Fed data reveals impact of pandemic on lower-paid US workers

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Federal Reserve Chairman Jerome Powell has again pledged to maintain an ultra-loose monetary policy while reporting central bank data revealing the extent of the hit delivered by the COVID-19 pandemic to lower-paid US workers.

In a speech to the Economic Club of New York on Wednesday, Powell reiterated his view that a “patiently accommodative” monetary policy was needed well into the future. He said that even if there were a rise in inflation to the Fed’s target of two percent it would not bring an immediate tightening of interest rates or alter the central bank’s policy of purchasing assets at the rate of $120 billion per month.

What stood out in his speech, however, was not the reassertion of these commitments to Wall Street, but rather the information he provided on the state of the US labour market. The focus on this area served two purposes: to underline the significant worsening of the state of the US economy and to provide a justification for the Fed’s continuation of monetary stimulus.

Powell began his remarks on the state of the labour market by noting that it could “hardly be more different” from the situation that prevailed 12 months ago.

“Employment in January of this year,” he said, “was nearly 10 million below its February 2020 level, a greater shortfall than the worst of the Great Recession’s aftermath.”

After reaching 14.8 percent in April, the unemployment rate has fallen to 6.3 percent as of last month.

“But the published unemployment rates during COVID has dramatically understated the deterioration in the labour market,” he said. The pandemic “has led to the largest twelve-month decline in labour force participation since at least 1948.”

This is a major reversal over the past five years. From 2008 to 2015, the participation rate had been steadily declining as a result of the effects of the financial crisis. But after 2015, the previous decline was reversed.

However, in the past year there had been a precipitous fall, as millions of working-age individuals dropped out of the workforce because there are simply no jobs available or because they are unable to work due to the pandemic.

“All told, nearly five million people say the pandemic prevented them from looking for work in January,” he said. “In addition, the Bureau of Labor Statistics reports that many unemployed individuals have been misclassified as employed. Correcting this miscalculation and counting those who have left the workforce since last February as unemployed would boost the unemployment rate close to 10 percent in January.”

He went on to note that “even those grim statistics” understate the decline in labour market conditions for the most vulnerable Americans. The reduction in aggregate employment since last February has been 6.5 percent. But this is not an even distribution. The decline in employment for workers in the top quartile of the wage distribution was four percent “while the decline for the bottom quartile has been a staggering 17 percent.”

According to Fed Governor Lael Brainard, the bottom 25 percent of workers are facing unemployment rates of 20 percent, equivalent to levels reached in the Great Depression of the 1930s.

Powell said employment prospects for the lower-paid have changed little in the past few months and could be worsening.

In recent months, the improvement in labour market conditions had stalled, as the rate of COVID infections sharply increased. In the leisure and hospitality sector, the number of jobs fell by more than half a million in December and a further 61,000 in January.

At the start of the pandemic, the increase in unemployment was almost entirely due to temporary job losses, "but as some sectors of the economy have continued to struggle, permanent job loss has increased" along with long-term unemployment.

Powell said that it would "not be easy" for the economy to return to full employment, and America was still "very far from a strong labour market." The situation was compounded by the fact that "we have seen that the longer-run potential growth rate of the economy appears to be lower than it once was," and this circumstance "can lead to worse economic outcomes—particularly for the most economically vulnerable Americans."

After detailing the effects of the pandemic on the labour market, Powell made clear that the support to financial markets, which has resulted in record highs on Wall Street and an orgy of speculation, would continue even if there were a rise in inflation and a tightening of the labour market. The Fed would "not tighten monetary policy in response to a strong labour market." It was explicitly seeking to achieve inflation that averages two percent over time, he said.

"This means that following periods when inflation has been running persistently below two percent [the present situation], appropriate monetary policy will likely aim to achieve inflation moderately above two percent for some time in the service of keeping inflation expectations well anchored at our two percent long-run goal."

This is an assurance to Wall Street that a sudden spike in the inflation rate will not result in the Fed immediately moving to lift its base interest rate from the present level of virtually zero.

Powell did not immediately comment on the controversy that has erupted following the publication last week of an op-ed piece by former US Treasury Secretary Lawrence Summers warning that the Biden administration's proposed $1.9 trillion stimulus package could spark inflation and lead to financial instability.

But he indicated his broad support for the stimulus measures, having been calling for such action for some time.

He said discussions on the fiscal package were "appropriate," without commenting on the specifics of the Biden plan. Given the number of people who had lost their jobs and "the likelihood that some will struggle to find work in the post-pandemic recovery," he added, achieving maximum employment would require support from government.

Without specifically addressing Summers' argument, he indicated his expectation that inflation would remain subdued even in the face of increased government spending.

"You could see strong spending growth, and there could be some overt pressure on prices," he said. "My expectation would be that will be neither large nor sustained. Inflation dynamics will evolve but it's hard to make the case why they would evolve very suddenly in this current situation."