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

Percent Change from Year Earlier

Services | Video & Audio Streaming & Rental | Medical Laboratories | Financial Services Other Depository Institutions & Inv. Companies | Social Assistance Individual & Family Services | Transportation Services | Recreation Services | Personal Care Services | Accommodations

Source: BEA, Haver Analytics
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
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

Index, November 2019=100

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

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