Exchanges at Goldman Sachs

The global economy in 2075: Growth slows as Asia rises

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Allison Nathan: Forget economic forecasting for 2023. Try planning for 2075.

Kevin Daly: Global population growth 50 years ago was around 2 percent per year. It's now down to around 1 percent per year. It is projected to fall to zero over the next 50 years. That slow down in the demographic picture presents a lot of economic challenges for economies going forward. And it is one of the factors that we expect to drive the slowdown in global growth over time.

Allison Nathan: I'm Allison Nathan and this is Exchanges at Goldman Sachs.

[MUSIC INTRO]

Allison Nathan: What long-term trends will shape the

global economy? Which countries will power global growth in the decades to come? And what does this mean for investors' portfolios?

For today's episode, I'm sitting down with my colleague Kevin Daly to discuss his very long-term view on global growth. Kevin is the co-head of the economics team covering Central and Eastern Europe, the Middle East, and Africa for Goldman Sachs Research.

Kevin, welcome to the program.

Kevin Daly: Thank you, Allison, it's nice to be here.

Allison Nathan: So, Kevin, start by giving us some context around this work on long-term growth, which actually has had a pretty interesting history at Goldman Sachs.

Kevin Daly: So, this all started a little over 20 years ago when former Head of Economic Research, Jim O'Neill coined the BRICs acronym. So, Brazil, Russia, India, China. And what was revolutionary at the time of that research was really the concept that you would get very

rapid growth over time in large emerging markets.

So, India and China, in particular, and to a lesser extent Brazil and Russia, more generally than emerging markets would capture a much larger share of GDP over time.

We had a major update ten years ago where we reviewed our long-term projections and revised them. And so, we're a little over 20 years since the first set of projections. We've updated them again. And expanded them as well to include a broad range of economies. So, we now have 104 economies. And we've extended the forecast horizon as well out to 2075.

Allison Nathan: So, looking back to that original work that was done 20 years ago, what about the economic growth have we gotten right? And what have we been more surprised by?

Kevin Daly: At the time, it wasn't anticipated that EMs would become the dominant force in the global economy that they are today. So, I think what we got right was the growing importance of large EMs [UNINTEL] and the contribution they make to global growth. Within that, on

the individual economies, I think some we got very right. So, India's and China's expansion in particular. But other elements we got wrong. We were over optimistic on Brazil. We were over optimistic on Russia, particularly over the last ten years.

There were some hits. There were some misses. But the broader message of the rise in importance of EMs, I think that has stood the test of time quite well.

Allison Nathan: And if anything, China has substantially surprised the upside, even if it was revolutionary that we identified them as a major force in the coming decades, they actually even surpassed our expectation.

Kevin Daly: Yeah. So, if you look back over the last 20 years as a whole, in the first ten years after the initial projections, we were too conservative in terms of the growth of EMs and India and China in particular. Bear in mind, back at the time of the first set of projections, China was only 12 percent of US GDP. It's now 80 percent of US GDP. So, China and India, in particular, have grown over the 20 years as a whole, actually faster than we anticipated.

Allison Nathan: So, Kevin, let me just take a step back here because most forecasters have a big challenge even forecasting one year out. So, what is a value of forecasting over such long horizons? And how confident can we be just given the uncertainty that comes with that amount of time?

Kevin Daly: The future is inherently uncertain. And the long-term future, in some sense, is particularly. One of the advantages of doing these long-term forecasts is that they strip out, to a large degree, the cyclical volatility that forecasters struggle with so much. So, the year to year cycle fluctuations that are inherently very difficult to predict. That over the longer term horizons that this set of projections, over ten, 20, 30, 50 years is that we can focus on things like population growth, capital, long-term productivity trends. And they're inherently more predictable.

To give you an example of this, let's take China's reopening from the COVID lockdown that is underway at the moment. That is crucially important for China's growth rate this year and into 2024. But whether that reopening goes well or whether it goes badly actually matters much less for where Chinese GDP will be in ten or 20 years time. So, we're able

to look through some of these cyclical volatility and focus on longer structural trends.

Allison Nathan: So, who is most focused on these long-term forecasts? Who's your audience for them?

Kevin Daly: There are important implications for long-term investors. But actually, it's from corporates in particular that we have the greatest demand for these types of projections. So, corporates typically have longer term horizons, need to make very long-term plans in terms of what markets they want to grow their market share in, what markets they want to target. And it's from those clients in particular that we have a lot of demand for these longer term outlooks.

Allison Nathan: And so, looking at those longer structural trends, one of your key findings is that the years of highest growth are actually behind us. [UNINTEL] is going to look much weaker based on those trends over the next couple decades than in the prior couple of decades, correct?

Kevin Daly: Yes. One of the major structural changes for

the global economy, the global population growth has slowed pretty significantly in the last 50 years. And will continue to slow over the next 50 years. So, global population growth 50 years ago was around 2 percent per year. It's now down to around 1 percent per year. It is projected to fall to zero over the next 50 years.

That's a good problem to have in the sense that slower population growth over time, I think, is a necessary condition for climate sustainability. But that slow down in the demographic picture presents a lot of economic challenges for economies going forward. In terms of population aging, how to plan for growing pension, sustainability, and so forth. And it is one of the factors that we expect to drive the slowdown in global growth over time.

Allison Nathan: And in particular, it's all about the labor force, right? So, if you have a shrinking population, you have a shrinking labor force. And that's, ultimately, a key driver of growth.

Kevin Daly: Absolutely. And what's interesting within that as well is that, actually, as we revise global population projections over time, the peak population growth is

declining to previous expectations. So, as previously the case that global population was expected to be rising above 11 billion, for instance, by the end of this century. It's now projected to peak at around 10 billion and be declining by the end of the century. That slow down in global population growth is one of, if not the most important secular trend for the global economy over the rest of this century.

Allison Nathan: So, population growth is very important. But what are some other trends that you're looking at that lead you to believe that growth will be slowing ahead?

Kevin Daly: There has been a slow down in productivity growth as well over the last decade, which appears to be linked to the slowdown in globalization and global trade growth. That's something that will be inherently quite difficult to forecast over longer time horizons. But will play an important role in shaping future growth.

If we broaden the discussion away from what will happen it global growth but what will happen to individual countries within that picture, one of the key trends is that income convergence remains intact. So, it is still the case that relatively low-income economies, so emerging markets in

particular, tend to be exhibiting faster GDP growth, faster income growth than high income economies. So, you are seeing that convergence is what fundamentally is driving faster growth in EMs over time. And we expect in the projections will drive the increase and importance of large EMs in particular over the next 25 and 50 years.

Allison Nathan: Right. But that's a continuation of a trend. Poorer countries get wealthier and, therefore, grow faster during that catch up phase.

Kevin Daly: Yeah. It was a particularly strong trend in the first decade of this century. And despite the fact that global growth has slowed in the last decade, that convergence remains very much intact. And that appears to be a feature that is now pretty robust and one within our projections we expect will continue going forward.

Allison Nathan: But it's interesting because if we talk a moment again about China, China still has relatively low per capita GDP, I would say relative to developed economies, but you are actually expecting pretty sharp slow down in Chinese growth over the next couple decades. So, what's driving that if the income still suggests they

have a lot of catch up?

Kevin Daly: So, the major force in China is demographics. So, we're in around the peak population level in China this year. I think there has already been quite a slow down and aging of the Chinese population to date. And that is a trend that is likely projected to continue going forward. So, that is the major driver of the slowdown in Chinese growth.

In addition to that, because China per capita has exhibited convergence over time to developed economies, the scope it has to continue to converge at the same pace has been reduced. So, most of the slowdown is driven by slower population growth and demographic factors. But some of it is also driven by a slower rate of catch up relative to the previous decades.

Allison Nathan: But in particular, in China, when we look at some of these demographic headwinds, they actually have been a function of policy. And China's aware of this. And have begun to take some measures to reverse that policy. Is there some potential for those trends to shift?

Kevin Daly: There are over the very long term. And one of the advantages of these long-term forecasts is that we can see over the next 18 years, at least, what the labor force growth is likely to be going forward because even if there is a turnaround in birth rates in China today, it's still going to be 15 to 20 years before the new births today will be entering the labor force in 15 - 20 years time. So, to a large degree, that slower labor force growth that is taking place in China is already set in stone, certainly over a 15 to 20 year period.

Allison Nathan: So, even if you do expect growth in China to slow over the next couple of decades, you are forecasting that China overtakes the US and becomes the largest global economy by around 2035.

Kevin Daly: This claim will be, perhaps, surprising. I'll make a couple of points in this regard as to why I think it shouldn't be surprising going forward. First of all is that most of the convergence in China's GDP to US [UNINTEL] has already taken place. 20 years ago, they were only 12 percent of US GDP. They've already risen to 80 percent of US GDP. So, most of that gap has already been closed.

The second is that although we expect, and there has been quite a sharp slowdown in Chinese potential growth, it is still, we estimate, around 4 percent per year, which is around double that of the US. The reason why it's still double that of the US is because of this income convergence. The fact that there's still a lot of catch up growth to do.

And given that China's population is so much larger than the US, to roughly three times the size of the US population, it can achieve a higher level of GDP even with a much lower level of GDP per capita. So, we expect on these revised projections for them to overtake the US in 2035.

Interestingly, that is pretty much bang on where the original set of projections thought it would overtake 20 years ago. We had turned more optimistic in the ten years ago projection. We had brought that forward to the late 2020s. And now in this set of projections, we're pushing it back again.

Allison Nathan: Interestingly as well, to me, if you think about the super charged growth of China over the last couple of decades, your recent work increasingly shows

that India is set for massive growth over the next couple decades. And will also catch up, eventually, to the US and China given that growth by 2075. So, talk to us a little bit about the drivers behind that growth in India that you expect.

Kevin Daly: The main driver is demographics. We've talked about the demographic problems that China faced in terms of slower population growth. That is not a factor in India's long-term economic outlook. It is already growing much faster than that of China and will continue to do so. Going forward, that will be a large driver on our projections of the catch up in the level of its GDP.

The second factor for India, which wasn't true previously ten, 20, 30 years ago, is that it is now delivering on that potential. India, historically, was a relatively poor performer in terms of productivity convergence. Over the last ten - 15 years, it has exhibited a much faster rate of convergence than was previously the case.

So, the combination of these two factors, stronger demographics, faster catch up growth, we think, over time, will drive India to be a much bigger force for the global

economy than it is today.

Allison Nathan: So, if a key takeaway from your work remains that you're going to see this continued convergence between emerging market economies and developed market economies, does that mean that the problem of income inequality that you mentioned and that we're all very focused on is set to diminish over time?

Kevin Daly: We think it is. And actually, the reduction that we've seen already, the income inequality at a global level, I think, runs counter to the common narrative that globalization has increased inequality. Because, actually, at the global level, that's not true.

It's that we find, and we show within the piece, that income convergence between countries has reduced global inequality. And that's a process that we project will continue over time.

One of the challenges, however, is that although global inequality has been declining, in many countries, certainly the majority of developed economies, there has been an increase within country inequality. And so, one of the

challenges going forward for policymakers is to share the fruits more widely of the benefits that globalization has brought within countries to help to ensure that there isn't a backlash against globalization going forward.

Allison Nathan: So, as we discussed, we're talking about long, very long-term timeframes here. And certainly, there are a lot of risks around these forecasts. So, what risks are you most focused on?

Kevin Daly: I think there are two risks that really I would highlight. One is the threat to globalization itself from the rise in protectionism. In our analysis, actually, globalization so far, the pace of that has slowed. It hasn't gone into reversal yet. But with the rise of popular nationalism in many economies, and the rise of protectionism in some economies, I think the threat of a reversal to globalization is a clear risk to the long-term outlook.

The second risk that we focus on is the risk of climate change, which I think is particularly important for low-income, developing economies which don't have the financial means of offsetting some of those risks. Because

often these highly populous, low-income emerging economies are in areas of the world which are most at risk from climate change. And that is a long-term threat to the outlook.

Allison Nathan: So, finally Kevin, given your findings, what should be the key takeaways for investors from this work?

Kevin Daly: I think one of the key takeaways is that over longer-term horizons, more economic and also financial market growth is likely to be driven by emerging market economies over time. That hasn't been so true over the last ten years, particularly in financial markets perspective where we've had ten years of exceptional US growth, exceptional US financial market growth in particular. And there is a tendency to look to the recent past amongst many investors and to extrapolate to the future.

One of the key points of our analysis is that over the very long term horizons going forward, actually more growth is likely being driven outside of developed economies and more of that driven by large emerging markets in particular.

Allison Nathan: Kevin, thanks so much for sharing your insights. It's not very often that we get to look so far in the future. So, thanks again.

Kevin Daly: Thank you, Allison.

Allison Nathan: Thanks for listening to another episode of Exchanges at Goldman Sachs. This episode was recorded on Friday, January 6th, 2023. If you enjoyed this show, we hope you follow on your platform of choice and tune in next week for another episode.

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