Zandi: 'Nothing Fundamental Has Shifted'

"The American consumer drives the train of the US economy," the Moody's Analytics chief economist told a ULI New York audience Wednesday.

By: Paul Bubny, Globe St., November 9, 2017

On the geopolitical front, "the stakes seem a little higher," Zandi said Wednesday.

NEW YORK CITY—A year ago, Donald Trump successfully campaigned for the presidency on promises of sweeping change. A year later, chief economist Mark Zandi of Moody's Analytics told an Urban Land Institute New York audience that America's economic and social fabric was better off than he'd predicted in November 2016.

"My mistake was that I thought something would get done," Zandi said Wednesday. Despite "a lot of chest-thumping and bellicosity" from Trump and other elected officials, "nothing fundamental has shifted."

In the near term, Zandi isn't expecting 2018 to bring much upheaval to what has been the second-longest economic expansion on record. "We're creating lots of jobs," he told the ULI NY audience. "We're on track to create between two million and 2.5 million jobs this year; that's about what we created last year and the year before and the year before that." The rate of positions being added is about twice that of people coming into the work force, "and so that means that unemployment and underemployment continue to decline."

Where the job growth is occurring, and not occurring, is a factor. Zandi noted that the only two employment sectors that haven't seen their ranks increase lately have been brick-and-mortar retail, which continues to be hit hard by e-commerce, and the energy industry.

For brick-and-mortar operators, said Zandi, "things are pretty tough—there have been something like 450 retail bankruptcies over the past year, and that's in a really good retail environment. What would it be if the consumer wasn't out there spending money?" In the event of a recession, he added, "that would be when the real shakeout occurs."

Stronger wage growth is the key reason for optimism about the economy over the foreseeable future, said Zandi. "Wage growth is the fodder for increased consumer spending," he said. "The American consumer drives the train of the US economy," just as the US, with its $500-billion trade deficit, drives the global economy.

The global economic outlook itself is the other major factor supporting an optimistic viewpoint: for the first time since before the Great Recession, said Zandi, "there isn't a single major economy on the planet that isn't growing." Combining a solid global economy with a stable dollar makes for "a pretty good mix."

Conversely, Zandi discussed potential causes for concern over the balance of this decade. One of these is the federal funds rate. "If you connect the dots on what I've been saying so far, it would suggest that interest rates have to rise," he said. "The Federal Reserve and other central banks across the globe have to utilize monetary policy in a more consistent way."

Zandi's own timeline anticipates a steeper increase after 2019 than the Fed is currently projecting. Where the nation's central bank expects short-term interest rates to hover just under the 3% mark by early 2020, Moody's modeling calls for a rate of 3.5% or more in the same time frame. Zandi based his projection on the expectation that we'll see "some form of deficit-based tax cuts" in the next couple of years, a factor that neither the Fed nor the markets have priced in, although the markets have begun doing so.

Another possible worry is geopolitical turbulence reaching a tipping point—or, as Zandi put it, grains of sand being added to a pile until, eventually, one grain causes the pile to collapse. "There's a lot of stuff going on," ranging from tensions with North Korea to instability in the Middle East. "There's always stuff, but the stakes seem a little higher and, given who's at the helm, it feels as though the risk is higher than normal."

There's also a "wild card" factor: tax reform. "I can see this going in lots of different directions," said Zandi. However, the net effect of lowering tax rates on the one hand and measures such as repatriating overseas revenues and eliminating the state and local deduction on the other hand would still lead to a deficit of about $1.5 trillion, he said.

"The question is, how do you pay for it all?" said Zandi. "There is no good way." He pointed out that "there's an argument that if you lower the marginal rates, that lowers the cost of capital for business. Businesses go out and invest more; that investment adds to the stock of capital and that raises productivity, promoting the growth of the economy; you tax that and you generate revenue. Now that's all true. But it's just not nearly enough, under any reasonable estimate of what the so-called supply-side effects are."