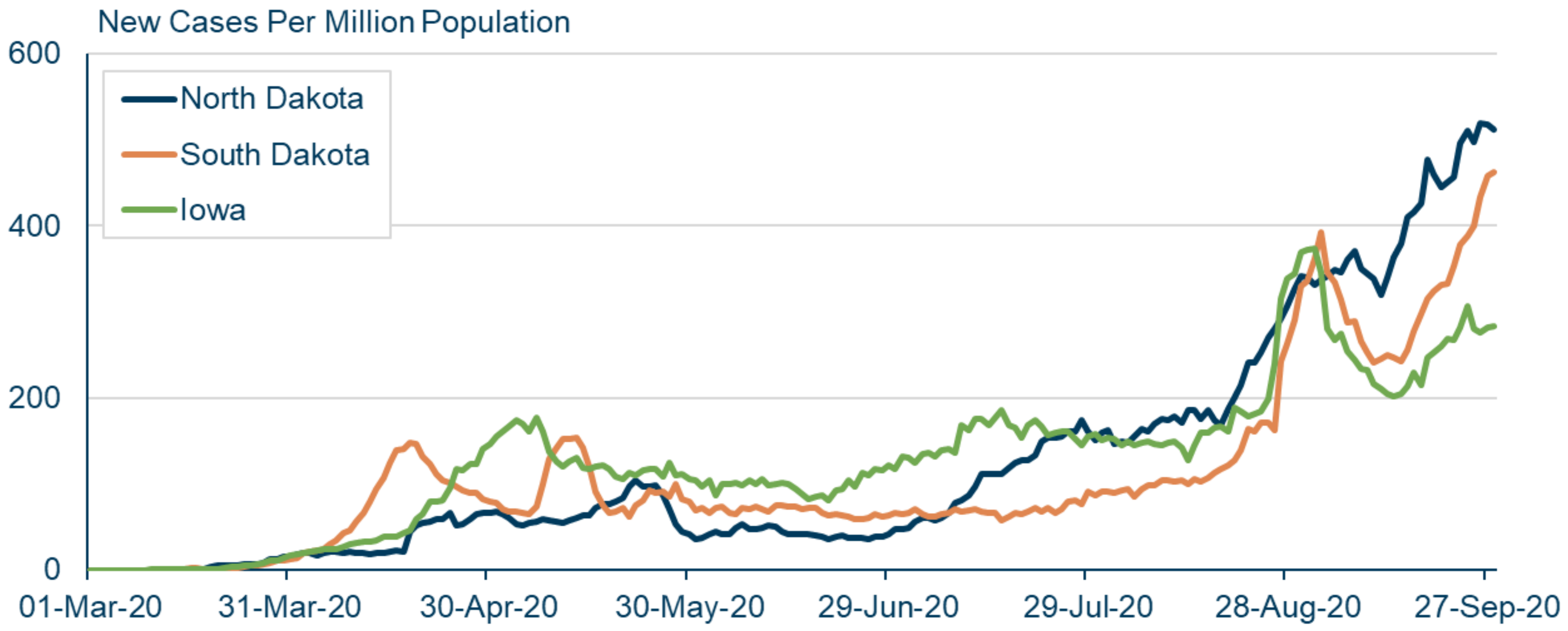


Note: New cases are seven-day moving averages. The Group of Seven (G7) Countries excluding the United States are Canada, France, Germany, Italy, Japan, and the United Kingdom.

Source: Johns Hopkins University

Figure 8: New COVID-19 Cases Per Million Population

March 1, 2020 - September 28, 2020

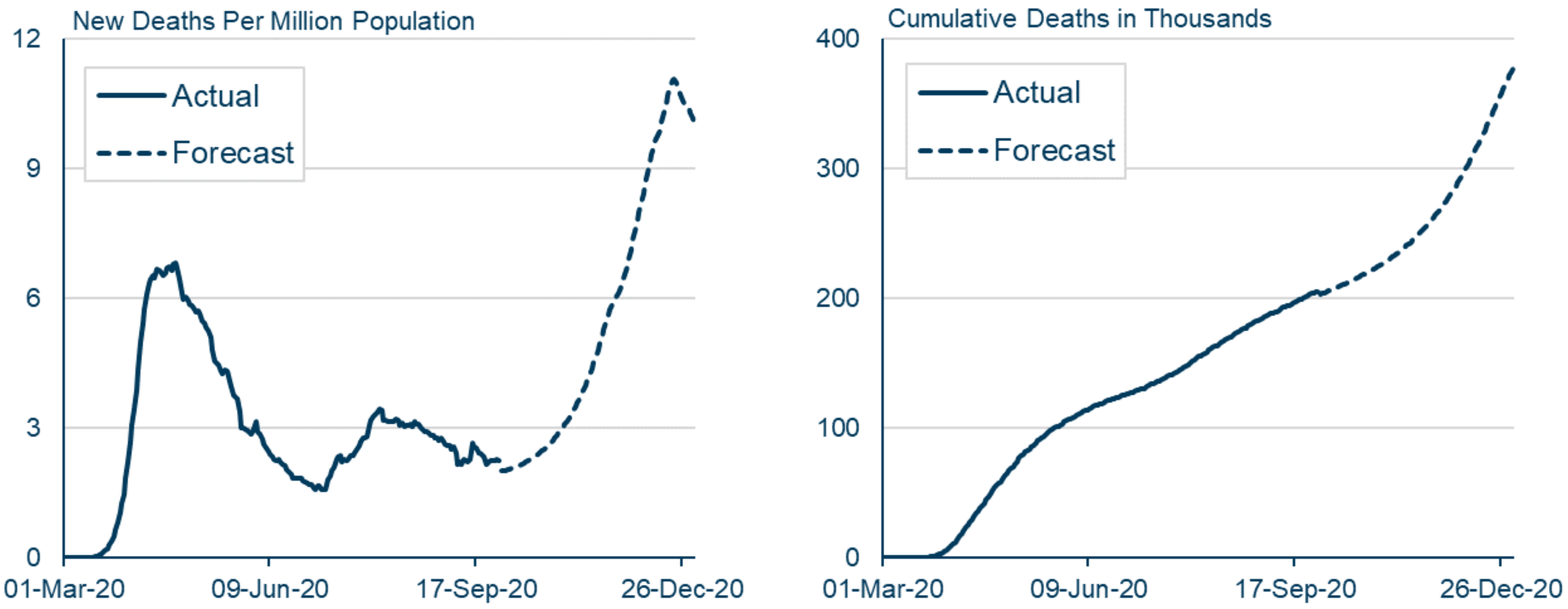


Note: New cases are seven-day moving averages.

Source: Johns Hopkins University

Figure 9: IHME Forecast for COVID-19 Deaths in the United States

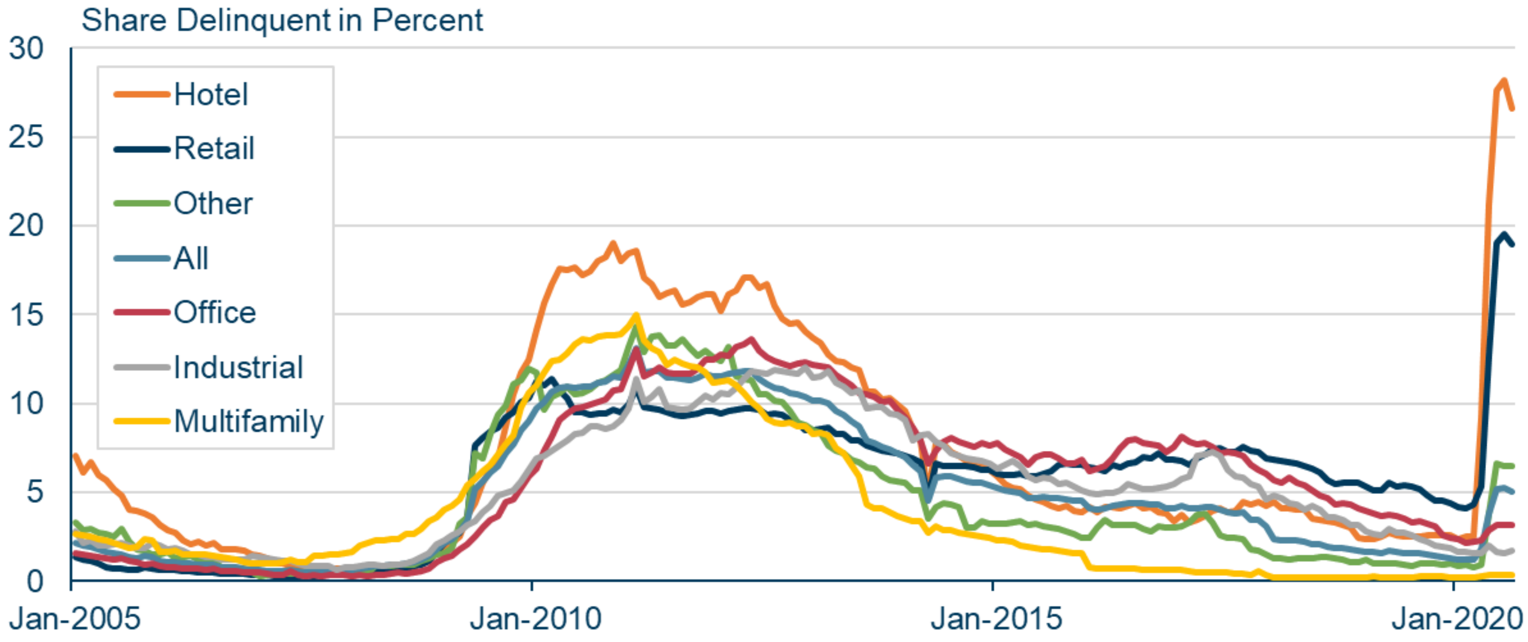
Mar 1, 2020 - Sep 28, 2020, Actual; Sep 29, 2020 - Jan 1, 2021, Forecast



Source: Johns Hopkins University, Actual; Institute for Health Metrics and Evaluation (IHME), Current Projection, September 18, 2020

Figure 10: Delinquency Share by Property Type for Loans in CMBS

January 2005 - August 2020

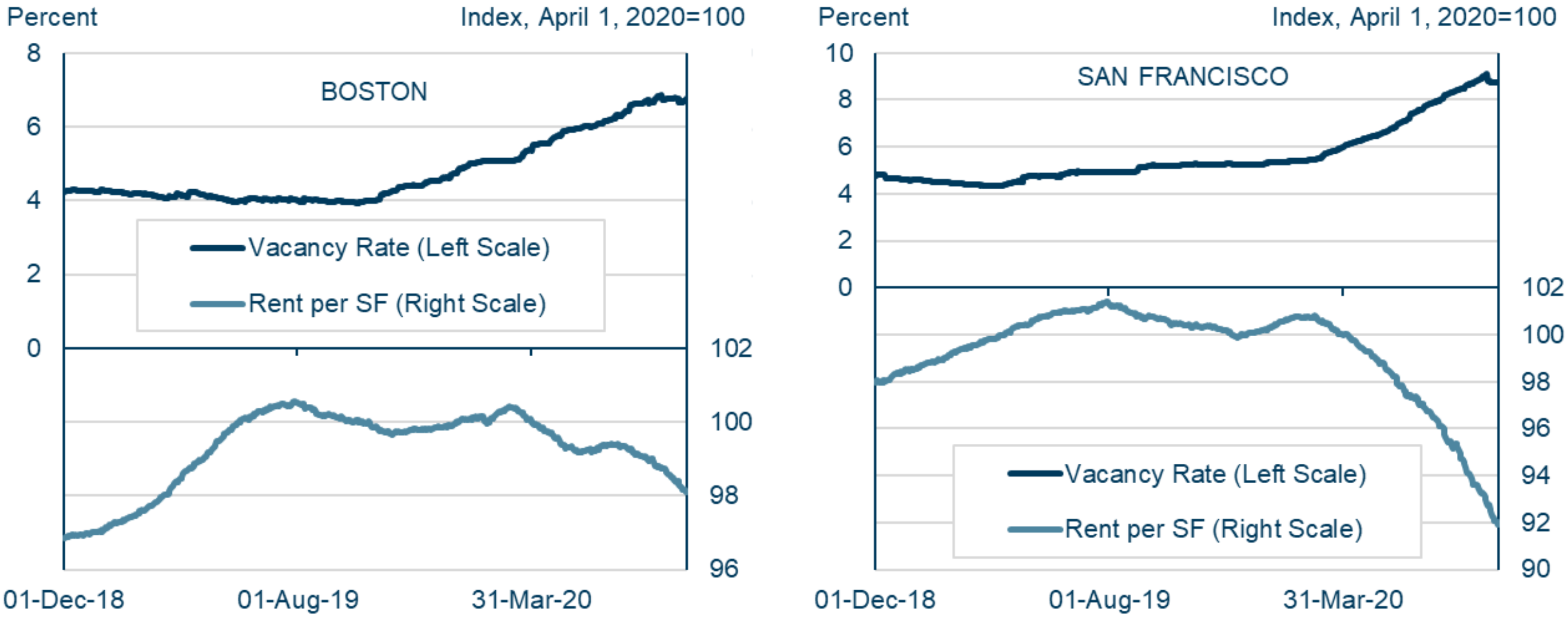


Note: Delinquency includes loans that are past due, in foreclosure, and REO.

Source: Morningstar and authors' calculations

Figure 11: Apartments: Daily Asking Rents and Vacancy Rates

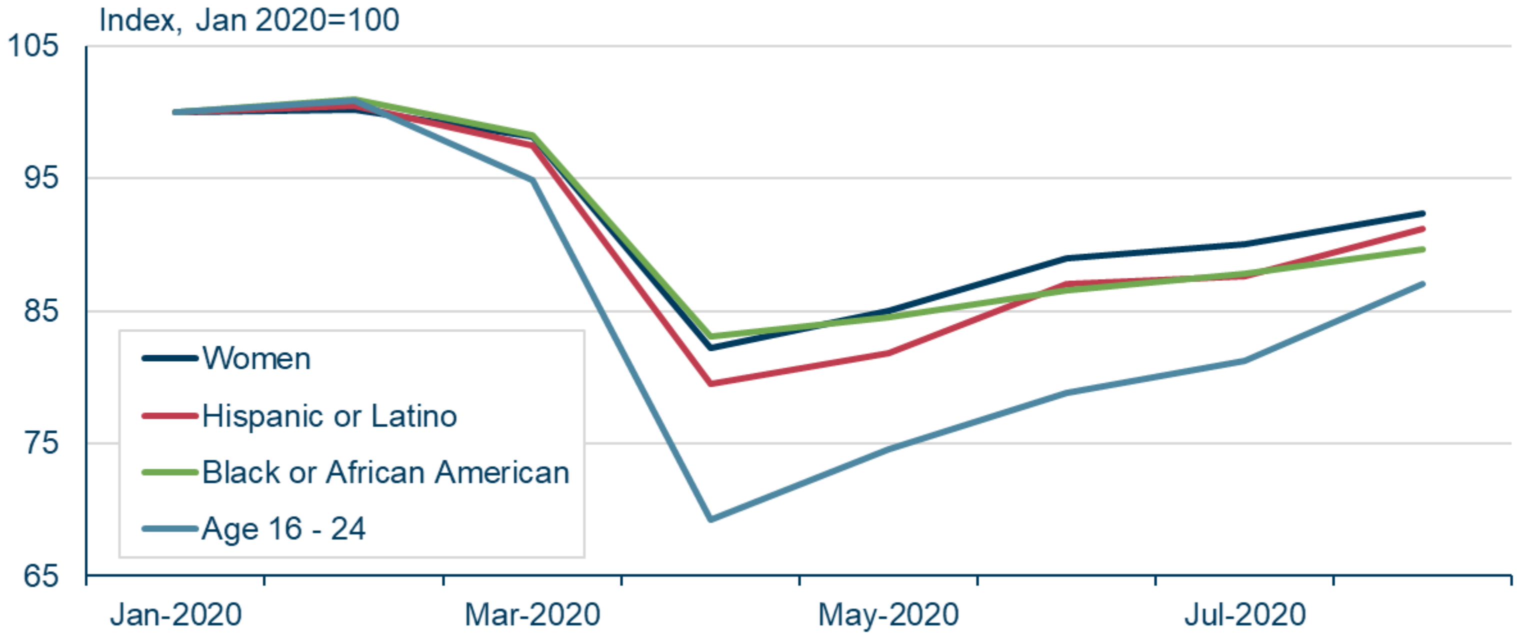
December 1, 2018 - September 9, 2020



Source: CoStar and authors' calculations

Figure 12: Labor Market Challenges: Payroll Employment Growth for Women, Minorities and Younger Workers

January 2020 - August 2020



Note: Persons whose ethnicity is identified as Hispanic or Latino may be of any race.

Source: BLS, Haver Analytics

Overview of the Fed's Main Street Lending Program (MSLP)

- Designed to provide support to firms that had been profitable before the pandemic, expect to be profitable after the pandemic disruptions abate, but have been severely impacted during the pandemic
  - Fed taking 95 percent participations in loans to for-profit companies or nonprofit entities
  - The interest rate is 3 percentage points over LIBOR
  - Requires no payment of interest until year two and no payment of principal until year three
- Banks receive fees, and reduced risk given that the Federal Reserve holds 95 percent of the loan

MSLP Underwriting Standards

- Some confusion on underwriting has resulted in the Federal Reserve issuing two new frequently asked questions
  - The first encourages banks to focus on borrower status both before and after the pandemic when considering whether a borrower is appropriate for the program
  - The second clarifies how the loan should be treated by bank supervisors, with all three federal regulators agreeing on the clarification
- Hopefully, these developments will encourage some banks to more actively engage with borrowers impacted by the pandemic, using the Main Street program

Figure 13: MSLP Loans to Borrowers by Status

as of September 28, 2020

Participation Status	Number of Loans	Participation Amount	Loan Amount
Loans Accepted	247	$2,153,142,183	$2,266,465,456
Loans Under Review	34	$664,731,626	$699,717,502
Total	281	$2,817,873,810	$2,966,182,957

Source: Federal Reserve Bank of Boston

Figure 14: MSLP Loans to Borrowers – Top 5 States

as of September 28, 2020

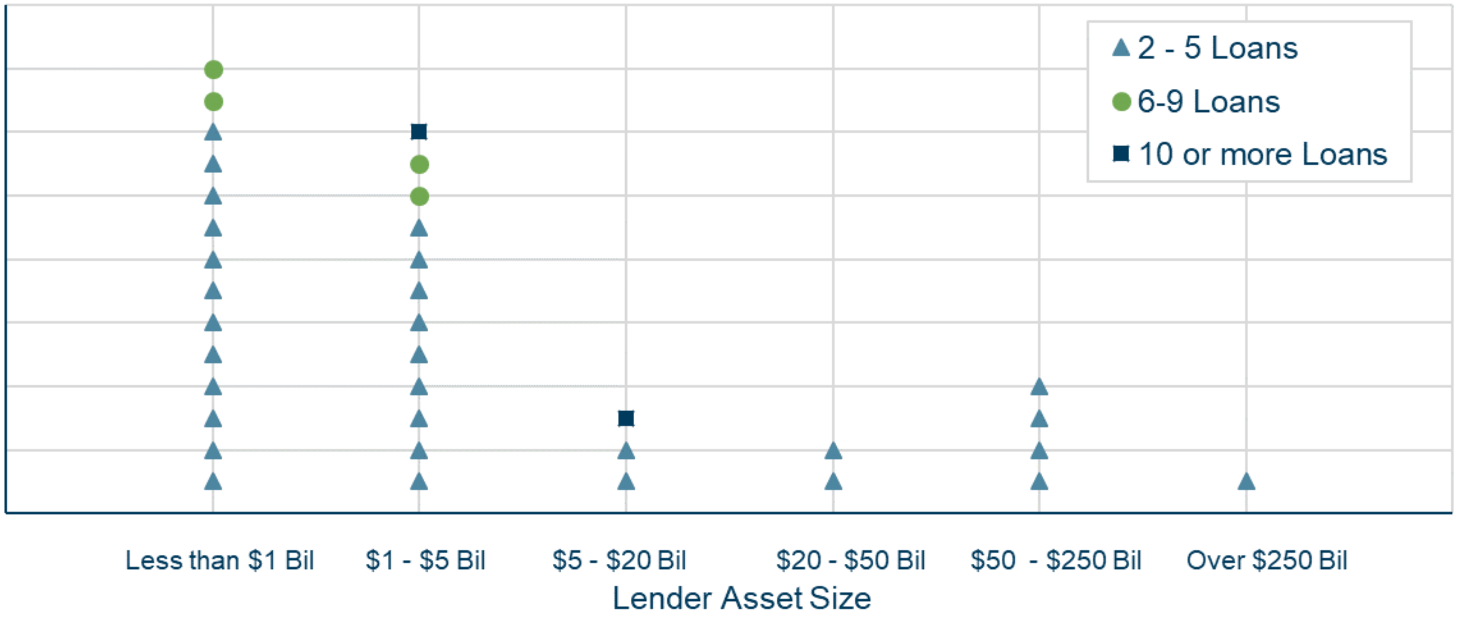
State	Number of Loans	Participation Amount	Loan Amount
Florida	92	$469,715,127	$494,436,976
Texas	40	$518,131,510	$545,401,590
California	20	$207,037,543	$217,934,256
Oklahoma	20	$105,158,114	$110,692,751
Kentucky	8	$59,564,734	$62,699,720

Note: Includes loans accepted and under review.

Source: Federal Reserve Bank of Boston

Figure 15: Number of MSLP Loans to Borrowers by Lender Size

as of September 28, 2020



Note: Includes loans accepted and under review.

Source: Federal Reserve Bank of Boston

Concluding Observations

- My view: The most difficult part of the recovery is still ahead of us
- A full recovery probably requires availability of a vaccine and more effective treatments for the virus
- I anticipate a slowly improving economy – economic activity still faces serious headwinds
- Potential financial impediments and challenges in the labor market make the recovery process more gradual than any of us would prefer
- Until a vaccine is widely available, my own view is it is appropriate to have highly accommodative monetary and fiscal policy
- Additional fiscal policy is probably the more effective tool at this time