The Economic Outlook – Optimism Despite the Challenges Ahead

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Starting New Year with Many Uncertainties Resolved and Some Positive Developments

- We now know that we have at least two vaccines that are highly effective against the virus
- Consolidated Appropriations Act, recently signed into law, provides needed fiscal stimulus
- Monetary policy will remain highly accommodative based on recent FOMC statements
- Reducing these areas of uncertainty has raised optimism and confidence (and stock indices)
Next Two Quarters Will Remain Challenging

- Economy’s performance is being impacted by pandemic
- Many states are experiencing record infections, hospitalizations and deaths
- More infectious strains amplify problems
- The labor market has stalled as infections have climbed
  - Nonfarm employment declined by 140,000 jobs
  - Unemployment remained at 6.7 percent
- Near-term economic recovery is dependent on public health: infections and vaccinations
Optimistic about Second Half of 2021

- Very low interest rates have helped consumers and businesses with debt payments
- The housing sector has been helped by low mortgage rates
- While consumer services remain depressed, the consumer goods sector has recovered nicely
  - Continues to benefit from the broad and expedited movement to online purchasing
- Many firms have increased their capital investments
  - Relying more on technology to conduct business and refit offices to accommodate more remote work
Still Significant Risks

- Delays in vaccinations could delay economic recovery
- Commercial real estate problems and nonperforming loans are likely to be revealed as forbearance ends
- Disparate economic outcomes during the pandemic have further highlighted the problems of income inequality that remain a significant challenge
- Financial shocks of March 2020 could have been ameliorated by proactively addressing problems with money market mutual funds and financial infrastructure before the pandemic hit

Addressing these issues should be a high priority
Figure 1: New COVID-19 Cases Per Million Population
March 1, 2020 - January 10, 2021

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, United Nations population estimates
Figure 2: New COVID-19 Deaths Per Million Population
March 1, 2020 - January 10, 2021

Note: New deaths 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, United Nations population estimates
Figure 3: Initial Claims for Unemployment Insurance
October 3, 2020 - January 2, 2021

Note: Four-week moving average. Data are seasonally adjusted.
Source: U.S. Department of Labor, Haver Analytics
Figure 4: Employment-to-Population Ratio
January 2020 - December 2020

Note: Includes population 16 years and older.
Source: BLS, Haver Analytics
Figure 5: Payroll Employment Increases and Decreases in Selected Industries
December 2019 - December 2020

Source: BLS, Haver Analytics
Figure 6: Real Personal Consumption Expenditures on Goods – Large Increases and Decreases
November 2019 - November 2020

Source: BEA, Haver Analytics
Figure 7: Real Personal Consumption Expenditures on Services – Large Increases and Decreases
November 2019 - November 2020

Source: BEA, Haver Analytics
Economic Recovery Intertwined with Public Health

- Overall, recent indicators suggest near-term problems stemming from elevated infections and persistent public health concerns.
- Near-term economic recovery is highly dependent on rapid, widespread vaccination.
- Unfortunately, to date, the inoculation rate has been disappointing, which likely will impact public health and the economy in the near term.
Figure 8: Personal Saving Rate
November 2019 - November 2020

Source: BEA, Haver Analytics
Figure 9: S&P 500 Stock Market Index
January 2, 2020 - January 8, 2021

Source: S&P, WSJ, Haver Analytics
Figure 10: Single-Family Home Sales
November 2019 - November 2020

Source: Census Bureau (New), National Association of Realtors (Existing), Haver Analytics
Figure 11: Unemployment Rate: Actual and Forecast from the Summary of Economic Projections
2019:Q4 - 2020:Q4, Actual; 2021:Q4 - 2023:Q4, Forecast

Note: The SEP unemployment rate forecast is for the unemployment rate in the fourth quarter of the year indicated, for 2021 - 2023. The central tendency excludes the three highest and three lowest observations.

Source: BLS; FOMC, Summary of Economic Projections, December 16, 2020; Haver Analytics
Figure 12: Delinquency Share by Property Type for Loans in CMBS
January 2005 - December 2020

Note: Delinquency includes loans that are past due, in special servicing or forbearance, in foreclosure, and REO.
Source: Morningstar and authors’ calculations
Policy Support for the Economy

- A major factor in the resilience of the economy through the pandemic has been the presence of significant fiscal and monetary support.
- CARES Act emergency lending facilities are now closed.
- Worth highlighting one of the more novel programs, the Main Street Lending Program:
  - Extended more than $16.5 billion dollars in lending.
  - Over 1,800 companies supported.
  - Surge in demand: more than half the loans were made in the last month of operation.
Figure 13: Weekly Change in Main Street Lending Program Loans Outstanding
July 22, 2020 - January 6, 2021

Source: Federal Reserve Board, H.4.1; Haver Analytics
Figure 14: Main Street Lending Program Number of Loans Outstanding
Weekly, July 22, 2020 - January 6, 2021

Source: Federal Reserve Bank of Boston
Figure 15: Main Street Lending Program’s Geographic Coverage
January 8, 2021

Source: Federal Reserve Bank of Boston
Figure 16: Main Street Lending Program: Top 3 Industry Concentrations by Loan Size

January 8, 2021

Percent of Total $ Participations

- Accommodation and Food Services
- Real Estate Rental and Leasing
- Transportation and Warehousing
- Professional, Scientific, and Technical Services
- Manufacturing
- Mining, Quarrying, and Oil and Gas Extraction
- Arts, Entertainment, and Recreation
- Construction

Source: Federal Reserve Bank of Boston
Lessons Learned from Main Street

- While the Main Street lending program provided very helpful financing, I believe that were certain tweaks permitted, it could have been more impactful.
- With less focus on mitigation of potential loss to the Treasury, much more credit would have been made available.
- Designing the program to have less legal and operational complexity would have made it more attractive.
- Structuring differently (e.g., banks earn fees as long as loan performed, vs. 5% participation) could have made the facility more attractive.
- Longer terms and greater ability to refinance (more akin to what was available to larger companies) would have increased demand.
Concluding Observations

- We enter 2021 with some optimism about the future.
- The pandemic is likely to continue to be a problem for public health and the economy until widespread vaccinations take hold.
- With substantial fiscal and monetary support, I expect a robust recovery starting in the second half of this year.
- I also expect that short-term interest rates near zero will be appropriate throughout this year, and that the Fed will continue to purchase long-term assets until the economy is on a stronger economic footing.