PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Macroeconomic Outlook and Themes for US and China to 2028

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Summary of medium-term themes for 2024 thru 2028

1. **The Federal Reserve will cut short-term rates, but fewer times and later this year** than markets currently are expecting.

2. **Long-term interest rates in the G7 will stay up** in coming years, even if short-term rates are cut heavily by central banks and inflation stays around target.

3. The trend **productivity growth rate in the US has risen** and this faster rate will be supported by widespread adoption of AI over the next two-to-five years. The spread and speed of similar productivity acceleration elsewhere remains to be determined.

4. **China** will find various fiscal and monetary stimulus policies ineffective, bearing out the **Economic Long COVID** analysis.

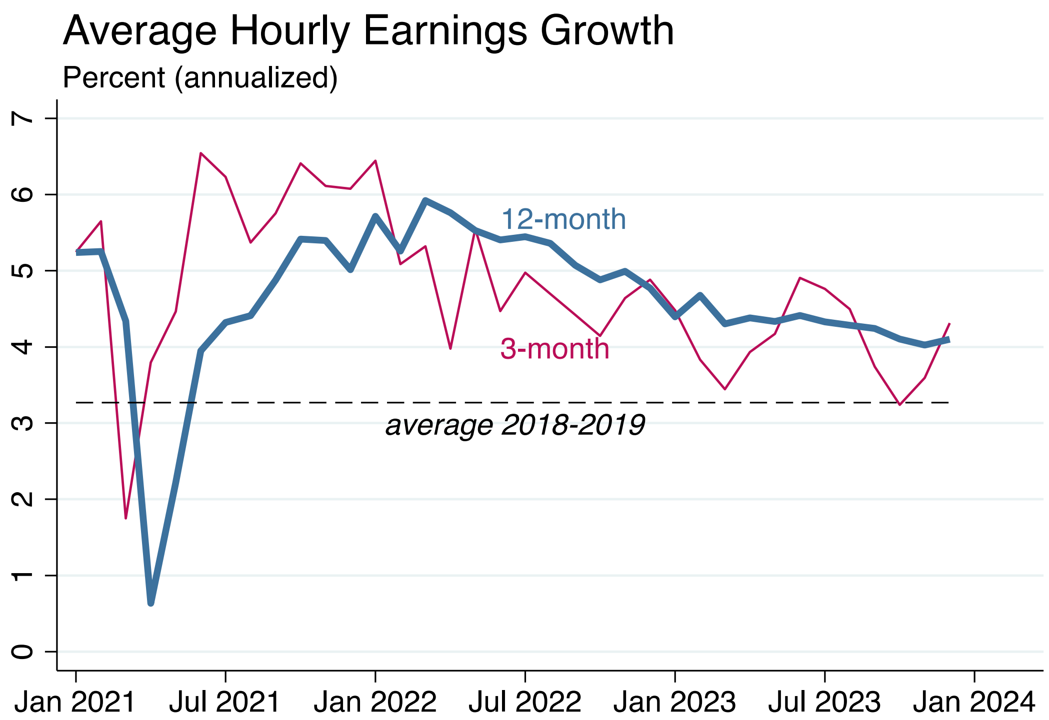
5. The **corrosion of globalization** continues in the critical areas of foreign direct investment, technological exchange, and business/research networks, though industrial trade is resilient.

Summary of the outlook for large economies

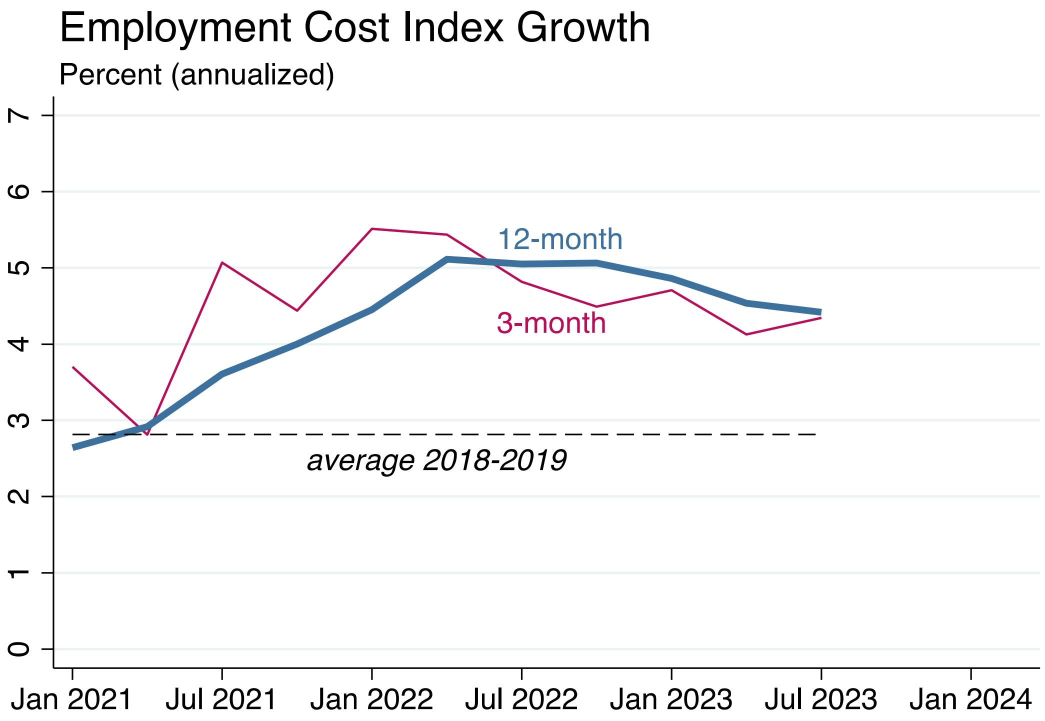
Real GDP Growth (Y/Y)	2021	2022	2023	2024
Global Growth	**5.9**	**3.4**	**3.1**	**2.8**
United States	5.9	1.9	2.4	1.6
Euro Area	5.6	3.4	0.6	0.7
Japan	2.2	0.9	1.8	1.3
United Kingdom	8.7	4.3	0.4	-0.3
China	8.1	3.0	5.2	4.5
India	9.1	7.2	6.5	6.2
Russia	5.6	-2.1	2.0	1.5
Brazil	5.0	3.0	3.0	1.3

Source: Consensus Forecasts for 2021-22**; PIIE for 2023-2024**.
Annual-average-over-annual-average growth rates. PPP weights.

US wage growth and broader compensation growth continue to ease



Data source: Bureau of Labor Statistics (via FRED).
Last data point: December 2023.



Data source: Bureau of Labor Statistics (via FRED).
Last data point: September 2023.

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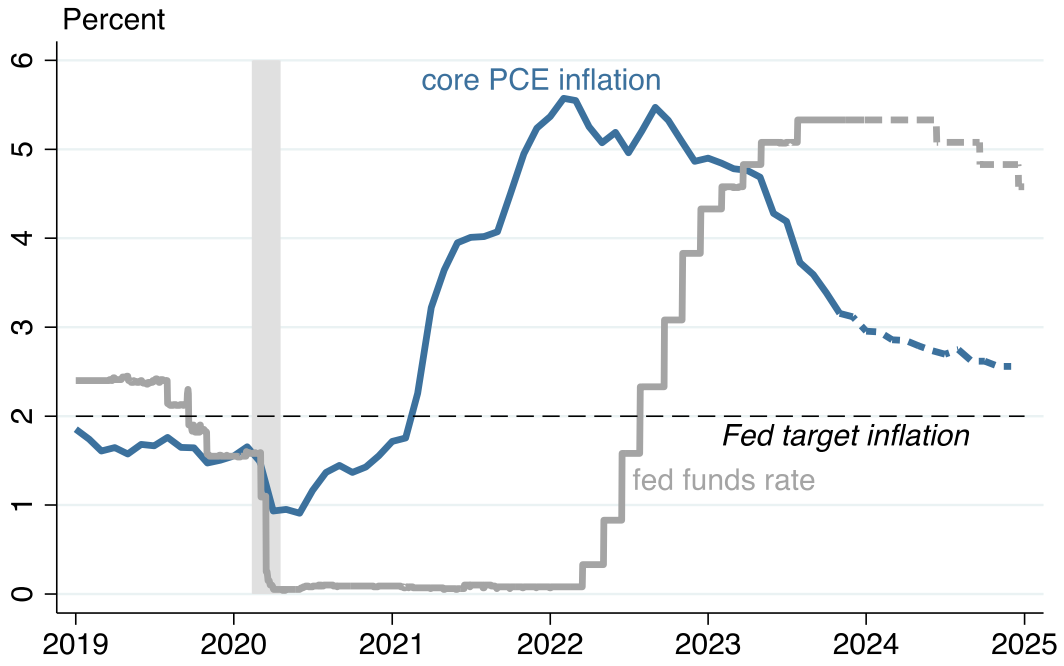
The Fed is likely to start rate cuts *after* mid-2024, fewer and later than currently priced in by markets

Core 12-Month PCE Inflation and Fed Funds Rate



Data source: Bureau of Economic Analysis and Federal Reserve Board (via FRED) and PIIE forecasts. Shaded area corresponds to recession.

Fed leaders are still "talking tough" to signal their commitment to reducing inflation and keep inflation expectations anchored

But, with inflation likely to drop below 3 percent early next year, some unwinding of the substantial Fed tightening will likely be warranted

Why will long-rates stay up if FFR comes down?

- Talking about r* or the average 10-year US Treasury rate at full employment
  - What will it be in 6-9 months from now, when inflation is down and growth is at potential?
- Most things that kept r* down from 2008-2019 remain in place, notably demographics and savings glut, and forecasts assume low productivity growth
- A number of things have shifted due to geopolitics and COVID, however
  - G7 and China will increase fiscal spending on defense, green, and industrial policy
    - Reversing the Cold War Peace Dividend, worth ~0.7% increase
  - Fragmentation of global financial markets will trap savings in China and reduce available savings in the West – net is higher rates in US transmitting elsewhere
  - Risk aversion has been reduced in US in response to YOLO and safety net
  - Productivity growth trend has arguably increased – the last 3 quarters are not a blip
- US 10-year Treasury average rate will increase over the next few years

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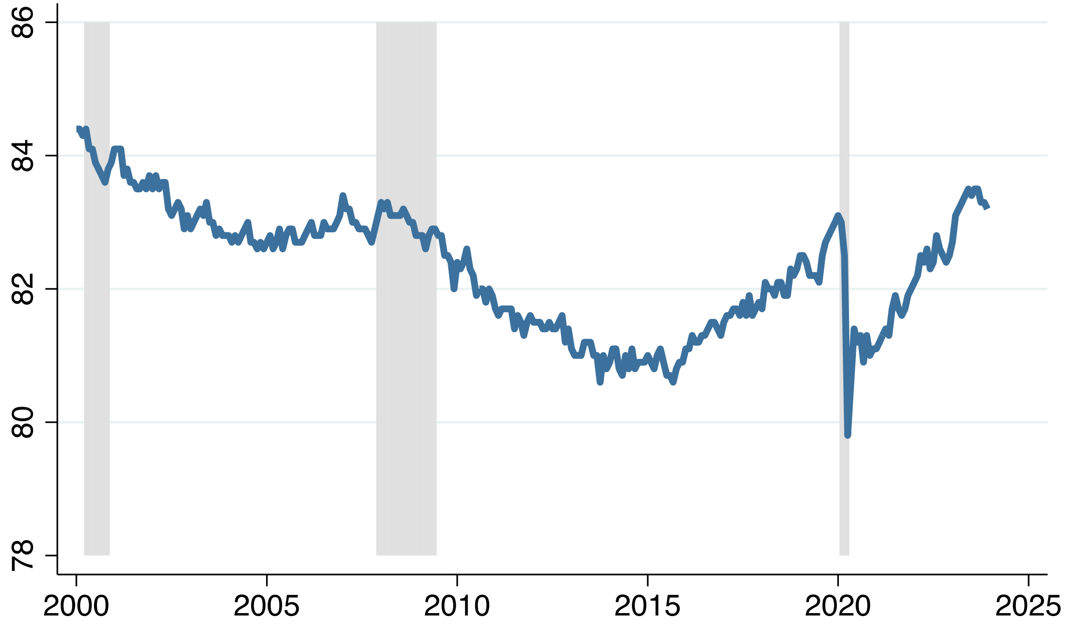
More labor supply has helped rebalance US labor markets – and may have increased productivity

Labor Force Participation Rate, Ages 25-54

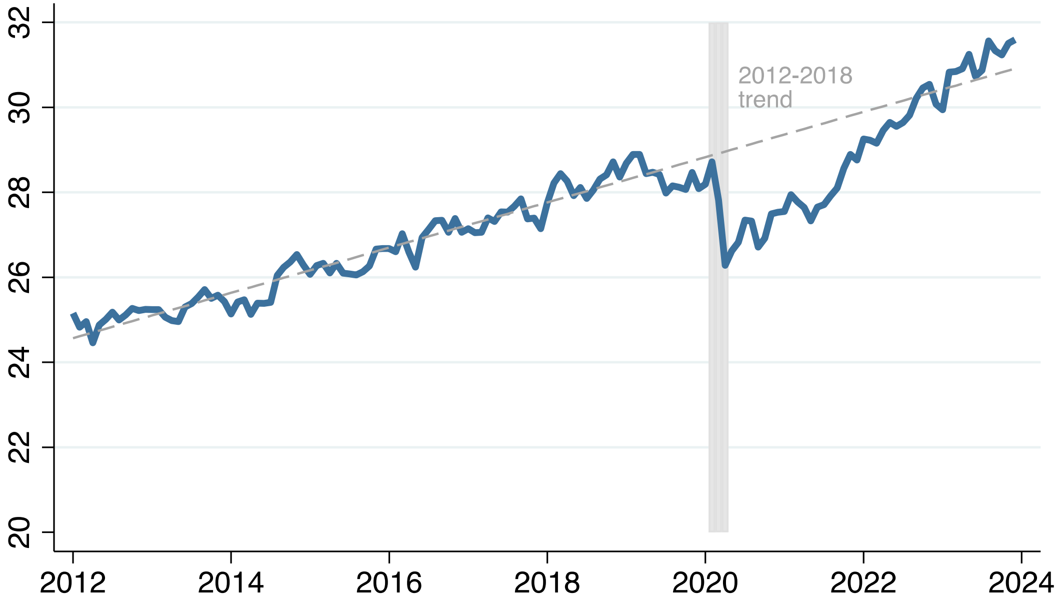
Percent



Data source: Bureau of Labor Statistics (via FRED). Shaded areas correspond to recessions.
Last data point: December 2023.

US Foreign-born Labor Supply

Millions



Data source: Bureau of Labor Statistics. Not seasonally adjusted.
Shaded areas correspond to recessions.
Last data point: December 2023.

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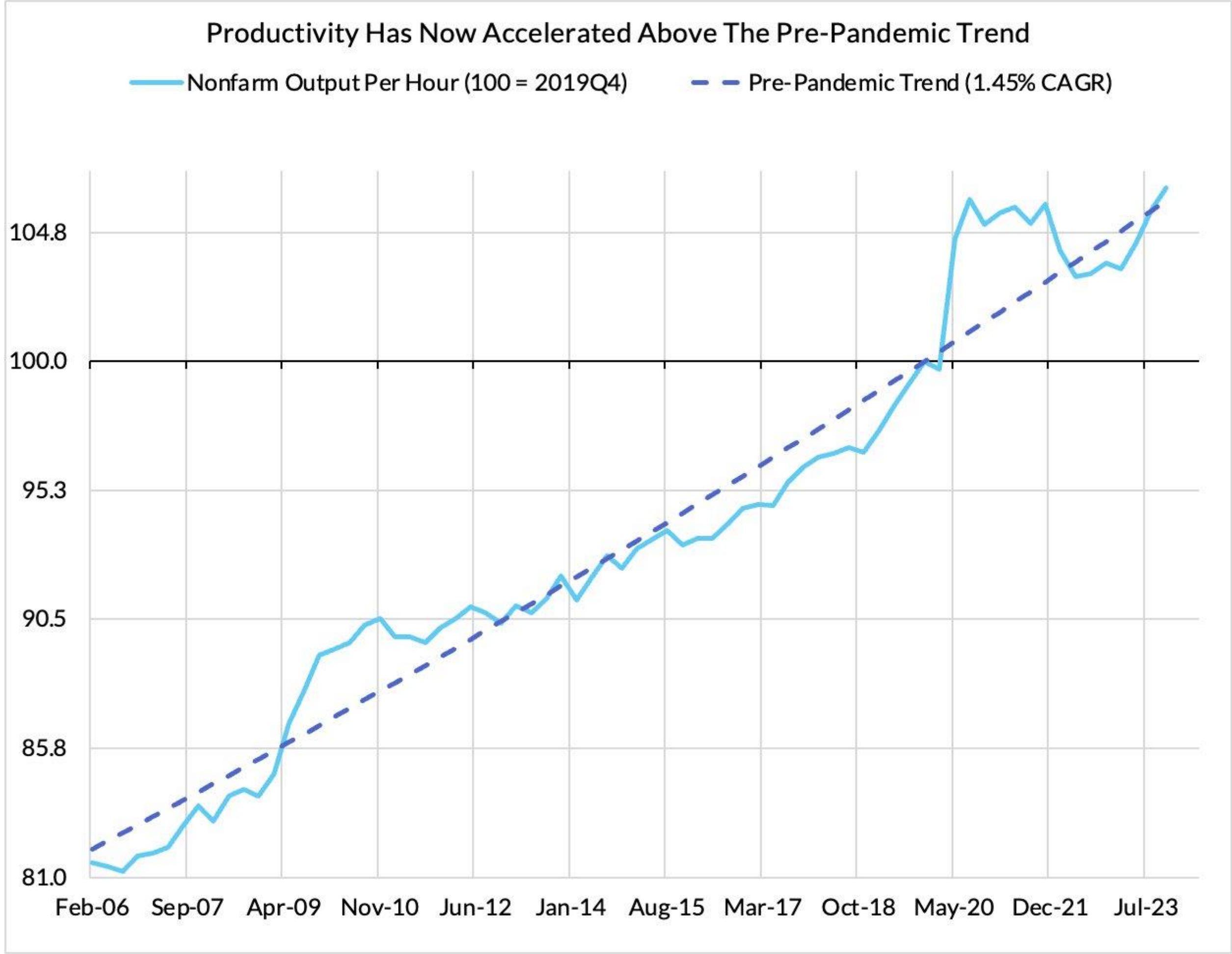

Source: Amarath (2024)
https://www.employamerica.org/blog/

The two-step US positive productivity story

- Labor market churn in the US in 2020-21 moved millions of lower-income workers to higher paid jobs, larger employers, and/or better benefits (safety net)
  - This is a one-time transition, but it isn’t transitory. The effects will run thru 2024.
  - The transition has resulted in higher labor force participation, more risk taking, more investment by employers, and thus a shift upwards in productivity.
- The growth baton will be passed to Generative AI adoption/implementation
  - Too soon to be more than a small part of the current improvement
  - From the top-down macroeconomic view, though, this looks like a technological leap
    - This is not based on evaluation of the tech, but the behavior of companies
      - Resolves the puzzle of labor-hoarding
      - Multiple investors crowding in to the same
      - Both were unseen in the last 20+ years of technological advances
- This development is neutral to positive for debt sustainability, but positive for r*

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A macroeconomic turning point for China

- A lasting shift in household and SME behavior towards self-insurance and liquidity
- Caused by a jump in CCP arbitrary interference in everyday commercial life
  - Ending "no politics, no problem" since Deng
- Resulting in lower investment and durable goods consumption, more low-risk savings, lower response to stimulus policies
- Could encourage Xi to further emphasize SOEs and increase barriers, in turn further encouraging exit
- Opportunity for US to shift from sanctions to suction of capital (financial, tech, and human) from PRC

Message to average Chinese households

China's 'zero Covid' policy was a mass imprisonment campaign

Murong Xuecun

The Chinese government used the pandemic to accumulate ever more power. The result was a totalitarian, anti-scientific humanitarian catastrophe

China

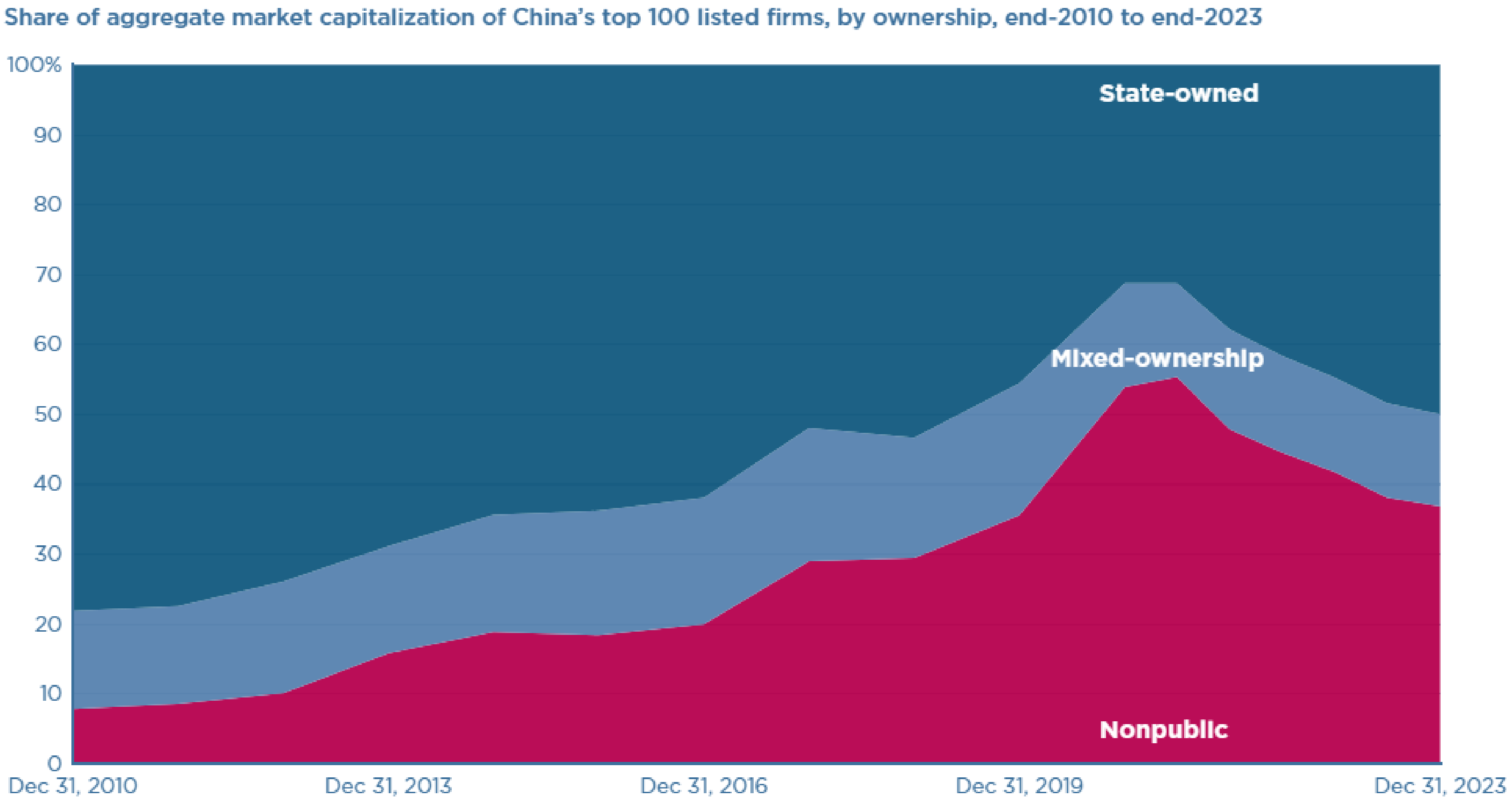
China's parliament approves changes to speed up 'emergency' laws

By **Laurie Chen**

March 13, 2023 12:18 AM EDT · Updated 6 months ago

Aa

Share of China’s top companies in the private sector continued to steadily decline in 2023



Notes: End-year data from 2010 to 2020; half-yearly from 2021. China’s top 100 listed firms are defined as the 100 mainland Chinese firms with the largest market capitalizations, whether listed in the mainland or abroad, including so-called variable-interest entities. "Nonpublic" are firms in which state entities hold an equity stake of less than 10 percent. "State-owned" are firms in which the state owns a majority stake. "Mixed-ownership" are firms in which the state owns an equity stake between 10 and 50 percent.
Source: Wind, authors’ calculations. Tianlei Huang and Nicolas Véron “Share of China’s top companies in the private sector continued to steadily decline in 2023” January 18, 2024

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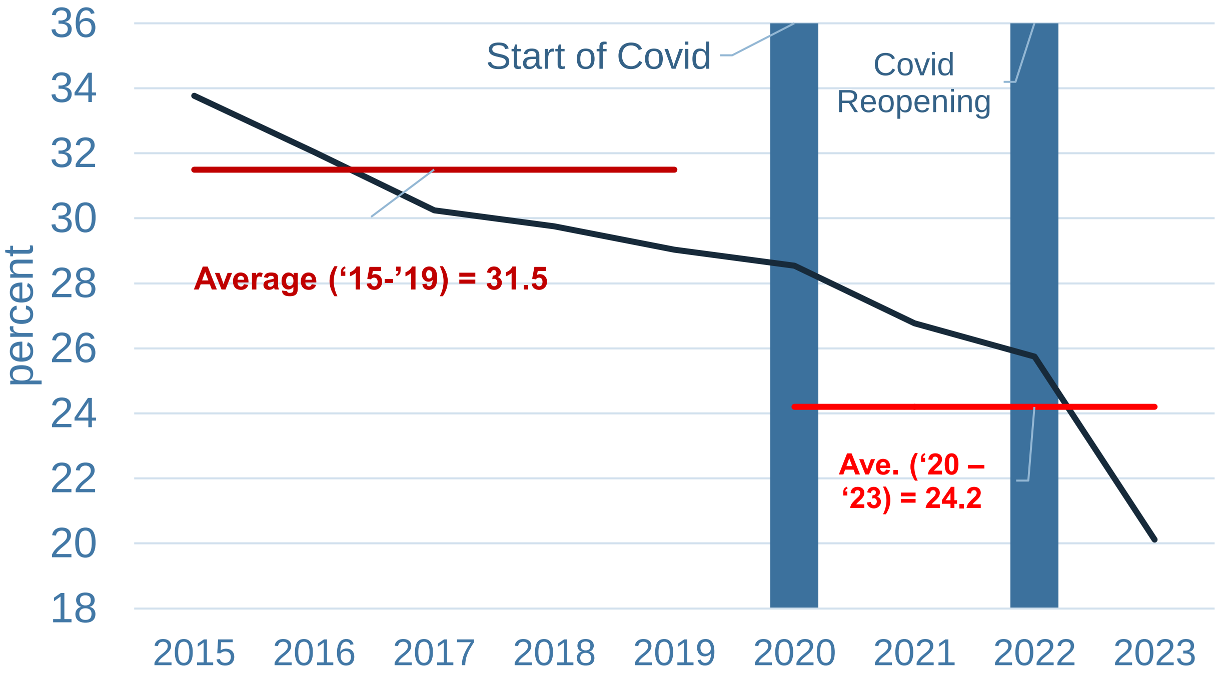
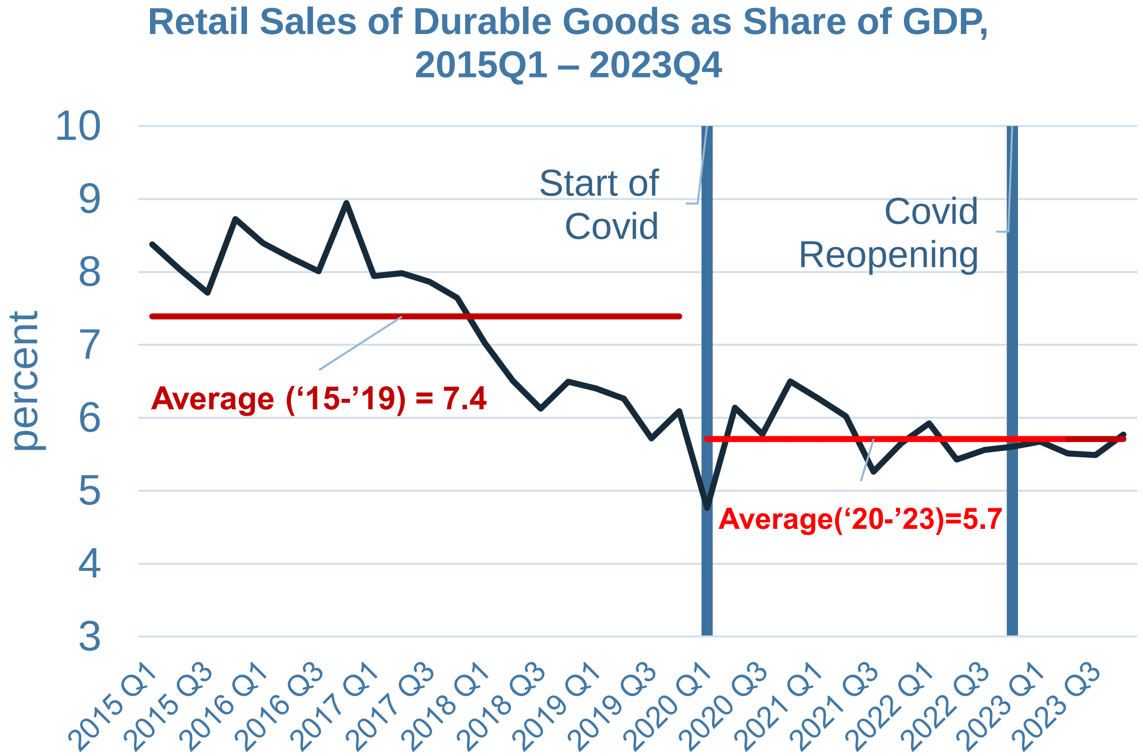
Diminished private investment in China

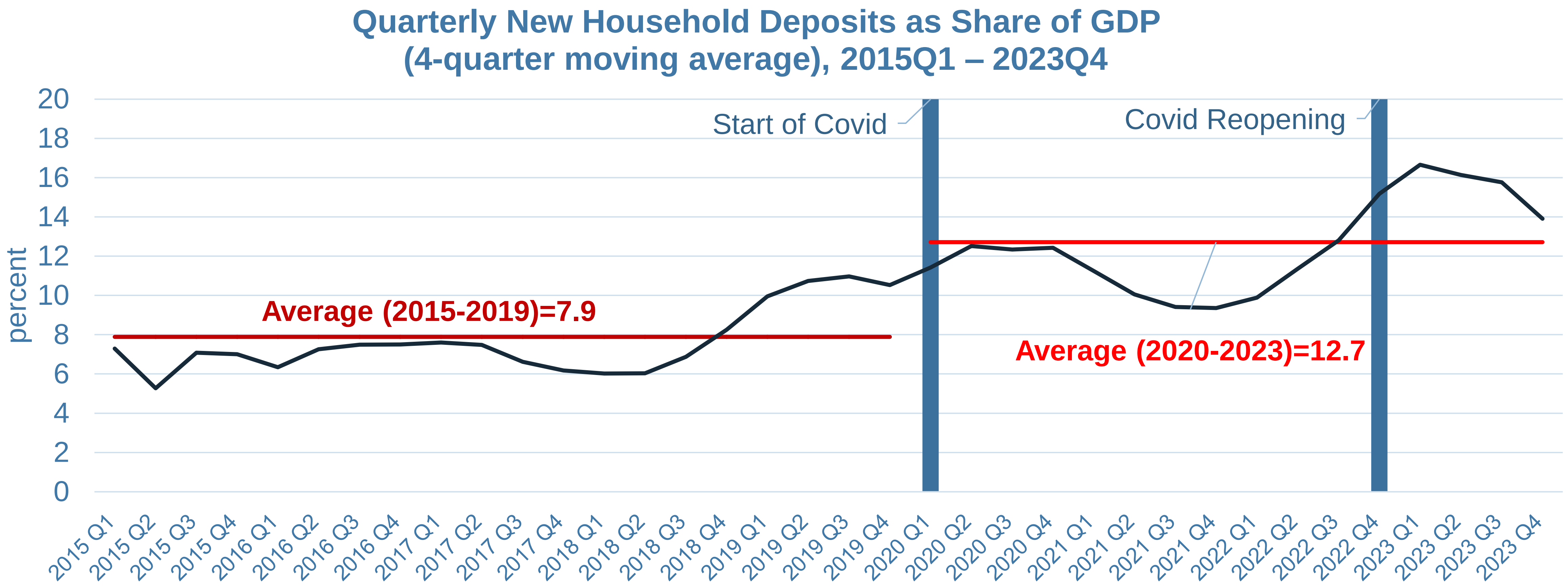


Source: National Bureau of Statistics of China



Source: National Bureau of Statistics of China
Note: Durable goods considered in this chart include gold, silver and jewelry, household appliances, furniture, telecom equipment, automobiles, and construction and decoration materials.

Increased liquidity preference in China



Source: People's Bank of China and National Bureau of Statistics of China

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Economic Long COVID
Not a collapse of either economy or regime

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The End of China's Economic Miracle

How Beijing's Struggles Could Be an Opportunity for Washington

By Adam S. Posen September/October 2023

Published on August 2, 2023

- The financial and real-estate sector problems could be surmounted as before, if the political economy allows
- The problem is that it is no longer credible for the regime to constrain itself from future intrusions
- Sluggishness and immune response to policy, leading to a less dynamic economy
- Other factors could offset the downshift in trend growth temporarily, but not reverse the basis
- The initial response to increased authoritarianism is greater obedience, but then exit starts to climb

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