Minutes of the Economic Advisory Panel Meeting

October 2nd, 2020

Present: Chair: John Williams. External Panelists: Julia Coronado, Kathryn Dominguez, Janice Eberly, Michael Feroli, Kristin Forbes, Simon Gilchrist, Austan Goolsbee, Peter Blair Henry, Sydney C. Ludvigson, Lisa Lynch, Alex Mas, Raghuram Rajan, Laura Veldkamp, Ellen Zentner. New York Fed staff: Jaison Abel, Ozge Akinci, Mary Amiti, Pablo Azar, Gianluca Benigno, Nina Boyarchenko, Rajashri Chakrabarti, John Clark, Matteo Crosignani, Hunter Clark, Richard Deitz, Marco Del Negro, Keshav Dogra, Thomas Eisenbach, Michael Fleming, Beverly Hirtle, Jan Groen, Fatih Karahan, Tom Klitgaard, Anna Kovner, Lorie Logan, David Lucca, Jonathan McCarthy, Paolo Pesenti, Maxim Pinkovskiy, Matthew Raskin, Julie Remache, Josh Rosenberg, Joao Santos, Asani Sarkar, Argia Sbordone, Or Shachar, Kevin Stiroh, Angela Sun, Andrea Tambalotti, Giorgio Topa.

Following introductory remarks by John Williams, Michael Feroli presented on "Evolution of COVID-19 and the Economic Outlook". He pointed out the divergence between the strong recovery of consumer spending in goods and the lagging recovery in services. He observed that the savings rate reached record high levels during the earlier stages of the pandemic as disposable personal income was supported through the effects of certain provisions in the CARES Act. Even though the savings rate has since declined, it could remain elevated for some time if households maintain high precautionary savings because of Covid-19-related uncertainty. He added that the prospects for a full economic recovery depend partly on driving savings rate to considerably lower levels. He noted that the expiration of the pandemic unemployment compensation (PUC) appeared to have little effect to date on consumer spending. On the longer-term outlook, he noted a number of factors that could affect future productivity growth. He also showed that U.S. manufacturing productivity growth has been quite sluggish over the past decade. On inflation, he said that the consensus and market view werethat the risks were skewed to the downside, although he noted some upside risks, including the large stock of household liquid assets that could exert upward price pressure when the economy improves.

In the following discussion, panelists posited reasons why the economic rebound to date was stronger than that implied by earlier forecasts, even in the face of the summer surge in Covid-19 cases and the PUC expiration. They pointed out that the fiscal packages had been large and fairly well-targeted. They also pointed out that there may be measurement issues that could affect the eventual understanding of the rebound. Additionally, panelists discussed the role of uncertainties relating to the virus and policy in leading to a higher savings rate, the sharp fall and strong rebound in small business formation during this episode, state and local government employment declines, the possibility that innovations during the pandemic will lead to a better balance of work and child care, and the outlook for further fiscal support.

The second presentation was on "The Long Term Effects of COVID-19" by Laura L. Veldkamp. She argued that "belief scarring"–a persistent change in the perceived probability of a future extreme negative shock–could lead to a large negative effect on future economic outcomes. Her analysis indicated that the total loss from scarring could equal about 57-90% of pre-COVID-19 GDP. She noted that belief scarring makes liquid, safe assets more valuable and could reduce the risk free rate by 67 bps in the absence of policy intervention.

In the following discussion, it was observed that the absence of policy intervention is a key assumption and the removal of tail risks may affect outcomes. The panelists offered many other associated insights. One panelist observed that labor market data show that younger generations have been hit harder, a pattern similar to that seen following the Great Recession, but not in the prior recessions, which could lead to reduced risk taking behaviors such as homeownership and marriages. Panelists discussed the extent of scarring from the pandemic shock, the impact of innovations in vaccines and pharmaceuticals on other productivity-enhancing investments, and effect of the Federal Reserve's spring policy actions on the information sensitivity of asset prices. Additionally, panelists expressed concerns that keeping interest rates near zero for long periods may increase economic inequality, particularly in circumstances where higher-income, college-educated workers are generally better able to shift to remote work. They commented that there may be permanent hit to the leisure, entertainment and retail sectors with deep economic and psychological damage. Panelists also commented upon the potential impact of climate risk on the beliefs of households and financial market participants, as well as on the differential impact of belief scarring across households, particularly for communities of color.