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"An Update on the Economy and the Main Street Lending Program"

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The views expressed today are my own, not necessarily those of my colleagues on the Federal Reserve Board of Governors or the Federal Open Market Committee.

Good morning. Thank you for the opportunity to address the Greater Providence Chamber. I look forward to the time when these events can once again occur in person.

For all of us, the effects of COVID-19 have been uniquely challenging. Cities like Boston and New York ended up with a high number of COVID-19 cases, given their population density along with their mix of transportation, tourism, international business travel, and education. Rhode Island, too, is one of several northeast states that has faced significant challenges from the virus. Fortunately, many of the states in our area are following a data-focused strategy for relaxing quarantine arrangements. This conservative approach to reopening is likely to pay dividends for the health of vulnerable populations and for the medium- and longer-term health of the economy.

Today I would like to speak with you about the pandemic, its effects on the economy, the implications for Federal Reserve policymaking, and some of the steps that the Fed is taking to address the crisis and mitigate its financial impact on American households and businesses. This includes the establishment of the Main Street Lending Program, which is being administered by the Federal Reserve Bank of Boston for the Federal Reserve System. I'll say more about the program in a few moments, but let me note up front how pleased I am that the program opened for lender registrations on Monday. Building the program and its operational background has been a complicated undertaking. I am confident that this innovative program can help lenders across the country support the credit needs of local businesses during these very challenging economic times, with the Fed standing ready to purchase 95 percent of eligible program loans – loans with terms to bridge businesses to better days, like a 5-year term and no principal payments for the first two years.

The program is needed because of the unique economic and public health emergency we all face. Restrictions on movement and commerce that were enacted in late winter to combat the virus came with great economic costs, but were necessary to avoid much worse health outcomes due, in part, to an overwhelmed healthcare system. These restrictions also allowed the time needed to implement safety protocols throughout society.

With states beginning to relax mandated restrictions—some earlier than others—we are seeing more individuals returning to work. Indeed, the employment report for May was more positive than expected.[1] Any improvement in employment is wonderful news, given the immense impact on individuals and households from job losses and unemployment.

However, we currently face an unusually complex employment situation, given the ongoing public health concerns. More people returning to work is good news in the longer run only if it can be done safely and on a sustained basis. If workplaces reopen without the necessary health precautions, the recent increases in payroll employment could be offset by possible business closures and serious health outcomes later. The prospect of such an outcome could also sap investor, consumer, and firm confidence. If reopening can be done in ways that protect public health, then better outcomes now will also translate to better outcomes in the future.

Even as many individuals are able to return to work, we must be mindful of the deep pain still occurring in many segments of the economy. Jobs related to personal services – such as restaurants, hotels, retail stores, and tourism – have been disproportionately impacted by the health crisis. These sectors employ large numbers of workers, many of whom have little savings to cushion against a disruption in wages that lasts for many months. Frequently, these workers are people of color, young workers, and workers with less educational attainment, and not surprisingly, the unemployment rate has risen the most for these groups. In addition, many of these workers are employed in small businesses, which are heavily represented in these service industries and typically have very limited financial cushions to carry them through a disruption. Simply put, business models have been disrupted and some business owners have had their life's work endangered.

Fortunately, policymakers have acted quickly. The federal government has expanded its usual programs to help individuals during a downturn, such as making unemployment benefits more available and paying higher benefits, as well as providing direct payments to lower-income individuals.

In addition, the Federal Reserve has taken a number of unprecedented actions to prevent bouts of financial instability from having significant spillovers to the flow of credit to consumers and businesses. Among these actions, the Fed has reduced short-term interest rates to essentially zero in order to lower household and firms' borrowing costs. The Fed has also stabilized financial markets with purchases of both Treasury and mortgage-backed securities, which lowers costs for businesses to borrow and individuals to buy or refinance mortgages. Lastly, the Fed has also initiated a range of emergency lending facilities to provide liquidity directly to borrowers and investors in key credit markets.

In my remarks today, I will discuss the progress of our Main Street Lending Program, which is designed to help credit flow to small and medium-sized businesses that were in sound financial condition before the onset of the COVID-19 crisis, but now need loans to help maintain their operations and payroll until they have recovered from, or adapted to, the impacts of the pandemic.[2]

Despite these important policy actions to date, I believe more support is likely to be needed from both monetary and fiscal policy. Unemployment remains very high, and because of the continued community spread of the disease, and the acceleration of new cases in many states, I expect the economic rebound in the second half of the year to be less than was hoped for at the outset of the pandemic. My own forecast is that the unemployment rate will remain in double digits through the end of the year, which is somewhat higher than the median view of participants at the Federal Reserve policy-making body, the Federal Open Market Committee, or FOMC. At the same time, the inflation rate is very likely to remain well below the Federal Reserve's 2 percent target. With low inflation and high unemployment through this year and next, I believe additional policy stimulus is necessary.

The Economic Outlook

The employment report for May was stronger than most forecasters expected. One possible reason is that states began opening up earlier than epidemiologists were recommending and workers returned to their previous jobs or found new jobs faster than anticipated.[3] Still, even with the employment gains, the unemployment rate remains quite elevated, as shown in **Figure 1**. At 13.3 percent, the U.S. unemployment rate for May was up dramatically from February.

However, even this very high unemployment rate understates the disruption in labor markets. The second set of bars shows the U.S. Bureau of Labor Statistics' estimate of how many respondents to the employment survey classified themselves as being employed but not at work—individuals who should have been counted as unemployed on temporary layoff. As you can see from the estimates, these respondents, if correctly classified, would have increased the unemployment rate by almost five percentage points in April and just over three percentage points in May. So yes, the unemployment rate did improve from April, but the picture is not as bright as the headline unemployment rate measure suggests. In addition, the number of individuals wanting a job now but not currently looking for work, the third set of bars, also rose once the pandemic hit. Taken together, these three sets of bars indicate a badly disrupted labor market.

Figure 2 shows that the unemployment rate rose for all age cohorts. However, individuals between the ages of 16 to 24 have a particularly elevated unemployment rate. This indicates the presence of significant challenges for those individuals who are newly entering the labor market and are frequently looking for entry-level positions. This should be particularly concerning, given prior evidence that the earnings paths of those individuals entering the labor market during a downturn are adversely affected for many years.

Figure 3 illustrates that Hispanic and African American workers have been disproportionately impacted by recent job losses, with Hispanic workers showing the largest increase in unemployment. In all, while prior to the pandemic unemployment for people of color had fallen to quite low levels by historical standards, these groups have been disproportionately impacted since the onset of COVID-19.

Figure 4 shows that the pandemic caused increases in unemployment across all educational attainment categories. However, the increase in unemployment is particularly pronounced for those with lower levels of educational attainment. Many of the jobs that are often filled by people with lower educational attainment are service jobs that have been particularly impacted by the pandemic, such as positions at hotels, restaurants, and tourism-related firms.

Figure 5 provides the median forecast for several economic variables submitted by participants at the June FOMC meeting. These median forecasts reflect the significant economic toll from the pandemic. Real GDP is forecast to decline by 6.5 percent this year, core inflation is expected to end the year at only 1 percent, and the unemployment rate is forecast to be 9.3 percent by year end. Unfortunately, I believe even this dire outlook may be too optimistic. My own forecast is somewhat more pessimistic, as I expect the unemployment rate to still be at double-digit levels at the end of the year, given what are likely to be persistent economic headwinds from the pandemic over the second half of the year. And my own more pessimistic forecast does not fully incorporate the challenges of a second wave of the virus that is more severe than the first – an outcome that occurred with the 1918 Spanish Flu, the 1957-1958 Asian Flu, and the 2009-2010 H1N1 Flu.

As **Figure 6** highlights, the economic toll of the virus is closely tied to how successfully we can get the public health pandemic under control. So far, in the United States efforts to contain the virus have not been particularly successful, with more cases per thousand than the other countries shown on the chart. This lack of containment could ultimately lead to a need for more prolonged shut-downs, which result in reduced consumption and investment, and higher unemployment – as shown on the chart. Countries with much more successful pandemic containment efforts, like Japan and South Korea, have also had much less disruption to their labor markets.

As a result, I believe that a more rapid and complete economic recovery requires better ability to contain the pandemic. Or medical solutions that make infections much less *likely*, such as with an introduction of a successful vaccine – or much less *severe*, such as with the development of more effective treatments.

Figure 7 shows differences in social distancing across states, measured in terms of mobility from cell phone-based foot traffic data to over 5 million points of interest. The figure suggests that social distancing behavior is strikingly different across states. In Massachusetts and Rhode Island, where the economy is now only slowly reopening, non-essential retail and restaurant visits are down dramatically and do not look much different now than in the middle of March. In contrast, a state like South Carolina, and to some degree Florida, have seen visits to non-essential retail establishments and restaurants rise following their initial decline in March, and especially since the early reopening of these states' economies. Especially in South Carolina, visits to these locations are only a little lower now relative to their pre-shutdown levels. Rapidly available (higher frequency) expenditure data show a pattern similar to the mobility numbers – with spending in many southern states that reopened earlier rebounding more than in states in the Northeast and West.

Whether states with mobility patterns like Massachusetts and Rhode Island – or South Carolina and Florida – fare better going forward will depend importantly on how changes in social distancing affect the progress of the pandemic; in fact, evidence is already emerging that new cases in South Carolina and Florida are rising (**Figure 8**). If there are significant flare-ups in states that have aggressively reopened, the reduction in social distancing that contributes to stronger economic performance in such states *now* may translate to more depressed economic activity and increased public health issues in those states in the future. And given the U.S. population's ability to travel, any region that does not socially distance effectively and suffers increased rates of infection will likely export their public health problems to other regions of the country that are tourist sites, transportation hubs, or educational centers.

In sum, given the death toll of the virus even with the economic lockdown, I see a substantial risk in reopening too fast and relaxing social distancing too much. And even if it turns out that the response to the pandemic has been calibrated appropriately, the forecast from FOMC participants highlights the need for additional highly stimulative monetary policy, including the use of Federal Reserve emergency lending facilities.

Update on the Main Street Lending Program

I will now turn to a discussion of the Main Street Lending Program, expanding on some of my earlier comments. Since the Federal Reserve first announced the program,[4] the Boston Fed has been very focused on taking all the necessary steps to operationalize this innovative emergency lending initiative, which aims to help facilitate credit flows that can bridge small and medium-sized businesses until better economic times. I'm very happy to provide an update on those efforts today, and would like to say a bit about the ways this program can make a difference.

First, some context. In contrast to many of the Federal Reserve's emergency facilities, which focus on buying relatively standardized market securities, the Main Street Lending Program focuses on bank loans to businesses. Since every business, and every business loan, is somewhat unique, the program is inherently complex. I am very proud of the team that is working tirelessly to stand up the program to serve the public interest at this terribly challenging time in our economy.

In particular, the program addresses a problem that is evident in **Figure 9**. In each of the past three recessions, business lending decreased significantly. While some of these declines resulted from reduced demand for loans from businesses, in two of the past three recessions lending conditions clearly tightened significantly, restricting credit supply. In general, credit supply is restricted when uncertainty is high and some banks experience elevated loan losses.

This dynamic is particularly relevant if bankers fear worsening economic conditions, or their bank's own financial condition makes them more reluctant to lend on the same terms as prior to the economic downturn. In severe downturns, such as the 2008-2009 financial crisis, poorly capitalized banks reduced their balance sheets by becoming much more restrictive with their lending. (Loans are assets for banks, so lending less preserves capital-to-assets ratios when capital is under stress). While banks are currently well capitalized, the economic outlook is highly uncertain, with substantial downside risks, and bank balance sheets may become more pressured over time. While some previous recessions have involved credit crunches, the kind of shock we've seen since the pandemic arrived is unprecedented in post-war history.

To facilitate the flow of credit for businesses, particularly those that are dependent on bank financing, the Federal Reserve created the Main Street Lending Program to participate in lending with banks. While I covered some of the details of this program in an earlier talk, recent changes to the program made it even more widely available for borrowers, allowing more small and medium-sized businesses to be able to receive loans.[5] The revised term sheet included significant adjustments. I would highlight that the minimum loan size was reduced to $250,000, making it more attractive to smaller businesses and community banks. In addition, the terms were made more attractive. The maturity was extended to five years (from four), and the amortization schedule was eased. No principal is due in the first two years, with interest deferred in the first year.

The program is designed to assist lenders in meeting the credit needs of the businesses in their communities, even amidst the pandemic's economic disruptions. The Fed will participate in the lending by purchasing a 95 percent interest in the loan, provided it meets the terms and conditions of the program. By purchasing this percentage of the loans, the Federal Reserve will take on most of the risk that would otherwise need to be absorbed solely by lenders, and will create additional balance sheet capacity for lenders to extend more loans at this challenging time for our country's economy.

Interested businesses will work with an eligible lender to determine if they meet the program requirements, which are available online, as well as the lender's own underwriting standards. The lender will determine whether a business is approved for a loan.[6]

In addition, the Federal Reserve just announced it is seeking feedback on a proposal to expand the program to support nonprofit entities.[7] While the loan underwriting conditions have been tailored to nonprofits, other aspects of the loan, such as maturity and amortization are the same as for small and medium-sized businesses (**Figure 10**). The Federal Reserve and Treasury are seeking comment on this term sheet before revising it and preparing to operationalize the program.

On Monday of this week, we opened the registration and verification process for financial institutions that wish to participate as lenders in the Main Street Program. These are still early days in the program, and we are seeing a steady stream of interest – with over 200 financial institutions, large and small, initiating registration as of yesterday. The institutions that have registered so far are geographically dispersed, representative of all 12 Federal Reserve districts. I am encouraged, too, by the interest of many smaller financial institutions like community banks.

Many more lenders have inquired about the program and attended our outreach sessions. We encourage lenders who have not yet registered to explore the program, learn about the ways it can help them help their business borrowers, register to participate, and in fact to begin to immediately make the loans that qualify using the program terms. Lenders need not wait to make qualified loans, which they will be able to sell 95 percent of to the Fed when the program's transactional phase begins.[8]

I anticipate that many more institutions will register for the program, given its benefits to them, their customers, and the areas where they operate. We continue to do widespread outreach and field significant numbers of inquiries. Lenders have a vested interest in the resilience of the businesses in their market, and this program gives them a way to help bridge those businesses that were sound before the pandemic to better days.

Of course there is a learning curve, but we are seeing tremendous interest in the loans from businesses. Lenders are determining how they'll participate in and communicate about the program. Borrowers will need to persist during this ramp-up phase. But I am very positive about the promise of the program in helping local businesses and lenders maintain vital business credit during these very challenging economic times.

Concluding Observations

I'd like to conclude with a few big-picture comments. The global pandemic has already made existing societal divisions starker – and recent tragic events have left us all wresting with the complex reality of societal inequities. Here at the Boston Fed, we know that now, more than ever, it is important to continue our work to make socio-economic outcomes inclusive of every American. The recovery after the Great Recession, with low levels of unemployment enjoyed across disparate demographic groups before the COVID-19 outbreak, illustrates that the Federal Reserve's fulfillment of the full employment mandate can help to support an inclusive economy.

The U.S. economy is currently suffering from high unemployment and low inflation, fully justifying additional monetary and fiscal policy actions to return the economy as quickly as possible to where we were prior to the COVID-19 pandemic. While these policies can help mitigate the economic impact of the crisis, much of the path of the economy will be determined by the virus and how successfully it can be contained, either through public health or medical innovations.

As well as more traditional monetary policy tools, the Federal Reserve is operating several significant emergency credit facilities. The Main Street Lending Program has recently expanded in scope to become more attractive for borrowers and lenders. Our hope is that this program will, over time, provide an important source of liquidity for small and medium-sized businesses that might otherwise not receive credit on the same terms. In addition, it provides an important backstop should the pandemic be more severe than anticipated this fall.

Thank you, and I wish you all continued health during these challenging times.

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[1] See May 8, 2020 Employment Situation Summary by the U.S. Bureau of Labor Statistics

[2] For more discussion of the Main Street Lending Program, see my remarks delivered to the New England Council on May 19, 2020: https://www.bostonfed.org/news-and-events/speeches/2020/main-street-lending-program-and-other-federal-reserve-actions.aspx.

[3] Forecasters likely knew states were reopening sooner than anticipated when writing down their employment outlooks so it is more workers finding jobs faster than they were anticipating given the reopening or the broader disconnect between the claims data and household survey data.

[4] https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm

[5] https://www.federalreserve.gov/newsevents/pressreleases/monetary20200608a.htm

[6] The Main Street program aims to assist businesses that employ a major share of the American workforce. For smaller businesses, in addition to reviewing the Main Street Lending Program materials, it may be useful to consult the Small Business Administration's Coronavirus Small Business Guidance & Loan Resources and the Treasury's Community Development Financial Institutions Fund - Tools and Resources, which has a list of current certified CDFIs, many of which make loans to small businesses and provide technical assistance.

[7] https://www.federalreserve.gov/newsevents/pressreleases/monetary20200615b.htm

[8] The Main Street Lending Program, administered by the Federal Reserve Bank of Boston, intends to purchase 95 percent of each eligible loan that is submitted to the program, provided that the required documentation is complete and the transactions are consistent with the relevant Main Street facility's requirements. The Main Street Lending Program will also accept loans that were originated under the previously announced terms, if funded before June 10, 2020.