Economic Outlook Amid COVID-19

Chicago Council on Global Affairs
Chicago, IL (via Zoom)

May 7, 2020

Patrick T. Harker

President and Chief Executive Officer
Federal Reserve Bank of Philadelphia

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OF PHILADELPHIA

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Good afternoon. Thank you for having me here today … in some form …

Before we begin, let me dispense with the usual Fed disclaimer: The views I express today are my own and do not necessarily reflect those of anyone else on the Federal Open Market Committee or in the Federal Reserve System.

It's no secret that we find ourselves in the midst of a crisis like none of us have experienced in our lifetimes. The coronavirus that arrived on our shores just a few months ago has already killed tens of thousands of Americans, ended a years-long streak of solid economic growth, and caused tens of millions of our fellow citizens to lose their jobs.

It's amazing to think how different my remarks would have been had I given them just two months ago.

Appreciation for the Frontline Workers

The coronavirus is above all a public health crisis and the Federal Reserve as an institution — and me personally — can't say enough to adequately convey our gratitude toward America's health-care workers, as well as other frontline workers like police, grocery-store workers, truck drivers, and innumerable others who are risking their own health for the well-being of the country.

The economic ramifications of this crisis, of course, have been stark as well.

Perhaps most notable has been a collapse in most forms of consumer spending, a component of GDP that accounts for about 70 percent of our country's economic activity.

In March, we experienced a literally unprecedented 7.5 percent fall in consumer spending, and April data will surely be even worse. In the same month, manufacturing output fell to levels not seen since 2011. And data from the Institute for Supply Management showed a stark contraction for April as well.

It's notable that this diminution, particularly on the consumer side, was observable even before states took serious action to curtail the spread of the virus. That strongly suggests that the coronavirus itself, and not just government policies designed to mitigate it, are harming the economy.

Before states and cities started imposing lockdowns and shutting down businesses they deemed nonessential, data show the cutbacks in spending: Airline bookings were collapsing and foot traffic into restaurants had already begun a steep decline, to name just a few examples of weakening consumption demand in some categories of goods and services. Consumers were voting with their feet — or at least with their wallets.

Even my presence here by Zoom is evidence that it isn't only government mandates that have slowed the economy. It was a decision we took ourselves, to stay home and to stay safe.

The point is this: Until the virus itself is under control, even as more states gradually open up, we can expect the economy to underperform relative to where it was just a couple of months ago.

Does that mean we should simply sit on our hands until effective therapies, or a vaccine, emerges? Of course not. And as you probably know, our institution, the Federal Reserve, has taken bold action to help deal with the economic consequences of what is fundamentally a public health crisis.

At the Federal Reserve, we have essentially found ourselves in the role of firefighter — and we've poured water on the fire. But we want to avoid damaging the underlying infrastructure of what just a few months ago was a very healthy economy.

Access to Liquidity for All

Our goal is to use our vast lending powers to maintain our underlying economic infrastructure by making sure that every sector of the economy has access to liquidity. I realize that more needs to be done, that people and firms will need infusions of cash, and that all of this is occurring at an unprecedented pace.

But that is a role for the federal government. Working together, we can try to ensure that the necessary conditions for a recovery will be there when this health crisis has passed.

Regarding Federal Reserve actions, we have, first and foremost, acted by lowering our policy interest rate to near zero — and we expect to keep it there for some time.

We've also taken a number of actions to keep credit flowing. Beginning in March, as the depths of the crisis became apparent, we started buying large amounts of Treasury bonds and mortgage-backed securities to prevent credit markets from seizing up. The markets have largely stabilized, and we've now slowed the rate of those purchases.

We're also focusing on using all of our available tools to get loans directly into the hands of those who need them most.

To do that, we're going to be buying bonds from cities and states, most of whose sales tax revenues have tanked along with consumer spending. This program, called the Municipal Liquidity Facility, will provide essential liquidity to local governments as they fight the pandemic.

We've also set up what we're calling our Main Street Lending facility. The goal here is to get cash in the hands of small- to medium-sized businesses whose operations have been hampered by the virus. These businesses tend to be the economic lifeblood of their local communities, and this lending facility is designed to forestall mass closures of small and medium-sized businesses on Main Streets across the country.

Relatedly, the Federal Reserve is also bolstering the Small Business Administration's Paycheck Protection Program by supplying liquidity to financial institutions that are issuing loans to those crucial businesses.

Stress on Higher Education

We know that this crisis is severely harming the nonprofit sector as well. As a recovering academic and university president myself, I'm acutely aware of the stress this crisis is inflicting on, for instance, the higher education sector. The Federal Reserve is thinking carefully about setting up facilities that can provide direct lending to colleges, universities, and nonprofit medical institutions.

I want to be clear. We're not in 2009 anymore and this is not quantitative easing 2.0. The principle behind quantitative easing was that people weren't engaging in investments because the cost of capital was too high.

That is simply not the case now. The reason people aren't engaging economically is the health crisis.

I also want to be clear that these facilities — as well as the actions that have been taken on the fiscal side, especially the CARES Act that Congress passed a few weeks ago — are not economic stimulus. There may be a time for stimulus later, after the acute phase of the health crisis has passed.

Our facilities, instead, are a form of emergency relief — of insurance. We're doing everything we can to help people get through a really painful time.

So, now the $64,000, or perhaps the $22 trillion, question. What happens next economically?

The second quarter data will be brutally painful as a result of both the virus and the government-mandated economic shutdown. Take your pick of bad, really bad, or really, really bad.

What happens after that to a large extent depends on how the virus moves through our society, and our reaction to it in terms of balancing stay-at-home policies versus an intelligent — and I want to stress, *intelligent* — reopening.

The Economy: Possible Paths

There are multiple scenarios as to how this plays out. But here are just two to consider: In the more optimistic scenario, the economy largely opens in June, we have technology in place to contain the spread of the virus, and there is no second wave in the fall. In that scenario, I would expect a severe contraction in GDP in the second quarter followed by a significant rebound in the second half. However, the second half rebound is not enough to fully offset the contraction in Q1 and Q2; 2021 would then show above-trend annual GDP growth.

The less optimistic scenario is that we open too quickly and see a significant second wave of the virus. Not only would this be a health catastrophe, but it would reverse the recovery as well. In this less hopeful scenario, I project a similar growth path to the baseline for 2020, followed by a painful economic contraction of GDP in 2021 as shutdowns are reintroduced.

Longer term, of course, there will be a recovery. But I also want to stress that it might be an uneven one. There's an old saying that a rising tide lifts all boats. But that might not apply here.

Manufacturers of durable goods, for instance, should come back quickly.

One large manufacturer in our District who temporarily halted operations reports that orders themselves never evaporated — they were simply delayed as virus mitigation measures took effect. But as Pennsylvania and other industrial states slowly and intelligently reopen, I think we can expect manufacturing output to quickly bounce back.

Travel and hospitality, on the other hand, may be in for a longer and more painful contraction. Businesses may have enough experience teleconferencing instead of holding physical meetings that they may decide to cut back on corporate travel. Families may choose to avoid crowded spots like amusement parks and cruise ships. The knock-on effects to airlines, hotels, and restaurants that cater to travelers could be severe and long-lasting.

Commercial real estate could also suffer for similar reasons.

Companies may find that working from home isn't so bad after all and reduce physical office space. There is also a strong possibility that many hotels and restaurants will never reopen. There will probably be retailers, big and small, that also shutter permanently.

In the long term, the uneven recovery will present a risk to our banking sector, which is heavily exposed to sectors like commercial real estate. The good news is we went into this crisis with a well-capitalized regulated financial system. But I want to urge banks to retain capital as we prepare to enter a tough period. In my personal opinion, they probably shouldn't be issuing large dividends at the moment.

I want to close by mentioning a subject dear to my heart: diners!

Near my house in South Jersey there's a diner that, just a few days after restaurants were shut down here, quickly turned into a full-service grocery store. Now perhaps this only demonstrates the ingenuity of the South Jersey diner sector. And I'll admit I'm biased on that score …

But I also think it underlines Americans' boundless ability to adapt — to retool when the times call for it. I'm sure that we will get through this.