The Economy and the Job Market: Where We're Going, Where We've Been

Rider University

Lawrence Township, NJ

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Good evening! It's really great to be here, a mere two years after we had initially planned to do this. The pandemic kept us apart for far too long, and I'm thrilled that we are finally together. So, thanks so much for having me.

The theme of this talk is "Where We're Going, Where We've Been" — so I'm going to begin way, way back at the beginning. I want to talk a little about what the Fed is and what it does. I also want to discuss what the Fed *doesn't* do, because I have to admit our powers are overestimated sometimes. I'll then discuss the current economic situation and a little bit about the job market. Then we can move to a Q&A, which I'm really looking forward to.

But before I can do any of that, 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 (FOMC) or in the Federal Reserve System.

Let's start with where we've been.

Federal Reserve History and Structure

The First Bank of the United States was the brainchild of the man who in recent years has become everybody's favorite founding father: Alexander Hamilton. The bank was located in Philadelphia when it was still the capital of the country. It was established in 1791 to deal with the debt from the Revolutionary War and to ensure the government's financial stability. It looked a lot different than the entity we are today, and it wasn't without controversy.

As Broadway has reminded us, Thomas Jefferson was among those who worried about power that was too strong and too centralized. He even once famously said he found banks to be more dangerous than standing armies. When the bank's charter was up for renewal after its initial 20 years, the Jeffersonian argument won out and the measure failed by a vote each in the House and the Senate. The bank was dissolved.

Five years later, Congress agreed to a central banking function a second time, and we launched the imaginatively named Second Bank of the United States. And 20 years after that, Congress decided not to renew the charter, again owing to a strain of popular sentiment that didn't trust powerful, centralized institutions.

But not having a central bank didn't really work because it tended to breed volatility.

The period leading up to the third iteration of American central banking — the Federal Reserve — was marked by currency instability, bank runs, and cycles of boom and bust. At one point, J.P. Morgan actually had to step in personally to bail out the country. If you've ever been to the Morgan Library & Museum in New York, you can stand in the room where the solution to that financial crisis was worked out.

Even during the Revolutionary War era, central banking was standard in democracies, and it remains that way today. There are no developed economies that don't have it in some form. So, the eventual adoption of our current central bank — in the 1913 Federal Reserve Act — was to some extent inevitable. And the configuration of the Federal Reserve System — a central bank with a decentralized structure — is something of a testament to old-fashioned American compromise. It also reflects the unique demands of the United States and our economy.

The Federal Reserve System consists of a Board of Governors, which sits in Washington, and 12 regional Banks located around the country, including the one I oversee in Philadelphia.

The Board seats seven governors, including the Chair. Each regional Bank has its own president and board of directors, which is made up of business, banking, and community leaders from the area. Fundamentally, this provides the Fed with a perspective, within each District, of the sectors and issues that make the region tick. You and I are in the Third District, which encompasses eastern Pennsylvania, South Jersey, and the state of Delaware. We're the smallest District, geographically, but I like to think we punch above our weight.

The Fed's decentralized nature is, in my view, a unique strength. We're making national policy, but we're doing it for an enormous country, and the averages of economic data can obscure realities on the ground. Conditions look very different in Philadelphia, Dover, or Lawrence Township than they do in Dallas, Salt Lake City, or Honolulu. This system gives, in my view, a voice to a range of localities and sectors. It also allows us to focus on regional issues within each Bank's District.

The United States has a unique set of needs. It's easy to forget that we're an outlier because we're such a big country: Only Russia and Canada are bigger geographically, only China and India have larger populations, and no one country has a bigger economy, at least for now. And that economy is vast, spreading across sectors and natural resources in a way that most other nations don't.

So, it makes sense that we have a system that feeds back information from around the country.

The other difference from most central banks is that the Fed has a dual mandate rather than a single goal; that is, we're charged with both maximum employment and price stability. Most just focus on one.

Maximum employment encompasses a wide range of metrics, although most attention is paid to the unemployment rate. That number, of course, will never be zero. Instead, we try to ensure that labor markets are functioning dynamically and efficiently. *Price stability*, on the other hand, is low and stable inflation, which we judge to be around 2 percent a year. More on both of these topics in a bit.

The decisions we make within the Fed — the way we look at the economy and respond to data — are built entirely on the foundation of our dual mandate. It is our North Star.

Now that we've established that, I turn to the question so many people secretly want to ask: What, exactly, does the Fed do? I'm delighted to talk about it, but just as important, I'll also mention what we *don't* do.

We have lending power. What that means is we do *not* have spending power. We have no authority over fiscal policy, which deals with debts, deficits, and taxes. Or investments to encourage growth. Or grants to worthy organizations. Or programs to spur job creation. Those all depend on elected officials, be they on the local, state, or national level.

So, what *do* we do?

We set monetary policy. We also regulate banks, along with an alphabet soup of government agencies. We are the lender of last resort during bona fide emergencies.

And the lede that always gets buried — and I wish it weren't so overshadowed by discussions of interest rates — is that we work within our Districts to help strengthen local communities' economies. We have a truly exceptional team in Philadelphia in our Community Affairs department, and they work with partners all over the Third District. They're doing truly vital work on employment, transportation, housing, and other issues. In fact, I'll discuss some recent research from this department a little later.

But first, let me talk a bit about monetary policy. Monetary policy is a fairly limited field with a fairly conscripted set of tools.

Our job is to create the conditions in which a healthy economy can thrive. More than anything, we're tilling the land.

Monetary policy is about meeting our dual mandate mostly by moving interest rates. There are other tools we use, but in normal times, it's mostly about moving what is technically called the federal funds rate. In the media, that's usually just called the interest rate.

The federal funds rate is the interest rate on loans that banks make to each other overnight. That rate tends to influence interest rates more broadly, so the effect ripples through the economy. When we move the federal funds rate, it affects the interest rate people pay on their mortgages and car loans and that businesses pay to borrow to meet or expand their payrolls or buy inventory. In fact, sometimes just announcing we are planning to raise the federal funds rate in the future affects these lending rates.

We set rates when the FOMC meets in Washington, which we do eight times a year. After two years of virtual meetings, we're finally back in person.

Regional Bank presidents don't always get to vote. Most of us rotate into a voting position every three years, but the governors always do, as does the president of the New York Fed. New York, owing to the presence of Wall Street, enjoys something of a "first among equals" status within the System. And while the rest of us don't always vote, we do always represent our Districts and play a part in the discussion.

The FOMC discussion is *never* political. Because we're appointed policymakers, we don't respond to swings in public opinion or election cycles. Unlike politicians, who suffer the slings and arrows of the 24-hour news machine, we operate in a rare, apolitical bubble. I truly believe that the independence of the Fed is crucial to making the best decisions possible for the American economy, free from the pressures of politics.

Although we're independent, that doesn't mean we're unchecked. The Fed is what's considered "independent within government." We're overseen by Congress, but neither Congress nor the presidential administration has a say in the decisions we make.

The State of the Economy

That's not to suggest the Fed doesn't come under intense political scrutiny at times, particularly when economic conditions are troubled. So now, I'd like to talk a little bit about where we are.

When thinking about the state of the U.S. economy, I think it's worth taking a step back and looking at the global situation. Sometimes when we're immersed in granular data, it can be easy to miss the economic forest for the trees.

So, where are we?

Well, first and foremost, we've made significant progress, particularly on vaccinations, but we remain mired in the midst of a now two-year global pandemic that has killed at least 6 million people globally and more than 1 million here in the United States. The human toll is immense and tragic, and the economic tribulations continue to reverberate. Tens of millions around the world were thrown out of work by the pandemic, and supply chains were throttled. Even now, there are significant issues getting supply chains back on line, which is contributing to high inflation that is harming American families.

Russia, meanwhile, has invaded Ukraine, fomenting death and destruction and spurring a humanitarian crisis in the heart of Europe.

I have to say, given these extraordinarily trying and tragic circumstances, one can't help but feel a little bit of awe at the underlying strength of the U.S. economy.

In the fourth quarter of last year — coinciding, at least in part, with the Omicron surge — GDP grew at an annualized rate of 7 percent, with a strong inventory investment and healthy demand for capital goods. For the totality of 2021, U.S. GDP growth was a very healthy 5.7 percent.

While delivery times remain elevated, there are some signs in the data, and in what we hear from our contacts, that supply chain constraints are finally easing, at least somewhat. It really depends on what industry — or more specifically, what good — you are talking about. And shocks continue — witness the recent lockdowns in China.

The job market, half of the Fed's mandate you'll recall, is extremely robust. For 11 straight months, new job creation has topped 400,000. But if you think that has led to a decline in Help Wanted signs, you're wrong. Even with all this job creation, vacancy rates remain elevated.

Nominal wage growth, as one would guess given these conditions, has been strong, though it has recently not kept up with inflation. Labor participation rates are edging up as well, though they remain below where they were before the pandemic. I suspect that the waning of the virus — at least here in the United States — as well as uncertain equity markets and even inflation may lure people back into the workforce and persuade others to delay retirement. I know some people my age who were thinking about retiring have recently decided to keep working. The unemployment rate, which is below 4 percent, should continue to fall this year.

So, I think it's fair to say the Fed has met half of its dual mandate. But the other side of our mandate is proving more troublesome.

The bottom line is this: Inflation is running far too high. I am acutely concerned about this. Generous fiscal policies, supply chain disruptions, and accommodative monetary policy have pushed inflation far higher than I — and my colleagues on the FOMC — are comfortable with. I'm also worried that inflation expectations could become unmoored.

The consumer price index (CPI) increased in March. Compared with a year ago, CPI is up 8.5 percent. The increase was driven, in part, by higher energy and food prices. Core CPI, which excludes energy and food prices, remains very high as well, having increased 6.5 percent in March from a year earlier. Russia's invasion of Ukraine will add to inflation pressure, not only hiking oil and gas prices but other commodities, like wheat and fertilizer, as well.

Inflation is widespread. It is showing up throughout a vast array of goods that comprise the CPI "basket." Both goods and services are experiencing inflation.

This is why last month we announced we were raising the federal funds rate for the first time since 2018. We raised our target by 25 basis points, and I expect a series of deliberate, methodical hikes as the year continues and the data evolve. I also anticipate that we will begin to reduce our holdings of Treasury securities, agency debt, and mortgage-backed securities soon. While the Fed cannot do much to ameliorate the supply issues that are increasing inflation, we can begin to affect demand.

With the runoff of pandemic support, tightening monetary conditions, and the war in Ukraine pressuring commodity prices, I think growth will moderate this year. We can probably expect to come in around 3 percent to 3.5 percent GDP growth this year — and then falling to trend growth of 2 percent to 2.5 percent during the next couple of years.

Inflation should begin to taper this year, too, though remain elevated, probably around 4 percent for 2022. The following two years should bring it back to our target of 2 percent.

The Job Market for Non-College Workers

Now, before we move on to our Q&A — and, by the way, I hope you'll really grill me — I want to talk a little bit about some recent research from the Philadelphia Fed's Community Development function.

Keeping with our theme, I'd like, once again, to start with *where we've been*. I know it can be tough to remember — it sure is for me — but let's try to think back to what economic conditions were like prior to the pandemic.

In general, the economy was actually quite healthy before COVID-19 struck, with solid GDP growth and low unemployment. But those headline numbers masked serious problems, most notably in the labor market. Many prime age workers, particularly men, and *especially* men without college degrees, had dropped out of the labor force altogether — so they didn't show up in unemployment data. Many more Americans were essentially "stuck" — they may have been working, but they had jobs with stagnant wages and minimal opportunities for advancement.

A big focus of our Community Development function at the Philadelphia Fed has been working to get more of these workers into what we call *opportunity occupations* — jobs that don't require a college degree and that pay above the median wage. They even developed an interactive tool called the Occupational Mobility Explorer, which demonstrates that many workers in lower-wage employment already possess the skills they need to transition to a higher-paying job with just a little bit of training. You simply input your job and your metro area into the tool, and the Explorer suggests available career paths. A bill collector, for instance, could become a credit counselor and enjoy a significant bump in wages. I urge you to delve into the Occupational Mobility Explorer at Philadelphiafed.org.

In recent months, my colleagues at the Philadelphia Fed set out to answer another important question: How did the pandemic affect workers without college degrees?

Initially, of course, it was those workers who suffered the worst effects of the pandemic-induced recession. Workers without college degrees were less likely to be able to work from home and were more likely to work in industries that were shut down either by government order or because of COVID-19 outbreaks. The huge spike in unemployment we experienced in 2020 — at its peak, the unemployment nearly quadrupled — was disproportionately concentrated among those without college degrees and those in lower-wage work.

But what happened to those workers when the economy reopened?

By June 2021, job openings were at record highs as a variety of factors kept workers on the sidelines even as consumer demand surged. Employers deployed all kinds of methods to lure workers. They, for instance, offered increased flexibility and training and bumped up starting salaries. These were favorable trends for workers.

Examining a data set of job postings, Philadelphia Fed researchers identified another trend favorable to workers without a college degree, in particular: The minimum level of education required in the online job market fell modestly, even after controlling for the postings' broad occupation and sector classifications. In other words, some job postings that before the pandemic might have required a college degree no longer did.

All told, compared with the five quarters preceding the pandemic, the five quarters following its onset included an additional 2.3 million "opportunity employment" job postings. You'll recall that these are jobs that don't require a four-year college degree and that pay at least the median wage. These additional postings can be attributed to both the greater volume of job postings for these types of jobs at 62 percent and also the lower educational requirements, at 38 percent of the increase. Which is to say, a lot of job openings that might have been previously off-limits to someone without a college degree became viable options after the start of the pandemic.

This is clearly a salutary trend, and we should be thinking of ways to build on it. You, as future college graduates, will play a key role in building a new economy that works for everyone.

So, thanks again so much for having me. I hope it was worth the two-year wait. And now I'm happy to take some questions.