The Certainty of Uncertainty

2020 CIO Leaders in Alternative Investments Summit – A Virtual Experience
Wharton Private Equity and Venture Capital Alumni Association
Philadelphia, PA (virtual)

December 2, 2020

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President and Chief Executive Officer
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Good morning! It's great to be back among so many of "my people."

You might say, after all, that I have at least a minor connection to Wharton, and to Penn in general. I went to Penn for undergrad. And I also have a master's from Penn — two of them actually. And a Ph.D. from Penn. I was a professor at Penn. Oh, and as many of you know, I was also dean of the Wharton School.

I should probably also mention that my wife went to Penn. And so did two of my three children. And Penn doctors recently performed surgery on my foot to rectify an old injury that I sustained … playing football at Penn.

So, yes, it's wonderful to be back — in some form — at what feels an awful lot like a second home.

Now, before we proceed, I need to give you my standard 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.

My plan for this morning is to share a few thoughts on where the economy is now and where it's headed. I'll also offer some observations on how we can build a durable and equitable recovery as we emerge from this period. After that, we'll open things up for a fireside chat with some Q&A, which I'm really looking forward to. I especially welcome the hard questions, such as what on Earth is going on with Carson Wentz?

The State of the Virus

It's no secret that the economy has been profoundly affected by the same scourge that has kept us physically apart today: COVID-19. The three most important things affecting the economy are: the virus, the virus, the virus.

So, let's begin with where we are with COVID-19, given that the virus itself — more than anything else — is determining the trajectory of the economy.

In the space of about a year, the virus has infected more than 60 million people around the world and killed more than 1.4 million. In the U.S., the death toll has now surpassed 260,000. The math is stark: With 4 percent of the world's population, we've suffered 20 percent of the world's fatalities.

And even within this disproportionately hard-hit country, certain communities have suffered more than others. Racial minorities have been sickened from the coronavirus at a far higher rate than other groups. They have also died at a higher rate. And in the ensuing economic contraction, they have lost their jobs at a higher rate.

While the number of infections and deaths fell during the warmer months, cases have been on the uptick since the week ending September 8. Deaths — a lagging indicator — are unfortunately now back to the highs we had not seen since the first wave in the spring. We are clearly in the midst of a second wave that, while not unexpected, is still shocking and heartbreaking in its viciousness.

The State of the Economy

COVID-19's resurgence is bound to have an economic effect, both as local governments introduce measures to curtail the spread and as consumers change their behavior. The latter is a crucial point that sometimes gets lost.

If people don't feel safe, they won't engage in the broader economy. And so, even before state and local governments took action this spring, many Americans had stopped dining out, getting on airplanes, and checking into hotels. That's a trend that has continued throughout the pandemic. Some local governments, including Philadelphia, have recently introduced measures to curtail indoor restaurant dining. But even before that, data showed that people had begun dining out less. Some people may have traveled over the Thanksgiving holiday, but TSA data indicated that passenger traffic was still down by more than half of what it was last year. In short, government actions to stop the spread of COVID-19 are somewhat of a lagging indicator as well.

It isn't surprising, then, that the economy has largely tracked the spread of the virus. In the second quarter of this year, as the U.S. experienced its first wave of COVID-19 and as state and local governments implemented various shutdown measures, the U.S. experienced its worst quarterly GDP drop in recorded history. The economy contracted at an annualized rate of nearly 32 percent; 22 million jobs evaporated. Those with low-wage jobs, particularly racial and ethnic minorities, were hardest hit.

Following that contraction, the economy rebounded quite nicely. Stay-at-home orders were lifted, and millions of Americans returned to their jobs. Indeed, a little more than half of those 22 million residents who were suddenly out of work earlier this year are now back, enough to nudge the unemployment rate down from 14.7 percent in April to 6.9 percent, which is still disastrously high. The recovery has been uneven, with segments like manufacturing and housing outpacing hospitality and leisure.

For now, I'm forecasting moderate growth for the rest of this year and the first quarter of 2021 that keeps us below the prepandemic trend. Indeed, we are currently seeing signs of plateauing in the economy. That's attributable both to COVID-19's continued circulation and to the evaporation of fiscal support — particularly for low-income households — that the federal government provided at the onset of the pandemic. I recently had a conversation with a major banker who expressed deep concerns about the fast-approaching "fiscal cliff," as many Americans will soon lose their unemployment benefits and begin to face hardships like eviction and foreclosure. Unemployment claims are already on the uptick.

My forecast calls for growth to pick up in the second half of 2021 and through 2022 before a light tapering in 2023. But that comes with two important caveats. For one, my forecast is premised on a safe and effective vaccine for COVID-19 — or perhaps, multiple vaccines — becoming available sometime in the spring or summer of next year. We've had very encouraging news on that front in recent weeks. My forecast also expects an additional $1 trillion of fiscal support for the economy. There, the news has been less encouraging recently, which is my way of saying this forecast is very, very uncertain.

The Fed's robust actions in dealing with this crisis — cutting rates fast and early and establishing a number of lending facilities — were effective in blunting the contraction. Even when those lending facilities, such as our fund that was set up to aid state and local governments, were not tapped as often as we may have expected at the outset, their mere existence was useful in getting private markets flowing. We witnessed a so-called announcement effect. Markets that were largely frozen thawed when we announced the establishment of those facilities.

In my opinion, those facilities should stay open past the end of this year. Until we get through this pandemic, the economy needs to be supported. At this point, the fewer changes we make to our lending facilities, the better.

Rising Automation

Now before we move to the discussion, I'd like to say a few words about the changes in our society that the virus is spurring.

Fundamentally, rather than fully changing things, this pandemic has had the effect of accelerating trends that were already present in our society. Categories like department stores were already struggling — and COVID-19 only served to expedite their demise. Racial minorities like Black Americans were already more likely to be unemployed than other groups, though one of the salutary trends of the prepandemic economy was that this gap was narrowing. Unfortunately, COVID-19 has erased that progress.

Similarly, trends in labor markets like the increased use of automation are not new. They are simply happening at a more rapid clip since the onset of the pandemic.

For decades, the U.S. economy has seen increasing automation in industries spanning manufacturing to food service to office work. But the COVID-19 pandemic has ensured that those transitions are now occurring at lightning speed.

Researchers at the Philadelphia Fed have been closely studying the effect of the pandemic on labor markets and automation and have made several key — if still rather preliminary — findings. I would like to share some with you.

Some of their findings have been predictable: It turns out that the most automatable jobs are those that do not permit remote work and those that carry a high risk of COVID-19 transmission. Obviously, machinery and software are not susceptible to the virus, so they have often become more attractive options than human workers during the pandemic. Think of meatpacking and slaughterhouse jobs, for example, which are increasingly automated.

Or, closer to home, think of the Pennsylvania Turnpike laying off more than 500 workers this spring as it switched to automatic tolling.

Other findings are more surprising and deeply alarming. You might expect that a lot of the jobs that were eliminated because of COVID-19 might come roaring back after the virus passes, for example. But this might not be the case.

Fed researchers have found, based on precedent dating to prior recessions, that, in fact, many of the jobs that the pandemic eliminated may never return — even after the virus has passed. They will instead be automated. Those Pennsylvania Turnpike workers were permanently laid off, for instance.

Our researchers have also found that minority workers are more likely than other groups to hold jobs that could be lost — permanently — to automation. And that leads to the alarming conclusion that pandemic-induced automation will — as we have in fact seen — only serve to accentuate preexisting disparities in our society.

We can't stop technological progress, of course. But this wave of automation will require each of us to think hard about how we can transition affected workers into new, stable careers filled with opportunity.

At the Philadelphia Fed, we're working hard on designing programs that can upskill people who are experiencing labor force dislocation, which I'm happy to talk more about during our discussion. It's my firm belief that we can seize the opportunity as we emerge from this tragic period.

So, thank you, and now let's open this up for discussion.