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**Covid-19 and the Future  
of the U.S. Economy**

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

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## **Introduction and disclaimer**

Thank you for inviting me to offer my views on the economy and the path ahead.

I should state at the outset that these views are my own and do not necessarily represent the views of my colleagues on the Federal Open Market Committee (FOMC) or others in the Federal Reserve System.

All of us have a role to play in recovering from the pandemic, which has taken a tremendous human toll and continues to pose many challenges. I am especially grateful for the services that health care and other essential workers have been providing throughout this ordeal. Their dedication has been indispensable and inspiring.

We obviously have lots of work ahead of us. As the economy heals, leadership by organizations such as yours will be critical in supporting local communities and businesses and in promoting development opportunities to help us achieve more vibrant economic outcomes for everyone in society.

My remarks today will focus on a few points that are fundamental for the economic outlook.

- I'll start with where the economy stands today. Even though growth has resumed in recent months, we are still far from the robust economy we had prior to the pandemic. Importantly, the unemployment rate is about 10 percent now, as compared with 3-1/2 percent last February. We have a long way to go to get back to normal.
- The second point is that the future of the recovery is inextricably linked to the virus. Until we've made sufficient progress in controlling its spread, activity is likely to remain suppressed—indeed, sporadic outbreaks could even result in further setbacks.
- Third, monetary policy and, particularly, fiscal policy have key roles to play. To date, Fed actions, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and other programs have provided important support to households, businesses, nonprofit organizations, and state and local governments. The expirations of expanded unemployment insurance provisions, Payroll Protection Program (PPP) lending, and restrictions on some layoffs for firms receiving special industrial relief aid loom large for the economy. These reductions will test the true resiliency of the U.S. economy. The potential hole in aggregate demand may be large, and in my view more fiscal relief will be needed in order to limit further damage to the economy.
- My baseline outlook assumes that there will be progress on controlling the virus and that additional fiscal support is forthcoming. Still, I expect it could be late 2022 before economic activity returns to pre-pandemic levels. It also will

be some time before inflation picks up to reach the FOMC's 2 percent objective.

- Of course, there are many unknowns in the outlook, and I will spend some time today talking about an important one: the potential implications of the disruptions to our educational system for the development of children's skills and for the labor force decisions of their parents. Even a one-year disruption to education or work can have lasting effects on children and parents, and thus poses an important risk to the outlook.
- I'll conclude with a discussion of monetary policy. The Federal Reserve has taken strong action to help the economy weather the crisis and is committed to supporting the recovery. Given my outlook, I expect this means highly accommodative monetary policy will be appropriate for some time to come. The revised "Statement on longer-run goals and monetary policy strategy" should also help clarify and support our policy goals.

### **Activity is picking up, but the hole is deep**

Let me start with where the economy is today. The virus and actions to stem its spread have upended everyday life and left a huge mark on the economy. After state and local governments issued stay-at-home orders for all but essential businesses, all indicators of economic activity logged record declines in the second quarter. Gross domestic product (GDP) plunged at an annual rate of

almost 32 percent—the worst quarterly decline in the history of the national income and product accounts (NIPAs) data going back to 1947.

Activity began to recover through the spring as state and city officials relaxed restrictions to varying degrees. Starting from such a low base, we can expect to see a huge positive number for GDP growth in the third quarter: The projections from outside forecasters are centered at around a 21 percent annual rate. On its own, a number that large would be remarkable and cause for celebration.

However, even with this anticipated eye-catching rebound, the level of GDP would still be about 5 percent below its pre-pandemic level. Furthermore, rising virus counts in some locations have delayed or reversed many reopening plans, and we are undoubtedly looking at much, much more modest growth in the fourth quarter.

The unemployment rate sums up the current situation well: It was a horrific 10.2 percent in July, and this was an improvement from the shocking 14.7 percent high in April—and this might have been closer to 20 percent when you consider some measurement issues! Today, nearly 18 million people are still unemployed.<sup>1</sup>

Though the labor market remains poor for many, some sectors of the economy have largely recovered. Retail sales are now above their pre-pandemic level, with

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<sup>1</sup> Most of the job losses still appear to be temporary layoffs, but the number of permanent job losers continues to rise and is now up 2.9 million. This represents about 1.8 percent of the labor force, up from 0.9 percent just before the pandemic, but still well below the 4.4 percent ratio experienced during the financial crisis.

a notable bounce-back in many goods and services that had seen the largest declines during the shutdowns. Other sectors still have a way to go. For example, manufacturing output has picked up 15 percent between April and July. That's a good start, but is still only a bit more than halfway out of the hole dug during shutdown.

Through this time, many companies have made significant efforts to operate safely. I regularly hear from contacts about their operational changes. Some describe accelerated adoption of technology, which has enabled many employees to work remotely. Others talk about creative solutions to help keep their workers safe, including monitoring employee and visitor health, adopting more stringent cleaning protocols, and modifying the work environment to implement social distancing.

Still, challenges remain. For example, some firms face high rates of absenteeism as workers get sick, are exposed to the virus and need to quarantine, or are reluctant to come to work because of health concerns. A few of my contacts have even hired extra workers to cover the high number of absences. Clearly, these efforts are costly, but they are necessary if businesses are to continue operating through the public health crisis.

### **The path of the virus and mitigation efforts will shape the recovery**

Ultimately, the course of the recovery depends on the path of the virus and efforts to contain it. Certainly, solutions to our health issues are necessary for

businesses, workers, and consumers to safely return to their usual ways. Importantly, to get the economy moving, these solutions must be effective enough to restore public confidence. Households need to feel comfortable reengaging in normal activities, such as going to work or school, riding public transit, going out to eat, and visiting a doctor's office. And businesses need to have confidence in sustainable improvements in demand in order to justify long-lasting commitments, such as major capital spending initiatives and workforce expansion.

Of course, a safe and effective vaccine is the ultimate goal. Until one is available, things we already know how to do—such as social distancing and wearing masks—are very important, as are increasing testing and quarantine.

Reintroducing restrictions on social and recreational gatherings, shutting down potential super-spreader events, and enhancing protections for the elderly would also help substantially.<sup>2</sup>

In the meantime, we are likely to see periodic regional outbreaks of infections, which may require reimposing certain restrictions on activity and may also undermine consumer confidence and spending. As we've experienced over the past couple of months, this isn't merely hypothetical. For example, a number of indicators of economic activity and consumer confidence stalled out in late June

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<sup>2</sup> For a recent analysis of the effects of economic restrictions and noneconomic, nonpharmaceutical interventions on mitigating a second wave of Covid-19 infections, see Baqaee et al. (2020).

and early July as states that reopened early and saw rising virus counts had to clamp down on activities.

And while outbreaks may be localized to start, it's hard to keep them so. Our nation is highly interconnected. Just think about how difficult it would be to prevent a surge in the Chicago area from finding its way into Northwest Indiana. So doing everything we can to keep the virus under control everywhere is crucial to the recovery.

### **Fiscal policy is essential**

The course of the recovery will also critically depend on receiving substantial additional support from fiscal policy. The initial policy response in March was swift, with the Federal Reserve, Congress, and the executive branch working to provide support to the millions of households and the many thousands of businesses affected by the shutdowns. The CARES Act included direct aid to households in the form of stimulus checks and expanded unemployment insurance, helping put food on the table and pay for rent and other essential expenses. Loans and grants to businesses enabled them to stay in business, keeping workers on payrolls, meeting day-to-day expenses, and avoiding costly bankruptcies.<sup>3</sup>

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<sup>3</sup> When firms go out of business, their relationships with workers, customers, suppliers, and lenders are destroyed. Rebuilding those connections—many of which have been built up over years and decades—is extremely costly.



This support was essential. But the needs remain great, and some important provisions of the CARES Act have now expired, threatening to put more vulnerable households and businesses in jeopardy. An inadequate fiscal response would significantly reduce household spending, further damage household balance sheets, and put many businesses at risk of failing.

Federal assistance has also been vital for state and local governments. They are on the front lines of fighting the virus; there is a heightened need today for the social services they normally provide; and they face the additional costs of addressing social unrest. These demands come at a time when tax revenues are down significantly because of the weak economy. Unlike the federal government, state and local governments cannot run deficits. So unless more federal funding is provided, state and local governments may be forced to take some difficult actions. They could cut back on the provision of health resources or other social services, which would make battling the virus and the recession even more difficult. And they might end up furloughing workers, which could have large effects, as state and local governments account for about 13 percent of total employment. I would note nonprofit organizations face similar challenges trying to maintain funding to provide food, educational, and other assistance to the most disadvantaged people. Partisan politics threatens to endanger additional fiscal relief. A lack of action or an inadequate one presents a very significant downside risk to the economy today.

## **My baseline outlook**

As you can tell from this discussion, two things I see as critical for a sustainable recovery are 1) the effective control of the virus and 2) adequate additional fiscal support. My baseline forecast assumes we will achieve both, though the health solutions, in particular, are not going to happen overnight.

As I noted before, I expect the third-quarter growth number to be big simply because of the restart of the economy from the most severe shutdowns of last spring. After this, I expect more moderate growth in the fourth quarter, with the level of GDP still about 5 percent below its pre-pandemic level at the end of this year.

Improvements in our control of the virus should allow growth to proceed at a moderate pace, though I don't expect activity returning to its pre-crisis level until later in 2022. Of course, this does not take into account the fact that the economy would have been growing in the absence of the crisis—it will take much longer to catch up to that counterfactual. With economic activity remaining well below its normal level, my baseline forecast has the unemployment rate in the neighborhood of 9 percent by the end of the year—still extremely high—and declining gradually to somewhere around 5 or 5-1/2 percent by the end of 2022. Of course, the uncertainty surrounding these forecasts is extremely high—there are just so many unknowns about how the virus and the economy will evolve over the next couple of years.

Let me say a few words about inflation. Overall consumer inflation stepped down significantly this spring, as the effects of weak demand for a range of goods and services far outstripped price increases in food and a few other products. Even with the recovery of some prices in tandem with the recent improvements in activity, for the 12 months ending in July, inflation as measured by the index for core personal consumption expenditures (PCE) was only 1.3 percent—far below our 2 percent inflation target.<sup>4</sup> Given the prolonged period of subpar economic activity and high unemployment, I expect inflation will run under our 2 percent target for some time.

To sum up, even with steady progress in controlling the virus and additional fiscal support, I expect it will be some time before the economy recovers from the hit it took. Along the way, we face many challenges, uncertainties, and downside risks. I would like to discuss one of those now.

### **The virus presents challenges for schooling and childcare**

Schooling and childcare bring together many people of different ages with a variety of health risks in the same space for prolonged periods of time. This poses enormous public health challenges. The lack of national guidance has led to a dizzying array of educational arrangements due to differential Covid-19 risks around the country. Some schools and childcare facilities have fully reopened to

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<sup>4</sup> While our objective is stated in terms of overall PCE inflation, core inflation—which strips out the volatile food and energy components—is a better gauge of sustained inflationary pressures and of where inflation is headed in the future.

in-person instruction, with a wide variety of social distancing schemes. Some school districts are opting for a hybrid model rotating online learning with classroom instruction, while others are pivoting to a fully remote learning experience. Continuing challenges for the foreseeable future will be that the health risks vary substantially around the nation and that different risk tolerances have been selected by the various state and local authorities. Furthermore, given the enormous uncertainty at this point over the course of the virus, all arrangements are subject to revision, making it even more difficult for parents to plan.

For children, the lost learning and socialization costs are potentially enormous. For some children, even a year of subpar instruction can have lasting effects on their lifetime educational achievement. Furthermore, the dependence of remote learning on internet access raises the possibility of students in many rural areas and disadvantaged households being left further behind their peers. And with social activity limited by large and uncertain Covid-19 risks, I also worry that some children will miss important developmental milestones that come through interactions with other children and adults in a safe environment outside the home.

Educating students at home also presents enormous challenges for parents. Can parents who work outside of the home still go to work? Who will be at home to supervise the children? If parents are able to work remotely, will they be able to do so effectively? How much flexibility do parents have to adapt to changing

school demands? And what is the toll on employee and family mental well-being? These Covid-19 channels risk widespread and truly devastating costs.

The added stress on families is enormous. Weighing the competing needs of family health, income, schooling, and child supervision, many parents may be forced to cut back on hours or quit work altogether. The predicament is even more striking for single parents and poorer households. And in our American society today, women are particularly vulnerable because they generally shoulder a disproportionate share of the childcare and household responsibilities.

For the economy, unless offset by other comparably skilled hires, a reduction in the hours worked by these parents represents a loss of current production.

Furthermore, a decision to withdraw from the labor market for even a year can have long-term adverse effects on these workers' human capital and earnings.

This represents not just a loss to them, but the loss of that productivity to the economy as a whole. The human toll is very large.

### **Monetary policy and revisions to the framework**

Though I spent a good deal of time discussing the necessity of fiscal policy, monetary policy is also playing an important role in supporting the economy during this unprecedented and challenging time.

The pandemic demands an all-hands-on-deck response. Our response has been both rapid and strong in order to limit any long-lasting damage to the economy from the challenges the pandemic poses. In March, the FOMC quickly cut policy

rates to their effective lower bound, putting the federal funds rate target range at 0 to 1/4 percent. As the Committee has repeatedly stated, the federal funds rate is likely to remain in that range until we are confident the economy is on the path to recovery. In addition, in order to address distress in crucial financial markets, the Fed conducted repurchase agreements and purchased large quantities of U.S. Treasury and mortgage-backed securities. We also activated special lending facilities to support the flow of credit to businesses, households, nonprofits, and state and local governments. These programs, which are deployed only in very unusual circumstances, rely on emergency lending powers that require the approval and financial backing of the U.S. Department of the Treasury. To broaden their scope, we have adjusted the terms on a number of facilities as appropriate.

These actions have clearly provided important support to the economy by easing financial conditions across the economy. The Fed will continue to provide such support as long as needed. As always, we remain focused on the achievement of our dual mandate objectives of maximum employment and price stability as expeditiously as possible.

To help us achieve these goals, in early 2019 the Federal Reserve embarked on a comprehensive effort to review the way we conduct monetary policy. In large part, the impetus for the review came from the realization that we live in a world where interest rates are much lower than they were in the past, which limits how much room the Fed has for using our usual tool—cutting the federal funds rate—

to support the economy during economic downturns. An important part of this process was a series of Fed Listens events, in which we heard from a wide range of workforce development, small business, and community leaders on how monetary policy affects their lives.<sup>5</sup>

Last week Chair Powell introduced a revised “Statement on longer-run goals and monetary policy strategy,” the document that lays out the FOMC’s goals and articulates our framework for conducting monetary policy.<sup>6</sup>

Among the noteworthy changes, the new statement emphasizes that maximum employment is a broad-based and inclusive goal and that the Committee would not be concerned with what might look like very tight labor markets as long as they were not generating unwanted inflation or other risks. The new statement also indicates that following a period when inflation has persistently run below our 2 percent target, policy will likely aim to generate a period of above 2 percent inflation. We’re not tied to a strict formula, but roughly speaking, we’re looking for inflation to average 2 percent over time.

These principles are consistent with the type of outcome-based forward guidance that I advocated and that the Committee used to speed the recovery after the Great Financial Crisis, when we were far away from both our inflation and our employment goals. We are in a similar position today. And I expect that

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<sup>5</sup> For a summary of Fed Listens events, see Federal Reserve System (2020).

<sup>6</sup> See Federal Open Market Committee (2020a) for the revised statement. See Federal Open Market Committee (2020b) for a comparison of this revised statement with the previous version from January 2019.

articulating outcome-based forward guidance for the rate path and asset purchases could be beneficial in the not-too-distant future.

One of the lessons that monetary policymakers have learned is that policy is most effective when it is clearly understood by the public. I think our new consensus strategy is another important step in providing this kind of transparency and, hence, in helping us to more effectively achieve our policy goals. Of course, strategies need to be implemented with actions, and it is important that our future monetary policy actions are true to the principles laid out in the new consensus statement.

Thank you. And I'd now be happy to take your questions.



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