



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

Growth Continues Despite Headwinds and Risks

Karen Dynan

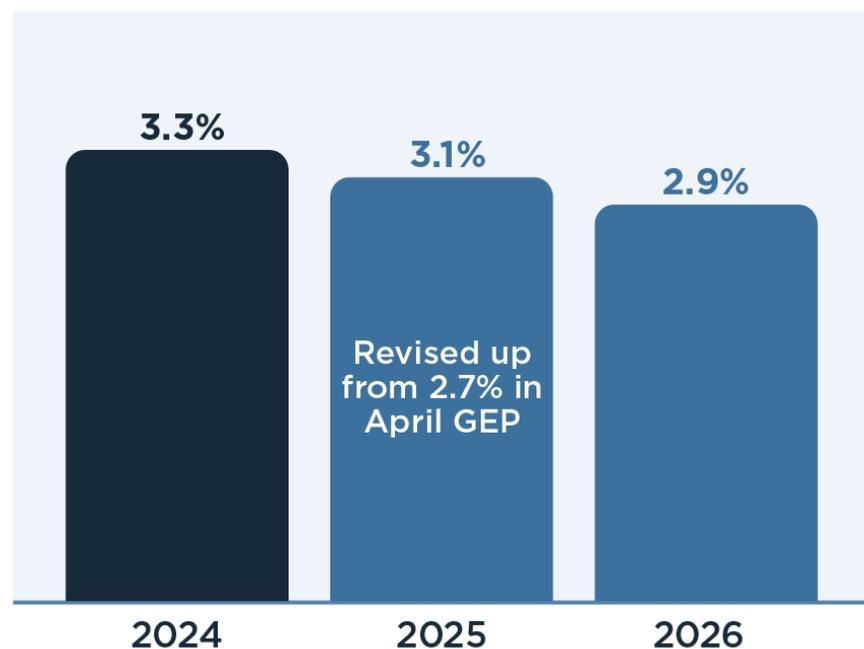
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The global economy has been stronger than was expected last spring

Global Real GDP Growth
Percent change from previous year



Annual-average-over-annual-average growth rates. PPP weights.
Source: Consensus Forecasts for 2024; author's forecast for 2025-2026.

All of the major economies have outperformed expectations this year—especially the United States and China

But global growth is likely to slow next year as the current pace does not seem sustainable

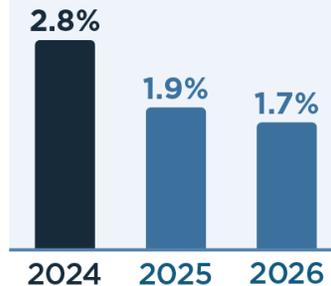
Most of the large advanced economies will downshift in 2026

Global Real GDP Growth

Percent change from previous year

US

AI optimism has supported US growth, but tariff drag intensifying



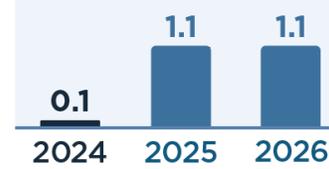
Euro area

Euro area divided, with south robust and north facing headwinds



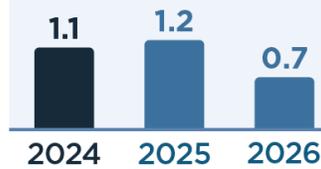
Japan

Fiscal boost will lift Japan's growth in 2026 before policy retrenches



UK

Fiscal restraint, strong pound, weak productivity weighing on UK growth



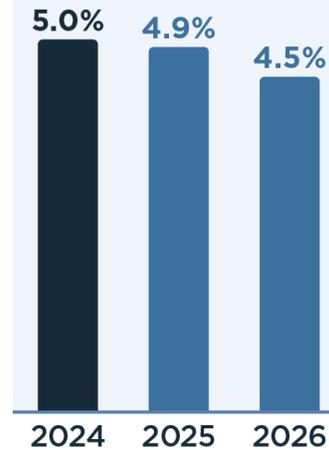
Annual-average-over-annual-average growth rates. PPP weights.
Source: Consensus Forecasts for 2024; author's forecast for 2025-2026.

Among the large EMEs, India and China are still leading even with tariff pressures

Global Real GDP Growth Percent change from previous year

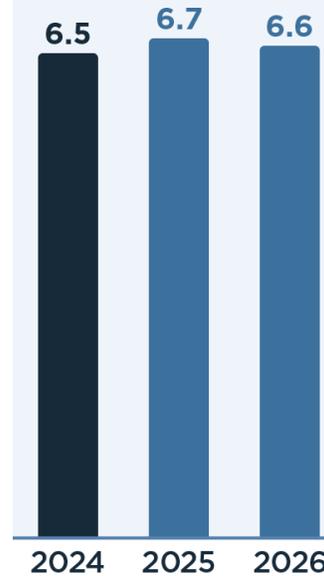
China

Chinese exports holding up, but property downturn still a drag



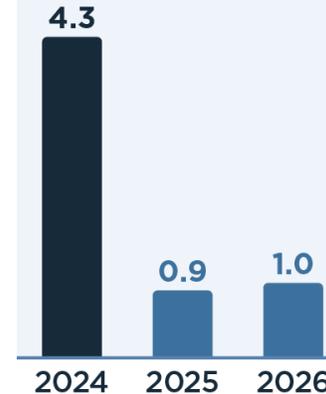
India

Domestic demand sustaining growth in India



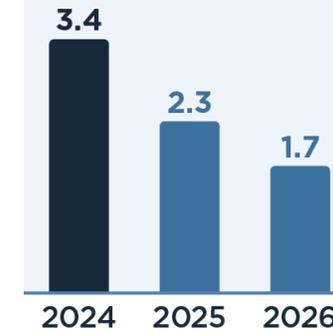
Russia

Weak oil market, lingering sanctions curbing Russia's growth



Brazil

Growth slowing in Brazil amid still-tight monetary policy and tariff drag

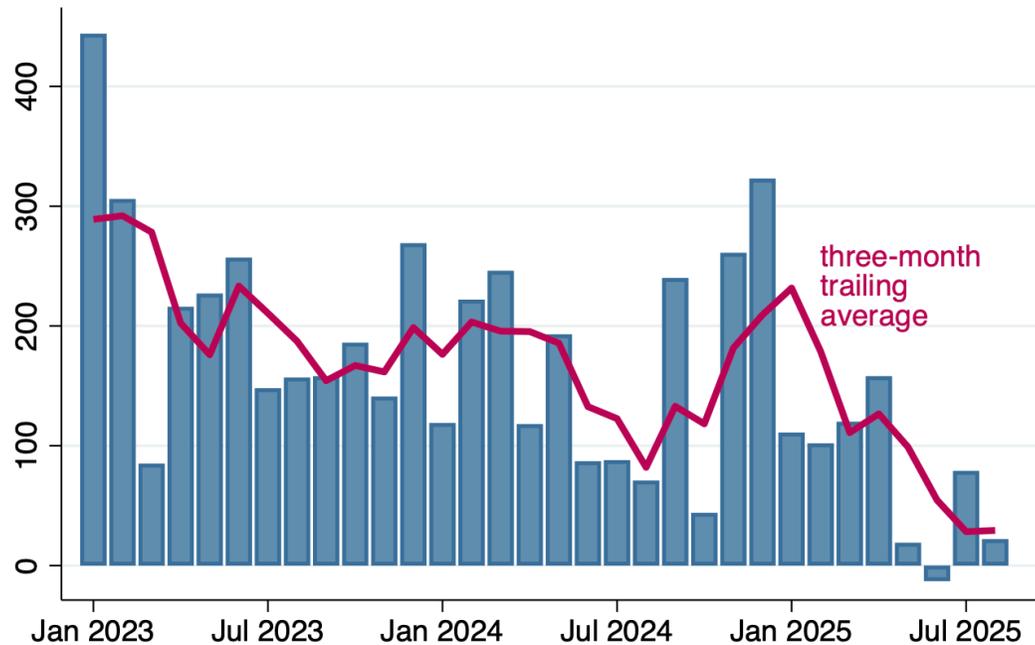


Annual-average-over-annual-average growth rates. PPP weights.
Source: Consensus Forecasts for 2024; author's forecast for 2025-2026.

US payroll growth has stalled, with a significant drag from greatly reduced immigration

Change in Nonfarm Payrolls

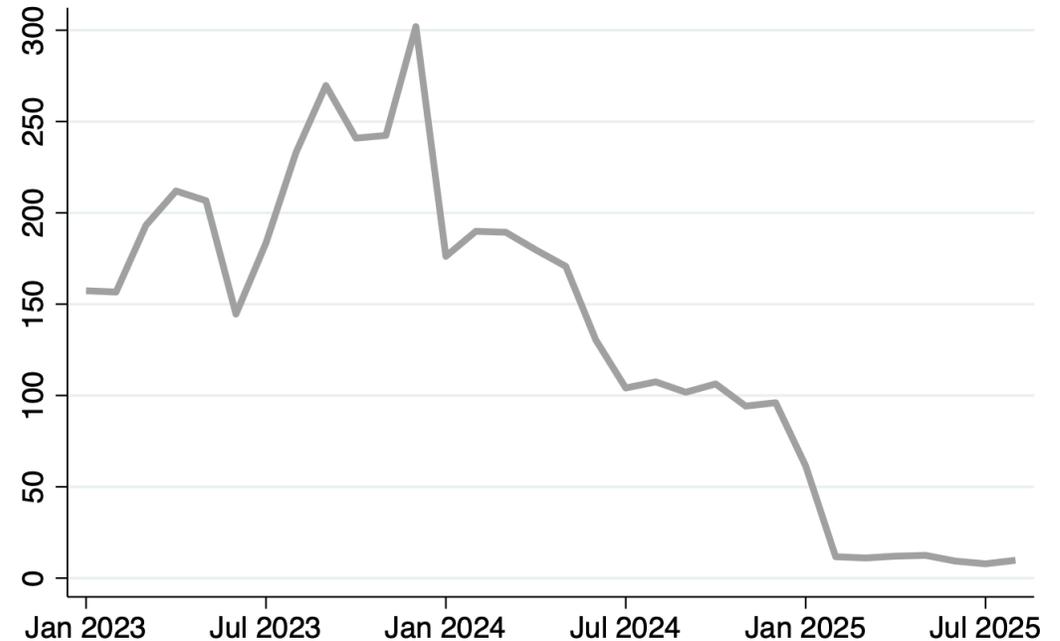
Thousands



Data source: US Bureau of Labor Statistic (via FRED). Last data point: August 2025.

Southwest Land Border Encounters

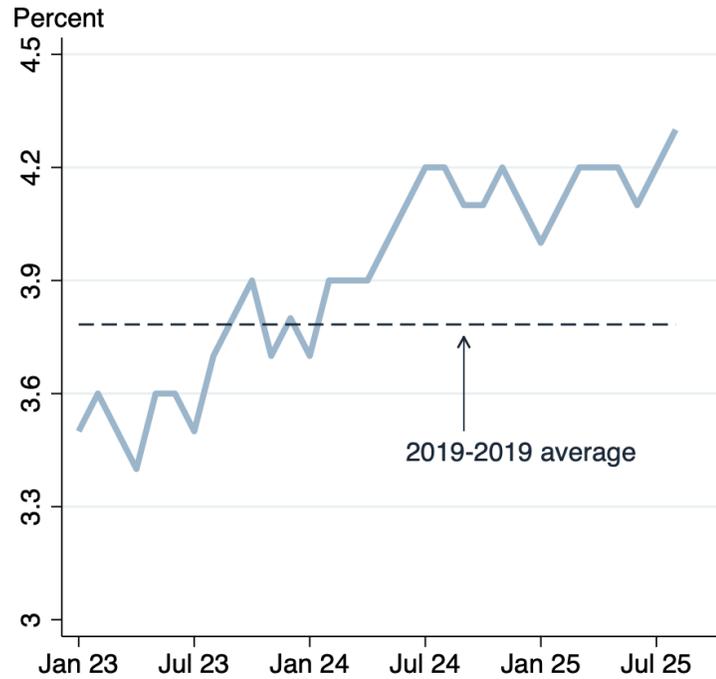
Thousands



Data source: US Customs and Border Protection. Last data point: August 2025.

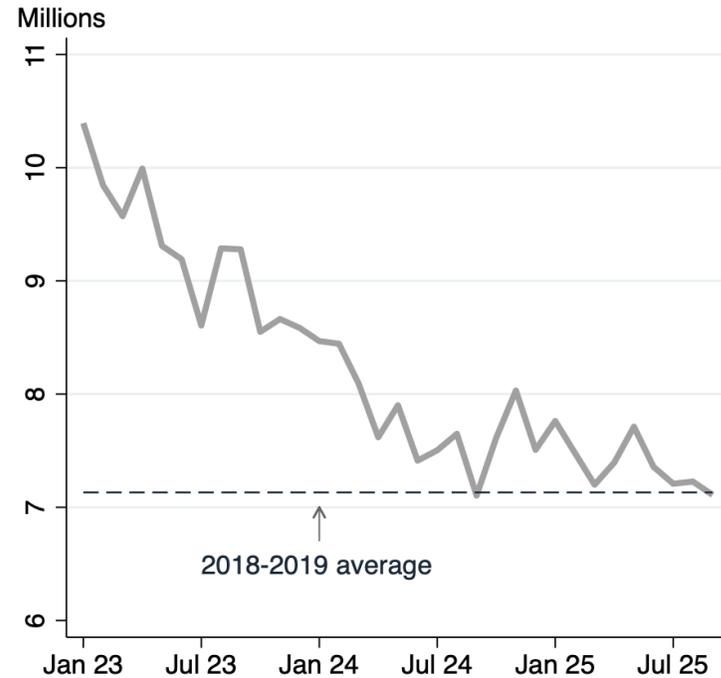
Yet, measured slack in the US labor market has not changed much over the past year

Unemployment Rate



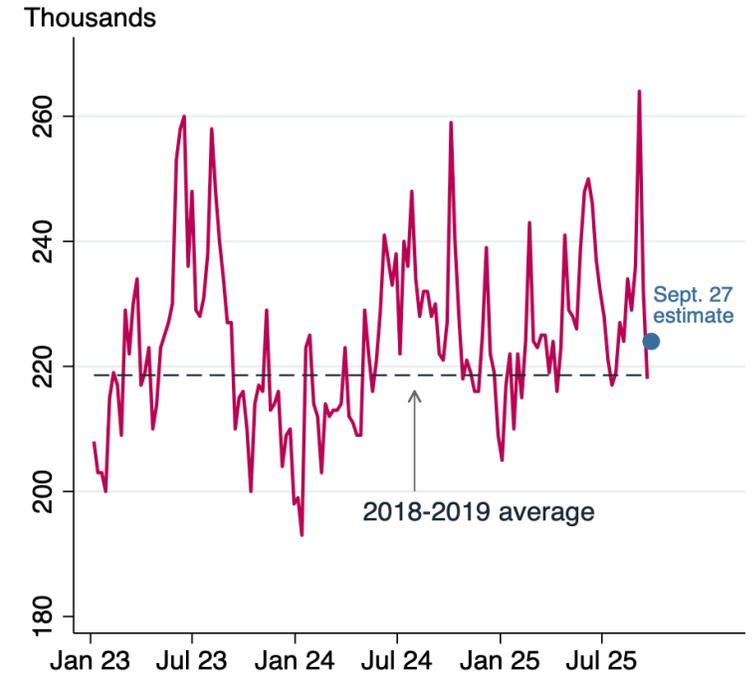
Data source: Bureau of Labor Statistics (via FRED).
Last data point: August 2025.

Job Openings



Data source: Bureau of Labor Statistics and Indeed (via FRED).
Last data point: Sept. 2025 (estimated based on Indeed data).

Initial Claims for Unemployment Insurance

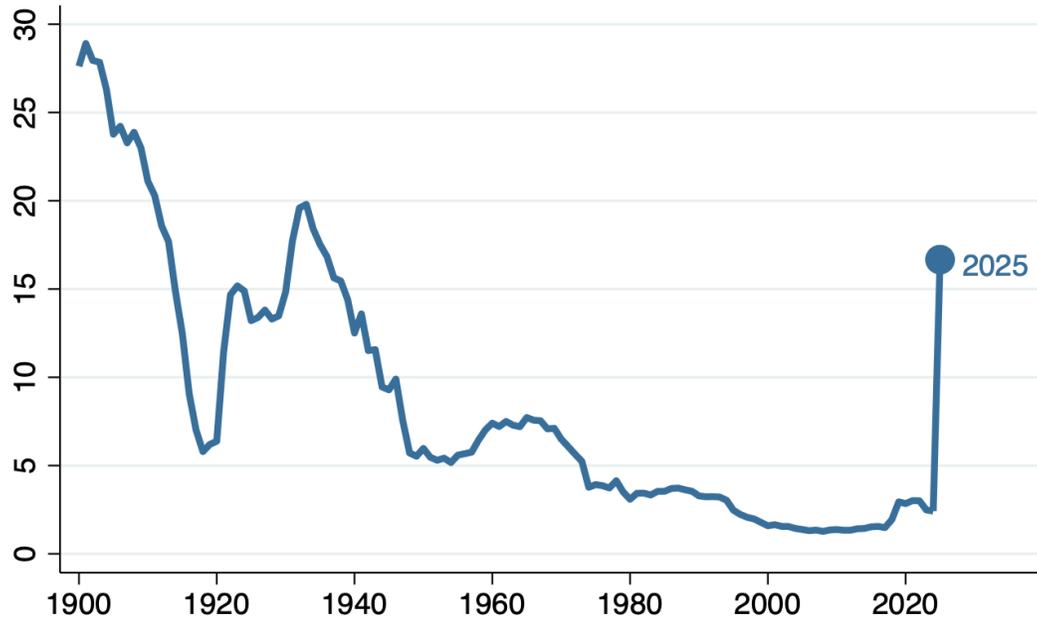


Data sources: Bureau of Labor Statistics and Goldman Sachs.
Goldman Sachs estimate for Sept. 27 based on state-level claims.

Tariffs are the highest in 90 years, and policy uncertainty remains very elevated

US Average Effective Tariff Rate

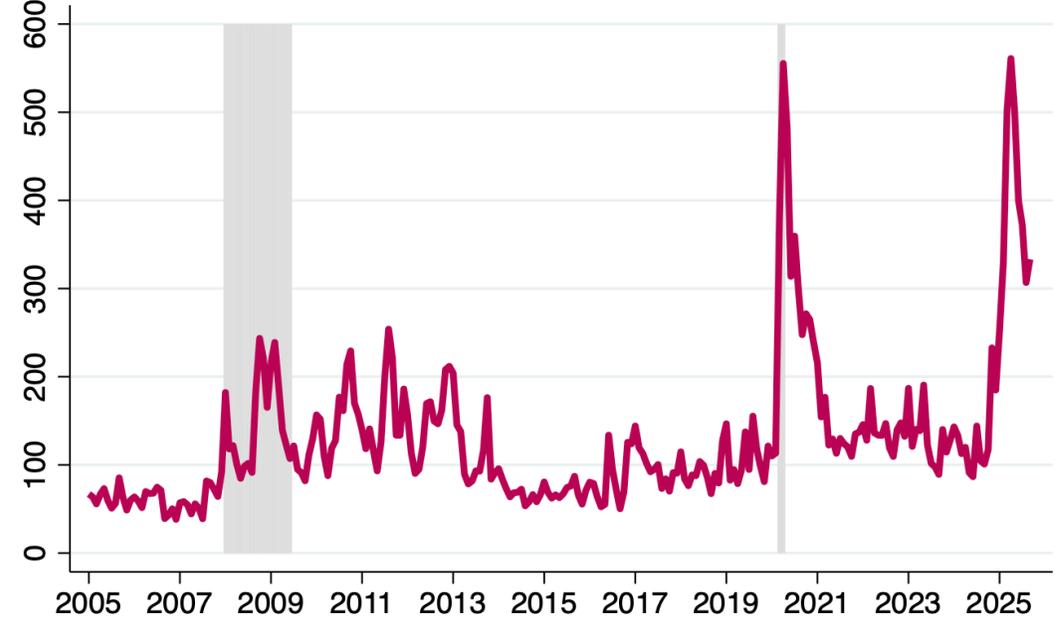
Percent



Data source: Yale Budget Lab.
2025 estimate includes tariffs implemented through September 26 and substitution effects.

Economic Policy Uncertainty

Index

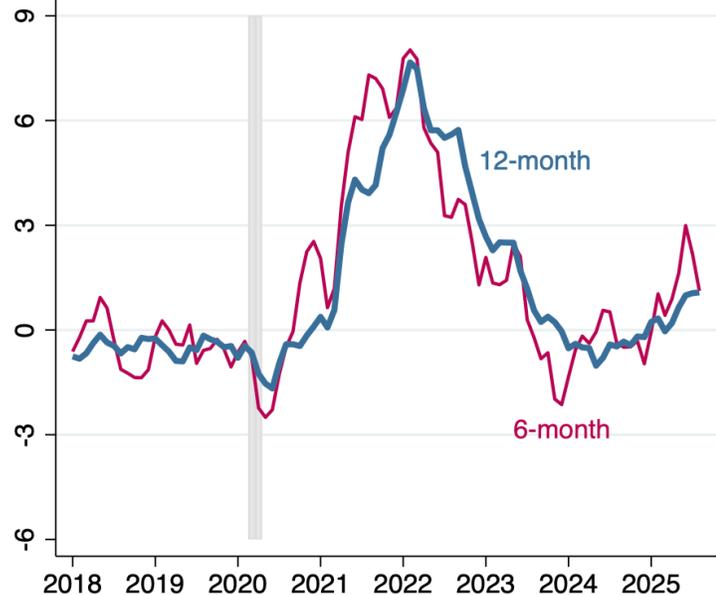


Data source: Baker, Scott R., Bloom, Nick and Davis, Stephen J. (via FRED).
Shaded areas correspond to recessions. Last data point: October 2025 (to date).

The tariff-induced rise in goods inflation has been offset by ongoing ebbing of shelter inflation

PCE Core Goods Inflation

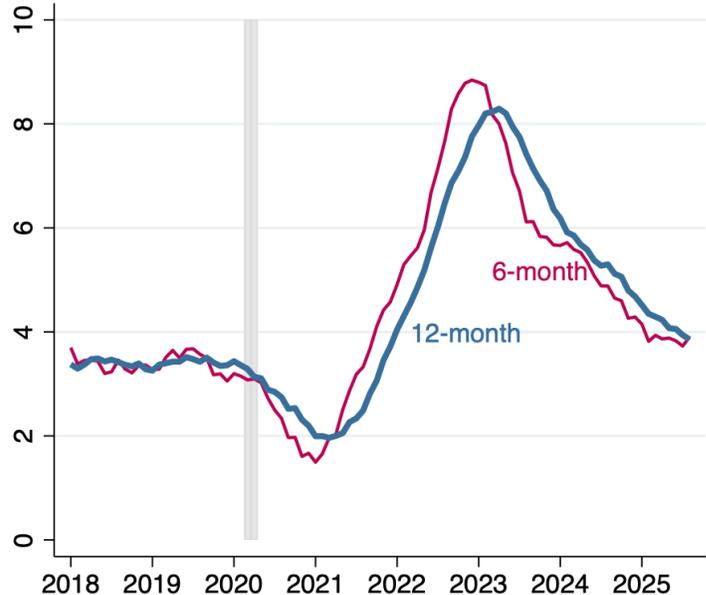
Percent (annualized)



Data source: Bureau of Economic Analysis.
Shaded region corresponds to recession.
Last data point: August 2025.

PCE Core Housing Services Inflation

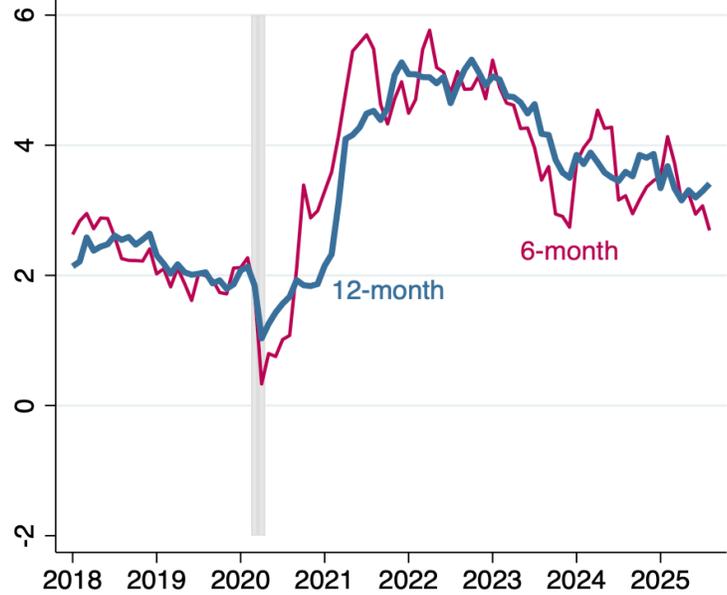
Percent (annualized)



Data source: Bureau of Economic Analysis.
Shaded region corresponds to recession.
Last data point: August 2025.

PCE Core Services Ex. Housing Inflation

Percent (annualized)



Data source: Bureau of Economic Analysis.
Shaded region corresponds to recession.
Last data point: August 2025.

But evidence suggests that the inflationary effects of tariffs mostly still lie ahead

Importers front-loaded shipments to beat the tariffs

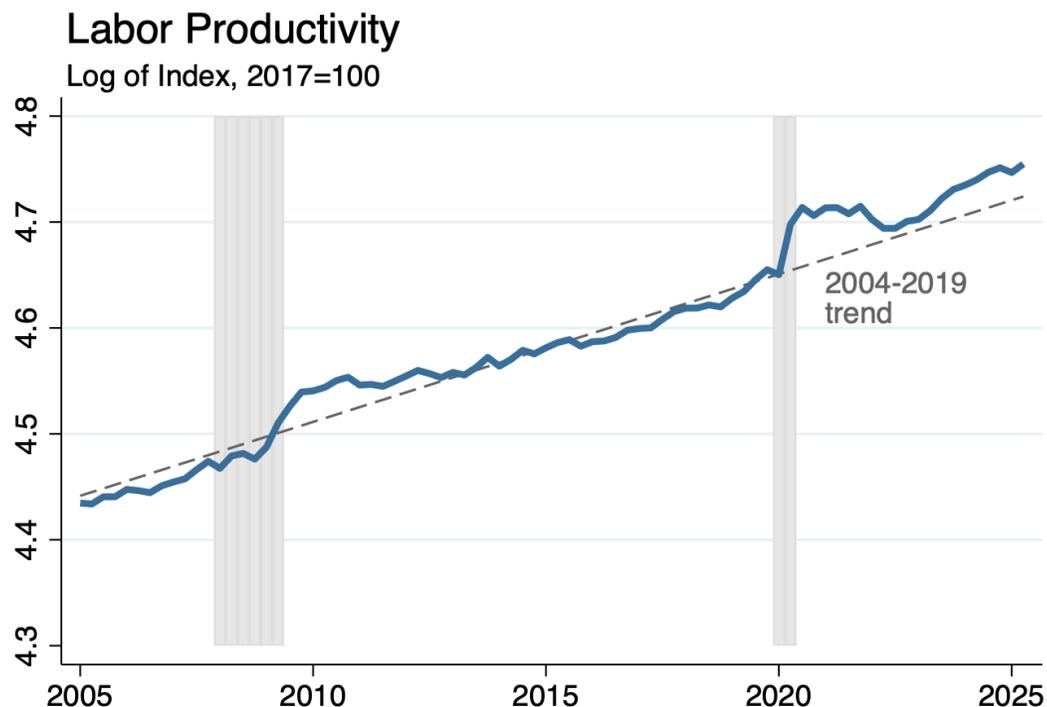
Bonded warehouses are holding back tariffed goods

Duties are slowed by payment lags and deferrals

Additional tariffs have been threatened or have been imposed but delayed

Importers and wholesalers have been absorbing more costs than seems sustainable

US productivity growth has been strong, and enthusiasm about AI is running high



Data source: Bureau of Labor Statistics (via FRED).
Shaded areas correspond to recessions. Last data point: 2025:Q2.

The step-up in productivity gains in recent years mostly reflects better job matches and organizational changes — but, looking ahead, many believe AI will drive strong productivity advances

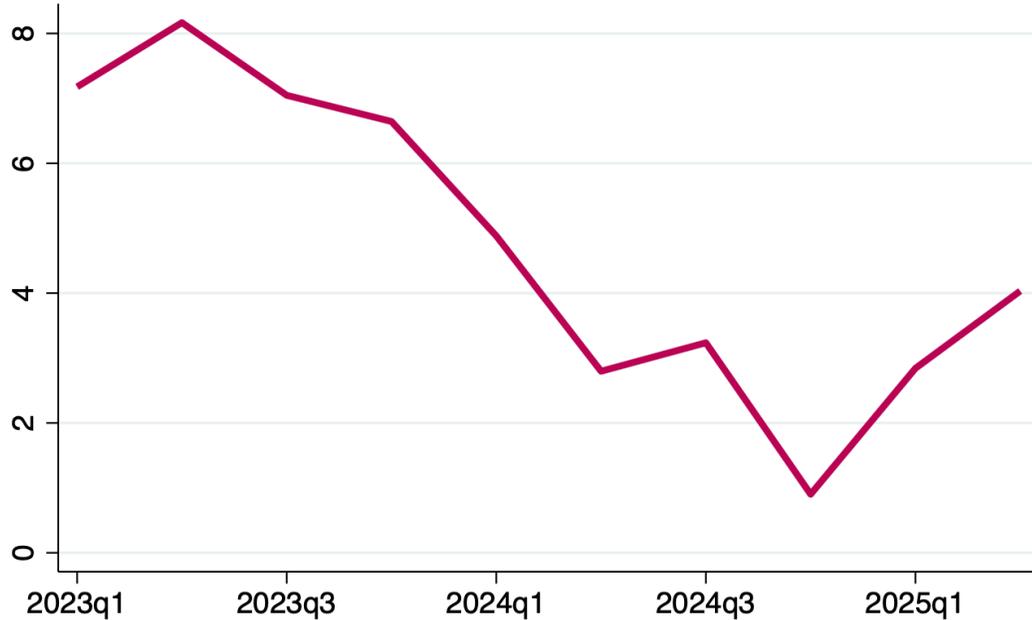
Google search ... reached 1 billion daily searches eight years [after it was released to the public in 1999] ... ChatGPT reached the 1 billion message milestone ... less than two years after its release.

Deming (2025)

US business investment continues to grow, but only because of AI-related categories

Real Business Fixed Investment Growth

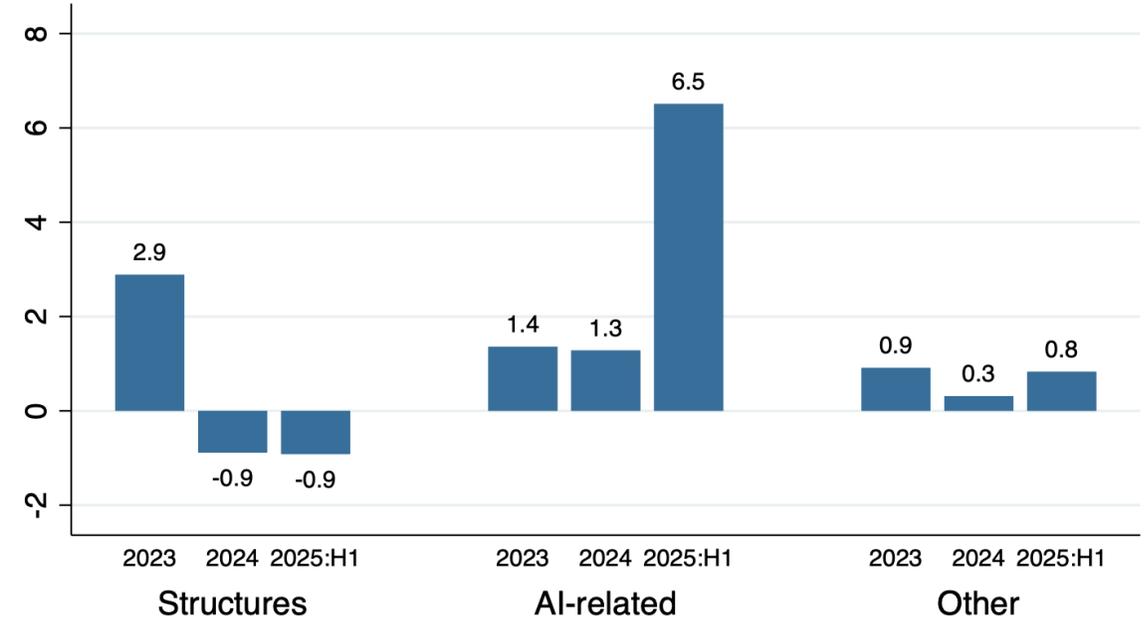
Percent change from 4 quarters earlier



Data source: Bureau of Economic Analysis (via FRED).
Last data point: 2025:Q2.

Contributions to Business Fixed Investment Growth

Percentage points (average for period)

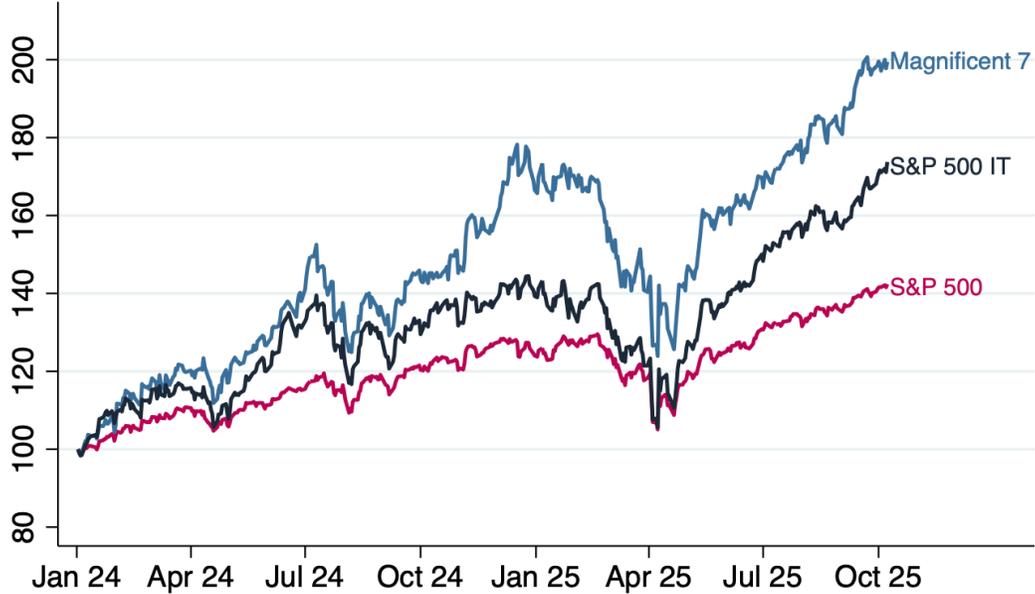


Sources: Bureau of Economic Analysis (via FRED) and author's calculations.
AI-related category includes information processing equipment, software, and R&D.

AI expectations have driven up the stock market

Stock Price Indexes

2 January 2024 = 100



Data sources: S&P Dow Jones and Roundhill Investments (via Google Finance).
Magnificent 7 includes Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla.
Last data point: October 8, 2025.

Magnificent 7 Share of S&P 500 Market Capitalization

Percent

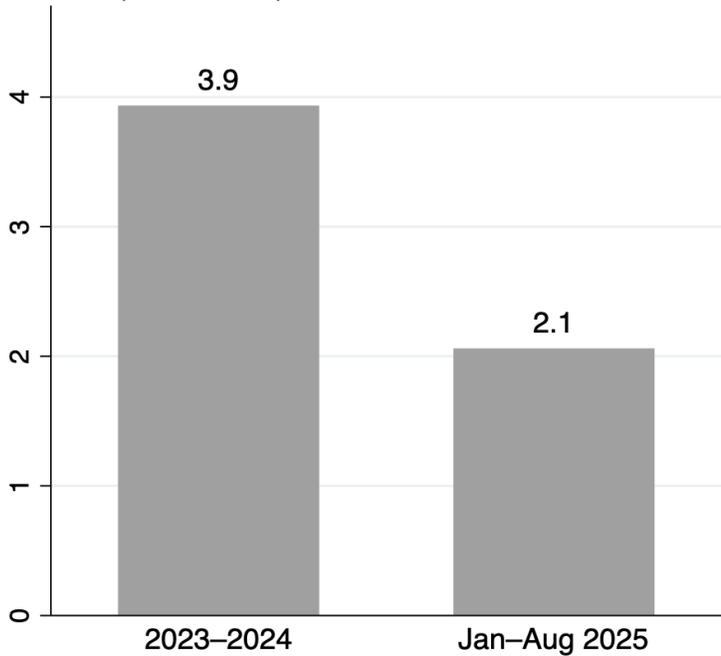


Data sources: Bloomberg L.P. and author's calculations.
Magnificent 7 includes Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla.
Last data point: October 7, 2025.

Slower income growth and lower consumer sentiment have weighed on consumption growth

Real Disposable Income Growth

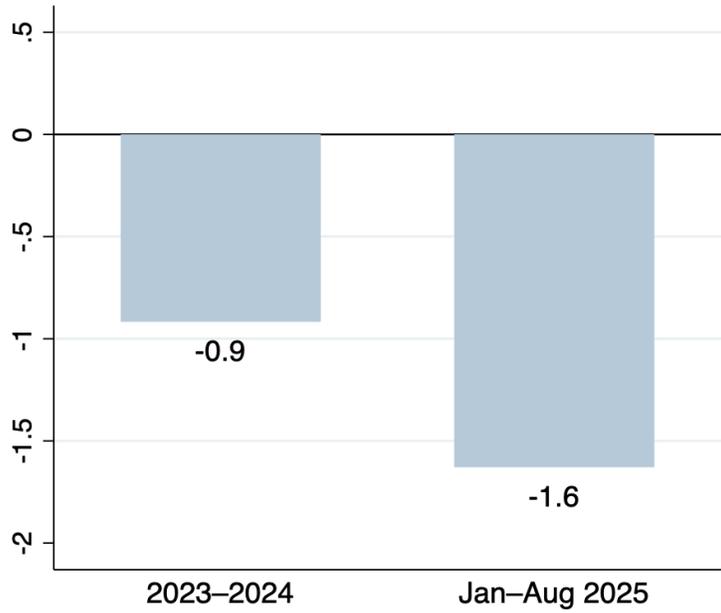
Percent (annualized)



Data source: Bureau of Economic Analysis (via FRED).

Consumer Sentiment

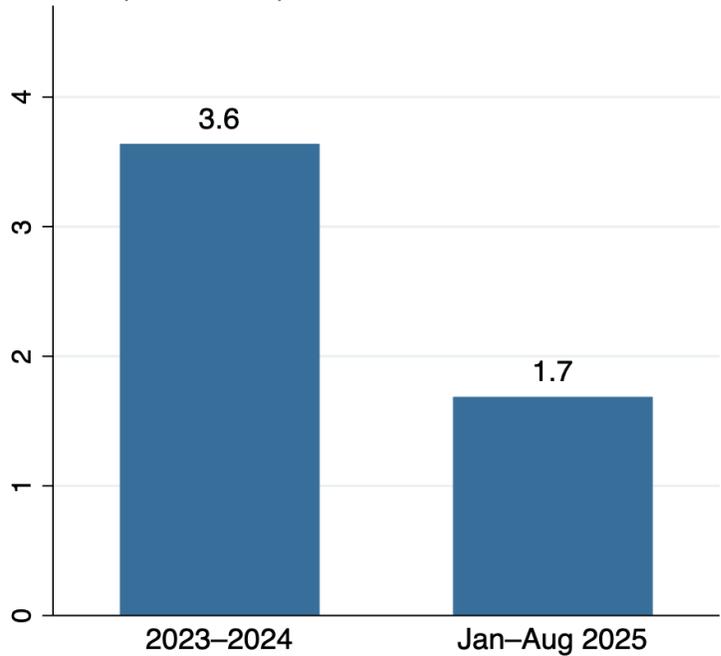
Index



Data source: Bureau of Economic Analysis (via FRED). Indexed to have a mean of 0 and a standard deviation of 1 between 2010 and 2024.

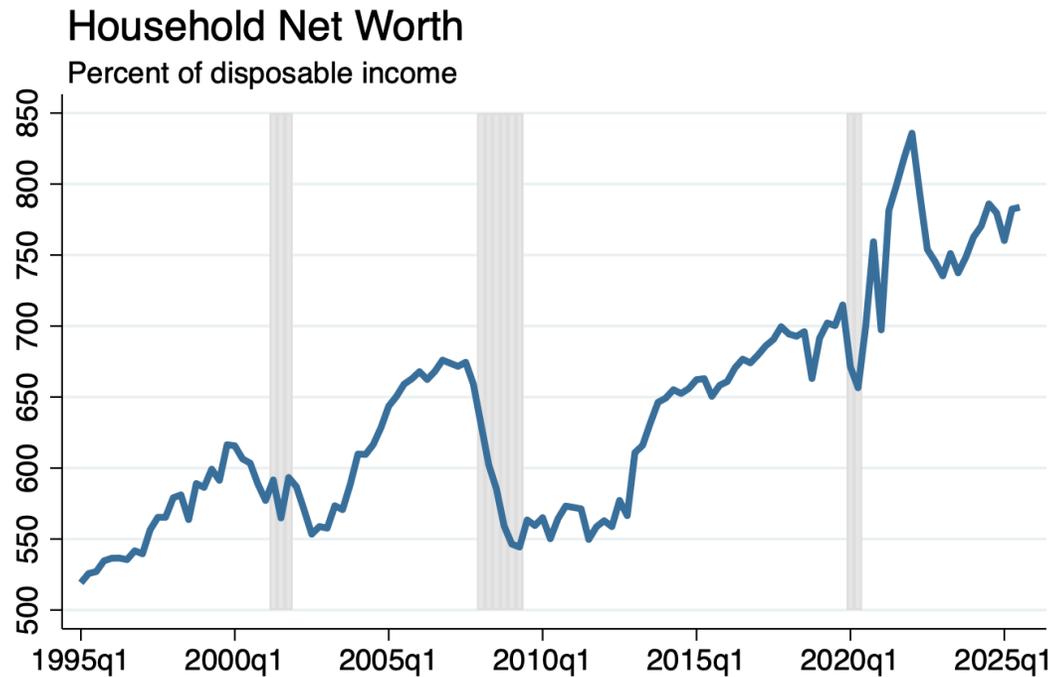
Real PCE Growth

Percent (annualized)



Data source: Bureau of Economic Analysis (via FRED).

Consumption growth would be even slower if stock prices had not risen so briskly



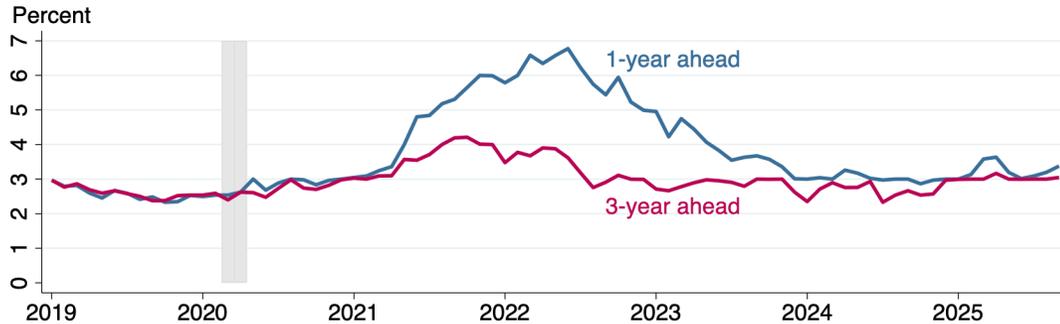
Data source: Federal Reserve, Bureau of Economic Analysis, Zillow, and S&P Dow Jones (via FRED). Last data point: 2025:Q3 (estimated based on actual stock prices and no home price growth). Shaded areas are recessions.

Surging stock prices have boosted household wealth, implying (given lags) considerable positive “wealth effects” continuing into 2026

But it cuts both ways—if stock prices were to decline by, say, 15 percent (~\$10T), standard rules of thumb imply a cumulative drag of about 1½ percentage points on consumption growth

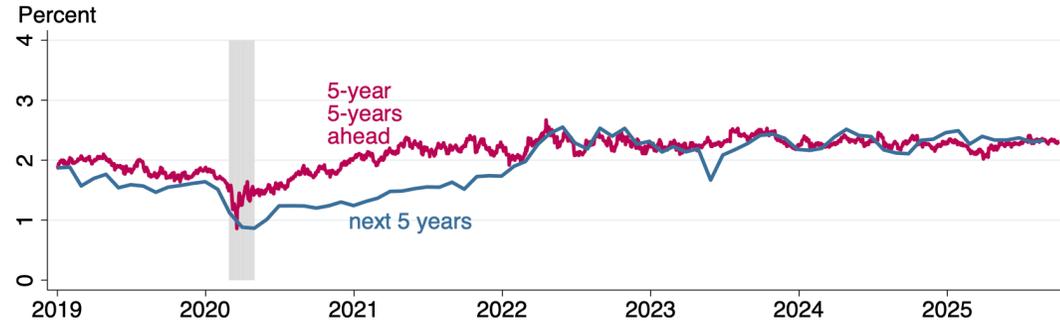
With inflation expectations roughly stable, the Fed is likely to cut two more times this year

Median Expected Inflation: Households



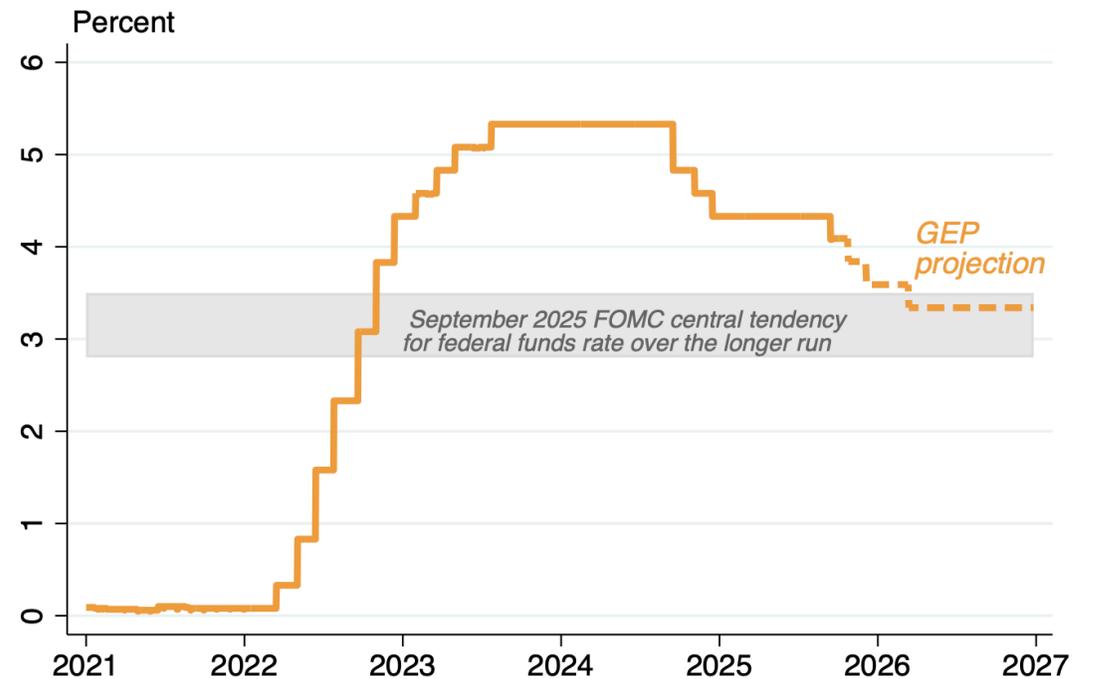
Data source: FRB-NY Survey of Consumer Expectations. Shaded area is recession. Last data point: September 2025.

Median Expected Inflation: Markets



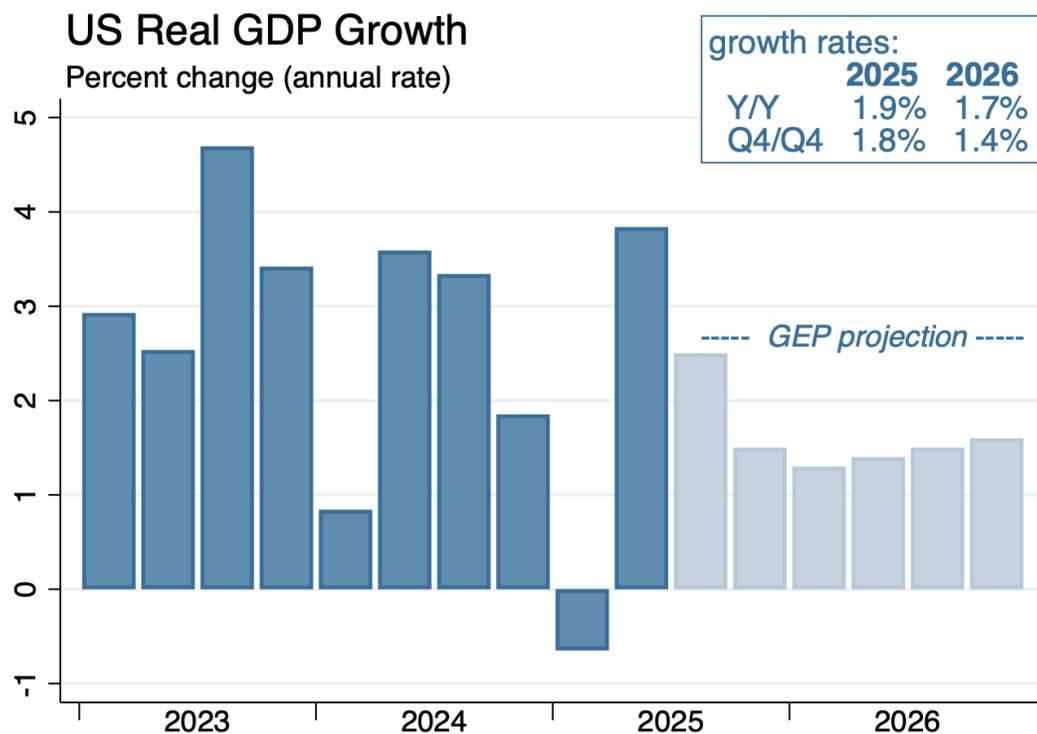
Data source: Federal Reserve Bank of Cleveland (via FRED). Breakeven inflation rates derived from TIPS. Last data point: October 8, 2025.

Federal Funds Rate



Data source: Federal Reserve (via FRED) and author's forecast.

US economic growth is likely to moderate in 2026



Data source: US Bureau of Economic Analysis(via FRED) and author's projection.

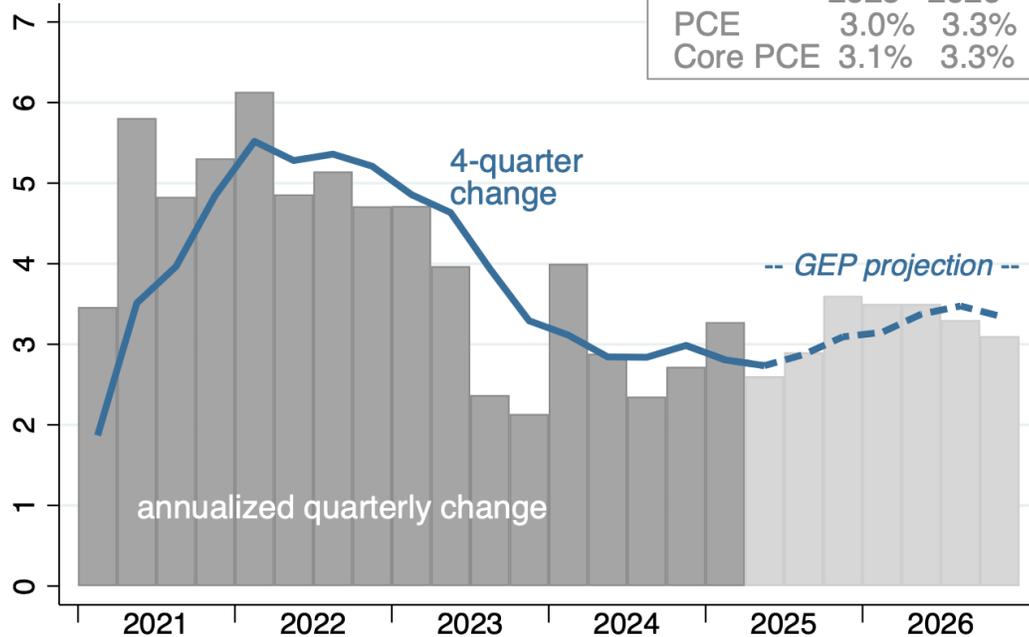
As price increases from tariffs and other factors reduce household purchasing power, the growth of demand will slow

On the supply side, the productivity boost from AI is likely to develop too slowly to offset the impact of reduced immigration and other policy changes that are weighing on investment and innovation

Inflation and unemployment will both increase in coming quarters

US Core PCE Inflation

Percent change from four quarters earlier



Source: Bureau of Economic Analysis, author's forecast.

US Unemployment Rate

Percent



Source: Bureau of Labor Statistics, author's forecast.

US growth is fragile

Further development and expanding use of AI will probably boost productivity and output growth substantially over time

But, the road to reaping those gains could well be uneven

With so much business investment and consumer spending dependent on exuberance about AI, any disappointments could sap the current economic momentum and expose the negative impact of tariffs, immigration restrictions, and other policies

Global Growth Outlook

Real GDP Growth (Y/Y)	2023	2024	2025	2026
Global Growth	3.5	3.3	3.1	2.9
United States	2.9	2.8	1.9	1.7
Euro Area	0.5	0.9	1.1	0.7
Japan	1.4	0.1	1.1	1.1
United Kingdom	0.4	1.1	1.2	0.7
China	5.4	5.0	4.9	4.5
India	9.2	6.5	6.7	6.6
Russia	4.1	4.3	0.9	1.0
Brazil	3.2	3.4	2.3	1.7

Source: Consensus Forecasts for 2023-24; PIIE for 2025-2026. Annual-average-over-annual-average growth rates. PPP weights.



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