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Moody's expert optimistic on city economy

Rating agency's top economist sees a bright future for city commerce and healthy growth nationally over the next three years, but not in the next few months. Full employment should return in 2016, Mark Zandi said.

BY ERIK ENGQUIST
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One of the nation's leading economists, who admitted to underestimating how well New York would do in recent years, predicted a strong future for the city as international demand for its business services increases.

Mark Zandi, the chief economist for Moody's Analytics, said in a speech Wednesday in midtown that city-based firms should have plenty of clients around the world in the coming years for advertising, accounting, legal and financial consulting services.

"It's always done better than I anticipate," said Mr. Zandi of the city during an appearance sponsored by the Urban Land Institute. He noted its recent job growth of about 2.5%, approximately a percentage point higher than the national figure. "And it's happening without financial services" contributing, he said. "I'm actually quite optimistic about New York City's economy."

He expressed similar sentiments about the national economy, although he said it wouldn't ramp up until it absorbs the tax increases that took effect this year and domestic political uncertainties are resolved in the next few months. He referred to the $1 trillion in military and domestic spending cuts that would take effect in two months if Congress does not act, as well as the debt ceiling, which Congress needs to raise for the federal government to pay its bills, and a new "continuing resolution," which Congress must pass to prevent a government shutdown.

Growth in the gross domestic product should continue in the 2% to 2.5% range in the next two quarters, he predicted, but should reach 4% in 2014 and 2015. Unemployment will probably finish this year in the neighborhood of 7.8% but should drop to 5.5% to 6.5%, which he described as "full employment," in the summer of 2016.

The legislation to avoid the fiscal cliff was "an OK deal as far as it goes" but "will take some steam out of the economy" because it did not extend an expiring 2-point reduction in workers' Social Security tax or the Bush tax cuts for households with adjusted gross incomes of at least $450,000. There was also a phase-out of deductions for households earning $300,000 or more.

But he said it would be far worse if the government were prevented from paying its debts. "Breaching the debt ceiling would be pretty ugly," he said to a group of several dozen business people gathered at a law firm's 50th floor office on Lexington Avenue. "Recession, downgrades, turmoil—it would be a mess."

Congress has until the end of February to resolve that. Meanwhile, the automatic spending cuts, known as "sequestration," would begin March 1, and the federal government would close April 1 without a new bill to keep funding it, because Congress never passed an annual budget.

"Nothing will get solved until the 11th hour," Mr. Zandi said. That would result in a "soft" first quarter. He foresaw sequestration being replaced by more carefully orchestrated spending cuts of about $1 trillion over 10 years in a deal that produce $1.6 trillion in deficit reduction. That would be "sufficient to get businesses to re-engage" but not enough to lower the debt-to-GDP ratio to a level sustainable over the long term, meaning future deficit reduction would have to follow, lest all private debt explicitly or implicitly guaranteed by the federal government be downgraded.

Listing his reasons for optimism, Mr. Zandi said, "Corporate balance sheets are about as strong as I've ever seen them," except for those of airlines and newspapers. Banks are especially strong, thanks in part to government forcing them to recapitalize in the wake of the financial crisis of 2008.

Household balance sheets of the upper-middle class are the strongest they have ever been, he added. Moreover, the housing sector, which has been the key drag on the economy for the last four years or so, is again becoming a source of growth, he said.

"All signs are pointing north," Mr. Zandi said. "We're going to see continuing improvement in housing. We should be in full swing by 2016." It's a part of the economy that generates jobs in myriad industries, he noted. Businesses with fewer than 50 employees, which have been laggards during the economic recovery, will be particularly helped by the recovery of the housing market.

He said interest rates would rise as the U.S. economy grew, but that the Federal Reserve would have ample time to implement measures to keep inflation from surpassing 3%.

Nonetheless, several major risks loom for the economy, said the man who sold his firm, Economy.com, to Moody's and has written several books.

One is the possibility that U.S. politicians won't reach settlements before the approaching fiscal deadlines. Another is that Europe won't resolve its debt crisis. "It's still possible that the euro zone will crack up," he said. "That would be very debilitating to Europe and would reverberate across the globe."

Another threat is Iran, a major oil exporter that has unsettled the world with its nuclear ambitions. "If oil prices spike while we're still trying to digest these tax increases, it could be too much to bear," Mr. Zandi said.

And finally, disagreements between Asian nations are brewing, threatening to disrupt economic growth there. He cited territorial disputes between China and Japan as one example. "It's just a hotbed of tensions and economic rivalries," he said.