The Pandemic Endgame Begins

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Power Up Little Rock: U.S. Economy and Monetary Policy
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Any opinions expressed here are my own and do not necessarily reflect those of the Federal Open Market Committee.
Introduction
Key themes

• The pandemic has worsened in the U.S. and Europe, but the early arrival of vaccines suggests the health crisis will wane in the months ahead.
• U.S. monetary and fiscal policies have been exceptionally effective and were designed for a larger shock than the one that has occurred.
• U.S. tracking forecasts of fourth-quarter real GDP growth are well above trend.
• Some downside risk remains, and continued execution of a granular, risk-based health policy will be critical to maintain economic momentum.
Health Crisis Worsens but Is Expected to Wane
Fatality rates and economic activity

• The global health crisis requires continued daily management.
• Daily fatalities per 100,000 population have increased in both Europe and the U.S.
• East Asia and Pacific countries continue to report daily fatalities per 100,000 population that are an order of magnitude lower than those of the U.S. and Europe.
• Key areas of global production are well past the initial phase of the crisis but must maintain safety protocols.*

Health outcomes worsen

Sources: Center for Systems Science and Engineering at Johns Hopkins University, Centers for Disease Control and Prevention and author’s calculations. Last observation: Jan. 5, 2021. For this chart, the East Asia and Pacific region consists of Australia, China, Indonesia, Japan, Malaysia, Myanmar, New Zealand, Philippines, South Korea, Singapore, Thailand and Taiwan.
But U.S. fatalities expected to fall

U.S. public health limits remain stringent

Fatalities skew toward older citizens

Death Rates for COVID-19 vs. Accidental Injuries

<table>
<thead>
<tr>
<th>Death rate (per 100,000)</th>
<th>COVID-19</th>
<th>Accidental injuries: 2018 data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 24</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>25-44</td>
<td></td>
<td>150</td>
</tr>
<tr>
<td>45-54</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td>55-64</td>
<td></td>
<td>90</td>
</tr>
<tr>
<td>65-74</td>
<td></td>
<td>60</td>
</tr>
<tr>
<td>Over 75</td>
<td></td>
<td>200</td>
</tr>
</tbody>
</table>

Vaccines will help bring the crisis to a close

• Vaccine distribution is being directed toward those most vulnerable to COVID-19, suggesting declining fatalities in the months ahead.

• The Oxford stringency index suggests business restrictions today are not too different from what they have been in recent months on a national basis in the U.S.

• Renewed increases in infections in recent months are likely coming more from personal interactions at the household level.

• Many businesses have learned to produce at normal levels despite health restrictions, contributing to rapid economic growth.
Effective Monetary and Fiscal Policies
A policy rate cut and increased liquidity

- U.S. monetary and fiscal policies have been exceptionally effective during the crisis.
- Monetary policy included lowering the policy rate to the effective lower bound and providing liquidity to financial markets through a variety of programs supported by the U.S. Treasury.
- The backstop programs stemmed an incipient financial crisis during the March-April time frame, to the point where current levels of financial stress are at pre-pandemic levels.
Financial stress has abated

Fiscal policy response to the pandemic

• In the first 11 months of the year, U.S. fiscal policy included the CARES Act along with additional legislation. In total, this fiscal policy response was valued at about $3.148 trillion.*

• The actual shortfall in U.S. real GDP in 2020, according to forecasters, will likely be closer to 2%-2.5% of GDP, or about $400 billion to $500 billion.

• The fiscal response drove personal income up to an all-time high in the second quarter, the opposite of normal recession dynamics.

• In addition, the Consolidated Appropriation Act of 2021 signed into law on Dec. 27, 2020, includes an additional $900 billion in pandemic relief.

* See the International Monetary Fund’s Policy Responses to COVID-19 and the Committee for a Responsible Federal Budget’s estimates of the cost of President Trump’s executive orders.
Personal income above 2019 trend

Personal income in 2020 versus 2019

U.S. Recovery Far Ahead of Schedule
Substantial expansion in Q3

• Current macroeconomic data suggest that April 2020 will prove to be the lowest point of the crisis, provided the remainder of the crisis can be managed effectively.
• Third-quarter real GDP growth, at an annualized rate of 33.4%, was the fastest on record.
• For the fourth quarter, real GDP appears to have grown at an above-trend pace, according to forecasts.
Above-trend growth forecasts for Q4

Percent change, q-on-q annual rate

Atlanta Fed GDPNow Estimate for 2020:Q4

Congressional Budget Office's estimate of the average annual growth rate of potential output.

Labor markets continue to improve

• Employment has rebounded more rapidly than expected, supporting the idea that many layoffs were temporary as firms adjusted to the pandemic.

• Hall and Kudlyak (2020), in particular, have emphasized that the temporary layoff category of unemployment has been dramatically more important in this recession as compared with previous recessions.*

• As a result, the U.S. labor market recovery is four years ahead of where it was following the 2007-09 recession.

Unemployment declining more rapidly than after the previous peak

Unemployment driven by temporary layoffs

Unemployment Rate and Temporary Layoffs

- Unemployment rate (left axis)
- Job losers on layoff as a percent of total unemployed (right axis)

The percent of the unemployed self-reporting as "on temporary layoff" is normally only 10-15%, but today is at 25.9%.

Last observation: November 2020.
Potential unemployment declines

• A back-of-the-envelope calculation suggests that there is room for further decline in the official unemployment rate in the months ahead.

• If all those unemployed identifying as “on temporary layoff” are simply recalled and nothing else changes, the official unemployment rate would decline to 5.0%.

• If the “on temporary layoff” category returns to a normal value (e.g., 1 million workers) and nothing else changes, the official unemployment rate would still decline to 5.6%.

• The median U.S. unemployment rate in the postwar era is 5.6%
How far ahead of schedule is the U.S. labor market?

<table>
<thead>
<tr>
<th></th>
<th>February peak</th>
<th>April trough</th>
<th>November</th>
<th>Percentage Recovered</th>
<th>Months ahead of previous recovery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate weekly hours (index)</td>
<td>112.0</td>
<td>93.2</td>
<td>105.9</td>
<td>67.6%</td>
<td>49</td>
</tr>
<tr>
<td>Civilian employment (millions)</td>
<td>158.8</td>
<td>133.4</td>
<td>149.7</td>
<td>64.4%</td>
<td>49</td>
</tr>
<tr>
<td>Nonfarm payrolls (millions)</td>
<td>152.5</td>
<td>130.3</td>
<td>142.6</td>
<td>55.6%</td>
<td>49</td>
</tr>
</tbody>
</table>

Inflation Expectations Recovering
Toward Inflation Target
Inflation expectations improving

Market-Based Inflation Expectations with a CPI-to-PCE Adjustment

<table>
<thead>
<tr>
<th>Percent</th>
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<tbody>
<tr>
<td>2.5</td>
</tr>
<tr>
<td>2.0</td>
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<tr>
<td>1.5</td>
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<tr>
<td>1.0</td>
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<tr>
<td>0.5</td>
</tr>
<tr>
<td>0.0</td>
</tr>
<tr>
<td>-0.5</td>
</tr>
<tr>
<td>-1.0</td>
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</table>

Aug. 27, 2020: Chair Powell announces new policy framework

2% inflation target

Inflation expectations moving higher

- Market-based inflation expectations have recovered from lows reached during March 2020.
- The FOMC’s new policy framework, announced in Chair Powell’s 2020 Jackson Hole speech, has likely encouraged some of this movement.
- The chart indicates that TIPS-based breakeven inflation, based on CPI inflation measures, could move considerably higher and still be consistent with a PCE inflation outcome modestly above the 2% target.
Conclusion
Light at the end of the tunnel

• The early arrival of vaccines suggests that the global pandemic will wane during the first half of 2021.

• In the U.S., monetary and fiscal policies have been especially aggressive, and the associated macroeconomic outcomes have been considerably better than originally expected at the pandemic onset.

• Aggregate resources available to fund consumption continue to be exceptionally high, suggesting continued recovery in the first half of 2021.

• Some downside risk remains, and continued execution of a granular, risk-based health policy will be critical in the months ahead.
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