

EconoFact Chats: The Uncertain and Uneven Economy

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

It's been three and a half months since I've interviewed Mark Zandi for an EconoFact Chats episode. A lot has happened since Labor Day. There was the longest government shutdown on record, and, as a consequence, a period when government economic statistics were unavailable. The President has continued his efforts to impose tariffs, although a case argued before the Supreme Court in November may invalidate some of these tariffs. Tariffs seem to be raising prices, and the President, who ran on the issue of affordability, now says that this issue is a Democratic hoax, and no one knows what affordability means anyway. Perhaps because of the issue of affordability, Democratic candidates exceeded expectations in an election last month. In a related vein, the President's approval rating has plummeted, especially in terms of his stewardship of the economy. But is all of this just a so-called "vibe-cession"? Aggregate macroeconomic statistics remain relatively strong. To discuss these and other issues, I'm very pleased to welcome Mark back to EconoFact Chats. Mark is Chief Economist of Moody's Analytics. He is the author of several books, including *Paying the Price: Ending the Great Recession and Beginning a New American Century*, which provides an assessment of the monetary and fiscal policy responses to the Great Recession, and *Financial Shock: A 360 Degree Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis*. Mark serves on the boards 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. I'm also very pleased to say that Mark is on the board of EconoFact. Mark, thanks for joining me once again on EconoFact Chats.

Mark Zandi

Thanks, Michael, it's so good to be with you. Really appreciate the opportunity.

Michael Klein

Well, it's great to have you on. So, Mark, let's start with some aggregate macroeconomic statistics. What are the current unemployment, inflation and GDP growth rates?

Mark Zandi

Well, this sounds like a test, Michael. Where's the blue books?

Michael Klein

Well, the blue books are actually on my desk. I gave exams today. You weren't in the classroom, so yours will be an oral exam.

Mark Zandi

Okay, very good. Well, real GDP growth, abstracting from the vagaries of the data, and obviously, with the government shutdown, we don't have all the data, but, you know, abstracting from that, is about 2%. That's close to the economy's so-called potential rate of growth, that rate of growth at which you're creating enough jobs to maintain stable employment. So unemployment is low, but it's moving a bit higher, and therefore we're probably just growing a little bit south of that 2% growth rate at this point. Unemployment, as I said, is moving higher, 4.4%. I think, Michael, it's very close to being rounded up to 4.5%. And it's up about a percentage point over the last couple, three years. So it's moving higher here, and that goes to the fact that there's no job growth. Job growth has come to a virtual standstill, no hiring. Fortunately, there's no layoffs. That's why we're not in recession. But, you know, it feels a bit uncomfortable with hiring as poor as it is, particularly for younger people. I know folks graduating from Tufts and other universities...are probably not Tufts, but other universities are having a tough time. The unemployment rate for kids that are between 20 and 24 years of age is now over 9%, and that's up three percentage points over the past couple of years. Inflation is high. It's above the Fed's target. I mean, if we look at consumer price inflation, CPI inflation, abstracting again from the vagaries of the data, it's about 3%. Target would be something just north of two, and the direction of travel here is a little bit disconcerting. It feels like we're going to still see some more tariff pass-through, and the effects of a restrictive immigration policy is going to lift inflation. So, you know, as you look into next year, it feels like inflation is going to be over 3%. So you add it all up, it's an economy that's growing, but it's a fragile growth, you know, and not recession, but certainly an economy that's at risk if anything else were to kind of go off-script here.

Michael Klein

Well, the mood of the country with respect to the economy seems worse than these aggregate statistics. Is there, in fact, a disconnect? And why do you think that's the case? You sort of indicated things aren't great, but we're also not in a situation where there's a deep recession.

Mark Zandi

Yeah, I think it's kind of where you sit. I mean, if you're in the top part of the income and wealth distribution, say, the top third of the distribution, you're fine. Things are actually quite good. You have a job, wage growth is better than the rate of inflation. You own your own home, and house

values are up quite a bit from where they were a few years ago in most parts of the country. You own stocks, and of course, the stock market's been on a tear, particularly if you own AI stocks, you're much wealthier than you were just a year or two ago. You know, you probably don't owe anything except maybe a mortgage, and you probably locked that in back during the pandemic and got a very low rate, two, two and a half, 3%. You're making more on your money market account than you're shelling out in interest expense. So you're in a pretty good spot. If you're in the middle part of the income distribution, say the middle third, you know, it's okay, but there's a lot of financial stress. You know, those folks, they don't own a whole lot of stock. They probably own a home, but they don't own a lot of stock, not benefiting from that. And they have a mortgage, they have an auto loan, they may have some credit card debt, and, you know, they've got a job, but I'm sure they're a bit worried if they lose one, because, as I said earlier, there's no hiring. So you really don't want to lose your job. If you're in the bottom third of the income distribution, it's really very painful, right. Inflation is high, as I articulated a minute ago, particularly for things that people need, necessities, you know, food, groceries, electricity, health care, child care, elder care, housing. It's just very expensive for these folks, and their incomes have not kept up. And of course, they have a lot of debt. In fact, the other thing that's kind of adding to the angst is student loan payments have resumed again this year. So people were enjoying a moratorium on those payments that ended in 2025, and they have to pay on their student loans, and they don't own any stock. So, you know, they're in a very uncomfortable spot. So one-third of the population...no problem, everything is fine, feels pretty good, but for the other two-thirds of the population, it doesn't feel all that great. I think that's what's reflected in this very dismal kind of Consumer Sentiment Survey results that we're seeing.

Michael Klein

So, Mark, you're speaking to the issue of affordability. Tariffs are one of the President's signature economic policies. Have tariffs affected affordability, and if so, how?

Mark Zandi

Yes, they've raised the prices for imported goods. We've seen prices for products that have been tariffed go up, and you can trace the re-acceleration in inflation back to so-called Liberation Day back in early April of this year. That's when President Trump announced the so-called reciprocal tariffs, the broad-based tariffs, and the tariff rate is now at 10%. The effective tariff rate is at 10%, up from 2% at the start of the year, and that is translating through. I mentioned CPI inflation...consumer price inflation is 3% this year over year through the month of September...hit bottom back in March, April of the year before the tariffs kicked in, at 2.3, 2.4%. And so the direction of travel here is, you know, for higher inflation. There's been some discussion, debate about whether the pass-through of tariffs to prices has been as quick as it has historically been. If you go back to the tariff and trade war of 2018–19, in President Trump's first term, the pass-through was a lot quicker, and I think there's some evidence it has been slower this go-round. But I don't think that obviates the likelihood that we will see pass-through. I think

because of all the uncertainty around the tariffs — they've been up, they've been down, they've been all around, I mentioned those reciprocal tariffs, they've been challenged, and now the Supreme Court is going to adjudicate on their legality...because of that uncertainty, businesses have been reluctant to completely pass through, fearful that if they do, they might lose market share unnecessarily if the tariffs go away again. The other thing to consider is, I do think larger businesses are very reluctant to raise prices aggressively because of the higher tariffs and get caught up in the political buzz saw...the President will be very upset by that. So the result of all that is, it's just taking a little bit longer for the tariffs to get passed through to inflation. But I suspect when we look back, you know, a year, two or three from now, we're going to see that that pass-through actually did occur. So tariffs have had a big impact on inflation and have contributed to the affordability issues that we're dealing with now.

Michael Klein

As you probably know, Alberto Cavallo at Harvard Business School is able to track prices on a very high-frequency, daily basis, and he was both a guest on EconoFact Chats, and he's contributed memos to EconoFact, and he's saying exactly what you were saying, that it's taking a while for tariffs to pass through, but it's starting to happen more and more. So that's the effect of tariffs on prices. The rationale for tariffs has been shifting. One stated reason is to spur manufacturing in the United States. Another is to raise revenues, perhaps even to the point where income taxes could be lowered. And a third set of reasons is political, like threatening tariffs on Brazil for prosecuting former President Bolsonaro for attempting a coup. What do you think about the likelihood of tariffs achieving either the manufacturing or the revenue goals?

Mark Zandi

Well, I don't see it in terms of manufacturing. You know, I think we certainly don't see it in the data so far. I mean, manufacturing is struggling. In fact, manufacturing employment is consistently declining. So, you know, maybe it's early days, and maybe we'll see more multinationals start to invest here, but we haven't seen it yet, and we didn't see it back in 2018–19 either. We saw the manufacturing sector go into recession. So there's no evidence of it so far, and intuition would suggest that it's not going to happen. I mean, you know, put yourself in the position of a CEO of a large multinational trying to make a decision about investing here in the U.S. To do that, you have to have some certainty with regard to what the tariffs are going to be over a long period of time. Because the investments you make, it takes a long time to build whatever factory or facility you are going to construct, and then you're hoping that that facility will be around for a decade, two or three. So you've got a long horizon here. You don't know what the tariffs are going to be next week, let alone next year or 10 years from now. So I just don't see it. You'll hear announcements. You know, why wouldn't you, if you're a CEO of a large multinational, announce a big investment here? But follow-through, I'd be very skeptical of that. And also, maybe I'm wrong. Maybe we will see more investment. But one thing I'm quite confident in is, if we do, it's not going to create a lot of jobs, because these manufacturing

facilities are, you know, very, very productive. They're robotic. They have to be able to compete globally and manufacture in the U.S. On the revenue side, it is generating revenue. But even there, I wouldn't count on it. I mean, I mentioned those reciprocal tariffs. The Supreme Court looks like it's going to strike down those as being imposed; they're not legal. They were imposed improperly. So that revenue will go away. There's all kinds of carve-outs and exemptions. And the President, of course, is also using a lot of that tariff money to help make industries and businesses that have been hurt by it kind of whole. Recent announcement was 10, 20 billion dollars for soybean farmers and other agricultural producers because they're getting crushed by the effect of the tariffs on demand for their product, particularly sold to China. So, you know, if I were at the CBO, the Congressional Budget Office — the folks that do the budgeting for a living, and they do a great job — I don't know that I'd count on a lot of that revenue making its way through over time. The final thing I'll say on that is, I suspect that because the tariffs are done under Executive Order, the next President, whomever that is, may easily decide to get rid of them in the next recession. You have a recession, you want to support the economy. The best way to do that, if you've got these tariffs, you can just get rid of them and give a big, nice tax break to low- and middle-income households to help support the economy. You don't need Congress to do it. So I don't know. I'm very skeptical that it's going to raise any consistent amount of revenue, certainly not enough revenue to make a difference in terms of our long-term fiscal situation.

Michael Klein

And you mentioned low- and middle-income households. Tariffs are a very regressive form of taxation, right? They hit people who are on the lower-income side of the spectrum much more than higher-income people, because, among other things, those lower-income people are spending a bigger portion of their income on goods and services.

Mark Zandi

Yeah, totally. It's very regressive. And it goes back to, you know, where we were a few minutes ago...the folks in the bottom part of the income distribution. They're the ones that are really struggling, and they're getting hammered by the tariffs because they devote, as you say, a much larger share of their budget to products that are imported, goods that come from overseas. It's one reason why they're paying a lot more for groceries and consumer electronics and for clothing. You know, all those things are much more expensive than they would have been otherwise because of the tariffs, and it's hitting that group harder. It's a tax on all income groups, but particularly pernicious for folks in the bottom part of the income distribution.

Michael Klein

So that's one topic, tariffs, that there's been a lot of controversy about. Another topic about which there's been a lot of controversy is the Federal Reserve and monetary policy, and the President's efforts to try to steer the Federal Reserve. So today, we're speaking on December 10, in the afternoon. The Federal Reserve just announced that it's going to have a 25 basis point cut in

interest rates. And, interestingly, there was dissension in that. Two of the regional Federal Reserve presidents who are voting didn't want an interest rate cut at all, and Stephen Miran, who recently joined the Board of Governors and retains a position in the White House, wanted a bigger cut, a 50 basis point cut. What do you see about the Fed moving forward? Do you think interest rates are too high? What do you expect the Fed to do in the coming months? And what does this dissension among the voting members say about the economy and the difficulty of setting interest rates when there's so much uncertainty?

Mark Zandi

Yeah, I mean, the Fed's in a pretty tough spot. Right? Tariffs slow growth, but raise inflation, and highly restrictive immigration policy does the same thing. It slows growth and it raises inflation. So the Fed is caught in between. What do they do? Do they focus on growth and the weaker economy and cut interest rates, which is what they've been doing, what they did today with their December meeting, or do they focus on the inflationary effects and hold policy unchanged? There's been no talk of a rate increase, at least not at this point, but hold policy unchanged, and that's why you're getting the dissent, because on either side of the decision to cut, because of these effects on the economy, they're just hard to disentangle for the Fed. How do they respond? Do they respond to the weaker growth, or the higher inflation, and thus the dissent? My own sense of things is that I would be focused on growth. You know, the job market is really struggling. I mentioned earlier, no job growth at all. And we may even see — we're going to get some data points in the coming week for October and November. It's been delayed because of the government shutdown, but we're going to get some data next week, and I think it's going to show outright job loss in those months, partly because of the DOGE cuts finally filtering through into the data, but broadly, I think we're seeing really weak conditions. Unemployment is, again, still low, but it's moving higher, and it's moving really much higher for young people. And the other group that's getting nailed are minorities; the Black unemployment rate is up a lot as well. So I think the Fed should focus on that, make sure that the job market, you know, does not start to weaken even further, that we don't see layoffs, because if we do, we'll go into recession. The thing I'd say is, I think if we go into recession, the Fed will certainly get blamed for it politically, and that might be totally existential to their independence. I mean, their independence is obviously already under a lot of pressure. President Trump has made it quite clear that he wants input into the decision-making process at the Fed around interest rates, and is doing what he can to engineer that through his appointments to the Fed and court cases and everything else. And, you know, I think that's a real threat. I mean, I do think a cornerstone of a well-functioning market economy like our own is an independent central bank like the Federal Reserve. And without that, history would say — and we've got plenty of history to show this — that it will lead to interest rates being too low for too long, and inflation down the road. So I think it's really important that the Fed works hard to avoid that recession. And in my mind, it's cutting interest rates, which would be consistent with what the President wants, maybe not to the degree that he wants it, but it's directionally what he wants. So I think I'd continue to move down that path. Not

that I'm not worried about inflation down the road — I am. But, you know, pick your poison. I mean, that's the problem with tariffs and a restrictive immigration policy; it puts the Federal Reserve in this very difficult, untenable position that they're in now.

Michael Klein

So let's talk about that lack of independence, or threats to independence, of the Federal Reserve. How do you think markets view this controversy about the executive branch attempting to influence monetary policy, and also about the possible successors to Chairman Jerome Powell? I mean, it's pretty clear he'll be looking for a new job next year, and there's a question of who will replace him. Right now, Kevin Hassett seems to be a leading contender for becoming the next Fed chair, and that wasn't viewed favorably in certain publications like *The Economist* magazine. How do you view all of this, and how do you think markets are viewing all of this?

Mark Zandi

Well, so far, Michael, I have to say markets have taken this in stride. You know, if your benchmark for how they're taking it is the 10-year Treasury yield, you know, that still remains in the low fours. You know, I think last I looked was 4.1, 4.15. So that's low. And if you thought investors were having a problem with Fed independence, you'd expect them to be more cautious, circumspect in their bond purchases, and that would result in higher rates, and that's not happened. So, so far at least, investors are pretty sanguine about this. Now, I think it might be because they're waiting to see who the President nominates to be Fed chair. You know, as you said, Jay Powell, the current chair, rolls off in May of 2026, and the President is going to nominate someone here pretty soon. You know, I think if it's Kevin Hassett, markets will be okay with that. I know there's been some reporting that bond investors are not thrilled, but I think generally they'd be okay with that. You know, Kevin is a good economist. I think, you know, he's also quite adept at kind of navigating the political environment that he's operating in. And I think at the end of the day, he'll ensure that the Fed maintains some semblance of independence. The independence will be impaired under anybody, but I think he'll maintain some semblance of independence. The other tell that I think will be important for investors with regard to how concerned they should be is what Jay Powell actually does. Now, he'll roll off as chair in May of 2026, but, you know, his term on the Board doesn't expire until 2028. Now, historically, when a Fed chair ends his term as chair, he or she will leave the Fed completely. But if Jay Powell decides to stay on, that would be a tell that Jay Powell is concerned about Fed independence; he's staying on to help preserve as much independence as he possibly can. The other key here I should clearly mention is the court case, right? I mean, there's a court case in front of the Supreme Court now around Lisa Cook, who's a Fed member. She's under pressure because of accusations of mortgage fraud, and the President wants to fire her and put in someone that will be more amenable to his view of lower interest rates, further impairing Fed independence. How the Court decides that, whether the Court decides the President has the authority to fire her, will be really important also to, I think, how bond investors think about this. So there's a bunch of

events that are dead ahead that I think will really help bond investors get a real grip on how concerned they should be about Fed independence. And I think if those things go in the poor direction, you will see bond investors ultimately say, oh, you know, we've got a problem here. Independence is going to be impaired to such a degree that we've got higher inflation in our future. Therefore, the Treasury has to pay me a higher interest rate to compensate for that inflation risk; interest rates go up. And of course, that's exactly the opposite of what the President wants. So I think the bond investors are kind of sitting on the sidelines right now waiting, but there's a few big events here dead ahead that are going to tell us a little bit more about how they're going to think about this, and how we all should think about Fed independence.

Michael Klein

So you talk about the bond market; I'd like to talk a little bit about the stock market. In the midst of all this, the stock market is doing very well. One concern is that it's doing well because of the valuations of companies that support, or are involved with AI, like Nvidia, and there's talk of an AI bubble. Do you see the stock market as a bubble now, or those companies as a bubble? And what do you think will happen with the stock market? Although everybody knows that's a really difficult question, and of course, the stock market is not the economy. Nonetheless, people pay a lot of attention to it. What do you think is going on?

Mark Zandi

Well, you know me, Michael. I'll give you my three cents about most anything, and in this case, it might be worth three cents. You know, bubble is a strong word. I mean, I think I can say with, you know, some certainty that the market is overvalued, certainly by tried-and-true measures of valuation, like P/E multiples of different stripes, for sure. It feels like it's bordering on frothy...some speculative elements. When I think about a bubble, that means that there's speculation, that investors are buying an asset, like a stock, simply because its price rose in the past and therefore it will rise in the future. There's no other reason. There's no fundamental reason from what we know why they're buying the stock other than that momentum. And there's some signs of that kind of creeping into the market, but I don't know that I'd go so far as to call it a bubble, certainly not the bubble of yore, you know, the Y2K bubble. We're still not in that league yet. But, you know, the market feels overvalued to me. It feels like investors are ahead of themselves or over their skis. So if you told me the stock market a year from now is kind of, sort of where it is today, that sounds about right. So, you know, it kind of goes sideways and lets earnings and everything else, reality, catch up to the higher prices and valuations kind of normalize. That would be my baseline. But, you know, having said that, I do think...markets don't work in a graceful, orderly way. They're very discontinuous. When expectations shift, the markets move very rapidly. So if you told me that the significant downside threat in 2026 is that we saw a significant correction in equity prices...down 15, 20, 25% from where we are — and they stay down for more than a week, but, you know, a month, a quarter, I don't think I'd argue with you. I think that's a real possibility. I do think investors are, you know, there's a lot to...AI is

a big deal. It's game-changing. It will, I think, ultimately raise productivity in a significant way. But I think investors are expecting all that to happen very, very quickly, probably too quickly, and therefore a correction seems like a real possibility. Not my base case, not in the middle of the distribution of possible outcomes, but certainly a scenario that one should consider and internalize when making their own investments.

Michael Klein

Finally, Mark, you already mentioned some things you'd be looking at. For example, if Jay Powell stays on the Board of Governors, what other economic signs will you be looking at in early 2026 to gauge whether the economy is on a good, or maybe not such a good path?

Mark Zandi

You know, Michael, to me it's about jobs. Again, we're going sideways here. We might get a couple months of negative numbers. We'll get some revisions, some more negative numbers. That's all happening simply because there's no hiring. The layoffs remain low. So I worry about layoffs starting to kick in to any significant degree. So let's suppose...the other way to think about AI is...let's suppose investors are right. Let's suppose that the productivity gains are going to come on quickly here. What does that mean for jobs? Does that mean we're going to start seeing big negative job numbers as we start to see layoffs because AI is coming on so fast? And what does that mean for consumers? Consumer sentiment, consumer confidence, consumer spending. And could that ultimately result in the kind of self-reinforcing negative cycle that characterizes recession? So for me, it's about jobs, and more specifically, about layoffs. And so I look at things like unemployment insurance claims, the initial and continuing claims. I look at WARN notices, corporate layoff announcements. I listen to what companies say with their corporate earnings releases. You know, what are they saying about their payrolls? Are they starting to lay off because of AI? So I think all eyes on the labor market, and particularly on layoffs. If they start to pick up, then we're going to go down a kind of a darker path here.

Michael Klein

Well, Mark, I always learn a lot in speaking with you, and I very much appreciate you coming on EconoFact Chats once again to offer your insights at a time when there is a lot of uncertainty in the economy. So thanks for joining me today.

Mark Zandi

Yeah, thanks, Michael. I always appreciate the opportunity, and thank you for calling me back. To be frank, I can't remember what I told you back on Labor Day. Hopefully it was roughly right, but maybe it was because you wouldn't have invited me back, I guess.

Michael Klein

Well, people can look at our archives and go and check the earlier podcast then. But I bet you were more or less on track. So we'll leave it to our listeners to go and double check.

Mark Zandi

Good idea.

Michael Klein

Take care.

Mark Zandi

Take care now.

Michael Klein

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