Economic Outlook
and the Anchor Economy Initiative

2023 Lyons Center for Economic Education and Entrepreneurship
University of Delaware
Newark, DE

January 18, 2023

Patrick T. Harker

President and Chief Executive Officer
Federal Reserve Bank of Philadelphia

The views expressed today are my own and not necessarily those of the Federal Reserve System or the Federal Open Market Committee (FOMC).

Economic Outlook and the Anchor Economy Initiative

2023 Lyons Center for Economic Education and Entrepreneurship

University of Delaware

Newark, DE

January 18, 2023

Patrick T. Harker

President and Chief Executive Officer

Federal Reserve Bank of Philadelphia

Good afternoon! It's great to be back at UD. I had many very happy years as president here, though I did recall the *one* downside to working here as I made my way down I-95 this afternoon: the traffic.

In all seriousness, it's really an honor to be here for today's event. I plan to speak a bit about the national economy, monetary policy, and an exciting new initiative from the Federal Reserve Bank of Philadelphia. And then we can get to the discussion, 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.

How We Got Here

You know, the last time I was here for this event was almost exactly three years ago in February 2020.

And if we take a step back and think about it, it's quite remarkable how much has transpired since we were last together. First and foremost, of course, is the humanitarian tragedy that our country — and our world — has endured because of the COVID-19 virus over the past three years. More than 7.5 million people globally have perished from the virus, including more than 1 million of our fellow Americans. This is a public health catastrophe on a global scale that is unprecedented in any of our lifetimes.

The tribulations of the U.S. economy over this period have been startling as well. During the early part of the pandemic, the national economy suffered its largest contraction in recorded history as the virus spread and state and local governments shuttered businesses that they deemed nonessential. Tens of millions of Americans were thrown into joblessness in one of the sharpest recessions in American history.

That downturn was followed by a period of extraordinary economic growth as states loosened restrictions and, with astonishing rapidity, highly effective vaccines against COVID-19 were developed and deployed.

But even as the economy came roaring back to health, scars were visible. Many older Americans had opted to retire at the onset of the pandemic, leaving labor force participation below where it was before COVID-19 arrived on our shores. Supply chains were badly damaged by the virus itself as workers fell ill, and by government lockdowns, which shuttered factories for extended periods. This left crucial items like computer chips in short supply. Meanwhile, large doses of fiscal spending from the federal government and accommodative monetary policy from the Federal Reserve stoked demand. This led to a phenomenon known colloquially as “too much money chasing too few goods” and the highest inflation in four decades.

Where We Are Nationally

High inflation is a scourge, leading to economic inefficiencies and hurting Americans of limited means disproportionately. I find it particularly disturbing that life’s true essentials like groceries, fuel, and shelter have skyrocketed in price.

The Federal Reserve is absolutely committed to bringing inflation back to our 2 percent target.

And we’re doing that by adjusting our monetary policy. Last year, we raised the target for the federal funds rate to between 4.25 percent and 4.5 percent. That was a significant move, and a very fast one, given that we started the year at about 0 percent. I expect that we will raise rates a few more times this year, though, to my mind, the days of us raising them 75 basis points at a time have surely passed. In my view, hikes of 25 basis points will be appropriate going forward.

At some point this year, I expect that the policy rate will be restrictive enough that we will hold rates in place to let monetary policy do its work. We are also shrinking our balance sheet, which is removing a significant amount of accommodation in and of itself.

Our goal is to slow the economy modestly and to bring demand more in line with supply. The Federal Reserve obviously can't fix problems like supply chain issues, or an endemic shortage of workers, though it does seem like these problems are finally easing a bit. But we can affect demand by making it more expensive to borrow money. And that's clearly already happening: We're seeing unmistakable signs of a slowdown in the most interest-rate sensitive parts of the economy, like housing.

What's encouraging is that even as we are raising rates, and seeing some signs that inflation is cooling, the national economy remains relatively healthy overall. In parts of 2022, the economy grew modestly even as we were tightening monetary policy substantially. Although inflation is biting, many Americans are still spending — even if they dip into their savings to do so.

We're seeing a healthy recovery in those sectors that suffered most during the pandemic, like leisure and hospitality, while some sectors that built up healthy order books like manufacturing are cooling somewhat. I do remain concerned about commercial real estate, as the embrace of remote and hybrid work is clearly dampening demand for office space in central business districts and suburban office parks.

I'm most pleased that the labor market remains in excellent shape. Last year, the U.S. economy created 4.5 million jobs, and while we are seeing scattered layoffs in certain segments like tech, there is little evidence of a major downturn in the job market. In fact, a record number of Americans are employed. And indeed, the national unemployment rate is exceptionally low at 3.5 percent.

Where We Are Going

But there's more good news: We are starting to see inflation come down across a spectrum of goods. And so, with monetary policy doing its work, supply chains healing, and excess demand running off, I forecast core inflation to come in at around 3.5 percent this year. I want to be clear: This is well over our 2 percent target. But it is suggestive of clear movement in the right direction. Core inflation should fall to 2.5 percent in 2024 and then back down to 2 percent in 2025.

GDP growth will be modest, but I'm not forecasting a recession. The labor markets are simply too hot to indicate a significant downturn at this point. I expect real GDP growth of about 1 percent this year before climbing back up to trend growth of about 2 percent in 2024 and 2025.

Lastly, I do think we will see a very slight uptick in unemployment, probably topping out at about 4.5 percent this year, before falling back toward 4 percent over the next two years. It's an underrated advantage that the Federal Reserve is taking on inflation from a position of such labor market strength.

The Anchor Economy Initiative

Now, in the remaining few minutes, I'd like to talk a little bit about an exciting new initiative from the Philadelphia Fed called the Anchor Economy Initiative. It's fitting that we are convening here on the STAR Campus today because this place exemplifies the Anchor Economy Initiative perfectly.

The Anchor Economy Initiative seeks to quantify the economic impact of higher education institutions and hospitals — *eds and meds* — that we call the *anchor institutions* in their communities.

This is vital work. Anchor institutions are often the largest employers in regions, they're the producers of talent that other businesses need, and they lay the foundation for durable economic growth.

They also have characteristics that other institutions just don't. For one, even though they've made sizable leaps in their use of technology in recent years — especially during the COVID-19 pandemic — higher education institutions and hospitals are physically embedded in their communities. In fact, that's one of the reasons we call them anchor institutions. Unlike corporate headquarters, manufacturing facilities, or sports teams that can pick up and move, higher education institutions and hospitals tend to stay where they are. Hospitals and higher education also tend to be labor intensive, meaning they are often among the largest employers in their regions.

Eds and meds also serve as bulwarks against the ups and downs of the business cycle. Enrollment in colleges and universities, for instance, is countercyclical, meaning that when the economy slows, usually *more* people go to school, boosting anchor institutions. Hospitals are also recession resistant; after all, people require medical care no matter how the local economy is faring. All of which suggests that regions with strong anchor institutions may have more durable economies than those without.

And in recent years, we've also seen anchor institutions take an increasing interest in building up the areas they serve. They are typically critical partners in community development initiatives. We've seen more hospitals and universities invest in neighborhood economic development, boosting local commercial corridors, seeding residential real estate development, and building neighborhood amenities.

Anchor institutions' impact goes beyond the immediate. This is a key point that I really want to stress. Fundamentally, anchor institutions stimulate growth through innovation, commercialization, new venture formation, and talent attraction. In that sense, they can drive *long-term* economic development and growth.

Let's not sugarcoat things, though. Eds and meds are both being radically disrupted by technology, demographic shifts, and increasing costs. As I alluded to earlier, the COVID-19 pandemic accelerated both telehealth and remote learning. This has certainly created opportunities for health systems and universities to expand their markets, but it also loosened the place-based nature of their services. Suddenly, these anchors are, frankly, a little less anchored.

Demographics are another downside risk, though with disparate impacts for universities and hospitals. With falling birth rates, fewer 18-year-olds are heading to college and even fewer will enroll in the future, especially if immigration rates remain depressed, as they are now. This demographic shift is most apparent in the Northeast and Midwest, which also happen to have higher concentrations of colleges and universities. That raises real questions about the viability of many of these institutions in the future — and the impact that will have on communities.

On the other hand, an aging population is one that will require more health care, boosting hospitals. Even here, however, the picture is mixed, as many hospitals have closed over the past several years.

Meanwhile, the ever-rising cost of education and health care means that more people may be priced out of accessing eds and meds altogether, which is both a humanitarian concern and an economic one.

That's why, at the Philadelphia Fed, we've developed what we call the Anchor Economy Dashboard, a new tool that quantifies the impact of higher education institutions and hospitals on more than 500 regions across the country.

For each of these regions, the dashboard calculates the total number of jobs — direct, indirect, or induced — supported by local eds and meds institutions. Direct jobs comprise those employed directly by anchor institutions, like doctors, nurses, and college professors. Indirect are those working in fields that directly support anchor institutions, like IT contractors supporting a hospital. And induced jobs are those that are supported by the economic activity that anchor economies generate.

One thing that makes the Anchor Economy Dashboard so neat is that it also calculates a *reliance index* for each region. The reliance index provides a summary measure of how dependent a regional economy is on anchor institutions. It adjusts economic impact by the size of the regional economy and incorporates measures of impact in terms of employment, income, and gross value added. A reliance index of 1 means a region's reliance on anchor institutions is at the national average — below that means it's less reliant, and above that means it's more reliant.

On a national scale, the dashboard clearly shows what I've been talking about: The economic impact of anchor institutions is massive; 9 percent of total U.S. employment, 6.3 percent of total U.S. income, and 8.1 percent of total U.S. gross value added comes from higher education institutions and hospitals. That translates to 18.2 million jobs, $1.1 trillion in income, and $1.7 trillion in gross value added to the economy.

For Delaware, our data support what I suspect a lot of us know intuitively: This state is quite reliant on anchor institutions. So, while Delaware's total employment in eds and meds ranks 46th out of 50 states and the District of Columbia, that is largely a result of the state having a small population. Delaware's reliance index, we calculate, is 1.23. In other words, Delaware overindexes on eds and meds employment, income, and gross value added, compared with other regions. Delaware is 23 percent more dependent on eds and meds for jobs, income, and gross value added than the United States as a whole.

Conclusion

I urge you all — after today's program — to head over to philadelphiafed.org to delve into the dashboard. We have data for 524 regions across the U.S. — truly a treasure trove. I think you'll find the information there useful and important.

In closing, I'd like to reiterate my thanks to you for attending, and the Federal Reserve's strong commitment to bringing down inflation. Now let's get on to the discussion.