ECONOMY

China economy overtaking U.S. is increasingly unlikely: ex-IMF official

Cornell professor predicts global protectionism and volatility if Trump wins election

Cornell University professor Eswar Prasad says China's economy "faces a variety of fragilities." © Reuters

YUTA SAITO, Nikkei staff writer
February 5, 2024 22:30 JST

NEW YORK -- The U.S. looks to maintain its strong growth while China confronts a slowdown, leaving the world's two largest economies on opposite trajectories as they try to shape the global order.

"The likelihood of the prediction that China's GDP will one day overtake that of the U.S. is declining," Eswar Prasad, a professor at Cornell University and a former International Monetary Fund official in charge of China, told Nikkei in a recent interview.

But Prasad said that if former U.S. President Donald Trump returns to the White House, he expects global protectionism and geopolitical tensions to escalate, with renewed American isolationism offering Beijing a chance to enhance its influence.

An edited excerpt of the interview follows.

Q: The U.S. economy has remained unexpectedly strong. Why do you think this is, and what do you expect in the future?

A: While most major economies are struggling, the U.S. is consolidating its position as the driving force of the global economy. The U.S. labor market is very flexible and strong. The government's fiscal policy and financial system have enabled small and midsize businesses to weather very difficult times [such as the pandemic and high inflation].

That said, I am a little concerned by the impact of the global economic slowdown. While U.S. GDP growth is not heavily dependent on exports, the sluggishness of other countries might be some drag. The increasing U.S. public debt and the increasing share of interest payments as a percentage of revenue are also significant concerns.

Q: There is a difference in view between the Federal Reserve and the market on interest rate cuts. What is your view on this?

A: The Fed had been slow in fighting inflation, but it is accomplishing the complex task of a soft landing by effectively adjusting monetary policy. Easing supply constraints has also helped to reduce global inflationary pressure.

But the Fed is clearly cautious about declaring victory too soon. If the economy and labor market remain strong, the Fed is unlikely to cut rates aggressively, although Fed Chair [Jerome] Powell has signaled that the Fed will be prepared to lower rates gradually if inflation remains low.

Eswar Prasad was in charge of analyzing China's economy during his days at the International Monetary Fund. (Photo by Jesse Winter)

Q: The outlook for China's economy is increasingly uncertain. What is your forecast?

A: The People's Bank of China's recent move to cut the deposit reserve ratio mirrors the Chinese government's concerns about slowing growth momentum and a slump in Chinese equities. But there is a limit to how far firms and households can go if they remain bearish. Chinese government moves to restore private-sector confidence and boost the economy still lack a broad reform framework.

China faces a variety of fragilities, including undesirable demographics [-- for example, a low birthrate and an aging population --] a collapsing real estate market, deteriorating investor sentiment at home and abroad and the lack of clarity over a new growth model. Even a 4%-5% growth rate will be difficult to sustain over the next few years. The likelihood of the prediction that China's GDP will one day overtake that of the U.S. is declining.

Q: You attended this year's annual meeting of the World Economic Forum in Davos. What was the atmosphere like?

A: The mood was somewhat gloomy due to a combination of geopolitical uncertainties and the difficult outlook for elections to be held this year in countries around the world. These elections are likely to further accelerate the trend toward promoting trade and investment among allies, [such as the fragmentation between Western countries and China/Russia].

Q: How will the outcome of the U.S. presidential election in November affect the global economy?

A: If former President [Donald] Trump wins, trade protectionism will escalate globally and geopolitical fissures will deepen. Trade and financial fragmentation could become serious. Increased uncertainty and volatility would likely atrophy private investment, which would have a negative impact on financial markets and economic growth.

Trump is likely to become more isolationist after his return to power. The U.S. will lose its leadership role in the operation of major international organizations and in addressing important global issues such as climate change. China will once again have the opportunity to strengthen its economic and geopolitical influence in the world, especially in Asia.