# **Global Economic Outlook**

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#### **Executive Summary**

The fundamentals of the global economy are improving: the inflation and interest rate shocks of the last few years are subsiding, real income growth is running at 20-year highs globally, housing prices are starting to inflect higher as interest rates come down, and credit growth is no longer falling. There are also signs that global trade is starting to recover, possibly because the shift back from goods to services consumption, post Covid, is now largely complete. Labour markets remain tight despite some increase in global unemployment, and vacancy to unemployment ratios are generally back at roughly 2019 levels.

Yet despite this list of improvements we forecast global growth to slow, from roughly 3.3% in 2024, to 3% in 2025 and then 2.7% in 2026. That is mainly because of the trend slowdown that is underway in the US, and China. In the US we are seeing the fading effects of fiscal stimulus. The US is ultimately a 2% rather than a 3% economy, but fiscal policy added a full 1 percentage point of excess growth in recent years. At the same time, there are signs that consumer spending could be increasingly constrained. The bottom 80% of the US income distribution has seen a 2-3 standard deviation drawdown in their liquidity position; the question is now how long the top 20% can continue to offset this.

In China, the weakness remains mostly concentrated in the property sector. We expect full stabilization by the middle of next year and that property activity may subtract between 1.5 and 2 percentage points from growth this year. Substantial stimulus has been rolled out. To remove the excess housing inventory in lower cities, we hope to see more stimulus and the funding rate for local governments to fall below the rental rate.

The other big factor in the outlook is US tariffs. Our China forecasts already include tariffs, but our rest of the world forecasts do not. We are waiting for the America First Trade Policy Review to compete (by April 1) after which perhaps we get more tariff clarity. The tariffs that have so far been announced or threatened (close to \$800bn) are 7-8x larger than what was implemented in 2018-2019. There is duplication in the announcements, however, (e.g. do sectoral tariffs need to be added to country tariffs or are they part of the aggregate country total) and some of the proposals which are said to be important don't seem consistent

with the US administration's goals. For instance, reciprocal tariffs, by our estimate, would imply less than a 2pp increase in the weighted average import tariff for the US and raise very little revenue. We doubt that is what the White House had in mind.

Tariffs are by far the biggest risk to the outlook and if even half of the announcements materialize we may need to lower our global growth forecast.

By contrast, one of the biggest upside risks is Europe. The US' reduced commitment to the war in Ukraine has spurred the EU into action. Defence expenditure is likely to be excluded from European fiscal rules, allowing for a significant ramp-up, likely only 0.3pp or so in the short run but ultimately Europe could increase its spending levels by as much as 1pp. In addition, Germany is changing the constitution to establish an investment fund of 11.5% of GDP, over 10 years. That has the potential to substantially lift Germany's growth in the short term, with positive spillover to the rest of Europe. This is, however, mostly a 2026 and beyond story; this year's outlook is much more dependent on tariffs.

Moreover, if there is a peace deal for Ukraine, the estimate reconstruction needs are over EUR500bn. How that will be funded is still unclear (possibly common issuance) but depending on how quickly it can get pushed out the door that provides meaningful additional stimulus. Beyond that, lower energy prices (if the peace deal is perceived to be lasting and enforceable) and improved confidence, are other potentially positive factors, that account for about half of the growth boost we think would come from a peace deal.

Central bank policy outside the US is likely to remain supportive, and we expect easing to continue. Global wage growth is still slowing, energy and goods price inflation have normalized, and core inflation is only about 60 basis point away from its pre-pandemic 'run-rate' (that would need to be sustained to fully see it in the annual numbers). In other words, the global economy is generally still disinflating, and growth remains somewhat sub-trend, thus allowing for continued easing. Tariffs complicate that outlook but for most countries they do much more damage to growth than they lift inflation, particularly if retaliation remains restrained. For the Fed the situation is more complicated, as they will need to incorporate a multitude of tariffs into their forecast. Our baseline is that they cut twice more in the 2<sup>nd</sup> half of this year, but would have to backload the residual easing until the tariff effects have passed in 2026/2027.

### 1. The fundamentals of the global economy have improved...

The two biggest macro shocks of the last few years - inflation and the synchronized central bank tightening cycle to curtail it - are subsiding. The monthly run-rate of global core inflation is within 5bp of pre-pandemic levels

(2.3% annualized vs a pre-Covid average of 1.7% and a peak of 6.2%), and if that pace can be sustained, the headline YoY data should start to converge back to central bank targets as well.

Figure 2: Emerging markets (EM) have normalized faster



The decline in inflation, in turn, is boosting real incomes, which are now running (globally) at their highest level in 20 years. That improvement in spending power has generally not yet led to a strong pick-up in consumption growth, but the accumulated loss of purchasing power is now rapidly being recouped.



Source: UBS, Haver [note: the red shading shows the global distribution of real wage growth and the black line shows the median.]

The global credit impulse – essentially the 'change in the change' in credit – suggest that the bulk of the transmission of central bank tightening is now behind us. The impulse has shot back into positive territory, implying that global credit growth is no longer falling. Measured as a % of GDP, the global economy was

receiving 4% GDP less in credit 12 months ago than the prior 12 months, but there has been no further withdrawal since. For the Eurozone and GDP the swing in the credit impulse (6-7% GDP) is even larger. Credit growth is not yet accelerating, in part because a lot of the central bank easing in developed markets is relatively recent, but credit as a source of drag on growth is dissipating.

Figure 5: DM unemployment has picked up a bit but EM unemployment is still near the lows

Figure 6: Global vacancy to unemployment ratio is back at 2019 levels



Other factors that look supportive are housing prices and labour markets. Housing prices took a big hit from the synchronized global tightening the last few years, but are now starting to inflect higher. That's important: in Europe, for instance, half of the fall in consumer confidence fall the last few years can be attributed to declining housing wealth. As housing wealth is rebuilt, the likelihood increases that consumer spending also picks up. As for labour markets, they remain close to full employment (i.e. healthy) and the slackening that has occurred over the last 18 months or so has mainly served to eliminate acute labour shortages. Central banks of course worry about unemployment increasing too much, but the increases in participation rates are slowing, and reduced supply of labour should allow unemployment rates to stabilize (barring further shocks which we discuss further down).

Finally, and perhaps perversely, in the face of the tariff risks emanating from the US, global trade volumes have just started to recover, and are nearly back to prepandemic levels. Trade and production have been the main sources of drag to global growth since roughly mid-2022. That weakness partly reflected (i) the post Covid global rotation away from goods consumption and back to services, and (ii) partly global demand weakness. Within developed markets that demand weakness can be traced back to the loss of real disposable income due to the inflation shock, and within EM the slowdown in China on, driven importantly by the property, slump played an important role.





To illustrate how important the trade/production weakness has been for global growth, we show in Figure 9 a decomposition of our global nowcast, which tracks 350 data series across countries representing 80% of global GDP. The contributions are all shown relative to their long run average contributions, so numbers below the x-axis imply that the data bucket is contributing less than normal. As is evident, most of the data globally is actually not running far from long run averages, but the production bucket (in which we also include things like trade, manufacturing PMIs etc.) has on average contributed half a percentage point less to global growth than its long run average. It now appears to be recovering somewhat.



2022

2023

2024

2021

Figure 9: Global nowcast contributions - deviations from

Figure 10: European growth broken down into high and low manufacturing countries

Figure 8: The strength in global import demand has largely

come from the US and Asia ex-China



Source: UBS, Haver

Source: UBS, Haver

A different way of looking at this is Figure 10, where we split the Eurozone's growth contributions into countries that have a manufacturing value added share above 15% and below 15%. Those economies that have more limited manufacturing, and hence are not as exposed to global trade, are basically growing in line with their long run average. But those that have large manufacturing sectors have collectively generated negative growth over the last 6 quarters, and account for a full percentage point swing in Eurozone growth compared to the 10 years pre-Covid. That explains a lot of the growth weakness in Germany, for instance (a traditional manufacturing powerhouse).

# 2. yet our forecast is for global growth to slow

Despite the list of improving fundamentals in the prior section, our forecast is for global growth this year to slow (from 3.3 to 3%), and to slow further to 2.7% in 2026. Why? Mainly because of a slowdown in the US and China. Figure X and Y show our projection for global growth contributions by economy in 2025/2026.



The US, we believe, is ultimately a 2% rather than a 3% growth economy. In Q4/Q4 terms US growth was 3.2% in 2023, slowed to 2.5% in 2024 and we forecast it to slow to 1.7% in 2025. The two main reasons for that are (i) diminishing support from fiscal policy and (ii) increasing distress among consumers at the bottom end of the income distribution. Figure 13 below shows how much fiscal stimulus contributed to growth (1 percentage point in 2023 and a  $\frac{1}{2}$  percentage point in 2024), essentially explaining almost all of the "excess" over the US' potential growth rate (roughly 1.8% we think).

That support is now, however, subsiding, and during most of 2025 the US will still be subject to budget caps agreed as part of the last debt limit extension deal. The reconciliation bill currently being debated in the US House of Representatives (and the one President Trump supports) looks somewhat contractionary relative to the status quo. It targets \$2 trillion in spending cuts and, if that is not achieved, the scope for tax cuts would fall from \$4.5 trillion to \$4 trillion. That would not leave enough space to extend the 2017 (TCJA) tax cuts, and would also prevent passage of some of the additional tax cuts President Trump campaigned on. There are still ways around that, e.g. Congress could change the accounting rules from "current law" to "current policy" (which would then reduce the need to find funding within the 10-year budget window), but what the House proposals convey is that there is not a lot of support within the Republican party to run more expansionary fiscal policy than is currently already the case (we project the general government fiscal



The other factor that should start to contribute to some additional slowdown in US growth is consumption. We show in Figure 14 the US population split into 5 income cohorts: the bottom 20% is on the left and the top 20% is on the right. Each bar represents a different point in time. What the chart shows is how almost every group has had roughly a 2-3 standard deviation drawdown in their liquidity over the last 3-4 years. That is in large part the counterpart of the excess savings drawdown (close to \$2 trillion) but also reflects the sub-trend savings rate in the US, and US consumers spending in excess of their income levels (at least relative to long run averages). Liquidity has now been depleted to the point that there is distress in delinquency indicators (e.g. auto loans, credit cards) but we have yet to see those liquidity constraints show up in aggregate spending data. And the reason we haven't seen that yet is on the right part of that chart. The top 20% remains extremely liquid. They own 80% of the financial assets and, as long as markets keep going up, they can carry a large chunk of US consumption spending (we

think the top 20% may be funding over half of US consumption growth). Nonetheless, if you assume spending by the top part of the distribution is stable (not liquidity constrained) and the bottom part is increasingly constrained, that should show up in some reduction in aggregate spending.

We'll get to the various ways in which the current US administration affects that outcome in the next section, but this is the basic backdrop.

Then there is China. We forecast China's growth to slow from 5% in 2024. There are two main parts to that slowdown: property and US tariffs. First, on property, our estimate of the drag from the lack of investment/sales/activity in property (broadly defined, i.e. coming from roughly 20% of the economy) is that it is still subtracting 1.7 percentage points from GDP growth in 2025 (after 3.2pp in 2024). By the middle of next year (2026) we expect the property sector to have stabilized, but on a full year basis that would still imply it is subtracting <sup>1</sup>/<sub>2</sub>-1 percentage point from growth.

Our assessment is that property prices still have not yet stabilized and that doing so requires removing the excess inventory overhang, particularly in the lower tier cities. That requires, we think, more funding than has so far been provided, but it also requires the funding costs of local governments to fall below the rental yields to incentivize them to do the buybacks. We are getting close to that but are not quite there yet. Once prices stabilize, we would expect demand to come back, and then with a lag construction should follow. Our assumption has been that a steady state in China would be roughly 800 mln square metres of floor space being built. We are currently well below that. But there is potential upside risk to our forecast, and it partly depends on how much additional stimulus is provided. We assume an expansion of the augmented fiscal deficit in China of roughly 2% of GDP, and we view he statements from the NPC meeting as consistent with that. But we would not rule out the need for further stimulus as additional external headwinds materialize.



Figure 15: The property sector's contribution to growth in China



Figure 16: Floor space being built versus starts in China

Source: UBS, Haver, CEIC

The other big headwind is potential US tariffs on imports from China. What we have in our baseline is 60% US tariff on China, for the simple reason that this is what Trump campaigned on. We recognize that this would need to be revised in the coming weeks/months. For China, the US has now implemented a 20% border related tariff in two steps (10%+10%), but it has also yet to complete its America First Trade Policy Review by April 1. With the caveat that it is all likely to change, we estimated that a 60pp tariff would subtract as much as 150bp from China's GDP spread over 2025/2026, even after stimulus. Lower tariffs on China than we currently have embedded in our forecasts are one of the major upside risks to China and global growth.

#### 3. Risks to the outlook

However, while lower tariffs on China are perhaps an upside risk, tariffs on many other countries are a downside risk. The US administration has thus far proposed tariffs worth at least \$786 billion, significantly more than the \$113 billion that was implemented during 2018/2019. Some of the proposals seem duplicative (e.g. if there is a country tariff, would tariffs on autos or steel/aluminum need to be added or are they included in that aggregate tariff rate?) so there may be some double counting in Figure 17. But the proposals thus far imply a major increase in US trade restrictiveness.



Clearly not all tariffs are equal in their effects, and modelling the impact requires making multiple assumptions about the extent of currency movement, margin absorption by corporates, retaliation, price flexibility etc. The tariffs that we assume would be most damaging are blanket global tariffs, particularly if there are no exemptions as that would impede the ability to substitute towards other goods. Our modelling suggest that such a global tariff, at a 10% rate, could subtract as much as a full percentage point from global growth, and add as much as 100bp to US inflation. For the US, such tariffs would be stagflationary: growth goes down and inflation up. By contrast, we have also modelled the 25% tariff on Mexico and Canada and, for those tariffs, find that for the US the growth impact would be 4x as large as the inflation impact. That result occurs largely because of very large assumed currency depreciation for the Mexican peso and the Canadian dollar, which does significant damage to US exports.

For most of the world, particularly if countries don't retaliate, the growth impact is much larger than the inflation impact: in the absence of retaliation, the only inflationary impulse is the extent of currency depreciation, but that can be offset by weaker growth or cheaper imports from other countries facing possible greater currency pressure. It is worth repeating that point: tariffs are only inflationary if you raise tariffs.

Because of the parameter uncertainty, our preference has been to publish the potential impact of the various tariff proposals as min-max outcome ranges. In the two charts below we show our estimates, for instance, of the combined impact of a 60% tariff on China and a 10% tariff on the rest of the world. The reason some of the US growth outcomes look positive is because imports collapse as a result of the tariffs, which from a national accounts perspective <u>adds</u> to growth. That obscures, the damage being done, as domestic demand in our benchmark specification declines 3x as much as real GDP. And if the world were to do a 100% retaliation, the GDP impact for the US increases six-fold. So for the US, looking at the tariff impact through a real GDP lens is not necessarily the right perspective, and we would look more at the domestic demand and profit impact which is more unambiguously negative.



Figure 19: The impact on growth from a 10% global tariff





Source: UBS, Haver

Source: UBS, Haver

What tariffs the US ends up imposing will perhaps become clearer in the next month. We would just make one point on the proposed reciprocal tariffs, which the administration has been pushing as a potential alternative to a global tariff. "Reciprocal" sound simple enough: the US would charge other trading partners the same tariffs as it is being charged, and the notion of reciprocity is embedded in the way multilateral trade agreements have been negotiated ("you lower your tariffs and I'll lower mine"). However, this reciprocity has generally not applied at the product level. The US has 12,500 tariff lines and roughly 200 trade partners. In theory that means that the US would have to examine, and potentially adjust, up to 2.5 million tariffs.

The interesting thing is that, for all its complexity, such reciprocal tariffs would have only a very modest impact on the weighted average US tariff rate. The reason is that these tariff differentials are generally quite small, on a trade weighted basis. The things that a country is good at exporting, it generally does not need to import. And so increasing a tariff on something that is not imported, doesn't really lift aggregate restrictiveness.

The other point to make is that the international trade databases that are used to make these calculations are full of errors. If there are missing tariff data, for instance, the databases often assume that the most favoured nation tariff applies. But that is often inconsistent with the actual free trade agreements that are in place. Our estimate of the US proposal for reciprocal tariffs is that it would lift the weighted average US tariff by only 1.65pp (0.8pp for developed markets and 2.2pp for emerging markets). In other words, this would be a fraction of the 10-20% global tariff that Trump campaigned on during the election, or the tariffs that he has threatened on Mexico, Canada, Europe, China and a range of specific goods (the weighted average increase in tariffs for Canada/Mexico/China over the border is 9.7pp, i.e. significantly higher than global reciprocal tariffs).

Compared to the blanket global 10% tariff, the reciprocal tariff would be worth only about two tenths of global GDP drag, though with even wider uncertainty bands given the sheer number of tariff changes and trade diversion that could occur. Also, reciprocal tariffs would raise only 0.1% GDP annually in revenue, which we doubt is what the White House had in mind. Now our estimates do not include the potential broadening of the notion of 'reciprocity' to include VAT rates, as the US agencies seem to at least be studying. That would be much more consequential in that the average (US import weighted) VAT of US trade partners is 13.5% (90% of countries have a VAT), but it would also make little sense, in that VAT equalizes the treatment of domestic and foreign producers, is not discriminatory vs any country, and is fully accepted by the WTO. But anything is possible.



Figure 22: The sizeable tariff differentials with the US sit mainly with EM trading partners



A second potential risk is the US fiscal situation. The US is running close to 7% GDP deficits, which means that it's government debt is increasing at roughly 3pp per year. By 2035, US debt will overtake Greece and it will be level with Italy. Indeed, there is no country under our coverage where debt dynamics are further away from being stable than the US. Even those numbers are potentially optimistic. The carrying cost of US debt is about 3.3% and market yields are currently higher. It remains to be seen whether Congress will pass a budget that lowers the deficit or not. In the Figure below we show some alternative US debt trajectories, for varying assumptions on yields and fiscal deficits. The risk is that the market at some stage starts to reprice the unsustainability of US debt dynamics. And because US Treasury yields are the risk free rates off of which many global assets price, that could be a negative financial conditions shock.



Figure 23: Conservatively, US debt will be level with Greece

#### Figure 24: But it could be much higher depending on market yields and deficit levels





Source: UBS, Haver

Source: UBS, Haver

The third risk is geopolitical, though the risks are two-sided. As always, there is a risk to oil prices related to tensions in the Middle East, but with the large amount of OPEC spare capacity there seems ample space to cap increases in oil prices. Indeed, the recent earlier than expected increase in OPEC production is weighing on oil prices, and if tariffs weaken the global demand outlook further, there is potentially more downside.

The upside risk in the outlook, we think, revolves largely around Ukraine. If there were to be a peace deal, with think European gas prices could fall 25-50% (boosting the energy intensive parts of the European economy, notably Germany), and business confidence could improve. We also believe there is then the prospect of Marshall Plan-like support for Ukraine to help rebuild its economy. The estimates are that this would cost at least EUR500bn (3% of Eurozone GDP but 270% of Ukraine's GDP), and that money can be thought of as additional fiscal stimulus, partially ending up in Europe. Regardless of whether there is a peace deal or not, it also looks like Europe will need to structurally increase its defence spending, as the US partially withdraws it support. The net effect of all this, we think, is to add between <sup>1</sup>/<sub>2</sub> and 1 percentage point to Eurozone growth over three



Source: UBS estimates [\*includes the direct impact of lower gas prices and indirect Source: UBS, World Bank impact of confidence]

It appears that Europe is getting ready to run substantially more expansionary fiscal policy in response to the US seemingly reducing its support for Ukraine, and perhaps Europe/Nato more broadly. The Commission has put forward an array of proposals to exclude defence spending from European fiscal rules (in first instance invoking the escape clause), and Germany, for instance, is changing its constitution to structurally exempt defence spending from its 'debt brake'. Combined with an investment fun of over 11% of GDP, Germany could increase

its fiscal spending by as much as 1.7pp of GDP which could add between  $1-1\frac{1}{2}$  pp to growth, and at the European level perhaps 20-30 basis points or so. These estimates are inherently uncertain as it is not clear how quickly spending can ramp up, nor how much of the spending will leak out of Europe (e.g. to purchase weapons produced in the US). The upshot, however, is that Europe seems to be putting in place s strategy to run substantially higher investment/defence spending levels. This essentially removes the fiscal drag we had in our forecast, where countries were trying to return their debt dynamics to more sustainable levels. The European changes imply more growth but also more debt.

# 4. What is the outlook for policy?

Central banks are generally now well underway in reversing the tightening they put in place in recent years. That removal of restrictiveness is generally still cautious given that wage growth in many countries remains elevated, and the runrate of the various inflation components is not quite back at pre-pandemic levels yet. Hence, the landing zone for inflation near central bank targets is not yet assured. However, most developed market central banks should be back to 'neutral' either sometime this year (e.g. ECB) or next year (e.g. Fed, BoE).

The Fed faces the largest conundrum. Most countries are experiencing relatively subdued growth and inflation dynamics, which makes the path for monetary policy relatively clear. But the Fed faces a relatively stronger economy as well as somewhat stickier inflation, at least in the CPI (rather than PCE) data. On top of that, there is now tariff risk. While each other central bank has to worry about just one set of tariffs (i.e. the tariff imposed by the US on their country and the potential retaliation) the Fed has to worry about ALL the tariffs, as each will lift inflation to a certain extent.

The other complication for the Fed is that, even if the growth impact is perceived to be greater than the inflation impact, the inflation data will deteriorate first. It will be hard to trust the models and keep cutting, particularly as existing inflation levels are still above targets. We expect that by the middle of this year the US will have slowed enough for the Fed to consider cutting two more times (to 3.75-4%), but that heavily depends on how many tariffs get put in place. Other central banks face the same sequencing uncertainty (inflation deteriorates before growth) but we believe will find it easier to keep easing, possibly after a pause.

On the fiscal side, we generally project fiscal policy at a global level to be neutral. Yes, there is now upside risk in Europe, and yes we don't yet know what the US budget will look like. But any changes are mostly a 2026 story. So the largest fiscal stimulus, this year, we think comes from China (see the two charts below for context, though note that this only shows China's central government impulse and thus understates the actual amount of stimulus).



Aside from fiscal and monetary policy, the most important 'policy' may be how countries respond to US tariffs. We polled our analysts on the likely level of retaliation against US tariffs, and the average response was that the world would do roughly one third of whatever the US implements (e.g. if the US has a global tariff of 10%, its trade partners would lift their tariffs on the US by 3%). That is an average, of course, and for many smaller countries we would assume no retaliation, but Canada and China's response to the border tariffs looks consistent with those assumptions (retaliation equal to 30-40% of the dollar value of the US tariffs). At the time of writing, Mexico had not yet announced its response.

# 5. Long run trends and AI

Pulling it all together: the global economy had started to recover and shocks were dissipating, but is now potentially faced with a new set of shocks. If tariffs materialize anywhere close to what has thus far been proposed (25% tariffs on the EU, Mexico, Canada, steel/pharma/semiconductors, 20% on China with possibly more to come, reciprocal tariffs, agriculture and copper investigations etc.) we see significant downside risks to the outlook. Without those tariffs, we would be substantially more optimistic, and we would likely be forecasting a growth improvement rather than a deterioration.

The tariff debate, however, is symptomatic of longer term perceived grievances in the US. One of those is the attempt to onshore some of the manufacturing production that had moved abroad. That, in turn, has fuelled a 'deglobalization' debate, which in turn gets equated with less competitive pressure and more inflation. The interesting thing is that, thus far, there is very little evidence of 'deglobalization' actually happening. The chart below shows how global trade volume growth has largely continued its march higher (a lot of the weakness has been in prices, not volumes).



The distribution of the continued globalization has been uneven, however. China is gaining market share faster than pretty much any other economy, and it is doing so while its export prices are falling. Historically, China's export deflators largely tracked commodity prices but the export price declines have become much more broad-based. Interestingly, this 'deflation' is not being exported to the US (where the market share is substantially down versus 2016 levels) but mostly emerging markets. That's largely a function of what China exports to different countries. For instance, electronics (which the US imports) tend to have more stable prices than other goods. Whether these market share gains by China become a source of tension with other countries in the region remains to be seen. China is also substantially investing in neighbouring countries as it tries to diversify its export base, and those investments are clearly beneficial to the recipients.



Figure 30: But the gains are unevenly distributed

How does artificial intelligence (AI) fit into the outlook. Well largely it doesn't, if you confine the outlook to the next two years, rather than the next 5 years. The rate of adoption is still verv low. thought the speed of adoption is clearly much Figure 33: Adoption speeds of new technologies have been shortening Figure 34: But Gen AI so far remains concentrated among specific tasks



The other big question is how many jobs AI would actually affect, and whether it just becomes an assistive technology that enhances worker productivity (and there are lots of examples already of that in software companies, anything related to writing tasks, etc.) or replaces those workers. Darren Acemoglu, one of the 2024 Nobel Prize winners in economics, for instance believes that AI would only affect

20% of US jobs and as such lift GDP by only 1.1-1.6 percent over 10 years (roughly an 0.05 percent annual gain in productivity). The optimists, of course believe that a far greater share of jobs will be affected.

But the other problem in seeing AI show up in the data is measurement. For many of the white collar jobs where AI could be productivity enhancing, the national accounts measure productivity not by looking at outputs but at inputs (costs). For instance, AI has tremendous promise in health care (development of new drugs, disease diagnosis etc.) and health care spending is on average around 10% of GDP in the OECD. But if AI lowers the costs of healthcare, the national account statistics will measure that as a decline in productivity, not an increase. Indeed, for now, there is little evidence that productivity is increasing and most of it can still be better explained by looking at the inflow and outflow of workers into the labour force, skills mismatches etc.

Finally, the breakthrough of Deepseek has the potential to significantly speed up the diffusion of AI, in part by improving affordability. The cost of inference is declining 10-fold in China and 5-fold outside of China. For the tech firms in the US, this raises the question whether the massive amounts of capex are consistent with potential revenue, whereas for China it raises the risk that the US will go even further in restricting access to lower-end Nvidia chips and lower-end Wafer Fab Equipment to stop China moving up the value added curve.

At this stage we have more questions than answers. Does DeepSeek increase the disruption in software and accelerate the loss of white collar jobs? Does the demand for high-end chips fall because you can build a reasonable alternative with less high-end chips or does it rise because undoubtedly DeepSeek increases the demand for inference but are the applications for inference in place? Many of these questions will be unresolved in the very short term, but the equity market's reassessment of likely winners and losers – and the repricing of US equities YTD – highlights how global financial conditions are to some extent already tied to AI developments.