# Some Thoughts on the Future of the U.S. Economy

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*Corridor Business Journal* Mid-Year Economic Review
June 24, 2020

FEDERAL RESERVE BANK OF CHICAGO

The views expressed today are my own and not necessarily those of the Federal Reserve System or the FOMC.

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## Introduction

Thank you for the opportunity to speak to you today. The views I'll express are mine and do not necessarily reflect the views of the Federal Open Market Committee (FOMC) or others in the Federal Reserve System.

Before I begin my remarks, I want to take a moment to reflect on the police incident in Minneapolis that led to the death of George Floyd and the protests that have spread across the country. Like you, I am outraged and horrified by injustices toward the black community. Racism has no place in our society, and each of us has a responsibility to combat it. At the Chicago Fed we have made diversity and inclusion a priority in our own corporate culture. It is a responsibility we all share.

We are also together in grappling with the worst pandemic in more than 100 years. Almost overnight, the health care crisis has developed into the sharpest economic downturn we've ever experienced. My hope is that states can safely reopen their economies and that, in due course, life will return to much as it was before. But the path ahead remains unclear.

In my remarks today, I will focus on three central messages.

- First, while I hope for a quick rebound in the economy, I expect broad recovery will take some time. Furthermore, the future is more uncertain now than at any other time in my professional career. The outlook depends on so many factors of a virtually unprecedented nature—we really are in uncharted territory.
- Second, the situation demands strong fiscal and monetary policy actions to help support households and businesses through these challenging times. Policy has already done a lot, but more may be necessary. For its part, the Federal Reserve is committed to using its full range of tools to support the U.S. economy through these difficult times.
- Third, while the economic impact has been catastrophic for an extraordinarily large number of people and businesses, sadly, the cost has fallen most heavily on some of our most vulnerable populations. No one could have adequately prepared for an event of this magnitude, but some, notably low-wage workers in exposed industries, have felt disproportionate pain.

**Broad recovery will take time and the outlook is highly uncertain**

Given the rapid onset and unprecedented scale of the current crisis, it is easy to forget the economy was doing well before the pandemic. Labor markets were strong. At just 3-1/2 percent, the unemployment rate was at a 50-year low. The improvements in labor markets were finally benefitting a broad group of workers. Consumer sentiment was high, and importantly, household spending was solid.

Before the pandemic hit, I—like most analysts—expected the U.S. to experience continued solid growth, supported primarily by strong consumer spending.

I don't need to spend time reviewing the specifics of the virus's threat or the actions taken to stem its spread. We all know and have experienced the heavy human and economic toll the health care threat has taken. Alarmingly, since February, employers have shed nearly 20 million jobs from their payrolls, and the unemployment rate reached an extraordinarily high 13.3 percent in May. The most severe job losses have been sustained by those with lower earnings and by the socioeconomic groups that are disproportionately represented among low-wage jobs in industries deeply impacted by the pandemic, such as leisure and hospitality and retail. Regarding the broader economy, most forecasters are looking for a massive decline in gross domestic product (GDP) in the second quarter—something on the order of –30 to –40 percent at an annual rate.

As states ease restrictions, economic activity is picking up. And there are some indications that it may be rising faster than most forecasters had anticipated. A number of daily and weekly indicators of individuals' mobility and spending appeared to reach bottom in late April or early May and then began to improve. Sales of motor vehicles also picked up a good deal last month. And though still at a very elevated level, new claims for unemployment insurance have moved down. Consumer spending, which is an important driver of economic activity, showed signs of recovery in May, with retail sales rising sharply for all major categories. As factories began to reopen, manufacturing production, which has been anemic, also picked up last month, although the increase was relatively modest. Then there was the surprising May labor market report. Although analysts almost uniformly had expected large job losses last month, nonfarm payroll employment instead rose by 2-1/2 million and the unemployment rate declined some.

At this point it is too early to tell how much of the improvement is simply timing, with firms bringing back workers and consumers returning to stores sooner than most analysts had expected, and how much represents stronger underlying demand.[1] It is probably a little of both. Most forecasters are looking for positive growth in the third quarter—with recent projections in the 10 to 30 percent range.

Turning to inflation, the Fed's explicit goal is for annual inflation to be symmetric about 2 percent, as measured by the Price Index for Personal Consumption Expenditures (PCE).[2] Even with the long recovery and expansion before the pandemic, we never reached this target. And now, with the pandemic's impact on aggregate demand, inflation has moved down significantly. In February, on the eve of the pandemic, core PCE inflation—which strips out the volatile food and energy components—was 1.8 percent.[3] By April, it had declined to just 1 percent. Large price decreases in some categories most directly affected by social

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[1] The labor market report from the U.S. Bureau of Labor Statistics covers activity for the reference period that includes May 12. At that point, most of the nation had begun to ease restrictions related to the pandemic, but many states were still quite early in the process.

[2] As mandated by Congress, the monetary policy goals of the Federal Reserve are to foster economic conditions that achieve both stable prices and maximum sustainable employment. Our two goals of price stability and maximum sustainable employment are known collectively as the dual mandate.

[3] While our objective is stated in terms of overall PCE inflation, core inflation is a better gauge of sustained inflationary pressures and of where inflation is headed in the future.

distancing contributed heavily to the decline in consumer inflation in March and April.[4]

What should we expect for growth and inflation over the next couple of years? As part of our normal policy discussions, FOMC participants periodically provide forecasts for key economic variables and views of appropriate policy that support those forecasts. These forecasts are released in our quarterly Summary of Economic Projections (SEP).[5] The most recent one was released two weeks ago after our June meeting.[6]

FOMC participants generally expect the economic recovery to begin in the second half of this year. Even so, GDP is expected to show a sharp decline for the year as a whole, with the median forecast for a fall of 6-1/2 percent. The median outlook then has GDP rising by 5 percent next year and 3-1/2 percent in 2022. The unemployment rate is expected to be somewhat above 9 percent at the end of this year and to decline to 5-1/2 percent by the end of 2022. That is still nearly 1-1/2 percentage points above the median participant's estimate of its long-run normal level. And I would note that the range of growth and unemployment rate forecasts made by the FOMC participants was quite wide,

[4] Overall inflation also has been held down by substantially lower energy prices, which more than offset the effects of surging prices for food. As a result, total PCE inflation has declined more dramatically from 1.8 percent in February to a mere 0.5 percent in April.
[5] In March, with states beginning to implement shutdown orders and the spread of Covid-19 driving events, there was too much uncertainty to provide a meaningful forecast. So we skipped the March exercise and returned to a normal schedule for the SEP in June.
[6] See Federal Open Market Committee (2020a).

attesting to the unprecedented level of uncertainty we face. My own forecast is in broad alignment with the FOMC median.

I can't speak to others' assumptions, but crucially, my forecast assumes growth is held back by the response to intermittent localized outbreaks—which might be made worse by the faster-than-expected reopenings. In this environment, many resources will be devoted to health and safety. I assume health solutions become widely available as we move through 2022, and I allow for a return to more normal operations by late in the year.

My forecast has real GDP returning to its pre-pandemic 2019:Q4 level sometime later in 2022. Of course, without the virus the economy would have been growing. So even after three years, my projected recovery places us below where the economy would have been had the virus not occurred. Unfortunately, I think some previously expected trend growth has been permanently lost.

This is my baseline outlook for growth. But as I noted, the uncertainties surrounding it are enormous. The forecast will undoubtedly be wrong. Still, it's a useful exercise for anchoring our thinking. One of my advisors kicked off our regular forecasting exercise at the Chicago Fed by quoting Dwight D. Eisenhower, who said, "In preparing for battle I have always found that plans are useless, but planning is indispensable."[7] I find this sentiment especially apt under the current circumstances.

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[7] This quotation appears in Andrews (1993, p. 688).

Usually, we are able to look to the past for guidance on what is in store for the future. But in this situation, there is simply no relevant benchmark. It is unlike anything we have dealt with before. First and foremost, there is the massive uncertainty over the future path of the virus and the success or failure of therapeutics and vaccines. Until the virus is treatable or controlled through other measures, the return of economic activity hinges on the ability of businesses to provide safe workplaces and consumer environments. How much these efforts will allow activity to recover is an open question.

Even once these modifications are in place, there is the question of the willingness of workers to return to their jobs and the eagerness of consumers to reengage in regular day-to-day activities. And somewhat paradoxically, there's also the risk that too hasty a comeback could create added health burdens that end up forestalling a more complete recovery. In this highly uncertain environment, business investment, which is critical for growth, may be delayed or canceled. And add to this the impact of social unrest on confidence, investment, and the spread of the virus.

There is also uncertainty over scarring from the downturn itself. Without the devotion of adequate resources, we risk a wave of bankruptcies that destroy businesses, supply chains, and human capital—all of which may have taken years to develop. Such risks could be particularly acute for the retail and leisure and hospitality sectors.

Now, there could be some positive surprises as well. We are devoting many resources to the health effort, and progress there could be faster than in my baseline. Our ability to run safe operations at scale may be better than expected. And workers whose old firms have folded may be able to move to new jobs more seamlessly. Still, for me, there seem to be both more and larger downside risks than upside ones—so I think the balance of risks to growth is skewed to the downside.

Regarding inflation, I think some of the extreme price declines in March and April are likely behind us. But the effects of soft aggregate demand could take some time to recede and show through to stickier prices. In the June SEP, the median forecast had core PCE inflation for 2020 at just 1.0 percent.

Looking ahead, I anticipate the downward pressure on prices from resource slack to diminish in 2021 and 2022. If inflation expectations do not fall, this should support some modest increase in inflation in those years.[8] The median FOMC participant's forecast has core PCE inflation rising, but to only 1.7 percent by the end of 2022.

Risks to the growth outlook I just mentioned, fragility in inflation expectations, the fiscal situation, and a number of other factors impart a great deal of uncertainty to this forecast. On balance, even with substantial monetary policy effort, I also see the risks to the inflation outlook as tilted to the downside.

These are my best assessments of what is in store. But the uncertainties are enormous, and as I said, I see the risks weighted to the downside. Indeed, other

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[8] Inflation expectations are a key determinant of actual inflation.

forecasts with more severe effects on economic activity are almost equally as plausible in my view.

**Policy actions**

Both monetary and fiscal policymakers responded aggressively when the crisis hit. Together, our policies have worked to support households and businesses through the shutdown phase to set the stage for as strong a recovery as possible. There will be losses, but the goal is to limit them as much as we can and to avoid the costly destruction of worker, employer, and business-to-business relationships. An important objective here is to keep temporary liquidity difficulties from evolving into more damaging solvency problems. Avoiding unnecessary bankruptcies will help preserve these relationships and help support the return of furloughed workers to their jobs.

On the fiscal policy front, Congress responded with the fastest and largest support in any postwar economic downturn.[9] The policies have many elements and include direct aid to households in the form of stimulus checks and expanded unemployment insurance; loans or grants to small businesses—in particular from the Paycheck Protection Program—with incentives for firms to maintain payrolls; and a host of other efforts providing aid to businesses, health care providers, and state and local governments.

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[9] To date, Congress has passed four bills addressing the pandemic and its economic consequences. These are the Coronavirus Preparedness and Response Supplemental Appropriations Act of 2020; the Families First Coronavirus Response Act; the Coronavirus Aid, Relief, and Economic Security (CARES) Act; and the Paycheck Protection Program and Health Care Enhancement Act.

The Congressional Budget Office puts the price tag of these efforts at almost $2.2 trillion, or about 11 percent of GDP, this fiscal year; this is huge.[10] And there is evidence that they have been effective. In research at the Chicago Fed, Karger and Rajan (2020) estimate that a recipient's spending increased sharply in the two days following the receipt of a stimulus payment, before slowly returning to baseline levels after two weeks.[11] The initial batch of payments was issued in mid-April, and the timing roughly coincides with the improvement we saw in some of the economic indicators.[12]

With regard to monetary policy, the FOMC acted quickly in March and cut the target range for the federal funds rate to zero to 25 basis points—what we refer to as the effective lower bound (ELB). The Committee also indicated rates would remain low until it is confident that the economy has weathered recent events and is on track to achieve our maximum employment and price stability goals.[13] Given the forecasts I just discussed, this is likely to be the situation for a long time. Indeed, in the June projections, all FOMC participants anticipated that it would be appropriate to maintain the federal funds target at its current range through the end of next year, and only 2 out of 17 penciled in a rate increase in 2022.

[10] The fiscal year ends September 30, 2020. For additional information, see Board of Governors of the Federal Reserve System (2020) and Swagel (2020).
[11] Overall, recipients increased spending by 48 percent of the stimulus amount in the two weeks following receipt.
[12] See U.S. Department of the Treasury, Bureau of the Fiscal Service (2020).
[13] This change was announced in Federal Open Market Committee (2020c).

In addition to easing the stance of monetary policy, the Fed has deployed various other tools to promote the smooth functioning of financial markets and support the flow of credit to households and businesses.[14] Some of these tools were used successfully during the Great Recession, and others are new.

First, in order to address distress in the crucial markets for U.S. Treasury securities and mortgage-backed securities, we conducted repurchase agreements and purchased large quantities of these securities. These interventions were successful, and we were able to scale back purchases. In June we announced that over the coming months we would purchase these securities at least at the current pace to help foster the effective transmission of monetary policy to broader financial conditions.[15]

Other programs have been designed to more directly support the flow of credit in the economy—for households, for businesses of all sizes, and for state and local governments.[16] These include the Money Market Mutual Fund Liquidity Facility (MMLF), the Paycheck Protection Program Lending Facility (PPPLF), the Municipal Liquidity Facility (MLF), and the Main Street lending programs. Some of these programs provide backstops to key financial markets, which can increase the willingness of private lenders to extend credit. Others deliver more direct participation in loans to small and medium businesses, nonprofits, and state and local governments. Many of these programs rely on emergency lending

[14] For a discussion of recent monetary policy actions, see Board of Governors of the Federal Reserve System (2020).
[15] This announcement was made in Federal Open Market Committee (2020b).
[16] A list of facilities established by the Federal Reserve in response to the Covid-19 crisis is available online, https://www.federalreserve.gov/funding-credit-liquidity-and-loan-facilities.htm.

powers that require the approval of the Treasury and are available only in very unusual circumstances, such as those we find ourselves in today. We are deploying these lending powers to an unprecedented extent with the financial backing and support from Congress and from the Treasury.

Despite all these efforts, more may be needed. Further fiscal policy actions are under consideration. On the Fed's part, as Chair Powell has emphasized repeatedly, we will continue to use our lending powers "forcefully, proactively, and aggressively until we are confident that we are solidly on the road to recovery."[17] And even after the recovery is well in train, we will use all of our tools to meet our dual mandate goals of maximum employment and symmetric 2 percent inflation.

**An unequal burden**

As I noted earlier, before the pandemic hit, even those who are sometimes last to experience the benefits of a rising tide were beginning to share in economic prosperity. For example, after hitting double-digits in the Great Recession, unemployment rates for black and Latinx workers had fallen to historic lows of 5.9 and 4.2 percent, respectively, by the end of 2019. Wage growth also had started to pick up for low-skill, minority workers. But things certainly have deteriorated—those black and Latinx unemployment rates are now 16.8 and 17.6 percent, respectively.

[17] Powell (2020a). See also Powell (2020b).

This recession is unique in its rapid onset, scope, and scale. And unfortunately, the burden falls most heavily on many who are least able to bear it. As I mentioned earlier, the impact on workers in the retail, leisure and hospitality, and other service sectors is especially severe. Because these industries tend to employ disproportionately more females, minorities, and younger workers, enormous job losses in these sectors have pushed already relatively high unemployment rates even higher for these groups. In addition, many of these workers have dropped out of the labor force since the start of the pandemic.

Also, stay-at-home orders have led to record high rates of business closures. These are hard on everyone, but become a much more serious problem if a temporary closure turns into an outright business failure. Although closures cut across nearly all industries, minority-owned businesses and those owned by women and immigrants are disproportionately at risk of failing—both because of the industries in which they operate and because they have fewer resources to survive the downturn.[18] Should these businesses permanently shutter their doors, their failures could have longer-term implications for their owners, their employees, and the communities in which they operate.

Frontline workers in essential industries have been working to meet our needs, and in the process, they risk their own health and the health of those in their households. This is a heavy burden to bear, and they bear it for all of us. Many of these workers are less educated and earn below-average wages; and many are

[18] For a recent analysis of business closures, see Fairlie (2020).

minorities. And they are unlikely to receive hazard pay for this exposure to greater health risk.

After the Great Recession, it took many years for the economic recovery to translate into employment and wage gains for disadvantaged workers. Even then, there were concerns that these gains were not sufficiently widespread or that they would not persist. Distressingly, the grim situation we currently face risks jeopardizing those gains: The longer the current recession lasts or the weaker the recovery is, the greater the risk of lasting damage for female, minority, younger, and less-skilled workers.

Prolonged periods of unemployment may downgrade their human capital and can have lasting effects on productivity and income. Another concern is that minority, female-headed, disadvantaged, and younger households have fewer savings to tap in an emergency and may face a greater risk of bankruptcy. Even after the worst of the crisis is past, the scarring of their balance sheets may leave them further behind.

Nonprofits and state and local governments are at the front line of providing services to many severely impacted households. They provide food, health care, virus testing, unemployment insurance, and other assistance. The ballooning need for these services and the additional costs of social unrest come at a time when tax revenues and funding for some nonprofits are falling. The budgetary stress on these institutions could have serious consequences for their ability to provide crucial services in the future.

The various fiscal and monetary policy programs I discussed earlier are designed to offer an unprecedented degree of support to households and businesses so as to mitigate the damage. Even so, given the enormous challenges that lie ahead, more may be needed.

## Conclusion

State and local governments are in the first stages of reopening their economies. It is too early to know how quickly the economy will return to normal or what the longer-term impact of the pandemic will be. We're going to learn a lot over the coming months.

The Fed's actions touch communities, families, and businesses across the country. Whatever is in store, we are committed to using our full range of tools until we are confident that the economy has weathered recent events and is on track to achieve our maximum employment and price stability goals.

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