Research @ Citi Podcast, Episode 20: The Resilient Global Economy & Trump 2.0

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Transcript:

Nathan Sheets (00:02)

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Rob Rowe (00:20)

Welcome to the Research @ Citi podcast. I'm your host Rob Rowe, U.S. Regional Director of Research at Citi. My guest today is Nathan Sheets, our global Chief Economist here at Citi, and our discussion today will be Nathan's forecast for growth for the global economy. Nathan, thanks for being with us today.

Nathan Sheets (00:40)

Hey, very much a pleasure, Rob. Great to be here.

Rob Rowe (00:44)

I noticed that your— you know, the published forecast for the global economy's growth is 2.6% this year, and that seems to be very much consistent with prior years or at least the last two years. And what kind of surprised me about that was I think most people would perceive that we're going into a year — 2025 — in which for one, we've had a change of administration in the United States, and one that may actually, I think most people would say, is going to cause more volatility given the potential for tariffs and the potential for a lot of change, especially within the U.S. government. In addition to that, we're probably seeing a lot more geopolitical concerns around the globe and tensions that probably haven't eased up all that much. And we're also in the middle of this very large monetary policy easing that we've seen, or that began in earnest last year. So how are you looking at this, Nathan, in the context of all that and coming to the conclusion that we're going to have global growth that seems to be consistent with the last two years?

Nathan Sheets (01:52)

Well, Rob, this is a great question. I think it really cuts to the heart of our views about the global economy. And kind of bottom line here, over each of the last two years, we've entered the year with an expectation that the global economy was going to slow significantly during that year. And in the event, we have seen ongoing resilience, particularly in global consumer spending. And bottom line growth has been just a notch below the 3% trend rate that we estimate. So we've seen in recent years the economy shrug off— largely shrug off the effects of the most significant central bank hiking cycle in a generation. There's been a slew of geopolitical challenges that have hit the economy. So in each of these last years, there are all sorts of reasons to be pessimistic and we saw spending in the economy remain pretty solid. And as we enter 2025, we are — bottom line — we're convinced that that resilience is likely to continue. If you press me, I would say part of that is that central banks are now shifting from mainly hiking to now largely being in a cutting cycle. And there's a debate, obviously, as to how much further we'll see that occur in 2025. But in any event, we're likely to see some more easing and then the effects of the past rate cuts pass through. But more broadly, I'd say, it's about a resilient global consumer and more broadly an economy that has shown a fair amount of momentum and, you know, if we're going to be surprised in 2025, after being surprised in each of the last two years by the stray, I'd say, let's be surprised by a weaker economy, which is not my expectation now.

Rob Rowe (04:02)

And maybe we can segue a little bit into the potential for tariffs and how you see that affecting the global economy. It's on the forefront of everybody's mind. I'd be curious to know how you feel you would calibrate them because some people feel they will be broad and severe. Others feel that it may be more unilaterally applied, you know, and especially towards China. And also how do you view that in terms of the global economy in terms of: Is this inflationary or is this more of a tax on the consumer?

Nathan Sheets (04:39)

So I think this is a close corollary to the first question you asked as well. And, you know, our sense is that as we kind of calibrate and tally up all the various policies that Donald Trump's spoken about, but more precisely the ones we think are actually likely to be put in place in 2025, that it's cutting in all sorts of different directions. You know, speaking from the U.S. perspective, there are positive and negative demand shocks, there are positive and negative supply shocks. And when we net through all of that, it's really not clear which direction dominates. And it leaves us— and this is really my bottom line for the U.S. outlook, but I think even for the global outlook, that our best appraisal of Trump's policies is roughly a net— they net out for growth. So I don't see it moving one way or the other. Maybe a little bit of on balance upward pressure on prices, which means that the Fed is going to have to be a little bit more vigilant than it would be otherwise. And I think we're hearing that from Fed speakers. But what this means is, the best advice for investors, and those of us who are analyzing the U.S. and global economy, I think, is to stay riveted on the fundamentals. And I think it's largely about the fundamentals that we'll be talking through the coming year.

Let me just give you a real quick kind of summary of what I expect from Trump during this first year, and this will be brief. But our sense is we could see some upfront tariffs on China. But largely the tariff threats are going to be used as a negotiating tool. So we think that there's going to be more bark than bite, at least to the extent the foreign countries, other countries are willing to negotiate. Fiscal, we're likely to see the extension of the Trump tax cuts. But it's going to be hard politically and we're already starting to see some of the political constraints start to assert themselves, to do a whole lot more than that, especially given the realities of the fiscal situation. We'll see a tightening of immigration inflows at the border. But the United States, we can see millions and millions of immigrants in recent years and the labor market is well supplied. And there will be some deregulation that I think will be helpful to energy and the financial sectors, for example. So on the margin here, these are important policies, but I really want to emphasize my view that it's primarily about the fundamentals.

Rob Rowe (07:30)

And Nathan, maybe that's a good segue into inflation and monetary policy even globally, because we seem to have been in an easing cycle. Even the recent payrolls print in the U.S. is probably going to maybe suggest that the Fed will take pause to see how this plays out. What's your prognosis for inflation? I think there's a lot of people that anticipate that we would see an uptick, you know, if on the margin, some of these things are positive for growth, and at the same time, with a strong payroll print in the U.S., how does that change necessarily the course of Fed or even let's just say global central bank easing because there's other countries that may not be in the same shape as the U.S.

Nathan Sheets (08:10)

So let me answer this question in two parts. Let me just give you a brief overview of how we're seeing the inflation fundamentals play through and then talk a little bit about how Trump's policies may influence this. And I think broadly — and this is true globally, it's true also specifically in terms of U.S. inflation — that over the last few years, we've seen both headline and core inflation come down significantly. They're still not back quite to where they were pre-pandemic, but they're getting close. But then if you break up core inflation into goods inflation and services inflation, goods inflation has fallen sharply and is at or below pre-pandemic levels, in some cases well below, and the services inflation has been more stubborn, but it is gradually retreating and we think that there will be further progress there. So on balance, we're reasonably comfortable goods inflation stays muted during the year ahead, we'll see further progress on services inflation.

So how does Trump change that? And let me emphasize here that the impact of tariffs on the U.S. economy is dramatically different than the impact of those U.S. tariffs on the rest of the world. So for the United States, a tariff acts like an adverse supply shock. What it tends to do is it makes prices higher, drives up prices, import prices are higher, and hence prices that people have to pay are higher. And at the same time, as you said, there is a tax on consumers. So consumers have less purchasing power and GDP goes down. So that's the environment you see higher prices and less spending, less real purchasing power, it's this adverse supply shock. But for the rest of the world, what you have when you put on these U.S. tariffs is it makes it harder for their firms to export. And what does that mean? That's effectively an adverse demand shock. And so the rest of the world faces less demand for their products. More of those products will need to be sold in other markets or at home, and it's likely to put downward pressure on inflation in the rest of the world. Now, there is an antidote. The foreign central banks can step in in the face of an adverse demand shock. Foreign central banks can step in and cut rates. So to the extent you do see this tariff, the clear policy prescription for foreign central banks is to be more aggressive with monetary policy. For the Fed, it's more complicated because yeah, they've got a weaker economy, but they also have higher prices and they've got to kind of wait and see which of those dominate or what's going on with inflation and how weak the economy is. It's actually a much harder shock for the domestic central bank to be able to deal with. But for the rest of the world, adverse demand, weaker— weaker growth, lower inflation, central banks should respond.

Rob Rowe (11:20)

Let’s explore what you said about how challenging it will be for the Fed. So— is it possible, though, that monetary policy could sort of go out of their hands if foreign rates are lowering a lot faster, anchoring our U.S. rates lower because they become more attractive on a yield basis, meaning it kind of drives rates down, maybe when the Fed wouldn't want to cut rates as a result of the increased growth in the U.S.?

Nathan Sheets (11:50)

Now, if we had had this discussion, say, 15 years ago, I would have said the probability that some development abroad would drive U.S. monetary policy, I'd say the probability of that is very, very low. At least the U.S. is the first mover, and then the rest of the world responds to what the Fed does. But hey, the reality is the global economy is much more integrated than it was, you know, 15, 20-plus years ago. We're more integrated. The rest of the world is larger relative to the United States. So, you know, the possibility that some kind of a response or a shock in the rest of the world might have an impact on U.S. monetary policy, you know, I'd say that that is increasingly possible. And indeed, I can think of a few instances over the last five, seven years where that's occurred. Finally, let me say in response to your question as a personal matter, having been the Fed's former international director who was reporting to the FOMC on what's happening in the rest of the world, I kind of feel vindicated that my sector is increasingly important for their deliberations.

Rob Rowe (13:12)

Maybe we can move on to the rest of the world and talk about where you think the principal drivers of growth are going to be. Obviously, U.S. exceptionalism is something that's been going on for a few years, or so-called U.S. exceptionalism. But what other areas of the world? I know that China has been challenged in terms of their economy as well as Europe. So how do you see it playing out?

Nathan Sheets (13:38)

Yeah. So on the China point, it is indeed the case that there are plenty of challenges in China, which we and colleagues at Citi Research have emphasized extensively. But it's also important to bear in mind that even a challenged Chinese economy for 2025, we're likely to see growth between 4 and 5 percent, which is above that global weighted average of 2.6% that you mentioned at the outset of this discussion. So there are challenges there, there are difficulties, but from an absolute growth standpoint, China's still doing okay. I think that as you move beyond China, we expect acceleration in Japan. We think that the Japanese economy is well positioned to put in a solid year. Specifically, all the indications are suggesting that the spring wage negotiations are likely to yield another year of solid wage increases, and that real wage gain that the Japanese consumers are likely to have should drive growth. So we're relatively optimistic about Japan.

And then from there, you know, there are emerging markets. India continues to grow at a solid pace. It looks like our expectation there is between 6 ½ and 7%. Indonesia is likely to grow at a 5% pace. Brazil is a very interesting case where it has continued to grow robustly, more rapidly than what we'd expected. But the downside of that has been that it's kicked off inflationary pressures which have been reinforced by the weaker currency, which has meant that the Brazilian central bank has had to go back on an aggressive hiking cycle. But the persistence of growth there is significant.

And then finally, let me conclude my answer here with a glimmer of hope for the euro area. And that is, yeah, in aggregate, we've got the euro area growing at just a 1% pace this year. That's a very weak Germany. But we also see meaningful strength in some of the “peripheral southern economy”. For example, we have growth in Spain at 2 ½%, and as a services producer — tourism-intensive economy — it's benefiting. And moreover, many of those “peripherals” reformed vigorously after the global financial crisis before the pandemic. It seems that they're reaping benefits from those reforms. So even within Europe, there are some parts of the euro area economy that are looking pretty solid, if not outright strong.

Rob Rowe (16:50)

And Nathan, in regard to the UK, the United Kingdom, we've seen a lot of volatility in their markets recently, their government markets, their rate markets, the concern being that the fiscal picture in the UK is not good. But has anything changed or is this just a— is this market reaction primarily about the UK, or is it also the fact that perhaps foreign direct investment is simply going to other areas, or is it really still a deep concern about the fiscal picture in the UK?

Nathan Sheets (17:24)

My instinct here is that it's some of both. When you look at the trajectory of UK fiscal policy, debt levels and so forth, there's a lot to worry about. You know, there's always— already been one very challenging near-crisis episode there in the fall of 2022, when Liz Truss was briefly the prime minister, and the markets are watching closely. Now, I think the subsequent governments have been aware of that and have talked differently about this goal. But at the end of the day, there was serious debate as to whether they've been sufficiently vigorous in addressing the problems as opposed to saying, “Oh, yeah, we understand there's a problem and we'll address those problems tomorrow.” But then more broadly, I think that we are in an environment right now of rising global interest rates. And I think that that is reflecting some developments in countries abroad. But really importantly, it's an example that the U.S. still matters a lot for the rest of the world, and we're getting those spillovers out of the U.S. bond market, where we've seen a dramatic increase in recent months— really, since the Fed started cutting, we've seen a dramatic increase in long-term U.S. interest rates. And it reflects ongoing strength of the U.S. economy. It reflects the fact that as the economy looks stronger, there's not as much scope for the Fed to cut, but it also reflects concerns about fiscal policy that are similar in the United States to what the market is reacting to in the UK.

Rob Rowe (19:17)

Fantastic, Nathan. Well, listen, this has been a pleasure, and as always, you've been very insightful, and I'm sure our audience is going to appreciate that very much. This episode of Research @ Citi was recorded on Friday, January 10, 2025. I'm your host Rob Rowe. Join us next time as we discuss China's future relationship with the U.S. Thanks, everyone.

[Disclaimer] (19:39)