EconoFact Chats: Throttling Back: The Long and Short-run Economic Effects of Continued Uncertainty
Mark Zandi, Moody's Analytics
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Michael Klein
I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org

Michael Klein
My last Econofact Chats interview with Mark Zandi, Chief Economist of Moody's Analytics, was in March. At that time, the economy was facing trade wars and DOGE cuts to jobs and government funding. Mark characterized the situation as uncertain. Uncertainty about tariff policy and fiscal policy has not been resolved three months later. And now there are new sources of uncertainty. The budget bill that passed the House and now is being debated in the Senate, the path of monetary policy, with the President criticizing the role of the Fed and Chairman Powell, and perhaps most importantly right now, the possible retaliation by Iran after the U.S. bombed its nuclear facilities; retaliation that could upend world oil markets. This is a good time to check in with Mark again to see how he views the evolving economic landscape. Mark is the author of *Paying the Price: Ending the Great Recession and Beginning the New American Century*, which provides an assessment of the monetary and fiscal policy responses to the Great Recession. And also *Financial Shock: A 360-degree Look at the Subprime Mortgage Implosion, and how to Avoid the Next Financial Crisis*. Mark serves on the board of directors of MGIC, the nation's largest private mortgage insurance company, and is the lead director of the Reinvestment Fund, one of the nation's largest community development financial institutions, which makes investments in underserved communities. Mark, thanks for joining me once again on EconoFact Chats.

Mark Zandi
Great to be with you, Michael. Thanks for the opportunity. I can't believe it's been three months.

Michael Klein
Yeah, lots happened in three months.

Mark Zandi
Sure has.

Michael Klein
And before discussing the possible outcomes for the economy, what has its performance been like since Donald Trump took office in January, and over the last three months?

Mark Zandi
I think the economy has throttled back. Take GDP, that's the value of all the things that we produce. That grew almost 3% in the calendar year 2024. Of course, it fell in the first quarter of 2025. It'll get a bounce

in the second quarter, but net-net, feels like the first half of this year grew 1.5% to 2%, so not quite half the growth rate we experienced in 2024. And you can kind of feel it in the labor market, the job market. The economy is still creating jobs, unemployment is still low, but the job growth is slowing. And so far, largely because of much less hiring, hours worked are down. So you know broadly speaking, Michael, the economy, I think, is still growing, still moving forward, but at a slower pace, it's throttling back.

Michael Klein
Given the trade wars and the DOGE cuts in the late winter and spring, is this what you would have expected to have seen by the summer of 2025?

Mark Zandi
Yeah, about what I expected. You know I do think going forward, it's going to get more uncomfortable. I do think the…so far the tariffs and the other policy steps like the DOGE cuts and immigration policy, it's been more about the impact on sentiment, confidence, and the fallout from that. But now we're going to start to see the real economic consequences. Tariffs are going to result in higher prices with the goods that people pay, and that's going to undermine or weaken their purchasing power. And we're going to see consumers pull back to a more significant degree. And I think the immigration policy, the very restrictive immigration policy, will start to bite to a greater degree as well. We'll see…many industries that rely on immigrants are going to have a difficult time finding workers, and construction trades, agriculture, transportation distribution, and leisure and hospitality industries. So far the effects have been largely through sentiment, confidence, that those uncertainty effects we talked about three months ago. But going forward, I think we're going to start to see the real economic consequences. Again, I think the economy will be able to navigate through without a recession, with a little bit of luck and hopefully some changes in policies and some movement there. But it's going to be a bit uncomfortable here going forward.

Michael Klein
So some people point to the fact that the sort of dire predictions haven't shown up in the data yet, but you're looking at forward looking things, consumer sentiment, maybe even stock prices and the prices of bonds. And I guess, what you're saying is…because it didn't happen yet doesn't mean it ain't going to happen.

Mark Zandi
Yeah, and also I think people kind of overstated the impacts. I never thought all this was going to be a cliff event, you know, where the economy kind of goes off the cliff into a recession. It's more like a corrosive…on the economy, kind of weighs on the economy, and that throttling back I mentioned will continue because of the weight of the tariffs, and the immigration policy, and the DOGE cuts and all the other things that are going on. So I think it was kind of mischaracterized or, I think folks that thought this was going to be…we're going to hit a wall, or go over the cliff, were probably…that was misplaced all along. The other thing to consider is that policy is changing. I mean, the administration is adjusting and adapting. When it looks like the policies are doing real damage to the stock market, or bond yields are rising or the economy is sucking wind, the administration will pivot, change, and avoid the worst outcomes. And so I think that's you know one of the reasons why we literally haven't gone off the cliff. The other thing I'd say is, the economy came into this year in really very good shape. It was about as good

as it gets in terms of the economy's performance. So it's going to take a lot to push it underwater to send it over the cliff. So I think all those things suggest that the more dire forecasts were probably overstated.

Michael Klein
Yeah, when we spoke three months ago, we were talking about the fact that the economy came into this year very strong, and it remains to be seen what happens. What I'd like to ask you, Mark, is a little bit more specific about particular policies. For example, the DOGE cuts to government spending were headlines for the first few months of the Trump administration. The promises of massive savings have not yet been realized, and most people think they won't be. In your opinion, what were the effects of this effort that was led by Elon Musk until his recent departure from this role?

Mark Zandi
Well, the script's still being written. I guess we'll have to see. But you know my sense of it is that it's kind of much to do about nothing. There's a lot of drama. Some significant job loss did damage. It obviously created a lot of angst among government workers, and then more broadly, I think, disrupted government programs. But it feels like all those things are being unwound to some degree. They're hiring back a lot of the workers that were laid off or furloughed. The cutting has come to an end. So when it's all said and done, and again, the script is still being written, but it feels like the script's going to say, when we get to the end of the script, it's going to say that this really didn't move the dial on much of anything, certainly not in terms of addressing the government's fiscal problems. This is small potatoes at the end of the day. Now, for certain agencies and certain policies that are being affected, it's a big deal. Like what does it mean for USAID or NIH, those kinds of things…but from a macroeconomic perspective, at least in the near future, you know I don't think it's going to amount to a whole lot.

Michael Klein
Well, thinking about some of the longer term effects that you were alluding to, what do you think those effects might be for things like research or accurate and reliable economic statistics or innovation?

Mark Zandi
Yeah, that's a good point. I mean, you know government employees, they do real work. They provide real value. They do things that are critical to a well-functioning society and economy. And if you don't do them, or you disrupt them, then they'll have a consequence. May not be today, may not be tomorrow, but at some point down the road, something's going to break somewhere because those folks are doing real work. I mean, of course, I know and you know the economic data well, and how important that is, and how that's gotten a lot more difficult to do. Take for example, the consumer price index, the CPI. Maybe you've talked about it on your previous podcast, but almost a third of the prices that are collected for that survey, you know the BLS, the Bureau of Labor Statistics, the keeper of the data, they send out folks to canvas and collect that data. Because of the cuts, the DOGE cuts, they have fewer folks that can do that, and therefore almost a third of the components of the CPI are now imputed, and kind of made up, in effect. And that's up from 10% of products and services before all this happened. That can't be good, particularly at a time when we're focused like a laser beam on inflation and trying to measure inflation. It's really critical to the conduct of good policy, particularly monetary policy, and the setting of interest rates. And here we are kind of flying blind, and increasingly blind, and that's because of the DOGE cuts. So will that result in bad policymaking? Will that wreck the economy? Probably not. But, you know, it

can't be good. It's like we're flying the economic airplane with faulty and imprecise measurements, and much more likely it's going to crash something because the measurements aren't working. And that goes right back to the DOGE cut. So that example was playing out in lots of different ways throughout the economy. FAA, FDA, SEC, CFPB, just go on and on and on. The same kind of dynamics are playing out in lots of different agencies.

Michael Klein
So special points to our listeners who knew what all those acronyms are.

Mark Zandi
Oh, yes, exactly. You got to be a little nerdy. But I figure if you're on this podcast, listening to this podcast, you got to be a little on the nerdy side, no?

Michael Klein
Well, you know, nerdy in a good way, I guess.

Mark Zandi
Oh, always. I never. Nerdy in my book is, you know, high praise. It's definitely not pejorative.

Michael Klein
Okay, great. It's nice to know.

Mark Zandi
Because I'm nerdy. I'm definitely on the nerdy side. yeah

Michael Klein
I guess I am too. I'm not sure I'm so willing to admit it so readily to a wide audience.

Mark Zandi
Embrace it, Michael. Embrace it. Embrace it.

Michael Klein
Well, one thing I am is a professor. And related to the kind of cuts that you were talking about is the President's policies towards universities. Universities are an important part of United States service exports. People from all over the world had wanted to come to the United States to attend world-class institutions of higher education, but the President's pulled up the welcome mat for foreign students. He's also cut funding for university research. What do you see as both the immediate and longer run effects of this?

Mark Zandi
Oh, it can't be good, if it continues. I mean, our economy's secret sauce is that we…the key ingredient in that secret sauce, the thing that makes us exceptional, or at least historically has made us exceptional, is we attract and keep the best and the brightest from all over the world. They come here to get educated and to learn, to go to our great universities like the ones you teach at. And invariably they stay, and they start

companies at a much higher rate than do the native born. And it's of course there where the innovation and technological change diffuses throughout the economy, and our standards of living rise, and we kind of drive the global economic train. So impairing that, taking that ingredient out of the secret sauce…it's just not going to taste nearly as good, and goes to the heart, of again, of our exceptional economy. It's just not going to be nearly as exceptional. Now, you know these are things that play out over long periods of time. Again, it's corrosive. It's not a cliff event. It's not like you know something's going to go badly off the rails here next year or the year after. But I'm confident that if we continue down this path for any length of time, 10, 20 years from now, the young people that are helping…Annika, who's doing the work here, is now doing the research, she's going to find that we were a much diminished economy because of the steps that we've been taking here. But I view that as a very serious mistake if we can't continue to attract the best and the brightest here, and keep them here. And by the way, even if they don't stay and they go back to their home countries, that's a good thing too, right? I mean, because it takes our values, our culture, all the things that we believe in. Our democracy and everything else…our capitalist system, and takes all that back to the rest of the world, and it helps us get all on the same page. And I think that's a good thing as well. So it's about keeping people here and allowing them to thrive, but it's also about letting them go back and tell the rest of the world about all the good things about how we operate our society and economy.

Michael Klein
So as people call this is soft power, and it is an important part of knowing our overall standing in the world. And as you're saying, it's probably becoming degraded by this. Another important issue is the budget bill that's working its way through Congress. This is also a source of uncertainty since its provisions are still being debated, but it seems like one outcome will be that there'll be a big tax cut and larger deficits. What do you see as the main macroeconomic effects of the budget bill, at least as far as you can tell, from what you think might be finally passed and signed?

Mark Zandi
Well, near term, long term. Near term, it's a wash. I don't think it's going to affect anything because all that's happening here really is an extension of the tax cuts for individuals that was put in place under President Trump's first term, the Tax Cut and Jobs Act, the TCJA tax cuts. They are set to expire under current law at the end of this year. So this piece of legislation, this reconciliation bill that's going through Congress would simply extend those. So from a macroeconomic perspective, it doesn't mean anything. All the other stuff, and there's a lot of other stuff on the tax side, spending side, some things add to the deficit, some things subtract from the deficit. The net of all that is basically zero. So there's really no, as economists would say, fiscal impulse here, at least in the near term, as far as I can tell. Long run, there's consequence though. While this piece of legislation will not, in my view, increase the deficit or debt relative to what it would have been otherwise if there were no change in policy, it still means that our deficits and debt are going to be a problem going forward. And just to give you a couple numbers, the deficit today as a share of GDP is 6%-ish. It's extraordinary. I mean, including interest payments, looking at the so-called primary deficit, it's 3%. And that's when we have an economy at full employment. We're [at] 4.2% unemployment rate. We should have a 0% primary deficit. We should be even in surplus, but we're not. We're at this extraordinary level. And that's going to continue. And the debt to GDP ratio, therefore, is going to continue to rise. Right now publicly traded debt to GDP is 100 percent-ish. You look out with this piece of legislation, it's going be 130% 10 years from now. And you can do your forecast

after that. It continues to balloon out. Interest payments on the debt, they're already pretty close to a record high as a percent of GDP. They are going to be at a record high in the not too distant future. We're shelling out more on interest than our own defense. That's never happened historically. So all of this suggests that this piece of legislation isn't going to make things worse in the long run, but it's not going to address our long-term fiscal problems. And those problems are quite significant. And I think at some point in the not too distant future, it's going to have real significant implications for lots of things, interest rates, the economy, asset prices, all kinds of things. That's a very significant threat to our long-term growth prospects.

Michael Klein
One concern with the high level of debt that you're talking about is that it can lead to inflation if the debt is monetized. That is, if the Fed purchases government debt to keep interest rates from rising. While this channel of inflation might not be a deep concern for the United States the way it has been for countries like Argentina or Turkey, there are concerns about the President's attacks on Fed Chairman Powell and concerns about who Trump could appoint as Fed chair when Powell's term ends next year. In fact, just recently, there's been talk of having a shadow Fed chair who would offer, I guess, an alternative to what the Fed is actually doing. How do you think markets are reacting to the Fed's policies and the President's comments on these policies, and how do you see this playing out?

Mark Zandi
Well, so far, I've been surprised there hasn't been much of a reaction. I do think it is reasonable to be nervous about the independence of the Fed in the context of all the things that you just mentioned. But I haven't seen that expressed in interest rates. Now, it's hard to disentangle everything, and you don't know what the counterfactual is, but the 10-year treasury yield is trading 4.25%, and that's kind of, sort of where it should be in the long run. It's equal to the nominal potential growth rate of the economy, and that feels like where it should be on average through the business cycle. So despite all of it, I haven't really seen or felt that it's had an impact. Now, it's still early days. President, excuse me, Chair Powell is going to remain chair for another year. And maybe the market and investors are not really focused on it yet. They're focused on lots of other things. And as we get closer and closer to this time next year, markets will start to focus, and they will focus on who is going to be the next chair, whether that person is going to be deemed to be relatively or hopefully fully independent from the executive branch or not. At that point, I expect that will make a big difference. It may be at that point in time, when all these things come together…the deficit, the debt, the concerns about safe haven status, the Federal Reserve independence, all the kinds of things…there's a lot of other things that are going on in the bond market…come together. That's the point in time where you know bond investors say, 'oh, you know this just isn't working for me.' Four and a quarter doesn't work. You got to give me 4.5, 4.75, 5, 5.25, 5.5, you know something like that. But so far I just don't sense that they're focused on it, and It hasn't really had an impact on rates. Do you sense something different, Michael?

Michael Klein
Well, I think that as the attacks continue on Chairman Powell, because markets are forward-looking, the probability of somebody coming in who will be more managed by the President, say, is going to raise issues with bond investors and stock investors. So maybe not yet, but you know as the debate gets more heated, the Fed has just said they're not going to raise interest rates more than once for the rest of the year.

If this becomes more and more a contentious issue, I think because of the forward-looking nature of these markets, you'll start to see it more quickly than when Powell's term actually officially ends.

Mark Zandi
Yeah, it makes sense. Maybe it's just a year away. Maybe it's a little too early, but yeah, I think you're right. Well before next year, I would expect to see some impact.

Michael Klein
Another centerpiece of President Trump's policy is tariffs. But he's repeatedly put off the implementation of some tariffs, and he reversed himself…the derogatory term TACO, Trump Always Chickens Out, has attracted a lot of attention. Many heads of companies have said that they might not like tariffs, but they can deal with them if they knew what to expect. But they don't know what to expect. What have you heard in your conversations with business people about Trump's tariff policies?

Mark Zandi
Just as you expressed it, I think they're unsure, uncertain. The word we used back in March still applies. Even to this day, a lot of questions. The tariffs are based on executive orders. They can be changed, and have been at the stroke of a pen. And are they legal? I mean, it's going through the court system. It's not clear what's legal, what's not. And that creates more uncertainty. So I think business people are kind of sitting on their hands. I don't know that they're pulling back on what I call 'business as usual investment,' you know things that they would do regardless of what the tariffs were or not. But I think it means that they're not, at this point, thinking about bringing more back here at home, investing more at home. In fact, there was a great recent survey done by the Dallas Federal Reserve, and they asked businesses, both manufacturers and service providers, what did they plan to do? How did they plan to respond to the tariffs? At the very top of the list of things that they were going to do is pass along the tariffs to their customers in the form of higher prices. 75% of manufacturers said that that was what they would do, 50%-ish of service providers...and then there's a long list of things, you know reduced profit margins, so forth and so on. At the very bottom of the list of responses was 'I'm going to bring more production and investment back home.' That was the last thing that they were going to do. And again, I think it goes in significant part to you just don't know what the tariffs are going to be. And if you're planning a major investment, you've got to know what those tariffs are going to be for a long period of time. And there's just no way of knowing that.

Michael Klein
Another signature policy of this administration is a crackdown on undocumented workers. There was some talk that this was going to be confined to people with criminal backgrounds, but of course, we've seen a much wider dragnet than that, and one that's also sweeping up people who are here legally. What do you see as the economic consequences of this aggressive policy? You alluded to it a little bit earlier. Maybe you'd like to say a little bit more about that?

Mark Zandi
Yeah, yeah, sure. And let me preface it by saying I do think the surge in immigration that occurred back several years ago created a boatload of problems…societal issues, and put a lot of pressure on communities across the country. And I do think that you could make a case that it's a national security

issue. Now, of course, that flow has been completely stopped. That began a year ago under President Biden when he issued an executive order making it more difficult for asylum seekers to come over the border. And then, of course, President Trump has cracked down even further, so there's just no flows. One interesting point I'd like to make is I do think despite all of the problems created by that surge, it also had the benefit of raising labor supply at just the right time. It was in that period, 2022, 2023, when the Fed was jacking up interest rates in an effort to cool the labor market off and get inflation back in the bottle. They had the benefit of all the workers coming in. In fact, these folks that came across the border invariably applied for work authorization, and they got it and they went to work. So we saw the surge in the labor force and it cooled things off. So it had that benefit. In fact, you could even argue it might have been the reason why we were able to avoid a recession because the Fed didn't have to jack up interest rates even more to cool things off because they got this benefit. But here we are on the other side of this, and now immigration flows have really stopped. And you can see it in the labor force data. I mean, labor force growth for foreign workers was 4% or 5% a year ago. It's now, I think it's negative if you adjust the population controls. And it started this year in January. And overall, labor force growth has come close to a near standstill. Obviously, you need labor force growth to create jobs and power economic growth. So this crackdown on immigration is going to have the effect of weighing on economic growth. It's also going to be inflationary because obviously wages are going to rise as businesses struggling to find workers are going to have to jack up wages, and that means higher prices. So it's kind of doing to the macroeconomy, the same thing tariffs are. It's slowing growth, weakening growth, and it's fomenting inflation. Both of these things directionally point to stagflation, right? Weaker growth, stagnating growth and higher prices. Whether we get real stagflation depends on to what degree these policies are implemented and for how long, but that's that's the direction of travel that we're headed here. I mentioned the industries before, but a lot of industries that are really critical to low and middle income Americans are being affected. I mentioned agriculture, that goes right to food prices. I mentioned construction, that goes right back to rents and housing affordability. So clothing, the textile industry, things that really matter to people are going to cost more as a result of all of this. So we have to consider the downside to all of it. And I think we're going to start to see that more clearly in the months ahead.

Michael Klein
So what you're talking about is the domestic supply of these things, but with tariffs international supply is also affected. And so it's a double whammy. It's both domestic and foreign sources.

Mark Zandi
I didn't think of it that way, but that's exactly…I should have, but that's a great way of framing it for sure.

Michael Klein
So finally, Mark, I'd like to discuss the possible economic effects of the conflict in the Middle East. We don't yet know how Iran will respond to the U.S. bombing of its nuclear facilities, but one dire possibility is that they close the Straits of Hormuz, which are vital for the shipment of oil from the Middle East to the rest of the world. I'm not going to ask you how likely that scenario is because no one really knows at this point, but I would like to ask you, if that happens, what would be the economic consequences?

Mark Zandi
Well, it just reinforces the macro consequences of the tariffs and the immigration policy, right? Higher oil means obviously higher oil prices. That's the key link back to us. And that means weaker growth and higher inflation. If we pay more at the pump, trucks have to pay more for diesel, airfares will go up. So that goes right to inflation and because of that, it undermines real incomes…after inflation incomes, which weighs on spending, so it slows economic growth. And there is a reasonable point that longer run, the higher prices may elicit more domestic production. And that would help to offset some of the negative consequences of the impact on consumption. But at least in the very near future, that kind of scenario would result in higher inflation, weaker growth, and just reinforce the stagflation tendencies created by the tariffs and the immigration policy, all of it kind of working in the same way, in a very pernicious way. Now, critical to ensuring that we don't actually see stagflation is a Federal Reserve that's willing to hang tough and make sure that that inflation doesn't get embedded into wages and get into that dreaded wage price spiral, which is a key feature of a stagflationary environment. So you need a Federal Reserve that is independent and has a backbone able to hold firm and make sure that we don't get into that kind of dark stagflation scenario. But again, given what we were just talking about, that's also something to worry about.

Michael Klein
I mean, both you and I came of age in the early 70s or came of economic consciousness in the early 70s, where we saw lines at gas stations and rising prices. And then subsequently the Fed not fighting against this and being very accommodating and leading to sort of the economic problems of the 1970s. So, it sounds like what you're saying is there is a possibility of a repeat of the 1970s. Although maybe, you know, without blue jeans and bell bottoms.

Mark Zandi
I think there's a lot of differences and I hesitate. That was a pretty virulent form of stagflation. That was double digit unemployment, double digit inflation. That's way out in the tail. But directionally, yeah, I think we have to worry about that. And actually, you're right. I mean, there's now good historical evidence based on the Nixon tapes that Richard Nixon and Arthur Burns…Arthur Burns, of course, was the chair of the Fed back in the early 70s, he was good friends with Nixon. Nixon really wanted him to hold the line on raising interest rates in that lead up to the 1972 election. And while there's a lot of things that go into that stagflation, that may have been one of the key aspects of it, that the Fed early on didn't do the things it needed to do to make sure that the stagflation didn't didn't take hold. So that's a cautionary tale you know for the current period.

Michael Klein
We have a really good EconoFact memo by Tom Drechsel at the University of Maryland, where he looked at the number of meetings between the President and people from the Fed. And he found that the Nixon episode was one where inflation was higher than what you would have expected, given what was going on during all other times. And it probably has to do with Nixon leaning on Arthur Burns.

Mark Zandi
Who wrote that? That's pretty cool.

Michael Klein
Tom Drechsel at the University of Maryland.

Mark Zandi
Would love to take a look.

Michael Klein
It's a really nice memo we have. And, you know, I was hoping, Mark, you'd be completely familiar with everything we've ever put out.

Mark Zandi
Yeah. But you publish a lot of stuff, Michael. I mean, yeah you're quite prolific. The organization is quite prolific. So it's very difficult. I can barely keep up with social media. It's like there's a lot of stuff going on. But I definitely will take a close look at that. That sounds pretty cool.

Michael Klein
Yeah, it's all about prioritization, Mark.

Mark Zandi
Yeah, that's what my wife says.

Michael Klein
Yeah. Well, in terms of priorities, speaking with you is always a priority for me.

Mark Zandi
Oh, you're kind.

Michael Klein
It's really interesting and you have great insight. So I appreciate you taking the time to appear once more on EconoFact Chats. Thanks very much.

Mark Zandi
Anytime, Michael. I really appreciate the opportunity. Take care now.

Michael Klein
You too.

Michael Klein
This has been EconoFact Chats. To learn more about EconoFact, and to see the work on our site, you can log into www.econofact.org. EconoFact is a publication of the Fletcher School at Tufts University. Thanks for listening.