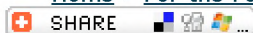


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Nationally and...



## Economic Outlook: What Matters Nationally and Locally



It is a

### Additional Information

**Sandra Pianalto***President and CEO,  
Federal Reserve Bank of Cleveland***The Center for Community Solutions  
Annual Human Services Institute,  
Benjamin Rose Institute on Aging  
Cleveland, Ohio***August 7, 2013*

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pleasure to join you today to talk about the labor market recovery and what recent developments mean for our country and our region.

The Federal Reserve Bank of Cleveland and the Center for Community Solutions share the goal of promoting economic prosperity for our communities. Like the Center for Community Solutions, my Bank conducts research to inform policy actions that will benefit our area's residents. And, as a member of the Federal Reserve's Federal Open Market Committee, or FOMC, I take the results of my Bank's research, as well as information from our interactions with community leaders, businesspeople, and others in this area, and I bring those perspectives to the national level as I help formulate our nation's monetary policy. So I truly value opportunities like this one, to discuss issues that are important to the future economic growth and development of Northeast Ohio. In addition, as a former United Way board chair, I am very supportive of the partnership between United Way and the Center for Community Solutions; it's another link in the chain that connects all of us who are working to improve the quality of life for our neighbors.

I was very interested to see that the July issue of the Center for Community Solutions' "Common Ground" publication discussed labor force participation, unemployment, and educational attainment in Cuyahoga County. The Federal Reserve Bank of Cleveland has been looking at these very same issues affecting labor markets locally and nationally. In fact, labor markets remain the most troublesome aspect of the weak economic recovery. Unemployment is still too high and has been that way for too long. And too many people have been suffering lengthy durations of unemployment, to the point where our labor markets may be sustaining long-run damage.

So in my comments today, I will describe the labor market recovery we are experiencing nationally and in Northeast Ohio. Then, because I am especially concerned about developments in Northeast Ohio, I will highlight some factors that can lead to long-term economic prosperity for our region. As always, the views expressed here are my own and do not necessarily reflect the views of my colleagues in the Federal Reserve System.

Let me start on a positive note. We are four years into a slow recovery, and while it is easy to miss the progress that the economy is making, there really has been some progress. In recent months, we have seen clearer signs of a more sustained recovery in the US labor market. On average over the past year, 187,000 jobs have been added to the economy each month.<sup>1</sup> That indicates to me that the pace of recovery in the labor market has picked up from the prior 12 months, when monthly jobs gains averaged fewer than 100,000. The unemployment rate has declined since last fall from about 8 percent then to 7.4 percent today. I take these recent improvements in the labor market as evidence that the economy is on firmer footing.

Even so, we still have a way to go before the labor market is fully recovered. As a country, we have about 2 million fewer people working today than were working at the start of the Great Recession in December 2007, and the labor force has continued to grow. That leaves 11.5 million Americans unemployed—and in addition, we have more than 8 million people who are underemployed. The number of people who have been out of work for more than a year reached an all-time high in the recession, and it still stands at 3.1 million. This is particularly worrisome because the longer people are without work, the more their skills atrophy.

In this challenging economic environment, the Federal Reserve has been taking unprecedented actions to support the economy. The FOMC's goals, which were set by the US Congress, are to promote maximum employment and price stability—these are referred to as the “dual mandate.” This means the FOMC wants as many Americans as possible who want jobs to have jobs. At the Federal Reserve Bank of Cleveland, we estimate that maximum employment will be reached when the unemployment rate is 6 percent. The FOMC also aims to keep inflation low and stable and has established 2 percent as our inflation objective over the longer term.

Right now, with unemployment at 7.4 percent and inflation at 1.3 percent, it is clear that the economy remains well short of maximum employment and that inflation is below our objective.<sup>2</sup> Under these conditions, a highly accommodative monetary policy remains appropriate.

Last fall, the FOMC initiated a third round of asset purchases. In this program, which is often referred to as “QE3,” we are purchasing \$85 billion of Treasury securities and mortgage-backed securities per month. This policy was designed to drive some near-term momentum in the economy with the specific goal of achieving a substantial improvement in the outlook for the labor market.

Labor market data comes in every month and is subject to different interpretations. In my view, there has been meaningful improvement in both current labor market conditions and in the outlook for the labor market since the FOMC launched the current asset purchase program. Employment growth has been stronger than I was expecting, and the unemployment rate today is more than half a percent lower than I projected it to be last September.

In light of this progress, and if the labor market remains on the stronger path that it has followed since last fall, then I would be



prepared to scale back the monthly pace of asset purchases.

This is not to say that the labor market is fully recovered; it is not. So even when the asset purchase program is scaled back, the Federal Reserve will remain committed to supporting employment growth and price stability. The FOMC has said it intends to maintain a high degree of monetary accommodation for a considerable time after the asset purchase program ends and the economic recovery strengthens. We intend to hold short-term interest rates low to support economic growth until the economy is closer to full employment, as long as inflation stays well behaved. These are, of course, the FOMC's longer-term objectives for the national economy.

So how have we fared here in Northeast Ohio in this recovery? There are important distinctions between the short-term progress we are seeing in the recovery and the longer-term economic objectives that we should be pursuing. In my 10 years as president of the Federal Reserve Bank of Cleveland, I have seen how short-run issues can drag into longer-run problems, and how a preoccupation with the present can sometimes cause us to overlook or disregard actions that would benefit future generations.

Like other regions, Northeast Ohio lost a lot of jobs in the recession and is still trying to recover those lost jobs. But it may surprise you to hear that our area actually weathered the Great Recession better than many other parts of the country. The region's unemployment rate has generally remained lower than the national unemployment rate during the recovery. The Cleveland metro area unemployment rate was about half a percentage point below the national unemployment rate as of June 2013.

There have been a variety of major hiring efforts announced in our region and—for a change—some of those announcements have been in manufacturing. These announcements, plus the possibility of bringing well-paying manufacturing jobs back to the United States from offshore, have helped to brighten attitudes about our region's future prospects.

In addition, residents of our region have made progress on a key measure— per capita income growth, or growth in the average income level of our area's residents. From the end of the recession, the recovery in per capita personal income growth in the region, and in Ohio as a whole, has been above real per capita income growth for the nation.

These are all reasons to feel hopeful, but the numbers I have just cited do not paint a complete picture of the region's economic prospects. In particular, the numbers neglect some long-run issues affecting this region. For instance, the region has about 8 percent fewer workers today than it had in 2000. This employment loss is linked closely to the job cuts in manufacturing.

The decline in manufacturing employment before the Great Recession was not unique to Northeast Ohio. It occurred throughout the United States. High-technology metropolitan areas like San Jose and San Francisco, California, also suffered large losses in manufacturing employment, as did southern metropolitan areas such as Dallas and Atlanta. In other words, the overall US economy took a hit from the decline in manufacturing employment. The difference between Northeast Ohio and many other areas of the country reflects two factors: first, manufacturing jobs were a larger share of our economy; and second, our economy did not have strong job growth in other sectors outside of manufacturing. So even though manufacturing is currently experiencing a cyclical rebound, it would be risky to rely heavily on the manufacturing sector to provide significant employment growth in the long run.

Northeast Ohio has underperformed the nation in two other important longer-term trends: population growth and income growth. In the 1970 census, the Cleveland metro area had the 12th largest population in the nation; as of 2012, it stands at 29. Also in 1970, the Cleveland metro area had a per capita income that was about 7 percent higher than the national average for metropolitan areas. In the most recent income data, 2011, the Cleveland metro area is about 2 percent below the national average. Weak income growth makes the region less attractive to residents and employers, even when the short-term economic performance is pretty good.

This is not to say that no progress has been made. Northeast Ohio has made considerable progress in reinventing our region, but we are still a “work-in-progress.” In some ways, regions are always under pressure to reinvent themselves, so there will always be a sense that our region is a “work-in-progress.” Here in Northeast Ohio, I believe there are steps we can take and must take to move our region onto a path of economic and job growth that is more in line with our potential.

The economists at the Federal Reserve Bank of Cleveland have grouped metropolitan statistical areas, or MSAs, into brain hubs and manufacturing centers.<sup>3</sup> Brain hubs are places where you find concentrations of workers in knowledge jobs. A knowledge job relies on human capital, innovation, and ideas. By comparison, manufacturing centers have high concentrations of workers that produce physical goods. Brain hubs are important because they have generally seen the largest increases in employment and per capita income since 1980. Manufacturing centers are certainly capable of creating job growth. But in recent decades, regions with the highest concentrations of knowledge workers have grown much faster.

As it happens, the country as a whole has become much more tilted toward knowledge jobs.<sup>4</sup> In 1990, the ratio of knowledge jobs to manufacturing jobs was about 1-to-1. Today, the ratio has more than doubled to 2.5 knowledge jobs for every one manufacturing job.

Most of the MSAs in my Federal Reserve District, which covers Ohio, western Pennsylvania, eastern Kentucky, and the northern panhandle of West Virginia, are manufacturing centers. However, some cities in my District, such as Columbus and Pittsburgh, are brain hubs, since they have a significantly higher-than-average number of knowledge jobs to manufacturing jobs. The ratio of knowledge-to-manufacturing jobs in Pittsburgh is almost 3-to-1, and in Columbus it is 3.7-to-1. In contrast, Cleveland today averages 1.8 knowledge jobs for every manufacturing job. Cleveland has actually lost ground in the number of knowledge jobs compared to the number of manufacturing jobs in our area since 1990, meaning knowledge jobs are not being created fast enough to keep up with the nation as a whole. And it’s not just Cleveland. All the metro areas in Northeast Ohio have a lower-than-average ratio of knowledge jobs to manufacturing jobs.

While we are mostly used to thinking of Pittsburgh as a sports rival, I think there are some valuable lessons Cleveland could learn from Pittsburgh. In the late 1970s, Pittsburgh was primarily known as the center of steel manufacturing in the United States. It had a large blue-collar workforce, and Pittsburgh was not a metropolitan area that could boast of having a particularly educated workforce. The closing of steel mills in Pittsburgh in the early 1980s represented an enormous regional shock. Unemployment in the Pittsburgh area remained above 10 percent for three years. It took decades for Pittsburgh to reinvent itself, but it has, and continues to do so. What I find particularly striking about Pittsburgh is how its younger groups of workers have become highly educated. Pittsburgh now ranks near



the top of metropolitan areas in the country in the share of young workers with college degrees.<sup>5</sup>

The news here in our area is not all bad: Cleveland has seen improvements in the skills of younger workers. Many are “skilling up” to increase their employability. However, to make more progress on the workforce challenges facing Northeast Ohio, we will have to encourage our younger citizens to pursue more education at every level, including four-year college degrees, associate degrees, technical certificates, and apprenticeships. While college degrees are a good indicator of future economic growth in a region, not every young person can gain from pursuing an advanced degree, and so, other avenues for building useful skills should be encouraged.

I do not want to leave the impression that this massive skilling up will mean that we will need to write off entire industries, such as manufacturing. I am certain that manufacturing will have a long future in Northeast Ohio; but manufacturing is unlikely to drive significant employment growth for any region of the country and the occupations currently being hired in manufacturing require higher skills than in years past.

Over time, regions with skilled labor pools will draw employers who need skilled workers; in turn, more skilled workers are drawn to those areas. Over a period of decades, Pittsburgh successfully navigated the transition from losing manufacturing jobs to becoming a brain hub. By working to develop a critical mass of highly skilled workers and innovative companies, we can become a brain hub right here in Northeast Ohio.

Whether we are considering the nation as a whole, or contemplating the future of Northeast Ohio, economic policies are working in both short- and long-run ways to counter one of the harshest periods in our nation’s economic history. Here in Northeast Ohio, we are keeping up with the national recovery in the short run, but we still need to do more to ensure our long-term economic prosperity. There are no quick fixes, and a long-lasting solution will require great commitment, patience, and endurance. For the past several years, I have been championing the results of a landmark Cleveland Fed study. It found that regions with higher levels of education and innovation see higher rates of income growth. That is no less true today than it was when I first said it years ago.

I encourage you, as leaders who care about our area’s future, to continue investing in human capital. In doing so, we can ensure that our area’s workforce is educated and innovative, and we can attract new companies and good jobs to our area. By focusing on building a skilled workforce over the long run, we can make Northeast Ohio a region that is ready and able to meet the opportunities of the twenty-first century.

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1. Average total nonfarm from July 2012 to July 2013.
  2. As measured by the year-over-year percentage change of the PCE index.
  3. This follows the terminology of Enrico Moretti, an economist at the University of California, Berkeley.
  4. The Federal Reserve Bank of Cleveland classifies jobs by industry, not occupation. Knowledge jobs are defined as jobs in one of the following industrial sectors: information; finance, insurance, and real estate; and professional and business services. Manufacturing jobs are jobs in the manufacturing sector.

5. Pittsburgh ranks 14th out of the 100 largest metropolitan statistical areas in terms of its share of workers aged 25-34 with a bachelor's degree, according to the American Community Survey.

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