

## [Transcript] Plain English with Derek Thompson / The 2023 Economy FAQ: Is Recession Inevitable? Will Housing Crash? Can Tech Recover?

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Peace!

Happy New Year, and welcome back to Plain English.

It's great to be back in this seat, hosting this podcast, which I have so loved doing for the last 13, 14 months.

One thing that I wanted to do at the beginning of 2023 is look back over some of the stories that I was telling about the world one year ago.

There were a lot of things that I think we thought we knew about the economy.

At the end of 2021, rounding into early 2022, this is a period where stocks were essentially at multi-decade highs, the tech industry was absolutely booming, crypto had not yet crashed, metaverse still seemed like a thing.

And looking back now, it's just remarkable how 2022 was an extinction level event for narratives that have thrived in the previous few years.

Michael Sembalst, who is the chairman of market and investment strategy for JPMorgan asset and wealth management, publishes an annual report about what to look out for in economic and finance news.

It just came out really like a few hours before we put up this podcast.

And it has this remarkable observation at the top, where it asks us to look at some of the, quote, equity market catalysts over much the last decade, and in particular in 2020 and 2021, the pandemic years, the peak pandemic years.

That is, what were the narratives that were driving growth, that were driving our sense of the future in the last few years?

Things like profitless innovation or the millennial consumer subsidy, the name that I gave to that fleet of companies like Uber and Lyft and DoorDash, Peloton, that were making very little money in terms of profits, and it still seemed to be growing and growing, those seemed to have crashed.

Quantitative easing, that's clearly over.

The Western conceit of geopolitical change through trade, the idea that we could change a country like China's values simply by trading with it, well, that's clearly been discredited. There was also this idea for a long time that inflation was over, that we were in this era of low-flation.

That has clearly changed.

Modern monetary theory, the idea that fiscal stimulus could solve basically any problem without negative consequences, that's gone away.

Tina, T-I-N-A, there is no alternative to equities.

That's gone poof.

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That Potemkin village of Metaverse and FinTech narratives, the pseudo-libertarian gibberish of unregulated crypto, as Michael put it, that has gone away as well.

That is quite the graveyard of narratives that seem to explain the economy just one year ago that no longer explain the economy today.

To look forward into 2023, today's guests are Michael Batnick and Ben Carlson of Ritholt's Wealth Management and the podcast Animal Spirits.

In today's show, we talk about what we got wrong about the economy in the last 12 months, what we think is going to happen to the economy in the next 12 months, whether there's going to be a recession, what the Fed is going to do, how far housing is going to crash, whether the tech swoon is going to bottom out.

It's a great episode and I hope you enjoy it.

I'm Derek Thompson and this is Plain English.

Michael and Ben, welcome back to the show.

Thank you for having us.

So what I want to do today is review the biggest stories, make the biggest predictions about the 2023 economy.

I thought one way that we could start is that in the interest of beginning a new year with a new slate, I wonder if there was one thing that you could tell yourself on January 1, 2022, tell yourself one year ago that you know now, what would that lesson be?

What is the biggest learning from the last year in financial and economic news?

And the rule for this game, before you guys, you draw from your answer, is that you cannot commit insider trading.

You can't try to tell your one year old self short Tesla or sell out of Nasdaq and crypto and buy United stock.

You can't do that.

You have to tell yourself a principle, an idea about the economy or the nature of markets that you've learned in the last 12 months.

So Michael, why don't we start with you?

Yeah, this is an easy one.

And usually markets don't work like this, where if you knew the news ahead of time, if you knew the economic numbers and had all of them, it's very rare that you could use that information to insider trade, to know what the market would do in response to anything. Take the pandemic, for example.

If you knew that the economy was going to shut down for several quarters, you probably wouldn't buy stocks, but you didn't know that the Fed was going to do what it did in response and fiscal statements and all sorts of stuff.

2022 was the outlier in the sense that if you had I known that inflation was going to be above 7% every month for the year, it would be very easy to know what to do with my money. What would I do?

I would short the longest duration stocks and bonds.

That's what I would do.

When you say longest duration stocks, what kind of stocks are you talking about?

So these are the high flyer, don't worry about when you pay me back companies, lose as much

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money as you want because money costs nothing.

If money costs nothing, who cares?

Just burn it and just grow, grow, grow, grow, grow.

Well, that trend reversed entirely.

So the Shopify's and Spotify's of the world and the Ubers and the monies that had yet to turn a profit because they were being substituted by Silicon Valley, all of those stocks are the ones that I mean by long duration and the same thing with bonds, meaning it takes you a long time for you to get your money back.

Those are the ones that are particularly sensitive to rising inflation, higher costs of money, and they got absolutely shellacked last year.

Ben, you go.

I thought we were going to have the same answer here, but we don't.

I would tell myself a year ago that the Fed no longer cares about the stock market as much as people think because for years in the 2010s, every financial pundit who was kind of an anti-fed, anti-government person said the only thing the Fed cares about is stock market.

And the stock market falls, the Fed steps in and lowers interest rates or does some sort of monetary policy.

And 2022 totally turned that on its head because the Fed not only said, we don't care about the stock market.

They kind of said, we don't care about the economy in terms of growth and unemployment. And there was days where the Fed would speak out and it's not like they were using some weird cryptic, tried to read into this thing.

Some of the Fed officials were saying, we're happy the stock market is falling.

And I don't think I ever would have believed that would have been the case before 2022.

So if I would have known the Fed was going to be cheerleading the stock market to fall, that would have probably helped head it going into 2022.

I'll tell you what I would have told myself.

And it lives at the intersection of your answers.

I would have told myself, Derek, you're wrong about the pandemic being an accelerator.

You guys remember like two years ago, especially in the middle of 2020, what everyone kept talking about was how the pandemic is an accelerator.

It's bringing us into the 2030s.

So e-commerce, is it X percent?

Well, the pandemic is accelerating us into the projected 2030s share of e-commerce in terms of total retail.

Streaming was clearly on its way to growing and taking over the movies.

And people said, well, the pandemic is an accelerator.

It's pushing us ahead five years.

I bought into that wholesale.

I totally bought into that narrative.

And that narrative was simply flatly wrong.

And I would have said, Derek, you're wrong.

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The pandemic is not an accelerator for e-commerce and streaming for the most part.

For the most part, the pandemic should be thought of as a kind of bubble.

It was a bubble for a category of companies that you can think of as promises without profits.

And this is the category that I think Michael was talking about.

The metaverse, SPACs, crypto, profitless innovation in software, e-commerce, biotech, all of that stuff.

Is that me or is that you guys?

You know, Derek, this is ironic because that was the ring which is owned by Amazon telling me that there is an Amazon package outside my front door.

And I was going to say that it's not just those really high-flying stocks that pulled everything forward.

It's Amazon.

I was on CNBC this morning talking about this.

I'm looking at the Amazon's operating income.

And to your point about 2020 being the bubble and just pulling forward years of growth, the operating income I'm drawing with my finger just completely went off the rails for Amazon and accelerated to like \$8 billion.

And now it's back on trend.

They're a little bit below.

It's \$2.5 billion.

So it's not just the money losers.

It's the companies that are at the center of our technology, technological universe.

Derek, my way of thinking about this is your point is the round trip.

And I think we saw a round trip in everything technology.

We saw this huge pull forward.

We saw these enormous gains in these stocks that everyone thought were going to change the world in 2020 and 2021, it really felt like they were going to.

If you just base it solely on the gains and what people were thinking, in 2022, you raced almost all or most of those gains for almost all those stocks and then also on their fundamentals.

Yeah.

2022 was our round trip to reality, absolutely.

And yeah, Michael, when your Amazon Echo told you someone's at the front door, that was Jerome Powell raising rates on the economy and knocking on the front door and bringing all of these valuations back down to earth.

All right, let's get into the questions and predictions about 2023.

So from the Wall Street Journal just yesterday, quote, more than two thirds of the economists at 23 large financial institutions that do business directly with the Federal Reserve are betting that the U.S. will have a recession in 2023.

Americans are spending down their pandemic savings.

The housing market is in decline and banks are tightening their lending standards.

And to quote, today, Tuesday, we learned that the quits rate, that is the share of Americans who leave their job, stayed elevated for another month.

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And so in the somewhat wacky logic of today's economy, that means the economy, or at least the labor market, seems to be stronger than many people thought.

And that suggests that wage growth will continue, which suggests that Fed rate increases might also have to continue.

So Michael, I have gone back and forth in the last year on the odds of a recession about 70 times.

What do you say for the next 12 months, recession, yay or nay?

Yeah, I've been arguing with myself a lot about this as well, Derek.

Like will they, will they, will they, won't they, or will there be, won't there be?

And I've got, I've got six questions that if I knew the answers to these, I could tell you what's going to happen by definition, which I guess is obvious.

But here they are.

Number one, has inflation peaked, and we can talk about all these later on.

But number two, is the wealth effect real?

We would, the logic would suggest it is, and what that means is, do people spend more money when they're at, when their net worth rises?

So you saw the stock market fall 20% last year, house prices are going to decline.

Those are people's biggest assets, right?

So how real is the wealth effect?

Number three, what happens with the excess savings?

Does that all get burned off?

Number four, will the Fed over tighten?

The market is expecting two, maybe three more little rate hikes, so we'll see about that.

I have a question about earnings, what happens to corporate earnings?

And then lastly, what happens to unemployment?

You can't really have a recession without unemployment.

So why does everyone, meaning two thirds of economists, why does, why do people seem to think that there will be a recession?

Even though we've been in this environment and the data is not rolling over, the economic data is okay.

So why does everyone think there's going to be a recession?

Maybe this is circular logic, but it's because everyone thinks there's going to be a recession.

It just seems like the smart thing to say that we are on the other side of an era of low rates and free money and do whatever you want.

And now companies are on the other side of that.

Wall Street cares about cash flow.

They care about not overspending and tightening and therefore laying people off.

So there is a lot of cross currents.

I could talk myself into it anyway, but I think it's possible, and maybe I'm both sides in this, but I do think it's possible that the Fed orchestrates the soft landing.

Because again, think about where the unemployment rate is.

It's as low as it's ever been, basically.

GDP, the Atlanta Fed tracker, which estimates GDP is looking at a 3.9-ish percent fourth

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quarter GDP.

So I know this is by definition, you can't have a recession with rising GDP and unemployment that is on the floor.

However, however, with the Fed continuing to raise rates and the housing market being susceptible to much lower prices, how long can consumers continue to spend with their biggest asset rolling over?

So I'm probably as, if not more, confused than you are.

Before we get to Ben, just in the interest of making everyone choose a side, even if it's 51:49, because the truth is, Michael, you're thinking about this in a very similar way to me.

I was prepared to both sides this, but now that you've both sides it, I think I'd prefer that everyone at least land their 51% on one side of the equation.

So recession, yes or no, even if this is marginal.

No.

Again, if I'm using my logical history brain, I would say almost definitely, because we've never had inflation this high that has come down without a recession.

And it's one of those things is I'm trying to figure out if I want to believe the Fed or not.

I'm playing chicken with the Fed right now.

And I think that the labor market is so strong.

I think this is one of those instances where history is going to be misguided.

And I've never seen a labor market like this in my life, and I think it's strong enough and the amount of savings people have are strong enough where the consumer has just never been more prepared for something like this.

I think we kind of just muddle through and don't get a recession again this year.

And people just next year, it's going to be 90% of economists predict a recession in 2024.

I think that's where we might land.

I can't believe that we're all agreeing on this.

I was sure that someone was going to pick yes.

Here's why I also...

We're definitely wrong then.

I know.

I'm a little bit nervous about my prediction.

Here's why I would say I'm 51% toward no.

So again, to both sides this a little bit, the bad news that I see that you guys haven't mentioned is that I think about global trade right now having a ton of headwinds.

You look at Europe, they are clearly...

The EU is clearly going to enter a downturn.

I think there's just no way that Europe muddles through what's coming for it.

China is clearly turning inward.

It's possible that China is already in a recession.

How I would know that beyond any certainty, I don't know because I can't really trust

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any of the specific statistics that are coming out of China, but you look at some other things. I think China is clearly turning inward and imports are going down.

So I wonder where is growth from trade going to come from?

If it's not coming from Europe and it's not coming from China, like Canada and Mexico can't buy all of our shit.

And I wonder if that export component of GDP comes down, down, down, and consumer spending isn't strong enough to make up for it, then we do enter a technical recession of GDP comes down for six consecutive months.

At the same time, you go back to the first thing that Michael said.

Inflation is the ballgame.

Inflation is the whole ballgame.

And every measure of inflation seems to be pointing in the right direction.

You look at overall inflation, which includes oil prices, it's going down.

You look at core inflation, which excludes energy and food, that's going down.

You look at what we're now calling super core inflation because we have to keep coming up with new terms that excludes energy and food and shelter and use vehicles for a variety of reasons.

Sometimes these measures have slight lags.

That's a pretty good proxy for services inflation.

That's going down too.

So in a world where the Fed is raising rates and that lever on the economy is our greatest threat for turning into a recession, they're raising rates because of years of inflation.

But inflation seems to be edging toward four or 3%.

I think that soft landing is in the cards here.

It's not the 1970s.

It's a new decade, new economy.

As Ben said, we can't just look to history to make predictions.

So I do think that we have a shot at muddling our way through this and coming through with either something that is a lot like a 2000 recession or 2001 recession, which is a recession in name only, essentially, or that there really is no NBER determined recession at all.

That's where I come down.

Michael, Ben, anything about that analysis that you guys want to poke holes in?

Yeah.

I guess I would just...

No, I think that's spot on.

I guess what I would add is the American consumer feels our economy.

And in order for them to stop spending, they need to get laid off.

And in order for them to get laid off, the economy needs to slow down.

Again, I know once again, this is maybe some circular thinking, but there needs to be a reason for people to stop spending.

And if the stock market going down 20% hasn't done it because retail sales are still right near all time highs and the housing market cooling off and we're just starting to feel it, has it done it, I question what is going to do it.

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So again, can you have a recession without unemployment rising, without people stopping spending?

The answer is no.

So you're going to have to see those things happen before the economy can cool off.

I think that's the biggest thing is if all that excess savings gets spent down and I think it's already lasted longer than people thought, I think everyone assumed everyone's going to take one or two trips and get that out of the system after COVID and then things will kind of settle down.

But if you go to the airports or a restaurant, they're all still packed with people and bustling.

And I think that's the thing.

If we finally see that, people pull back a little bit, but I don't know what's going to stop that short of people losing their jobs.

That's a really good point.

And it goes back to the thing I said earlier about the pandemic wasn't an accelerator, the pandemic was a bubble.

Because what did you see during the pandemic?

The services economy was fundamentally closed and as a result, everyone had to order shit, order goods from companies like Amazon or experience things in the services economy virtually by, for example, streaming.

But the second the services economy opened up, we saw everything shift.

We saw a goods recession and we saw that people started flying more, people started going out to restaurants more and services boomed.

And that's where a lot of the energy around inflation is right now.

So I agree.

There's been a really historically bizarre tradeoff between goods and services in the last three years.

Services have shut down and goods explode and then goods fall into recession and services explode.

But there's a possibility they fall in the next 12 months into a kind of normal equilibrium that leaves us out of a recession.

Any last words before we go on to predictions about the Fed?

My only thing is that the economy is so big and dynamic in the United States now that we could just see recessions in certain sectors that don't impact the entire economy.

So last year, we certainly had a recession in technology.

If you worked one of these companies, it felt like a recession because a lot of people got laid off.

And then this year, it's probably going to be something like the mortgage industry where no one's refinancing anymore because mortgage rates doubled.

No one's taking out new loans because there's not a lot of housing activity.

So I think we could just see these mini pockets and it might kind of move around a little bit to different sectors and segments of the economy that are impacted more than others.

We're going to put a pin in housing because that is coming up after this next question.

But the next question is about the Fed.



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So the Fed is clearly raising rates until inflation settles at a number closer to 2%.  
And 2% for whatever historical reason has this sort of magical power about it.

It is the shelling point.

It is the number that everyone thinks they're aiming for, even if we don't know exactly why 2.0% is a number that we should aim for.

Where do you think the Fed will be satisfied if inflation hits that number for several consecutive quarters?

Do you think they're satisfied if we hit 4%?

3.5%.

Michael, to you.

Yeah, this is an interesting question because inflation, the headline numbers that people see on USA Today or whatever, the average person sees year over year numbers.

The thing is there's a huge gap between year over year numbers and say month over month or if you annualize the most recent three months.

So we could be at 6% year over year, but 2% to 3% with the three month moving average on an annualized basis.

And so the question is, and I know the Fed should be apolitical, but of course there are politics involved here.

So I think it depends.

What the market is expecting is a 25 basis point rate hike in February and another 25 basis point rate hike in March, taking us to 4.75% to 5%, that would be the range.

And then they're expecting maybe one more in May.

Now that's like the Fed funds probabilities that you could find online.

The bond market is disagreeing because the two-year yield, which is a reasonable gauge for where these rates are going, is below that.

And every time that's happened, the Fed has stopped tightening, but right now they're still going.

So I think the biggest risk is the clear and present danger that's staring us right in the face of the Fed just doing too much.

And I think it's going to be dependent on, I think wages are the big thing.

That is going to determine.

I don't think it's going to be so much a number year-over-year as much as it is going to be combating the sticky part because a lot of the things we've worked through.

You mentioned oil and rent and things like this, but it's the wages that really don't go away.

Ben, I want to follow up on that with you because you're a really close Fed watcher.

I wonder what is it about the words Strom Powell is using that make you confident that he's going to either go too far and raise rates into the teeth of a recession, or raise

rates just enough to settle inflation between 3-4% without tipping us into an actual downturn?

What about his words give you a clear indication of his motivations?

The only thing I'm really confident about the Fed is that they're probably going to change their mind at some point.

If you look at their past forecasts of anything with the economy, interest rates or inflation

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or growth, they're just as bad at this as all of us are.

Their past forecasts are nowhere near anything close to what actually happens.

I think they say, well, we're data dependent and we see what happens.

I think the people that say, listen, the Fed is telling us exactly what they're going to do and they've been doing it, that's fine, but I think once the data shifts and if inflation does have a serious downturn and it gets to 3 or 4%, I think they'd be nuts to not try to rethink what they're doing and recalibrate because at that point, do you want to send the economy into a recession just to prove a point?

I looked at this, the Paul Volcker led Fed in the 1980s.

When they sent the economy into a recession, inflation was much higher back then.

It was like 15% in 1980, but it took a long time for inflation to ever hit 2%.

It wasn't until 1986 and the majority of the 80s was above 4%.

I think it was 60% of the time, it was above 4%, the trailing 12-month inflation rate.

No one looks back at the 80s as this hellscape of inflation and crazy prices.

So I think as long as it's heading in the right direction and trending downward, people are going to be happy.

Derek, on one of the podcasts we were on with you before, early in the year, we talked about the importance of gas prices, I guess this was early last year.

Gas prices are lower at the end of 2022 than they were at the beginning of the year.

Just after hitting \$5 a gallon.

It's so crazy, it's crazy.

That's one of the many big surprises of 2022 that there was, but that's the kind of sentiment thing where people aren't going to be as angry about it anymore once these things start to come down and their real wages are going to be rising as inflation comes in because it's not like the employers are going to take back all the wage gains that they gave them.

So what does the Fed raising rates actually do to the economy?

Where is it most acutely felt?

And the answer to that is housing.

The housing market.

So you saw 30 year mortgage rates went from, I don't know, 3% up to over 7% in a year, which is an unprecedented gain.

And the housing market is roughly 20% of the economy.

And so I think that nuking the housing market, it's hard to see how that doesn't have broad ripple effects.

Everything from constructing and the financial aspects of it and the lending and all those people that are involved in that portion of the economy.

That is a substantial piece of our economy.

I want to know how far you guys think housing is going to fall or how far it's going to crash.

So my view is that housing prices are probably going to decline in 2023, that they'll probably fall by about 10% from peak to trough, that it might take several years for us to dig out of that hole.

We just got news that mortgage applications volume was down more than 13% at the end of

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last week from two weeks earlier.

That is a huge drop.

Clearly there is a bit of an ice age coming for housing.

Michael, to you, you said that you don't think that a recession is coming, but you also acknowledge that housing is 20% of the economy and it is likely entering its own finite recession. So how do these things square?

Yeah, that's a good question.

So Ben and I were talking about this yesterday in Animal Spirits that we mentioned that everything was artificial in terms of asset price, inflation, for lack of a better word, after the pandemic and housing is maybe the poster child for this.

If you look at the median sales price for a new or an existing home, you have this trend line and it just completely went off trend vertically.

And part of that is obviously low interest rates, but it's also the pandemic, people trying to get out, work from home, all of that sort of, the perfect storm of housing prices accelerating.

So if you were to just get back to the prices, the average price for 2019, so pre-pandemic, you would have a 32% plummet in housing prices, which would be, unfortunately, by far the largest price decline that we've ever seen.

And it would get super scary that headlines would be absolutely diabolical because during the great financial crisis, the max decline was roughly 22%.

So again, just to get back to the average 2019 price for a new home sale, that's a 32% decline.

Now, I don't think that's going to happen.

Why?

I think that this is a structural issue.

And so long as mortgage rates don't go back to 7% or beyond or higher than that, I think buyers will return very quickly because there are, I don't know what the, this is directionally right, I might be misquoting the number, but 70 million millennials that are entering really like peak home buying age.

And they have to buy a house, right there, they're having kids, they need the house.

And so there is just way more demand than there is supply.

So any easing of mortgage rates, and I think you mentioned mortgage applications plummeting, I think that you're going to see a huge uptake very quickly.

One statistic that I found from a JP Morgan analyst note from Michael Sembelis, who's really fantastic, notes that, quote, we are seeing the largest percentage increase in multifamily units coming online since the 1970s, end quote.

That basically means that the share of apartment buildings that are under construction relative to the entire rental stock is the highest it has been since the 1970s.

That is some really good news for millennials looking to buy or rent, the fact that we could potentially have a lot of housing come online.

That's the good news.

The bad news, at least for the short term could be that a lot of supply coming online plus these rising rates could mean that prices could fall substantially in the short term contributing to a recession.

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So the long term is longer than the short term.

I'm happy that there are more apartments coming online that I am unhappy that we might see a relative minor recession in the housing market specifically.

But that's some news to look out for.

Ben, what's your outlook for housing in 23?

This is the one where you asked us earlier what we wish we'd have known at the beginning of last year.

If you tell me where mortgage rates are going to end the year, I think I could probably tell you how housing works.

If rates stay above 6% or 7%, it's going to be a tough year.

If rates go back to 4% or 5%, I think to Michael's point, there's going to be a flood of people that are just waiting on the sidelines.

The thing is, in the first two years of the 2020s, the first two or three years, we had bigger gains than we've seen in any other decade besides one.

And that was the 1940s when we had this huge snapback from World War II and the Great Depression.

So we pulled forward a whole decade's worth of gains in probably 18 to 24 months.

So even a 20% bear market in housing would bring us back to March 2021 levels, and we'd still be 20% or 30% above where we were pre-pandemic.

A double-digit decline wouldn't surprise me even though that's very rare historically because we pulled forward such huge gains.

And having rates go up that much with price rises that quickly, a 10% or 15% decline really wouldn't surprise me.

I just do think that structurally the lack of supply and the fact that we have so much household formation means there's probably going to be a floor eventually where people just start hopping in. And even if people don't get the peak prices that they thought that they were going to get it just six or nine months ago, housing is going to be a problem in the United States for a while, I think.

So I think people are going to be ready when that happens.

Yeah, I think people are relatively okay for overpaying for a home, right?

It's not an asset that they plan on flipping 12 months in there, that's sensitive to price.

Where it becomes a huge issue, and it already is a huge issue, is just affordability, plain and simple.

Like there is only so much money that you could put down for a house.

There's only so much money that you could pay towards a monthly mortgage payment.

And so if rates cool off and they're stabilized and prices remain elevated relative to history, all right, so it's an extra 70 bucks for your monthly mortgage payment.

People are relatively okay over paying for houses.

We have a weird thing where we anchor to higher low values.

So when rates went from three to five, that five seemed really high.

If rates go from seven to five, that five is going to seem low because people were looking seven in the face and going, this is ridiculous, I can't believe how high my payments are going to be.

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And so I think having that relative change, having that 7% up there and seeing declines from there, I think is going to cause some people to come back in a little faster than they would have otherwise.

The last question I have for you guys is about what's happening in tech.

So the tech swoon was one of the biggest stories in markets in 2022.

I remember one of the first shows that I did at the end of 2021.

So two years ago, in December, 2021, I talked about how Elon Musk was not only time's man of the year, but he might be one of the most important figures of the century.

That Tesla and SpaceX were extraordinary accomplishments and this guy had gone from being a fintech entrepreneur to being the richest person, maybe in the history of the world.

He is now, after 2022, the owner of the not so proud moniker of being the only person who lost \$200 billion in one year in terms of net worth.

So that, I think, is just a little detail that goes to show a broader story, which is that the tech swoon was absolutely astonishing and it came on the back to the Fed raising rates as inflation increased.

It's obviously a bigger story than just Elon Musk.

All the NASDAQ was down about 60%, 70%, FANG was absolutely crushed.

That's Facebook, Apple, Amazon, Netflix, Google.

Do you guys think that 2023 is the year the tech swoon ends, or is there more pain in store for this group of companies?

Michael?

Yeah, I think that there is more pain in the real economy of tech.

The stock prices we'll see.

But a lot of these companies just overstaffed.

If you think back to when Facebook bought Instagram for \$1 billion when they had 13 employees, it seemed like, oh my, it just seemed like a crazy number.

And then it's a decade, more than a decade later, Instagram has 20,000 employees.

And so the productivity growth just gave them the green light to just accelerate their hiring.

And it was all not in the case of Facebook, but certainly in a lot of the startups, it was all being subsidized by low interest rates and by Silicon Valley that were happy to subsidize our loss or their losses, which were the consumer's gains.

But I think that is over.

And so I just, I don't have it up here, but I made a chart of employment at these big tech companies from 2019 to today.

And Apple has remained relatively sober, but a lot of the other tech giants just overhired.

And I think back to the point you made about Elon, he cut, what was it, 75% of the workforce at Twitter?

And the wheels didn't completely come off.

I mean, for the most part, it still functions.

And I think a lot of them are going to use that as a roadmap, not to that same extent.

But you know what, we could probably do with 20% less employees, whatever the number is.

I mean, Salesforce just announced today a 10% layoff and a rule on animal spirits.

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And it's a good one.

If you see around 10% layoff, that is never, ever, ever where it ends.

There's always another one coming.

Ben.

There's this old saying on Wall Street that nothing fails quite like success.

And I think that's, that happened with tech because you had this thing where tech used to be the upstart, right?

It was the, we started our companies in garages in Silicon Valley and look at us now.

And then they became the behemoths where they're making up 25, 30% of the stock market.

And I think when you get that big and that potential for overconfidence seeps in, and that's why you see overhiring and you see this stuff where they're doing these crazy ideas that sometimes don't pan out because things have worked out so well.

In the aftermath of the dot-com bubble blowing up in the early 2000s, even eight or nine years later, the tech sector as a whole was down like 50% from the highs in terms of like the NASDAQ.

So it took a long time for that to happen.

Things got a little crazier back then and the business models are certainly much more secure now and they actually produce some revenues and cash flows and like back then.

But this is the kind of thing where when we see these huge regime shifts in the markets, it doesn't, it's not so often that it cycles back immediately and goes back to the winners.

A lot of times when we have a regime shift, the winners going in are rarely the winners coming out.

And it's, you've seen it in energy stocks, they got pummeled for years and years and years.

Oil hit negative, it was negative \$37 a barrel in April 2020 or whatever.

And people threw the energy stocks out for dead and now they've been the only thing kind of holding up the stock market for the past 18 months or so.

And so these things are always cyclical.

So I'm not saying that these companies are going to go out of business by any means, but to see them immediately return to their leadership position, I think just after this short of a downturn probably doesn't make a lot of sense.

I talked about this on other shows.

I do think that the entire tech industry is experiencing something like an existential midlife crisis, not understanding what comes next.

What is the next mountain that we have to scale in order to retain the kind of earnings ratios that we are used to?

Because the advertising business is not only a mature business, it's also no longer the kind of duopoly that it was five years ago where Google and Facebook just ate everybody's lunch.

Now, Amazon is the largest growing or the fastest growing advertiser in the U.S.

Netflix is after the chat.

Here comes Netflix.

Here comes Microsoft, which is now working with Netflix in May.

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I suppose one day even by Netflix, if the price gets juicy enough and U.S. regulators allow such a thing.

I mean, I think we're seeing that that mountain of add of essentially attentional economics, right, create stuff that people look at and then sell advertising against it.

That is such a mature business that the margin is going to come from something else.

Maybe it's AI, maybe it's some other technology that I can't necessarily think of right now.

Maybe it's clean energy.

Maybe a lot of the money that's going to come into this space is going to come into solar and wind and geothermal and nuclear, but you can tell they're all looking for that next mountain to scale with Elon Musk.

I think the midlife crisis is more literal than it is existential and conceptual, but they're all looking for that next thing.

I do wonder, I think I agree with what you guys said about the theme that we saw emerging from the last few months of 2022 carrying on, which is that people like Elon discovering that you can keep a company afloat even after firing 50% more of the 50% plus of the staff.

We could see that continue.

We could see more layoffs in these big tech companies, but I wonder what the next shoe to drop is.

What's the 2023 narrative that we can't quite see yet?

I wonder if it's going to be in this general space of we can see that these companies like OpenAI are breaking open this really exciting frontier and they're leaving the big guys in the dust.

How do we catch up?

I'm very curious to see what happens there, but I don't exactly understand how that's going to cash out in terms of stock prices and labor.

I actually think the biggest surprise for a lot of people in tech would be that there's not an X-Big thing for a while.

I think people have been trying to predict that and what if the big tech stocks that we have, Amazon and Apple and Facebook, they're the big four, like the big four automakers and there just isn't a whole lot of moving forward for a while and those big behemoths just turn into these old school kind of value companies that eventually have to start buying back stock and paying more dividends.

That's really interesting.

I wrote this essay for the Atlantic about how what I called the Eureka theory of progress is wrong, which essentially said that when we tell a story of scientific and technological progress, we often focus too much on invention.

We say, well, Edison invented the light bulb in 1879, yada yada, that was electricity.

It's like, no, actually electricity had like nothing to do with the US economy for the next like 40, 50 years.

Deployment implementation rather than invention is the real story of progress and it's possible that we're in an era of deployment rather than invention for these big tech companies.

Amazon isn't reinventing drones so much as they are catching up on advertising.

Netflix isn't reinventing television so much as they're catching up on advertising.

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All these companies are essentially becoming what GE was in the 1980s, 1990s, this kind of megalith that tries to do everything it possibly can in order to add more and more and more to the bottom line.

So it's possible that, Ben, you're right, this is not an era where we're going to see a clear next mountain materialized.

It's going to be an era where people are trying to catch up to each other on the mountain already created and they're all trying to essentially become very similar to the next company.

I see this in entertainment a lot.

What was the old line that Netflix wants to become HBO before HBO becomes Netflix?

Now every entertainment company is trying to become the exact same thing.

They're all trying to become a major streamer that also plays in film.

It's just that Netflix has to catch up in film and Disney has to catch up in streaming.

And Paramount figures out where it fits into that landscape and HBO figures out where it fits into that landscape.

But they're all trying to become the exact same company.

So yeah, maybe we're just in an era of big corporate sameness and that essentially is an era of deployment and not invention.

I'm seeing nods.

All right.

That's why I'm never cutting my cable because all the streamers are going to eventually turn back into a bundle again and I'm going to be sitting there waiting with open arms.

Yeah.

I said this in a podcast tour at the beginning of the show that the history of media is the rebundling of unbundled bundles.

And a lot of people got mad at me because they didn't like me saying bundle so often in a row.

But anyway, we will leave it there.

Michael, Ben, happy New Year and thank you so much for reviewing 23 Econ and Finance News with me.

We will see you again very soon.

Thank you.

Perfect.

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