EconoFact Chats: The Economy and the Tenuously Resilient Consumer

Mark Zandi, Moody's Analytics

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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

I last interviewed Mark Zandi, Chief Economist of Moody's Analytics, for an EconoFact Chats episode at the end of 2025. At that time, I began the interview by saying "A lot has happened since Labor Day." Well, a lot has happened since New Year's Day as well. Most notably, President Trump started a war with Iran that led to the blockage of the Strait of Hormuz and a spike in energy prices. The Supreme Court ruled that the President's use of the International Emergency Economic Powers Act to levy tariffs was unconstitutional, but the President continued to raise tariff rates based on other statutes. Kevin Warsh was nominated and confirmed as the new Chair of the Federal Reserve despite concerns that he would not preserve the Fed's independence from the Executive Branch. He presided over his first Open Market Committee meeting in mid-June, at which time the Board kept interest rates unchanged. One possible reason for this is that inflation in May was 4.2%, well above the Fed's 2% target. Income growth has slowed. Most recently, the Atlanta Fed's GDP Now estimate, an estimate of what GDP is at the minute, is 1.7% annual rate of growth of real GDP in the second quarter of 2026, down from a high of 4.3% in late May. But in the face of high inflation, slowing growth, spiking energy prices, and tariff uncertainty, the S&P 500 index is up almost 10 percent since the beginning of this year. What do these events and statistics tell us about the state of the economy, and its prospects? I'm very pleased that Mark has joined me once more for an EconoFact Chats podcast, in which he can discuss these issues. Mark, thanks for joining me today.

Mark Zandi

Thanks, Michael. So good to be with you. I can't believe it's been since the end of last year since we last chatted. Do you recall what I said? I mean, did I get it right, or wrong or what?

Michael Klein

You know, Mark. The problem with podcasts is that people can go back and look at it, and I invite our listeners to go back and see what you said. But to be fair, there's the Yogi Berra saying, "forecast is difficult, especially about the future." And it's really hard when there are all these intervening events that I outlined in the introduction. So, Mark, you recently posted your views on the outlook for the U.S. economy, and the post had the subtitle "The Tenuously Resilient Consumer." In what ways have consumers been resilient?

Mark Zandi

Well, if you look at overall consumer spending…so the whole shooting match after inflation, so real consumer spending…that grew 2% last year. That grew roughly 2% in the first quarter, and according to our tracking estimates for the second quarter, we'll get data on that soon, it'll be 2% so it's kind of sort of like 2% right on the nose, and in the face of all the things that you mentioned, that shows a fair amount of resilience. That's kind of the bottom line – overall consumer spending growth has been very, very stable and pretty close to the economy's potential. The economy's potential is probably a little north of two, but kind of in that ballpark.

Michael Klein
You also make the case that there are differences across income groups, and you refer to the so-called K-shaped economy. What do you mean by that?

Mark Zandi
Yeah, well, I think there's this bifurcation under the hood. I mean, it's 2% in growth in aggregate, but it's really all that growth is being driven by folks that are in the top part of the income and wealth distribution. Let's call them the well-to-do. And just to give you context, over the past say three years, overall real consumer spending growth has been 2%. Folks that are in the top 20% of the income distribution, the growth in their spending has been, on a real basis, after inflation, close to 4%. And the folks in the rest of the distribution, the bottom 80%, their spending growth has been close to zero. So you know that's very K-shaped. The well-to-do are doing really well. They're fine. They're out spending, doing their thing, and the folks in the middle and lower parts of the distribution are struggling to kind of hold on. They're holding on, you know. They're kind of hanging tough, but barely. And that's the K-shape. That's in my mind the description of a K-shaped economy.

Michael Klein
So, what are the implications of this of consumption being very different for different income groups?

Mark Zandi
Well, from a near-term macro perspective, it shows a tenuousness or fragility. That's the tenuous part of the tenuous, resilient consumer. Consumer is resilient, but it's also very tenuous because the spending growth is concentrated among the small group of very high-income, high-net-worth individuals, households, and their spending is being driven in a significant way by the increase in their wealth, which goes back to the equity market, the stock market, which you mentioned at the top of the conversation. Stock prices have been rising very rapidly, particularly AI, artificial intelligence stock prices, and that's driven up a lot of wealth. Just to give you a statistic, a couple statistics there…and I'm rounding, so this is roughly right, not exactly right. If you look at the total value of all publicly traded stock as measured by the Wilshire 5000 it's up about $40 trillion in the past four years. I pick four years because that's about how long it's been since Chat GPT was put on the planet back in late 2022. That's a doubling in the value of all the outstanding equity on U.S. exchanges…$40 trillion increase. So that drives a lot of spending. Here's the other statistic: the folks in the top 10% of the income distribution account for 90% of those equity holdings, so if you add up all the equity, corporate equity, directly held, indirectly held, and mutual funds and everything else, 90% of the value of all those holdings are held by the folks in the top 10% of the distribution. So, just again, goes to the tenuous nature of the spending. The spending is dependent on a small group, who in turn is dependent on a run-up in equity prices, which is also very narrowly concentrated among AI stocks. There's other reasons to be concerned about this in terms of equity, in terms of what it means for our political and societal dynamics. But those are more longer term. In the near

term…and it's really about how tenuous things are, how fragile things are, because it's based on just a few people doing their thing and the stock market.

Michael Klein
So the way in which this is tenuous, Mark, is I guess there are some views that the stock market is overvalued, looking at things like the Cyclically Adjusted Price-to-Earnings Ratio. And so if there is what is euphemistically called ‘a correction,’ we could see the collapse in net consumption among the very wealthy right?

Mark Zandi
Yeah, that's the concern…that the stock market has come a long way in a very short period of time. Tried and true measures of valuation in the equity market are saying the market is overvalued, frothy, bordering on speculative. My favorite measure of valuation is the ratio of that Wilshire 5000, the value of all publicly traded stocks, to all after-tax corporate earnings. Kind of think of it as like an economy-wide price earnings multiple. Not too different from the measure that Warren Buffett has popularized, and also not inconsistent with the cyclically adjusted P/E multiple that you just described. And if you look at the economy-wide P/E multiple, on average since 1960, and I've got data back that far, the multiple is 12 times. So the value of all publicly traded stocks is 12 times after-tax corporate earnings. It's currently sitting at about 20 times, and that's more than two standard deviations away from that average. And the only other time in history where it's been that high briefly, was in the internet bubble back around Y2K, and of course that was a bubble that ended badly. So those valuations…maybe they're justified, but maybe they're not, and thus the risk. And there's other signs of, as I said, speculation. And when I say speculation, I mean that you have investors that are simply buying…because the price has risen in the past; it will rise in the future, and it's not based on any kind of more fundamental understanding of what's going on, or any sense of what's happening with these companies that they're investing in, it's just simply momentum. And there's lots of signs of that. Things like increasing risk taking, like leveraged ETFs, and increasing amounts of margin debt. The other thing to consider is that we are now starting to see a lot of IPOs, initial public offerings. So you saw SpaceX go public not too long ago, and I just point out, those companies don't go public unless they think they're getting a pretty good price. So they're cashing in, and that goes to the valuation. So maybe it all works out. Maybe these valuations are justified, and stock prices continue to rise, or hold their own…let earnings catch up. But I think there is a reasonably high risk that these valuations are too high, the stocks are overdone, there's a misstep. There could be simply one or two of these big hyperscalers not hitting their very lofty expected earnings, and you get a correction, or a decline in price, and that would reverse the so-called wealth effects. The wealth effects are now positive because of the run-up in equity prices and wealth that's allowing high-end, well-to-do households to spend more out of their income. That's what they're doing. But if prices were to fall, that could go into reverse, and you have the so-called negative wealth effects, and thus the risk. Particularly given, going back to the lower part of the K, the middle income groups-they're just holding their own, they're not driving the train. So we really need those high-income households to continue to spend. If they don't, we got a problem.

Michael Klein
Mark, you used the B word, bubble. Do you think we're in a stock market bubble?

Mark Zandi
Did I use that word, Michael? I don't think I said bubble. I think you said bubble, my friend.

Michael Klein
And then you sort of said, "well, it's a little like the late 1990s…and used the B word."

Mark Zandi
Well.

Michael Klein
Are we in a bubble?

Mark Zandi
I think bubble, as you can tell, is…a loath to say, just because it's such a strong word. But when I say speculation, that is a key ingredient of a bubble, and I think it's just a matter of degree. I don't think we're quite there yet. Let me put it this way: you know, I'm old enough to remember very clearly the internet bubble, and that was a bubble. That was a bubble that blew. And if you look at the speculation that was going on in that period, it was much greater, at least in my mind's eye, than what we're experiencing now. So speculation is evident. Increasing leverage is evident. There are signs of a bubble developing. It's a matter of degree. We haven't quite gotten there yet. I may say something different to you, if we have a conversation six months from now and the stock market's up another 10% then bubble might be the right word to use. But I think it's a little premature, but we're getting pretty close to being able to confidently use that word.

Michael Klein
Okay, well, we will talk in six months, and we'll see if the B word comes up again.

Mark Zandi
Okay, there you go.

Michael Klein
So what we've been discussing is, in a way, the resilience of the people who are at the upper end of the income and wealth distribution, and how their consumption is tenuous. What about people at the lower part of the K, as you put it? Is the resilience of the consumers at that lower part of the K…of that lower end of the income distribution, also tenuous?

Mark Zandi
Yeah, quite tenuous. I mean, obviously, those folks are much more dependent on what's going on in the job market, the labor market, in their income and compensation. They're much more at risk for the higher rates of inflation, rising cost of living, the Iran war, and the impact that's having on gas and grocery prices. And so, if you look at real after-tax income, so real disposable income…this is data from the Bureau of Economic Analysis through the month of May…it's gone sideways. It's zero to slightly negative over the past couple of months, and I don't think that's going to change. And that's kind of across the board. So that's on average, kind of in the middle of the distribution of consumers. So that means folks

in the bottom half of the distribution are now experiencing outright declines in real after-tax income. It feels like this is going to make it worse because the Iran war has started up again. Oil prices are back up to $90 a barrel, close to. Gas prices are moving north, I think I just heard we're now back over $4 a gallon for regular unleaded, and so that's going to do some real damage. Real incomes are going to likely start to fall here if things don't change quickly in the Middle East. The thing is that saving rates are very low. Now, part of that is the wealth effect. I mean, high income net worth households are saving less because they don't need to save, because their nest egg is now much larger, but I also think it reflects the fact that lower middle income households have drawn down their savings to try to maintain their spending in the face of these very weak income numbers. So I think low and middle income households are in a very tenuous situation. The other thing I'd point out is higher interest rates. So interest rates are up. Of course, the Federal Reserve, before the war, we all thought the Fed would be cutting interest rates this year. Now the thinking is, if anything, they'll be raising interest rates. And of course, long-term interest rates have risen. The 10-year Treasury yield before the war was below 4%. Now I just looked today; it's 4.6%. Fixed mortgage rates have risen consistently with that. We were below 6% on a 30-year fix at the start of the war. We're now at 6.6, 6.7%. And the higher rate does damage to that lower middle income group in lots of different ways. If you have credit card debt, that's tied directly to the funds rate, so your credit card interest payments are going to rise. You have a home equity line of credit, that's tied directly to the federal funds rate, you're going to be paying more. If you're a small business person and you get a loan from a bank that's tied to the prime rate, which is directly tied to the federal funds rate. And of course, fixed mortgage rates go a long way to impacting refinancing activity, and home sales and home buying. So that's also going to do a lot of damage. So yeah, I think the low and middle income households are already quite vulnerable, even before the war started up again. Now, with the war kind of back in full swing, this could become a real problem for that group and thus the broader economy pretty quickly.

Michael Klein
So, you've been painting a picture of a pretty fragile economy, I guess, at this point. And as we mentioned a few minutes ago it's really hard to forecast because you don't know what's going to happen to policies or to actions that impact the economy. But with those caveats, what do you think will be happening with, for example, trade policy? With the Federal Reserve? Will there be any changes in tax policies that you see on the horizon? And how will these impact the economy?

Mark Zandi
Yeah, I think fiscal policy, tax spending policy, that's on hold. We got a…obviously a big package of fiscal changes with the One Big Beautiful Bill Act, which helps to support growth, you know, in the first half of this year. The tax refund checks were much larger this year than last because of that. But that's temporary, and that's all in the rearview mirror at this point. And now, given the midterm elections…we'll have to see how that goes, but assuming that the government is divided on the other side of that election, I don't think we're going to see any additional significant fiscal policy made after the election. On trade, similarly, the President has had to backtrack a bit because of the Supreme Court ruling you mentioned at the top of the conversation. He's trying to juggle things and use other legal authorities, and he might be able to get some of that through, and the effective tariff rate might push up a little bit, but I don't expect much change there going forward either. We're sitting at around the 7, 8% effective tariff rate, and that's probably where it's going to be a year from now. So really, no change on the fiscal side. On the Iran war, that's the one I'm obviously least confident got a grip on. I mean, hard to know how that's going to play

out, but my thinking, and it's consistent with investors' thinking…that's why the stock market hasn't taken it on the chin…is at the end of the day, the President knows this is going to do a lot of damage and if the Strait remains closed, you know, for the next month or two, oil prices are going to start spiking because global inventories of oil are going to get to a level where it's just not workable, and we're going to see physical shortages of refined product around the globe. So I think he's going to figure out some way to bring an end to this and reopen the Strait and get oil flowing. But if he doesn't, then that's the fodder for an economic recession…downturn, you know, later in the year. And again, given that prospect, I can't imagine that he's not going to figure out a way to kind of stand down, pivot, and move on. On monetary policy, as I mentioned, investors are now thinking it's more likely the Fed will hike interest rates because of the higher inflation than lower interest rates. My sense is they're going to hold the line. You can tell from the conversation so far that I'm not very enthusiastic about how the economy is doing. I think the labor market is really fragile and soft, and the economy is at risk. And of course, that would help, all else equal, forestall a Fed tightening. The other thing that would forestall it is that inflation expectations, as least measured by the bond market, say like five-year or 10-year break-evens, are pretty consistent with the inflation target. And I think as long as that remains the case, I think the Fed will hold the line on rate increases. I don't expect any rate cuts going forward this year into next. I say this with less confidence, but I don't think there will be rate hikes either. I think the Fed will hold their own. So, bottom line policy, you know, fiscal policy, foreign policy, monetary policy…I think the most likely kind of scenario, best baseline assumption, is that there's no real fundamental change here. We're kind of on our own.

Michael Klein
So, to conclude, Mark, what advice would you give people who are concerned about the circumstances that you've outlined? That you know things don't look like they're going particularly well. People might be worried about their portfolios. You know, if they have a 401K, people who don't have much in the way of savings or wealth might be worried about how to make it through the next paycheck. Do you have any advice for people in these sort of very uncertain, and perhaps dire times?

Mark Zandi
Yeah, don't look, Michael. Just don't look. Especially when it comes to your stock portfolio, right? Because if you're invested in stocks, if you're invested for the long run, meaning you know 10 years, 20 years, hopefully even longer, so you should just not pay attention to the ups and downs and all the rounds. And I think ultimately you'll be rewarded. What's the Buffett phrase? "Don't bet against the U.S. economy." I think that holds in the long run. So it may go down here, may correct, but you know, okay, it's doubled in the last four years. Give back some of that it's not great, but, still you're you're much better spot if than you would have been otherwise. So, to a significant degree, I'd say don't look, and don't make big decisions when things are moving in the market up or down. The other thing I'd say is if you do have debt, it probably is wise to, if you can, pare that credit card debt as fast as possible. Average credit card interest rate today, it's hard to believe, 20%. You're paying 20% on a credit card loan, and that's going up, not down. So you really don't want to be paying on a credit card. You really want to get that debt paid down. And finally, I'd say, Michael, go vote. You gotta vote if you want something to change in Washington, you got to vote for it. So I think that's goes without saying, but I'll say it again go vote.

Michael Klein
Well, that's all good advice. I especially like the one about voting. Everybody should be voting.

Mark Zandi
Absolutely.

Michael Klein
And if you're voting, you should be knowledgeable about what you're voting for and what the implications would be, and so today, Mark, you helped lay those out. So thank you very much for joining me on EconoFact Chats.

Mark Zandi
Oh, anytime, and I'll have to go back and listen to that podcast in December, see how good I was, and then we'll take another crack at it six months from now. Talk to you soon, Michael.

Michael Klein
Great, see you soon.

Michael Klein
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