Season 2 | Episode 58

An Economic Forecast: Inflation, Interest Rates, National Debt, and More

PAYCHEX Business Series

Coronavirus

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Full transcript

Gene Marks:
Hey, everybody and welcome to the Paychex Business Series podcast. My name is Gene Marks, your host today. As you know, I write in a bunch of different places like The Hill, and The Guardian, The Washington Times. Today, we're talking economics with Mark Zandi, who is the Chief Economist of Moody's Analytics. Mark has a great new podcast that's out and in addition to that, he will also be talking about inflation. Our conversation really kind of dug into why there are concerns about inflation, what inflation expectations are, what some of the factors are that's impacting potentially rising in price, and I'm going to get some forecasts, some predictions from Mark as to what he thinks inflation is going to be over the next few years. I think you'll find it very, very helpful, and will also help you guide your business in this era of rising prices. All right, so Mark, thank you very, very much for joining me today. I am really glad that you're here.

Mark Zandi:
It's good to be here, Gene. Thanks for the opportunity.

Gene Marks:
Sure. Okay, so your title is Chief Economist of Moody's Analytics, so first of all, tell us what does Moody's Analytics do?

Mark Zandi:
Well, it's a big multinational company. I'm a small itty-bitty part of it. I sold my company to Moody's 15 years ago, an economic consulting firm, and we provide economic data analysis, analytics, modeling to a wide range of financial institutions, government, non-financial corporations, just a broad array of companies. So, in fact, right now we're doing a lot of work on climate risk. So as you know, in the financial system globally there's a lot of concern about what climate risk means for loans and securities, and we're helping financial institutions figure that out.

Gene Marks:
Got it. So, companies hire you guys, they are looking into getting new markets, they're looking at evaluating risks, like you just said, climate risk. They're looking for overall economic forecasts within certain countries, certain areas. They would turn to you, Mark and say, "Okay, we need you to do this analysis for us." And that's what you guys do. Is that a fair summary?

Mark Zandi:
Yeah. I mean, everything from the State of Virginia needs help determining what their tax revenues are going to be next year, to the federal government, the Federal Housing Finance Agency that regulates Fannie Mae and Freddie Mac is worried about mortgage credit risk. I mean, how many people are going to default on their mortgages, to the Indian Central Bank is interested in understanding the impact of cryptocurrencies on the payment system in India. So, it's pretty wide-ranging.

Gene Marks:
Got it. Okay. That's great. And good luck with that last topic.

Mark Zandi:
A lot of fun.

Gene Marks:
I can imagine. So, you're a Chief Economist, so what is your background? You are a PhD economist or what is your training?

Mark Zandi:
Yeah, I'm speaking to you from the suburbs of Philly. This is where I grew up. My kids joke that I've sheltering in place all my life. So, I went to Penn undergrad. I went to Wharton for business school undergrad, and then I got my PhD in economics from Penn. I started my company pretty much out of my graduate work, and then 15 years later I sold it to Moody's, and I've been part of Moody's for the past 15 years.

Gene Marks:
Wow. All right. That's great to hear. And I'm speaking to you from my apartment, my home office in Center City, Philadelphia.

Mark Zandi:
Oh, I didn't know that.

Gene Marks:
Yeah.

Mark Zandi:
Really? You live in Center City? Oh, okay. Where is-

Gene Marks:
Main building where Marathon restaurant off of Rittenhouse Square, like 19th and Spruce.

Mark Zandi:
... I didn't know that. Yeah.

Gene Marks:
That's where we are everybody and it's funny, I didn't know that you were a local. That's another topic for another time, but hey, all right, let's get into the topics that I know our audience is interested in. And again, like I told you before we started this up, it's mostly small businesses, so it's inflation. Okay? So, Mark, let's first of all talk about why there was so much talk of inflation in the air. What is driving inflation and inflation expectations?

Mark Zandi:
Yeah, demand and supply. Yeah, pretty straightforward. So, demand is picking up because the economy is coming back to life on the other side of the pandemic. We're not quite there yet, but we're clearly moving in the right direction. Center City, Philly is, I think, open for business now. Right? I mean, you can go to any restaurant.

Gene Marks:
We are.

Mark Zandi:
Yeah, there you go.

Gene Marks:
75% capacity right now.

Mark Zandi:
Oh, is it?

Gene Marks:
Yeah.

Mark Zandi:
That'll go 100% pretty soon. And I was down in Florida for much of the winter and they're 100% open, so they're wide open.

Gene Marks:
True.

Mark Zandi:
So demand, a lot of demand, a lot of pent up demand. Vehicle sales in April were 18.5 million, that's a record April sales month, that's boom like sales.

Gene Marks:
Yep.

Mark Zandi:
And then of course supply is constrained, restrained because of the pandemic. I mean, everything kind of shut down and people went off and did their thing. A lot of manufacturers and commodity producers pulled back on production and getting all that back up and running, getting global supply chain sorted out. Of course, the pandemic is still raging in many parts of the world, which complicates things because a lot of what we consume is produced all over the world.

Gene Marks:
Right.

Mark Zandi:
You have to get it through the supply chain. So, you got a lot of demand, really boom-like demand, and the supply side is just trying to catch up. And so in that environment, you're seeing prices jump for everything from lumber, and copper, to diapers, to vehicles-

Gene Marks:
Packaging, raw materials, commodities, right? That's all part of the problem.

Mark Zandi:
... Also the other thing that happened, was in the pandemic all these industries that got nailed, like the accommodation industry, the restaurant business, the rental car industry, airlines, they cut prices, right? And so now all they're doing is getting those prices back up to what you consider to be more normal, but you're going from very low to now normal that's a big increase in inflation. And so we're seeing these jumps in prices.

Gene Marks:
Yeah, it's funny that you mention that. I literally just booked a flight to Dallas for June today, 900 bucks round trip from Philly to Dallas, and I think that's exactly what you just said. I mean, it's American Airlines catching up on the price decreases that they had over the past year. There was supply chain issues, and you did mention about while this all gets sorted out, I mean, supply chain is going to sort itself out eventually, don't you agree?

Mark Zandi:
Oh yeah, yeah. I mean, when prices go up, you can make money, and when people can make money, capitalism is a beautiful thing. People will figure it out and they figure it out pretty fast. So, I expect the supply side of this economy to wake up pretty fast. We've got a few more months of high prices, spiking prices, jumps here and there, but by the fall, by September, October, the supply-side will have caught up to the demand-side of the economy and prices will start settling back in.

Gene Marks:
Yeah. I'm definitely using some of your quotes for a piece I'm going to write, because I do think by the fall for small businesses, things are going to start shaking out and the fears of inflation I believe will be tempered a bit, but we have a ways to go before we get there. So, we talked about supply, you talked about demand, what role does labor play in all this, Mark? I mean, we hear about labor shortages, every one of my clients are complaining that they can't find good people, I mean, that's got to be driving the price of labor up.

Mark Zandi:
Yeah. So that's demand and supply too, right? So, all of a sudden, all these restaurants open up, they need people. I need to get them back all at once across the country, but supply is constrained for lots of reasons. I mean, you've got people who are still a little nervous about the pandemic, may not want to go back to work. You've got moms and dads that are staying home with their kids because schools haven't gone back to in-person learning, so they have to stay home with their kids. And then the unemployment insurance, the supplemental UI, that's 300 bucks a week. That's probably playing a role. Although I suspect that, that's going to become less important because you've got a lot of states now that are saying, "Hey, I'm not going to do that. I'm not going to give the 300 bucks. I'll take the money from the federal government and now I'm going to give a signing bonus for anyone who wants to go back to work."

Mark Zandi:
So, as you get closer to the expiration of that supplemental UI in September, I think workers are going to realize, hey, I need to take a job. I'm not going to wait until September. So as we move into the summer months, July, certainly by August, I think the labor supply issues will start sorting themselves out and by September, I think they're gone because schools will be reopened and everyone will get back to work.

Gene Marks:
Yeah. I think all of that. I couldn't agree with you more and that is good news to hear assuming that all plays out. Let's talk about, you're talking about demand and supply, let's talk about the demand and supply of money. There has been M2 money supply, which bank deposits has gone up by like five trillion dollars, I think since the beginning of the pandemic, somewhere in that range. And I don't know if you agree or not, but I think our treasury and our federal reserve officials have learned a lot since the Great Depression and that liquidity is very, very important for an economic system. So, when the you know what hit the fan, they delivered, and made sure the liquidity was there. So that's great, but we do have a big supply of money that's out there on deposit, and we also have obviously some multi-trillion dollar stimulus spending that's going to happen. So how does that impact inflation?

Mark Zandi:
Well, that goes to demand. So, the money's sitting in the checking accounts combined with all the pent-up demand, people sheltering in place and not going to ball games, or restaurants, or traveling, or getting their haircut, or buying cars. Now they can, and they've got the cash, so that means those two things come together and that's one of the reasons why demand is booming and taking off. And it's another reason to suspect that this economy is going to get back to full employment, which means an unemployment rate that's back to where it was pre-pandemic, 23 and a half percent-ish, probably within the next 18 to 24 months, so very, very quickly. So this is now, as economists would call it, a V-shaped recovery. I didn't think we were going to have this six months ago, but because of all of the government support and because of the monetary support coming from the Fed, that's a lot of juice, and that means that this economy is roaring and is going to roar until we get back to full employment.

Mark Zandi:
There is some reasonable concern that we're going to shoot past full employment, it's going to be so tight the supply side of the economy can't catch up to demand and we have higher underlying rates of inflation. So that's a reasonable concern, but I'd say, bring it on. Our problem for the last 25 years has been that inflation is too low, it's been uncomfortably low. So at least so far, I'd say, what is dead ahead of us is more of a feature than a book.

Gene Marks:
Why is inflation not a bad thing?

Mark Zandi:
Well, you want some inflation because if you don't have any inflation... So, say the economy has zero, prices aren't growing. What does that mean? That means some businesses are experiencing price cuts. They had to cut prices, right? Because the economy is not monolithic, it's made up of a lot of different companies and lots of different businesses. So, if it's zero, that means somebody is raising prices, therefore somebody's cutting prices, right? You ask any small business-person what the world feels like when they have to cut prices, what do they have to do, that's pretty difficult.

Gene Marks:
Sure.

Mark Zandi:
I mean, it's hard to manage a business in a declining price environment. So, if you keep inflation at two, which is where the Fed wants to keep it through the business cycle, that means even the weakest businesses probably are around zero, no price increases. So some businesses are experiencing price declines because of the technology, that's a difficult business to manage, but generally you want to make sure that the economy has enough inflation so that people aren't in that environment where they're having to navigate around a falling price environment.

Gene Marks:
The higher the inflation, and again, without being too high, is obviously that it contributes to increased wages as well, which theoretically also spurs more consumer spending.

Mark Zandi:
Yeah, exactly. I mean, the other thing that happens is workers, as you can imagine, think of this as workers, they have a problem if an employer comes to you and says, "I'm going to cut your wage." They can come to you and say, "I'm not going to give you as big a wage increase next year because inflation is up." But if my employer comes to me and says, "Hey, Mark, you're getting 15 bucks an hour and now you're going to get $14.00," I mean, that makes life difficult because I got debt payments, I got rent payments, I got mortgage payments. I got things I got to pay and they're not getting cut in price. So, you don't want that to happen. So you want, again, a modicum level of inflation results in a modicum level of wage growth so you don't have to actually cut people's wages, which again, like a business person, if people have to manage cutting their wages that becomes pretty difficult.

Gene Marks:
All right, I'm throwing all these questions at you because these are the questions I get from clients and business owners worry about this stuff. So, I'm going to get back to inflation, but kind of connected to it is overall deficits and national debt. I mean, I mentioned before about the multi-trillion dollars in proposed government spending over and above the stimulus payments that have already been legislated. Our national debt is something like 1.4 times our GDP, something in that area. Tell us, as business owners, are we concerned about that? Are you concerned about the levels of our national debt going forward?

Mark Zandi:
Yeah, I am. I mean, I would say though that wouldn't have stopped me from providing all of the government support that was provided during the pandemic.

Gene Marks:
Okay.

Mark Zandi:
Because If we hadn't provided that support, good chance the economy would have evaporated, and our fiscal problems would be even worse. Revenues would have been slashed even more, automatic government support because Medicaid, and food stamps, and unemployment insurance are hardwired into the system to try to cushion the blow, they would have ballooned out and our fiscal problems would have been even worse. So, we had a Robson's choice. There was no good choice. We took the least bad choice, which was okay, this is a crisis, we're going to borrow money, navigate through, get to the other side. But as economists say, there's no free lunch. We now have a much higher debt load, which will become an issue as interest rates rise.

Mark Zandi:
And so we do need to really focus any new policy, in my view, any new policies we put in place that requires additional government spending or tax cuts means we've got to make it up somewhere else in government spending restraint, or cut somewhere else, or tax increases somewhere else. And so, you'll notice like the Build Back Better agenda that Biden put forward that is paid for, at least in paper, we can debate if it actually paid for, but on paper it's paid for over a 15 year period. You get a lot of infrastructure spending, a one off -- a project, you spend, it's done. And then he says, "Okay, I'm going to pay for that by raising the tax rate on corporations and high income, high net worth households," which remains in place in perpetuity, unless the future Congress takes it away. So if you do the arithmetic after 15 years, that's paid for. So, we may not agree on is that a good policy or not, but it is in my view, good policy in the sense that it's sticking to the principle that we now have to pay for what we do.

Gene Marks:
Yeah. There's a growing number of economists that support modern monetary theory, and again, correct me if I'm explaining it wrong here, but the idea here is that governments, as long as we're using our own currency, so this is different than like Greece that were using not their own currency, can basically generate as much of their own currency as possible to spend as long as the economy has the capability of absorbing that. And there's sort of, theoretically no limits to what can be spent, again, as long as the economy absorbs that. So the theory being that if a lot of money is going out of his infrastructure bill, some monetary theorists say, we don't really need to have this tax increase because the money's going to go out to companies that will take it and spend it on employees and materials. They're building bridges, and roads, and all that kind of stuff. What do you think of that theory? Do you think that it is… . Well, what do you think of modern monetary theory? I'm curious.

Mark Zandi:
I don't think much of it. I mean, it's kind of the analog to supply-side theory, which is the I can cut taxes forever and they pay for themselves, so don't worry about it. And by the way, if they don't pay for themselves, don't worry we'll just cut government spending.

Gene Marks:
Right, like that's so easy to do.

Mark Zandi:
Yeah. And then the monetary side is, oh, we'll increase government spending, generate a lot of economic activity, it'll pay for itself, and if it doesn't, don't worry, we'll raise taxes.

Gene Marks:
We'll increase taxes, right.

Mark Zandi:
So-

Gene Marks:
Or we'll let the politicians decide that.

Mark Zandi:
… I don't think much of either theory, and by the way, the modern monetary theory is going to be tested pretty soon because what's going to happen here is we did borrow a boatload of money. The amount of support provided, forget about Build Back Better agenda, up until this point, all the government support,

the CARES Act last year, the American Rescue Plan a few weeks ago, that's 25% of GDP that [inaudible 00:17:35]. So we're going to get back to full employment, inflation is going to pick up, so we're going to see the limits of this idea that I can borrow and spend infinitely in the future, it's just not going to happen.

Gene Marks:
What if it fails? I mean, give us a worst-case scenario. I mean, there's really nothing, there used to be a time, Mark, where I tried to explain some of these things to my clients, and then I got bored of doing it because I felt like, well, there's really nothing you can do. I have a client in Bristol, PA up in Bucks County, and they make paper and film packaging products, and we can talk about the deficits all day, and they're like, "I just got to get back to work and make sure I'm delivering my orders." You know? I mean, what impact does all of this have on us? Do we even understand it?

Mark Zandi:
Well, when interest rates rise, unless interest rates rise you can't connect the dots. So, you say deficits and debt are a problem, someone says, "Well, how? Why?" If interest rates remain low, then there's no mechanism for that to hurt the economy, but we are getting, and again, in my view, the economy is going to be so strong, and inflation is going to pick up, and interest rates are going to start to rise. They're already starting to rise. Long-term interest rates are already rising. And a couple, three years down the road, interest rates are going to be high enough, they're going to mix in with the higher debt loads. Our interest payments on the debt are going to start to rise and people are going to say, "Oh, well, I'm just going to spend more on interest expense, servicing the debt than I'm going to be spending on the defense budget."

Mark Zandi:
That makes no sense to me and therefore politicians, policymakers can connect the dots in our mind and say, "Hey, we've got to do something and we'll do it." And the last time we did it, by the way, it was when interest rates rose in the early 1990s, that was Bill Clinton and Robert Rubin was Secretary of Treasury. Those are [crosstalk 00:19:25] vigilantes, interest rates rose. They could connect the dots. Clinton pulled back on his government spending plans and we had a budget surplus by the end of the decade. So that's the dynamic I think that has to occur, if that doesn't occur, if I'm wrong, interest rates don't rise, then no one's going to connect the dots, and we're going to continue to add to deficits and debt.

Gene Marks:
So back to interest rates and inflation. So, my take from you is that you do for the most part agree with Fed Chairman Powell and Treasury Secretary Yellen that this rise in inflation is somewhat temporary. It's not a long-term rise, you don't think that, that is a chronic issue. And I see you nodding at that, so that's good to hear. What, as a business owner, would you be forecasting for inflation over the next few years?

Mark Zandi:
Well, the Fed's target is something over 2%, two and a quarter percent per annum on a measure of inflation called the core consumer expenditure inflator, translating that into consumer price inflation, which I think most businesses can get their minds around, it'd be about two and a half percent inflation. So, if you saw two and a half percent inflation on a consistent basis over the next two, three, four years, I'd say that sounds about right to me.

Gene Marks:
Yeah, and it's funny, I don't know how old you are, but I mean, I remember what I just started working in Philly, it was in the 80s, and inflation was like 15%. Interest rates were like 18%. It was like some crazy times. So, with all of this yelling and screaming about inflation, you're predicting, you're forecasting that we're looking at maybe two and a half percent.

Mark Zandi:
Yeah. Yeah. We're not going back to the early 80s when we were kids and it was like a double-digit inflation in interest rates. I mean, at that time we had problems with oil price embargoes, and that's when oil really was a key input into many of our activities. Manufacturing was a lot more important to the economy. We didn't produce as much oil. Now we produce as much as we consume, and so when prices rise, it doesn't mean nearly as much. And the other big difference is back then the Federal Reserve did not understand the role of inflation expectations, which you had mentioned earlier.

Gene Marks:
Yeah.

Mark Zandi:
And when oil prices rose, they focused on the negative impact that had on the economy, not the impact it had on inflation, so they kept interest rates low for too long and reinforced the inflationary pressure, got into wages, and got into a wage ... . The other thing is you had a lot of COLA agreements, unionization was a lot higher so had a lot of cost of living adjustments and wage contracts. So, we live in a very, very less globalized economy. I can go on and on there's many, many differences between now and then, which makes it just not likely. I mean, I've run many scenarios in my work.

Gene Marks:
Yeah.

Mark Zandi:
I produce that for my clients. I don't have a scenario where I get anywhere back close to... I have a stagflation scenario, low growth, high inflation, but high inflation is four, five, 6%. It's not 10, 11, 12%.

Gene Marks:
Okay. So let's take that worst case scenario and then I'm going to let you go, but let's say that you're marginally incorrect, it's not two and a half percent, let's say three and a half percent inflation over the next couple of years, which really is you'll get as close to doubling what the inflation rate is now. I know you're an economist and not necessarily an operations' manager of a business per se, but what would you say, Mark, if okay, listen, we've got budgets to do, we see your costs are going to rise, some of them are going to double, increase, what type of operational steps do you think companies should be taking if they do believe that inflation is going to go up to that extent to protect themselves? Do you have any ideas?

Mark Zandi:
Yeah. I mean, you should be focused like a laser beam on the productivity of your workforce and on your operations, things like what you do for a living, but that's the way to address inflationary pressures. You become much more productive and you invest in things that will improve productivity, which many businesses have not been doing, perhaps because inflation has not been an issue. They've not been facing these kinds of problems. They've not really had severe labor shortages, persistent, severe labor shortages, or inability to get certain products, lumber, or copper, or aluminum, or whatever it is. So I think we need to double down again and think really carefully about how we improve our use of everything from labor to lumber, and that's I think what the businesses will need to do to address the higher inflationary environment that's dead ahead.

Gene Marks:
Mark Zandi is the Chief Economist at Moody's Analytics. Mark, what is your website at Moody's?

Mark Zandi:
Oh, I do want to plug up my podcast called Inside Economics. So Inside Economics, you can find it on Apple, and it's not... This was very entertaining. There's a lot of competition, but I think you'd enjoy mine as well.

Gene Marks:
Well, first of all, I'm a big podcast listener. I didn't even know you had one, which is bad on me, and I will-

Mark Zandi:
Just two months out, so it's new.

Gene Marks:
... Okay. I feel a little bit better. I do listen to a couple of other economists that you probably know. So, I will, Tyler Cowen is one of them, he's got a really good one. I will absolutely subscribe to it. In fact, I'm going to ride my bike pretty soon and maybe I'll listen to a couple of episodes.

Mark Zandi:
Yeah, and we talked about inflation. We do it every Friday afternoon. So, we talked about CPI inflation, which came out on the hot side as you know, so you might find it interesting.

Gene Marks:
That's great. All right, Mark. Thank you very much for joining us. Guys, if you enjoyed this conversation, if you need some advice, tips, help in running your business, please visit us at paychex.com/WORX. That's W-O-R-X. My name is Gene Marks, thanks again for joining us. We will see you on our next segment. Take care.

Speaker 3:
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