

Peterson Institute for International Economics

Global Economic Prospects: Spring 2026

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[00:05:13.04] - Maurice Obstfeld

Good afternoon, everyone. I'm Maury Obstfeld, a senior fellow here at the Peterson Institute. I want to welcome you all here for this kickoff event for the spring meetings season here in DC in spring, our Global Economic Prospects. Uh, we have a great panel of experts to, uh, present their insights today. Uh, as usual, we will lead off with Karen Dynan presenting the global outlook and the U.S. outlook. Um, I'm sure most of you know Karen, but, uh, I'll just say that Karen is a non-resident senior Fellow here. She has had a long career at the Federal Reserve Board, at Brookings, at the US Treasury, where she was Assistant Secretary for Economic Policy. And she is now at Harvard University as a professor of the practice. Karen will be followed by Jed Kolko, Senior Fellow here at Peterson also, who joined last April. He's also the Head of Macro Strategy at Rokos Capital Management, has been the Undersecretary for Economic Affairs at the Department of Commerce, was a Chief Economist at Indeed, and has a wide range of experience. And finally, we will have our senior fellow Tianlei Huang, who will speak about the Chinese economy.

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Tianlei has been at Peterson as a research fellow and a research analyst since 2019. I want to flag that he will have a book coming out to be published by Peterson called Detox: China's Fiscal Reckoning in the Shadow of the Housing Bust. With that, I'd like to turn it over to Karen to start us off.

[00:07:37.57] - Karen Dynan

Yeah, thanks. It's—

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oops.

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Yeah, it's great to be here, and thank you for that introduction. Thank you, everyone, for coming. Um, he also going to offer the global outlook. Uh, global growth continues, uh, but the outlook is much more cloudy than it was just a couple of months ago. Uh, so let me start with some country-specific forecasts. Uh, I have here the large advanced economies and, um, starting with the US, they're leading amongst the large advanced economies. Um, I, in the US, we have, um, an AI boom. That is offsetting a bunch of headwinds in other areas. I will talk about it in much more detail in a moment, but I've got growth slowing from 2.1% to 1.9% over the forecast period, which I think is a more sustainable pace. As you can see, if you look across the other large advanced economies, you can see I have more softness in the near term, and that is largely because these economies, their economic activity has more exposure to the increase in energy prices we've seen since the war began, but there are other factors that are also shaping the contours. So for example, in Europe, we still have the northern countries struggling in terms of economic activity because of various challenges.

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In the UK, fiscal restraint is weighing on activities. Now in terms of the large emerging market economies, there continues to be a lot of heterogeneity. So starting with China, and Xinlei is going to say a lot more about this in a moment, But we've got a, you know, the property crisis continues to be a significant drag on the economy there. So I have growth slowing down into the mid-4s and then to 4.3% next year. India continues to lead amongst this group of large emerging market economies. They have a lot of energy exposure, so that will drag on their activity, although You know, at this point, given how far, you know, energy prices are down on net— or sorry, are up on net— I think it's kind of only a moderate to modest drag for them. Russian growth is soft on an underlying basis because of the Ukraine war. For them, actually, higher energy prices are a bit of a plus. So I've raised my forecast there since the war started. And for Brazil, Brazil continues to have underlying structural challenges along with some uncertainty about an upcoming election. In terms of, they are a net exporter of energy products, but they're an importer of fertilizer, and that's a drag on their economy.

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So, you know, clearly kind of the big thing that people are talking about these days is the fallout from the Iran war. It is, in my forecast, lowering expected global growth, It is certainly, it's raising inflation and certainly adding a lot of uncertainty to the outlook. I want to be clear, and I think this came through in the charts I've already discussed, there are a bunch of other factors that are shaping both kind of the underlying growth pace of the economy as I've talked about, but also the path they're taking over time. So as before the war, the global economic outlook

continued, you know, continues to be bolstered by this boom in artificial intelligence, the US most notably. It continues to be dampened by the trade war. There's a lot of other policy uncertainty and structural challenges that vary from country to country that are shaping the trajectories. But these disruptions we've seen from the war, and I'm talking about both higher energy prices, but also disruptions to supply chains for key non-energy products, they've lowered expected growth. They've pushed up expected inflation. And, you know, and I would say kind of, yes, Energy prices have reversed.

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They've come down a bit since the ceasefire was announced on Tuesday evening. But I'll show you a chart in a moment. They're still up notably from before the conflict. Uncertainty is high, and that is a risk to the forecast. So just to give you— this chart gives you a sense of the size of the movements in energy prices. So first of all, you know, it's about what's moving through the Strait of Hormuz. And that's not only oil. It's about a quarter of the world's oil supply. But it's also significant amounts of natural gas and its other inputs as well, including fertilizer, helium, which is important to semiconductors, and other raw materials. But on the left here, I have energy prices, and what you can see here is you can see the rise, and they did peak kind of higher just a short while ago, and you can see kind of the plunge we saw both in Brent crude oil prices and in European natural gas prices just since the ceasefire was announced. But what's coming through in this chart is you can see Brent prices are still up, you know, something in the order of 30% relative to where they were before the war.

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And you can see natural gas is about, it's closer to 50% there actually. I've got Brent, the Brent futures curve here. And the way to think about my forecast is that I've embedded what futures markets are roughly showing. So futures markets think prices are going to decline from here, getting to something about \$90— for Brent, \$90 per barrel by the middle of the summer, and then coming down to \$80 a barrel by the end of the year. There's a lot of heterogeneity in terms of different countries' exposure to the energy shock. In the United States, the reason it's not a bigger deal for my forecast is partly because we're a net exporter at this point of oil. You know, this doesn't mean there's no effect. I mean, the people who own the oil companies, presumably they have lower MPCs than the people who, than the average US consumer. So I do think there will be some drag on demand, but it's certainly a very different situation than we were in in the 1970s, for example. But if you look to the right on this chart, You can see there are a number of European countries and then especially Asian countries, India, Japan, South Korea, that have a lot of exposure to energy prices.

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We're seeing kind of the news about, you know, the fallout from the war in terms of energy prices and supply chains. We're seeing them show up in financial market indicators. So here you can see on the left, you can see stock prices have fallen sharply on the war. Again, they came up after the announcement the ceasefire, but they have not recovered kind of all the losses we saw in earlier weeks. And then you can see on the right, you can see that government borrowing rates are up. And I think that's largely an inflation story having to do with energy prices. Again, a little bit of decline after the ceasefire was announced, but up on net. Okay, just one last thing on energy prices. So you can see here the panel on the right shows my global forecast, and you can see my baseline forecast is for global growth to slow from 3.3% last year to 3% this year before rebounding some to 3.1%. But things could be worse. I model an alternative scenario where energy price or Brent prices reach about \$150 by the middle of this year and then come down a little bit more slowly than futures as the curves suggest, and you can see that takes 0.4% off global growth.

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That's not putting the global economy into recession, but it's a materially worse outcome. Okay, so with all that said about the global economy, let me just go a little more deeply into the US economy. So there are a bunch of different background factors that are bearing on our economy beyond energy. The first thing I wanna highlight is the sharp pullback in immigration. Jed Kolko is going to talk a little bit more about this. I really just think the numbers are staggering. In the early 2020s, during '22, '23, net immigration to this country was 3 to 4 million people. And in 2025, I think our best guess is that it's fallen to about zero. Those are gigantic numbers relative to the size of our economy. That's reducing both supply, our productive capacity, and demand in this economy. The AI boom, I talked a lot about that in October in my last GEP presentation. It is boosting investment. I will show you some numbers on that. It's also been supporting consumption via wealth effects. And I think it will continue to support consumption a bit this year. We've also got a little bit of fiscal stimulus, tax cuts associated with the one big bill of 2017.

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They've created a modest fiscal impulse. And in addition to the tax cuts that occurred, we've seen for some categories like overtime, we've seen claims for deductions being kind of larger than what was estimated. So that means the fiscal impulse was probably even higher than what you would get just looking at the change in tax rates. And then, of course, we've got uncertainty, which is really kind of, you know, in the background everywhere, a drag on demand. There's just so much uncertainty still about tariffs. About Fed leadership now, about federal spending,

defense spending. And then outside of policy, you know, we have issues burbling up like potential fallout for private credit and whether that has implications for financial stability. So I think all those things are weighing on private decision-making. In terms of US data, so let me start with the labor market. So Jed's going to do a whole presentation on the labor market, but From my perspective, I kind of have been focused because I'm interested in what's going to happen with monetary policy on the balance in the labor market. And I think if you look at kind of indicators of slack in the labor market, I think we're still looking at an economy that, or a labor market that still looks pretty balanced to me.

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No doubt it's cooler than it was during, you know, the period of high inflation. It has cooled since then. But remember, that was by design to get rid of the inflation. But if you look, for example, at the unemployment rate here, you can see it's a little bit above the Fed's estimate of the long run or natural rate, but it's not high by any standards. Job openings are kind of about at their pre-pandemic average. Initial claims for unemployment insurance are below their pre-pandemic average. So this still, as of yet, looks like a labor market that's in balance to me. Consumption. Consumption growth has moderated, and we saw that also— I don't have it here— but in the PCE report that we had released today, it's moderated. I think, you know, given what we've seen, you know, this is an aggregate number, aggregate spending, given the sharp decline we've seen in population growth because of the stalling of net immigration, I think it's hardly surprising to see some moderation I think all things considered relative to kind of other fundamentals that affect consumption, you know, these numbers are holding up pretty well. And I think a lot of the story there is that wealth effects have been propelling consumption forward.

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I did an estimate of the net, net worth relative to income based on kind of what happened to asset prices in the first quarter of this year. And you can see it came down a bit. So I think we have been benefiting from wealth effects. They feed through to the economy on a lag basis, so there's still some benefit now, but we're— that's going to wane because, you know, wealth was moving sideways until the— well, wealth relative to income has come down materially and now is back to its mid-2025 level. So, yeah, in just a moment, just on kind of the foundations under consumption. A lot of talk, of course, about heterogeneity across different parts of the income distribution and the K-shaped economy. When I look at the measures of household financial distress that I think have a lot of signal in them, I'm just not seeing— I'm still seeing a pretty solid foundation as yet. These indicators are from before the war, and no doubt there'll be some deterioration as gas prices rise. But if you look on the left, I've got loans transitioning into serious delinquency. You can see they have come up some in recent years.

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Some of that has to do with some subprime lending that occurred after the pandemic, but you can see they're hardly at levels that we saw, for example, during the Great Recession. And for the credit card delinquency rate, which has increased the most, you can see it increased and it's stabilized. So it's not getting worse at this point. And if you ask households, which is what I've got on the right, their expectations about the odds they'll go into delinquency rates, there really aren't kind of a lot of warning signals here. You can see kind of there's been a bit of an uptrend since, you know, post-pandemic when people were flush with their pandemic savings. But again, not a lot of sharp movement recently. Okay, so let me talk for a minute about business investment. AI is just a big, big story. I've split business investment into growth, into contributions from different components in the chart on the left. And what I've got here is I've got the 3 groupings are structures, then a bunch of categories that are related to AI, and then other equipment investment. And then the 3 bars are for 2023, 2024, and 2025.

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What you should be looking at there is that big bar for AI-related investment in 2025. And you can look and you can compare that to the 2025 bars for the other categories. And you can see the whole story for business fixed investment growth is really about the AI-related categories. It's actually offsetting in that negative elsewhere. And I don't think, I just think in the absence of that, we would see much weaker investment growth. On the right here, I've got a measure of economic policy on uncertainty. And it's just, you can see it's just really high by the standards of the series. And that has to be a drag on kind of investment outside of the AI categories. Okay, let me turn to inflation, my last kind of data points here. So I've got here the 3 categories of core inflation, PCE core inflation, I've got goods on the left, housing in the middle, and then other services— sometimes it's called super core— on the right. But, um, and I've done it this way because they all have different dynamics. But what you should notice here is that housing inflation, uh, has come down quite a bit.

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It's below where it was prior to the pandemic. Some of that's a statistical anomaly that will bounce back up, but housing inflation really has made a lot of project progress towards disinflation. I think it's, it's there. But you can see core goods inflation has popped up. These are 6-month changes, by the way. I think that's partly a tariff story. And then you can see core services never came back to where it was pre-pandemic. It is still very elevated. And we got new— this data came out just this morning. I can say core, the, the print was higher than

many people expected. Core PCE inflation actually came in on a 12-month basis at 3%. So the broader point is just, this is all February data. Even before the war, we were just well above the Fed's target. I guess the good news on inflation has been that inflation expectations have remained largely anchored. I've got households on the left and what's implied by the TIPS market. On the right, there was a pop in household expectations with all the talk of tariffs last spring, but you can see household expectations have come down. And, you know, there's a little bit of post, you know, outbreak of war data at the end of the household series, and it's in the market series as well, and you just don't see the movement in inflation expectations.

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So I think that's good news on inflation expectations. I will say that I think expectations are probably less firmly anchored in wake of what happened a couple of years ago. If you have not read Joe Gagnon and Steve Kamin's paper put out through PIIIE about the lived experience and how important it is to expectation formation, you should read it because it really makes, I think, a compelling case that expectations are anchored less firmly. Okay, so in just my last minute or so, let me talk about Fed policy. So I think it's an uncertain time for the Fed. I think they are always data dependent, but they're especially data dependent right now. I think there are questions about the underlying inflation path. There are questions, of course, about the evolution of energy prices. There are questions about the effect of energy prices on the US economy now that the US is in a very different situation than in the 1970s, where we were a net energy exporter. Orders. And then there's the question about inflation expectations. But anyway, under my kind of baseline assumptions about what's going to happen with energy prices, I think that basically the Fed's going to— most likely outcome is Fed will stand pat.

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They will let the inflation shock pass through, and then we'll see another cut at the end of this year. So you can see that on the right here, and it's at the top end of what the central tendency from the last FOMC meeting. Okay, so where does that leave us in terms of the economy as a whole? So inflation, I think, is going to run hot this year. You know, I had to take these numbers down a little bit with the reversal of energy prices, but basically I think we're going to see overall inflation on a four-quarter basis being a bit above 3%. Same for core inflation, and part of that is modest effects from the energy shock, but just a high starting point., and then kind of the numbers receding next year. Um, core more slowly than, uh, total, because I just think core is just quite sticky at this point. A little bit of increase in the unemployment rate. Don't have a lot. I actually think that the issue about fewer immigrants in this country is going to keep our labor market pretty tight, but this does put us a little bit above, uh, what I think is the natural rate of unemployment.

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And then finally, in terms of GDP growth, you can see on a year-over-year basis, you already know I'm expecting a mild slowing, but you can see my forecast here. Basically, there's a divot in the short run, and that's the energy shock story and the supply chain constraints. But then you see growth climbing again to a little, on a quarterly basis, to a level above 2%, which is where I actually think, you know, potential output is right now. So we're climbing back to that. Of course, there are risks on both sides. The AI boom could be a bigger positive both on the supply and demand side than what we've— than what I'm figuring for this forecast. But I just think there are a lot of downside risks, both because the sharp slowing of immigration, the broader policy uncertainty, and then of course, if the situation in the Middle East re-escalates. So with that, I am done and I am going to turn things over to Jed Kolko.

[00:28:34.05] - Jed Kolko

I wasn't sure if that was my entrance music or something else, but I'll take it. It's perfect. Perfect. Thank you. Thank you all for being here today. I'm going to dig a little deeper on the US labor market, what I'm calling a divergent labor market. What I mean by that is the headline indicators by which we track the labor market are pointing in all directions to an unprecedented degree. When you look at the range of where headline labor market measures are pointing, it is more different than we have seen in the modern era of having this range of labor market indicators. That actually creates problems for the narrative around the labor market because you can support almost any story positive or negative you would like to tell, if you are selective with your labor market indicators. It also puts more pressure on economic statistics because if they're not all pointing in the same direction, then there is more risk should there be any harm or damage to any one economic statistic since we really need all of them to understand the labor market. But today, I want to explain where this divergence is coming from.

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My starting point is completely in line with Karen. When we look at the unemployment rate, the labor market looks largely in balance. Unemployment is low by historical standards. The prime age EPOP ratio looks, if anything, slightly more favorable. However, payroll growth is now near zero. And I'm going to dig a little deeper into showing that's mostly due to low immigration. The hiring rate is even more dramatically low. And it has been questioned how much of that is due to AI. My hunch, it's largely something else. Nonetheless, is a good excuse to talk about whether AI is affecting the labor market already and what we should expect in the future. For the rest of these few minutes, I'm going to go in this order. Couple minutes on payrolls and immigration,

and then looking at the hiring rate as an excuse to talk about AI in the labor market. Nonfarm payroll growth is now essentially near zero. In 2025, nonfarm payroll growth averaged 10,000 a month. That is basically the lowest level we've seen this century outside of recessions. The decline in nonfarm payroll growth since the pandemic's been dramatic. Of course, 2021 was a big rebound from what we saw in 2020.

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Naturally, that would recede pretty quickly. Though not all the way down to 10,000 a month. That is dramatic, especially when you compare the previous decade where nonfarm payroll growth annual average was pretty steady in roughly the high 100s a month. The story, of course, is immigration. Immigration has dropped dramatically. I am showing you Census Bureau estimates of net international migration. That is the blue line. That is the sum of the green line, which is gross inbound immigration flows, and the orange line, which is gross outbound emigration from the US. Net international migration, according to the Census Bureau, dropped from a peak of 2.7 million in 2024. This is year ending July 1st, 2024. That's how Census does this. To an expectation of 321,000. In 2026. Again, year ending July 1st, 2026. Now, to put this drop from 2.7 million to 300,000 in context, the average from the 2010s was around, around 1 million a year with fairly little variance. Also, the rest of population change comes from natural increase—births minus deaths. That is typically pretty stable right now, around 500,000 a year. So at a moment when immigration is 2.7 million, that means nearly all population growth is coming from immigration, net immigration.

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Whereas right now, a majority of population growth, low as it is, is coming from natural increase rather than immigration. There's a direct link between the rate of immigration and an estimate of the break-even rate, how much job growth we need to keep the labor market in balance. My estimate is where immigration was in 2024 implied a break-even rate of about 100,000 \$79,000 a month nonfarm payrolls, where Census estimates it is in 2026 implies a break-even rate of about \$45,000 a month. But most of us think that Census estimate is probably still a little high. The most reasonable outside estimates suggest lower net immigration than that with an implied break-even rate somewhere closer to the 0 to 20,000 a month range. Right about where actual nonfarm payroll growth was in 2025. Now, keep in mind, this game of trying to assess whether actual nonfarm payrolls are above or below the breakeven rate assumes both some precision about what you believe with immigration estimates, about which there is, you know, great uncertainty and debate, mostly well-meaning, not entirely. As well as uncertainty about nonfarm payroll growth, given the size of both monthly and benchmark revisions. So the game of figuring out whether payrolls are above or below the breakeven rate is a shaky game, especially now.

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The other point about immigration going beyond these questions of breakeven and slack is what the impact's actually been on the labor market. Most striking to me is immigration policy actually hasn't boosted native employment. So I'm showing you the unemployment rate seasonally adjusted for native-born versus foreign-born workers. This is directly reported out of BLS Current Population Survey household side of the jobs report. The gold line shows you native-born unemployment by month until March. And you see that it's slightly up year over year. Foreign-born unemployment slightly down. Now, this is, you know, perhaps not what was the intent of current immigration policy, but is actually pretty consistent with most academic research about immigration, which understands that generally speaking, native-born and foreign-born workers are more likely to be complements rather than substitutes. A sudden shortage in the availability of foreign-born workers leads many firms to cut back on production. And therefore, that hurts native-born employment. Immigrants are more likely to be competing with other immigrants for jobs than with native-born workers, completely consistent with what we see here with a downward shock to the supply of foreign-born workers. The other point I'll make is this is a similar picture when you look at EPoP for native versus foreign-born.

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But be careful because the age distribution of native versus foreign-born workers is quite different. So looking directly at EPoP levels for native versus foreign-born brings in the fact that a higher share of native-born workers are retirees than— native-born population's retirees than the foreign-born population. Let me turn now to the question of the hiring rate and what that says or doesn't say about AI. So I mentioned that the labor market is divergent. The hiring rate has actually become completely unmoored from other measures. What I'm showing you here— first, focus on the green dots, please. That is the pre-pandemic relationship between the unemployment rate on the x-axis and the hiring rate. This is the gross hiring rate in the JOLTS report on the y-axis. It's reasonably tight. When unemployment's low, the hiring rate is high, just what you would expect. Leaving off 2020 since the numbers are literally off the chart, Post-pandemic, starting 2021 to 2026, the dots take this counterclockwise arc down to where we are in the lower left in February 2026. Hiring during all the reallocation and recovery from the pandemic, followed by a hiring rate today that is so low that we have seen it pre-pandemic typically only when unemployment is the— in the 8% to 9% range.

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Now, this is quite plausibly payback for the very high hiring rate in the early part of the pandemic recovery. But there are temptations and perhaps even incentives to attribute this low hiring rate today to AI. Now, that incentive is intensified by the fact, as is typically the case when hiring rates are low, that the employment picture looks worse for young people. I'm showing you the year-over-year change in EPOP by roughly 5-year age group. Looks pretty bad for the teenagers and folks in their early 20s. Much better, proud to say, those of us in the late 50s, like Gen X. We are having our revenge at the moment in the labor market. Yay, us. Looks pretty similar when we look at the unemployment rate instead of EPOP, which has increased significantly for the youngest workers. Though I'll mention that it's both unemployment up and labor force participation down for young adults. That's part of the story. Now, this is initially consistent with perhaps the most widely reported on piece of research about AI in the labor market, which showed that AI-exposed jobs were growing more slowly for young people. This is the Stanford Digital Lab Canaries in the Coal Mine research from last fall by Brynjolfsson and co-authors.

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At the same time, other research pointed out that overall, when we compare employment in AI-exposed occupations with less AI-exposed occupations, the broader labor market shows relatively little difference. In other words, looks kind of fine. And that is the Eckhart and Goldschlag and many others' conclusions. Now, how do we square all this? I think one tricky part of the story about AI contributing to this very low hiring rate, particularly affecting young people, is that hiring slowed a lot earlier than when we would expect AI effects to have appeared. Commercial public ChatGPT only launched in late 2022, and it was not the productivity-enhancing tool that it is today. And we also know technology takes years or decades to show up in the economic data. Even if that is faster for AI, it's probably not the case that changes in the labor market are showing up even before AI was fully launched. I think more broadly, the long-term effects of AI on jobs are unknowable. Current effects, even if they were clear and conclusive, are still weak signals. Given that AI's capabilities change faster than it takes for academic papers to get reviewed. So anything that we would see published about AI in the labor market by the time it was published might no longer be relevant for what is currently happening with AI, let alone about the future.

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More so, there's a lot more than just what AI is doing to labor demand. We know from the history of lots of other technological disruptions and changes that labor supply matters too, whether it's labor-saving appliances, the pill, technologies around remote work and video conferencing. These all affect labor markets as well. And that has been an underexplored or

unexplored part of the labor market. We do know some things. Short-term disruption, highly likely, given that regardless of how many jobs ultimately are created, what the unemployment rate settles at, There are going to be jobs destroyed and jobs created, and not everyone will adapt. And some of the most thoughtful research coming out of AI in the labor market is looking not just at who is more exposed, but also who has greater capacity for adaptation. Furthermore, even if AI is different from past technologies and the disruption ends up in the long run looking different than other kinds of disruptions, there are still lessons about managing disruptions in the short term. And some of the most useful policy tools we already know, whether it is health insurance that carries with you between periods of employment, an unemployment insurance system that is more robust.

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It's an example of the case that sometimes sexy problems have unsexy solutions that we already know. And history is useful. When we look at the longer term of what disruptions have looked like, This most recent few years with pandemic and the rise of AI still has caused less labor market churn. And I'm showing you a measure of churn that basically compares this decade to the previous decade, how dissimilar the occupational mix in the labor market is. Churn is growing slightly, but still far below the kind of disruption that we saw in the '40s and '50s and in the 1910s. So there are points in history that we can look to, even very different kinds of technological change or disruption, that can still give us lessons about what adaptability looks like, what short-term transitions need, even if the long term in many ways is still unknowable. Thanks very much.

[00:42:24.31] - Tianlei Huang

Hello everyone. My discussion today will focus on China's housing slump and its implications. Specifically, I will address 4 questions. First, why the housing market is not recovering. Two, what is it doing to government finance? Three, why haven't we seen a financial crisis in China? And lastly, how is the housing slump affecting China's external imbalance? Let's get started. China's housing market peaked around mid-2021 and has been in a sustained decline ever since. There are some recent signs of a stabilization in top-tier cities in recent months, but for most Chinese cities, their housing markets remain deep in a freeze. And to me, for two reasons, this downturn could last for a while before reaching the bottom. And the first reason is that the real estate—the real interest rates in China remain elevated. One key reason why China had a housing boom earlier, which later turned into a bubble driven by speculation, was that the real interest rates in China was very low and oftentimes negative. That created strong incentives for households to shift their savings into real estate. And as the left-hand side chart shows, real interest rates and real housing price growth have an inverse relationship.

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And when real rates are low, housing prices tend to grow faster. When real rates are high, housing prices tend to grow more slowly or decline, which is where we are now. So even if we look at just nominal rates, mortgage rates now— nominal mortgage rates now remain higher than rental yields. This means that for investors borrowing to purchase housing and renting it out still does not generate a positive return. So until mortgage rates can fall below rental yields, the investment case for housing will remain weak. And of course, fundamentally, there can only be investment demand if there is underlying residential demand. In a country like China, where the overall population is shrinking and urbanization is slowing down, residential demand will likely only see positive growth in certain large cities and the large city clusters surrounding top-tier cities. And in many smaller Chinese cities where there has already been population outflows, the huge supply-demand imbalance in the housing market locally means that the local housing markets will likely face a prolonged downturn, even if interest rates fall meaningfully. The second reason is weak household expectations. A key driver, again, of China's housing boom earlier was this widespread belief that both the economy and household income will continue to rise, probably indefinitely.

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And that belief has now shifted fundamentally. Here I show the household income confidence index and housing price expectation index, both are based on PBOC's survey data. And since peaking around 2018, both indices have declined significantly. While income confidence have shown some stabilization the second half of last year, housing price expectations continue to worsen. And just like how optimism helped create the bubble earlier, this growing pessimism about housing can also become self-fulfilling and prolong the downturn even beyond what fundamentals would suggest. Now, in China, one important channel through which the housing market affects the broader economy is through government finance. Land and real estate-related revenue are a key source of local government revenue. At the peak, they accounted for about 40% of total local revenue. And now after years of decline, that share is now about 25%. As the right-hand side chart shows, overall government revenue has been declining for many years, and actually that decline started even before the housing bust. And that was caused by multiple rounds of tax cuts in earlier years, and also shrinking tax base over time. The housing downturn has made the revenue decline even worse. So with less revenue and the government's reluctance to issue more debt, what we are seeing is that government spending has declined as a share of GDP since its peak in 2020.

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And this has exacerbated the deflationary pressures faced by the Chinese economy. Now, if we just look at China's fiscal deficit, which is the green bars in the right-hand side chart, it has been rising in recent years. And if we just look at that, we may conclude that China is pursuing fiscal expansion, but as we just discussed, that's not true. The rising deficit is largely a result of declining revenue rather than increased spending. So looking at deficit alone can be quite misleading. Now, in response to growing revenue pressures, local governments in China have increasingly relied on non-tax revenue, especially by tapping into existing public assets. This is an understandable approach given the Chinese general government does own a large amount of assets, many of which are poorly managed. But the problem now is that the current asset monetization strategy relies heavily on one-off transactions involving state assets, which can certainly provide relief in the immediate term, but it will be very difficult to sustain as a stable recurring source of revenue. And as the left-hand side chart shows, the recent increase in state asset-related revenue has been driven mostly by this so-called paid use of state assets and resources, which are the black bars on the top.

[00:48:01.37]

And they include leasing or selling of natural resources rights, which again are largely one-off in nature. And by contrast, more sustainable revenue sources that are based on state assets, like dividends from SOEs, remain very limited. Even though dividend payout ratios of non-financial SOEs have increased quite significantly in the last couple years, as the right-hand side chart shows, the underlying profits of non-financial state firms in China have actually been stagnating. So the actual amount of dividend contributions of those state companies to the state budget which are the blue bars in the left-hand side chart, still remain very modest. In any case, SOE profits are also pro-cyclical in general, and they can only be a complementary source of revenue. Ultimately, China will need to pursue some kind of broader tax reform, such as introducing a nationwide property tax and strengthening personal income tax to expand its revenue base. Now, in the near term, the biggest challenge facing the Chinese economy is still weak domestic demand, which is reflected in low and declining price levels. And to support domestic demand, the current fiscal spending is hugely insufficient, and a more forceful fiscal response is needed. And I would argue that China does have the fiscal space to act more countercyclically, at least in the short to medium term.

[00:49:27.20]

And one key reason is that the general government still has a relatively strong balance sheets. While the general government's net financial position has been deteriorating in recent years, largely because of the expansion of local governments' off-budget liabilities, it remains comparatively strong among all major economies. And this provides room for a more

countercyclical fiscal response to address deflationary pressures. China may eventually need to pursue some kind of fiscal consolidation to deal with the local debt issues, but now is not the time to do it. Now, just briefly on financial stability, there has been no financial crisis in China so far, and the banking system appears broadly resilient despite its large exposure to real estate. This resilience is partly due to the authorities' proactive policy support, including recapitalization of both large and small banks, and timely disposal of bad assets. And also, the strengthened financial safety net is also being helpful. As the left-hand side chart shows, non-performing loan ratios have actually declined in recent years for most Chinese banks. Obviously, this decline does not reflect improving quality of the underlying assets. Instead, it's achieved through growing loan write-offs and transfers of bad assets to asset management companies.

[00:50:52.54]

And there are also many forbearance measures in place, which mechanically keep NPL ratios low. They're essentially delaying loss recognition and hiding underlying asset quality risks. And at the same time, Chinese banks are also facing growing profitability pressures from narrow interest rate margins, weak loan demand, and rising write-offs. And their return on assets have seen some sharp declines in recent years, which is constraining new credit growth. So systemic risk remains contained for now, But obviously, the story is not over yet because the Chinese housing slump has yet to bottom out, and the pressures on the financial system will likely persist or even worsen in the foreseeable future. That said, it still seems to me that the risk of a systemic crisis in China is still low. The Chinese state is highly risk-averse when it comes to financial stability and is willing to go to great lengths to prevent a systemic meltdown, at least as long as it retains the fiscal capacity to do so. Finally, on the external side, we all know that China had some record-level trade surplus last year, and that large trade surplus is fundamentally driven by a widening saving-investment imbalance domestically in China, and the housing bust plays a central role here.

[00:52:13.41]

Housing is the largest component of household wealth in China, and as housing prices decline, household wealth shrinks. It depresses consumption, increases precautionary savings. At the same time, households are investing substantially less in housing. As a result, the household sector's saving-investment balance has increased significantly in recent years. The general government has moved in the opposite direction. It has reduced its savings, increased its investment, which helped offset partially the increase in household imbalance, but not entirely. So as a result, China's overall saving-investment imbalance has still widened, which is reflected in the rising current account surplus. So in this sense, the housing slump is really a key driver behind China's rising external imbalance in recent years. And without a recovery in the housing

market, I think China's external imbalance will only get worse before it can get better. Now, this slide just concludes what I have discussed today. Let me stop here. Thank you.

[00:53:47.52] - Maurice Obstfeld

Thank you. Those were three very rich presentations, so I thank the, uh, the panelists. And, uh, uh, I wanted to ask them all, uh, the same question, uh, based on a sort of common theme that was raised in each presentation. So I, I, on Sunday I returned from Asia where there was a huge concern expressed about shrinking populations and the long-term effects those would have on the region. And it struck me that, you know, for the US, for China, there is the pressure of a less quickly growing or shrinking population largely due to self-inflicted wounds. You know, in China, the one-child policy, in the US, immigration and deportations. So I wanted to ask each of you, and maybe we can go in the same order as before, to just reflect for just a couple of minutes, because I want to leave time for audience questions, on what do you think are the most problematic aspects of this fact going forward for the US and Tian Lei for China?

[00:55:03.13] - Karen Dynan

Yeah, I said, I, I, I Great question. I can understand, having been in Asia, why you— why it's on your mind. I think the aspect that's most relevant for the United States in the near term is certainly the drop in net immigration. As I said before, the numbers I think are just staggering compared to the size of our economy. Because it's kind of both influencing supply and demand, in the short run, it's turned out to leave labor markets, for example, largely imbalanced. I don't think we can count on that to prevail over the next year or so, particularly as we have this fiscal boost. We'll see what happens. Maybe the drag from the war will kind of offset that. But I do think there is a potential for another worker shortage to reemerge, which would be a story about kind of, you know, particular bottlenecks in particular sectors. I think that's the short-run issue. The longer-run issue, of course, for us is sustainability. You know, and the issue there is not so much the shrinking population as the aging population, the number of retirees per worker is going to go way up, and that's going to put stresses on public finances.

[00:56:20.11]

But that's a whole other conversation.

[00:56:26.21] - Jed Kolko

So for sure, the slowdown in US population growth is not on the scale of slowdown in population growth elsewhere in the world, particularly in parts of Asia. I agree that there are ways in which in the short run, the, again, relatively modest overall slowdown in population growth, even

though large by US historical standards, still largely keeps supply and demand in balance in a macro sense. But I think there are 3 issues, 2 that already appear in the short term and a different kind of, an additional kind of long-term issue. In the short term, it wreaks havoc with measurement and our understanding of the economy. Not just nonfarm payroll growth and the breakeven rate, but interpreting any kind of aggregate growth measure in the economy needs to look different when this deep measure of labor supply is growing much, much more slowly. Even down to a fundamental question of, should we think differently about how we define recessions, given that the recession dating committee indicators are aggregate measures that implicitly make sense if labor supply is growing roughly steadily. But if these measures slow down entirely because of slowing labor supply, not at all because of any sort of per capita change, is that a recession in the same way?

[00:57:56.38]

So I think there's an important measurement question, though that may be something only economists care deeply about. I think the supply and demand being roughly equals true at the macro sense, but can be quite imbalanced at the sectoral sense, given that the immigrant share of labor supply is not— is quite different across sectors, while the immigrant share of consumer demand is both different and less variable across sectors. So at the sector level, there can be serious and sustained imbalances, shortages, wage pressure, so on. I focus on an additional longer-term issue, and that is not about the slowing population overall, but if the reason is slowing immigration, given that we know from US history that immigrants immigrants have contributed disproportionately to entrepreneurship, to technological innovation, and to productivity growth. A world in which the rate of immigration is lower will hurt US productivity long term. Everything from US history points to that. And so I think of the long term less in terms of population growth overall, and rather the reason for population growth, and specifically the reason being immigration.

[00:59:23.56] - Tianlei Huang

Well, to me, I guess I'm not that worried about shrinking population. Mostly important— most important reason is that I think urbanization in China still has potential. I mean, the headline urbanization numbers that we see from official Chinese sources are likely overstated. And this is because a large portion of urbanization rate increase is driven by rural residents still living in rural areas. They are just, on paper, being classified as urban because of city boundary expansion. They still keep their lifestyle. They still keep their rural hukou. They have not really become urban citizens. So the true urbanization rate in China is likely a lot lower than what we see in the official sources. So urbanization still has potential. What I worry the most probably is one thing that Karen mentioned earlier, which is what it means for public finance, especially for

the public pension system. Now, the Chinese public pension system faces very serious fiscal sustainability problems. And because the dependency ratio just keeps going up, and the retirement age reform that was introduced more than 1 year ago is just insufficient, and there's a lot of flexibility built into the reform. Basically, if you want to retire later, you can.

[01:00:50.32]

If you don't, you don't have to. So the contribution rate of the public pension system in China is among the highest in the world. I don't see much room for it to go up further. Replacement rate is already very low, and I don't think there is any room for it to go down further. So China really faces a very tricky issue, how to pay for its aging population, its rapidly aging population. What they have been trying to do is to transfer some state assets to pension reserves. But the current scale of that transfer is simply not sufficient. And this is an open question, how China can pay for its rapidly aging population.

[01:01:37.24] - Karen Dynan

Yeah. Just a tiny add-on. Both Chenlei and I are very focused on public finances because we're economists. But I just want to say, as the number of retirees per worker goes up, it's also just an issue of producing enough for those retirees to consume. And so we focus on the financial aspect of it. But we can tell retirees, oh, or people who are approaching retirement to save so they can finance their retirement. The world isn't producing enough goods. That's a problem. We do have a part of the world which is young, which is Africa, but it remains to be seen if that productivity growth can pick up enough there to be able to support this older population.

[01:02:16.46] - Maurice Obstfeld

Import restrictions on what they produce are not going to help. We have time for maybe a couple of very concise questions. If you have one, Jess has a microphone, or you can come up to standing in the middle there. And there's a, there's a question back there also. Uh, Jess?

[01:02:46.52] - Tianlei Huang

Yes, I just have a quick question about underemployment. You know, you spoke about unemployment levels, but that I know personally numerous people that have had government work with USAID or the Naval Research Lab, and they've taken different positions at Home Depot and managing Girl Scout troops. And so this is a different kind of employment. They are employed, but they're— and they're doing rewarding work for the community. But, you know, maybe you could address that and how that shows up in your data.

[01:03:21.11] - Jed Kolko

Mostly, I'm just going to agree. One of the striking trends in recent years in US employment data has been an increase in the number of multiple job holders. Now, this is one of these things that in part is a measurement issue as you try to square what we see in the household survey with the payroll survey. But there are surely deeper questions there. It is not obvious which direction that goes in terms of cyclical. I have joked for a while that if I were an assignment editor, you know, for data journalists, unpacking this recent increase over the past few years in multiple job holding would be like high on my list of data journalism topics I would assign. So I agree, I think it's still sort of unclear what's behind that. I think both a look demographically, sectorally, occupationally, and where that's coming from would be helpful.

[01:04:25.37] - Maurice Obstfeld

Hi, back for another round. I forgot to ask this earlier. Kerry Mori, I'm interested on— I have a question for Jed too. On the war shock, the oil shock, the energy shock, is this at a point where you think the IMF and World Bank ought to be responding? And if so, how? And for Jed, You know, the Fed has called this job market equilibrium right now a very uncomfortable place for them to be. You know, zero non-farm payroll growth and very low labor force growth. Do you think it's stable, sustainable over the long run for the US to keep operating at that sort of equilibrium or not?

[01:05:06.45] - Karen Dynan

I guess I'll take the first part, and Maury may want to jump in on the IMF part. But I think they were in the— kind of right, as far as I understand it, right place now, which is they're advising countries on how to respond with this oil price shock for many countries that have this exposure. You know, how do you avoid the hardship? How do you support aggregate demand? You know, that's not an easy thing to do because you don't want to— if the world's energy supply is restricted, you don't necessarily want to just kind of give money to people to buy more energy. That's going to push up prices and make the situation potentially worse. So I think that what at least the IMF is doing right now and kind of just trying to guide countries how to do this without making the situation much worse is a really important role for them right now. But I don't see, in terms of a larger response, I don't know that I see that current conditions warrant that.

[01:06:00.51] - Maurice Obstfeld

I mean, the Fund has several facilities that were set up before and also after the COVID shock. That I suppose could be activated. But, you know, fundamentally IMF support comes with a program and, you know, until you have countries in crisis coming for program support, not that

much is going to happen. I think the IMF can, you know, give good advice, which they are giving. It's ultimately up to individual countries to support their populations with fiscal and monetary tools as best they can. And unfortunately for many countries, fiscal space is not what it was, and there's a challenge of inflation. I think one area the IMF could speak out, and this is a longer-term issue, but is to really come back to the messaging from previous years that was opposed by the Trump administration about renewables. They don't have to espouse renewables on the contested grounds of climate change. They can espouse renewables on the grounds of sensible diversification of energy sources and the difficulty of fossil fuels in a turbulent geopolitical environment. And that's what I would push if I were still at the Fund.

[01:07:29.46] - Jed Kolko

I like very much the question about the sustainability of zero. Zero is an important number. Arguably, it takes on outsized importance. There is probably— it is less of a magic threshold than it is often treated. I think I worry more in terms of long-term sustainability around the two issues that Karen and I both raised around the long-term effects of slower population growth, fiscal sustainability, dependency ratios, and then the impact longer term on productivity of much lower immigration rates. The bigger sustainability concern I have actually is around the low hiring rate rather than zero-ish nonfarm payrolls. Because we know that labor market churn is very important for necessary reallocation or technological change, for career growth, for wage growth. If we believed that the current low hiring and low separations rate were to continue, I would be much more concerned about that than I would about a slower supply-driven net zero payroll growth number. I don't think the low hiring rate is going to stay like this forever again. I think the main explanation is not some sort of structural shift due to AI. Rather, I think it is in part payback from the high hiring that we saw soon after the pandemic recovery.

[01:09:04.44]

And we can certainly live in a world where nonfarm payroll growth is around zero with lots and lots of gross flows in both directions. So the zero is perhaps the least important of all of the indicators once you start thinking about other household measures like unemployment, age-adjusted EPOP, and the important churn measures looking at gross flows.

[01:09:36.11] - Maurice Obstfeld

We are not only out of time, but in negative territory. So let me— ask you to thank our panelists for a great set of presentations.