The US Economy is the Greatest Uncertainty for the Global Economy in 2024[1]

Nathan Sheets

Q1: How do you take stock of the U.S. economic outlook in 2024? Although the worries on recession seem to have subdued, there are still some who suggest that a recession may be inevitable for the U.S. to bring inflation back to target. What is your take on that?

The U.S. economy has been extremely resilient over the last several years. As 2023 began, I was expecting a recession in the year. Instead, we've seen above-trend growth from the United States.

The key to the strength of the U.S. economy has been a cycle where consumer spending, particularly on services, has been very strong. That strong services spending by the consumer was then supporting the labor market and the demand for workers, and putting upward pressure on wages. As wage growth has risen, that's further reinforced the strength of spending in the economy. So, in some sense, the U.S. has had a virtuous circle.

Are we seeing some of the services spending starting to slow? Are we seeing some evidence that the labor market might be softening a notch? I would say "yes", but it's all in the sense of moving from very strong restraint down to more moderate restraint. We still see solid indications of where the economy is. And I don't see anything at the moment that convinces me that a U.S. recession is around the corner.

Our formal call for some time has been for a recession in the middle of 2024. But the data do not support it. As a result of that, the expectation between recession and soft landing is very finely balanced.

Finally, one of the reasons why I've continued to expect a recession is because historically, when inflation has been this rapid, and when wage growth has been this high, part of the process of bringing them back down to more sustainable paces and bringing the economy back into balance has been a loosening of the labor market and increase in the unemployment rate in a period of recession. So, historically, that's been a feature of disinflation, and it very much remains to be seen whether this time is different, but that really is the big question for 2024.

Our formal forecast for U.S. GDP growth for 2024 is a 1% rate. That is down from over 2% in 2023. But it also embeds in it the view that there will be a recession. If there's no U.S. recession, then I think 2% plus, for various reasons, is likely to be where we're going to land.

But when I look at various countries around the world, the one where I think there is the most uncertainty in terms of its performance is the United States, where I have two distinct scenarios. One is there a recession. I know that many Fed watchers, U.S. analysts, and markets are saying no, but for the reasons I've described, I'm less convinced. If there is a recession, 1% growth or less is likely. If there's not a recession, then it's going to be another year similar to 2023, where the economy is pretty solid with growth in the neighborhood of 2% plus/minus a few ten-s.

1 Nathan Sheets is Group Chief Economist at Citigroup. The interview with Mr. Sheets was conducted by CF40 Research Department at the end of 2023.

So, there is still a wide range of outcomes. But I was surprised on the upside in 2023, and I'll be happy to be surprised on the upside in 2024.

Q2: Why hasn't the fight against inflation this time plunged the U.S. economy into recession? What has made it different?

That's probably the question I've spent the most time thinking about in 2023. If you'd ask me two years ago that, if the Fed is going to hike rates by more than 500 basis points over roughly an 18-month period, what will be the implications for the U.S. economy and the global economy? I would say the implications of such a rapid hike in such a short period are going to be very severe—certainly recession, financial market stresses, challenges, difficulties, and so forth. And in the event the economy has absorbed the Fed's tightening surprisingly well, what's going on? I think there are a couple of things.

First, I mentioned the strong consumer demand for services. A lot of that demand is pent-up demand that was accumulated during the pandemic. During the pandemic, U.S. consumers weren't consuming as much on services, travel, leisure, hospitality, entertainment, or going to restaurants. Then, coming out of the pandemic, there's been this very price-insensitive, interest-rate-insensitive demand. Consumers were determined to do it, regardless of the broader economic circumstances.

Consistent with that, there was also a fair amount of pent-up or accumulated savings in the economy as a result of the pandemic that they could use to finance these expenditures. So, we had this big quantum of demand for services that the Fed's tightening just has not slowed appreciably. That's one key factor.

The second key factor is that, during the decade preceding the Fed's rate hikes, we had very loose monetary policy and very low rates. During that period of time, households and firms took advantage of the low rates to refinance their mortgages and debt obligations. And a key feature the U.S. economy is we have these 30-year fixed rate mortgages that don't adjust as the Fed hikes. As a result of that, the U.S. household sector has largely been insulated from the effects of Fed rate hikes. People, firms and households have termed out their debt, and the Fed's hiking has not had the same effect that it would have had otherwise.

A final point that's more structural and longer term is the economy is increasingly about services, and services sectors are less capital-intensive, less about borrowing for investment, and therefore, less sensitive to Fed rate hikes.

So, those are the three key factors that I would point to in explaining the insensitivity of the economy. But the bottom line is that the U.S. economy has been remarkable and quite surprising.

One other related argument is whether all of this means that the lags for monetary policy have already played through and the effects of Fed rate hikes have already affected the economy, or if it means that the lags are simply longer than they were before, and the Fed's policies will eventually bite—it will just be more slowly over time.

I think the jury is still out on that question. I would lean more toward a longer-lag scenario, largely because all of that debt that is termed out eventually will need to be refinanced. People will eventually need to take out new mortgages, and firms will need to refinance debt as it comes due.

Similarly, over a couple of quarters, we'll see the pent-up demand for services play through. It's moving in that direction, and it should be completed at some point—in my mind, likely in the first half of 2024.

Q3: Do you think the Fed is pivoting is paramount target from curbing inflation to delivering a soft landing? Or should it do so? And what implications would that policy change have?

I think that the Fed is pivoting. Many people have used that word to describe Jerome Powell's December press conference. I think that is appropriate.

In previous press conferences, Jerome Powell has said that the Fed's first objective is to bring inflation down. As its seeks to bring inflation down, it's going to try to get policy right, and ensure that it's neither too tight nor too loose. But if it is going to make a mistake, it is going to make the mistake of being too aggressive and making sure that it fights inflation and extinguishes inflation from the economy.

At the press conference in December 2023, Jerome Powell was asked a very similar question, and instead, he emphasized how hard they would try to avoid a policy where it proved to be too aggressive. It was a very different tone than the previous press conferences, and it does lead me to believe that with inflation now on its path—at least down to the high-twos—that the Fed is waiting, bringing down inflation, and protecting the economy much more equally than had been the case before. It further leads me to think that the Fed is saying, "look, high-twos inflation versus a recession is not a good trade-off." So, I think they are in that process of pivoting.

You also asked whether I think that's the right thing to do. I would have been comfortable with the Fed being a little bit more gradual in implementing that pivot than what we saw. It felt like just a very abrupt shift in Federal Reserve policy. As a result of that, the financial markets have focused on the December press conference, and we've seen a substantial easing in financial conditions, which are a key channel through which Fed policy gets transmitted. As financial conditions ease, that means the restraint and the traction of Fed policy on the economy diminishes. Ironically, as the markets are jubilant and rise, it makes it harder for the Fed to achieve its objectives.

So, I can understand, under these circumstances, why the tone of Federal Reserve policy and communication shifted at the December meeting, but I think it would have been better if it had shifted a notch at the meeting. There may be a notch in the spring and another in the summer, as opposed to flipping three notches all at once. It was a very acute shift in his communication across a broad range of topics.

Q4: Do you think it's safe to say that the Fed is gaining victory against inflation?

The trajectory of inflation has been front and center in the Fed's thinking. The Fed has made significant progress in bringing down inflation. Specifically, core PCE inflation, which is the Fed preferred measure and peaked in 2022 at around 5.5%, is currently running at around 3.5%. But given the data that we're expecting over the next few months and other technical factors, it's very likely that by early 2024, the Fed's preferred measure of inflation will be a bit below 3%.

So, we have seen some appreciable progress from the mid-fives down to 3% or even lower in the Fed's preferred measure of inflation. I think that's giving the Fed a lot of satisfaction - we heard that from Jerome Powell in his recent press conference.

Now, I think the big question that many analysts are still debating and remains to be seen is, is this final chapter of inflation coming down from very high levels back to the Fed's 2% target likely to resemble the previous chapters? Or, is it likely to be more challenging?

My feeling has long been that the final part of inflation is more about services inflation, and bringing down the demand for services—which has been strong for a variety of reasons, but especially because of that pent-up demand—may require a broader loosening of the labor market and a higher unemployment rate in recession. It may be more painful than the disinflation that we've seen so far, which has mainly been about falling goods prices driven by healing of global supply chains, weakness in global goods demand, and declining commodity prices.

There's a lot of uncertainty about what this last chapter of disinflation looks like. But so far, the Fed has made significant progress, in my view, bringing inflation back down. It's just how hard that last percentage is likely to be.

Q5: What is your outlook for the inflation in the U.S. in the coming 1-2 years? How long do you think it'll take for it to fall back to target?

My expectation is that this last percentage point getting from 3% to 2% is likely to be challenging. It's likely to be more painful. It's likely to require deeper adjustments in the labor market and potentially a higher unemployment rate than we've seen so far.

Given that reality, it's likely to be a longer slog. I would not expect necessarily to see 2.0% inflation in 2024—I think it's more likely to be achieved in 2025. Having said that, from where we are today back to 2%, we will see some gradual progress through 2024. I just think this last leg of inflation is going to be the most challenging and the most difficult.

I also think it's going to highlight a related question, which is, as inflation falls into that 2-3% range, how hard is the Fed going to fight that? At the point where inflation has a 2-handle, 2.9%, 2.8%, 2.7%, as it's in that range, is the Fed really willing to stay as tight and risk a recession to bring inflation from 2.9%, 2.8% or 2.7% back down to 2%? Or will the Fed start taking its foot off the brake?

At his recent press conference, Jerome Powell was signaling that the appetite for further monetary restraint and high rates is more limited than I would have thought. It may be that the Fed itself is signaling that it's willing to allow some time to get back to 2% inflation rate. I think, ultimately, the Fed will be happy to give itself as much time as inflation expectations will allow it. And I really think that the Fed's guiding principle, or its north star, in this process of disinflation, is inflation expectations. If inflation expectations are staying well-anchored at around 2%, then that gives the Fed plenty of freedom to be very gradual in bringing inflation back down.

So, there are lots of considerations, but I think both from a macro view and thinking about the Fed's monetary policy strategy, the progress on inflation is likely to be much, much slower from here.

Q6: Do you think inflation can or needs to fall back to the 2% target from a pragmatic point of view?

That is a critical question. If you asked 15 macro economists where the optimal inflation target is for the United States, I think the preponderance of people would say something more like 3%, rather than 2%. So, from that perspective, you can argue that it's not even the optimal solution for the Fed. Then, why should the Fed sacrifice economic growth and employment to achieve it?

But on the other hand - economists are famous for having two hands - the key attraction for the Fed to 2% and the core of its obligation to get back to 2% is indeed a very pragmatic consideration, and that's that the Fed has *committed* to a 2% inflation target.

Why does the Fed need to get back to 2%? It's not so much that 2% is better than 3%, but because it's promised the public, the markets and the world that it will get inflation back to 2%. So, it becomes a matter of Federal Reserve credibility. So, I do think they need to get back there.

But as I've said, how fast you get back to 2% can be governed by how much space the markets are giving the Fed to operate. And that space is determined by inflation expectations and how well-anchored they are, which, in turn, reflects Fed credibility. So, the Fed is credible. It can give itself more time and sacrifice less employment, growth and economic activity on its way back.

In this cycle, it's important for both pragmatic and policy reasons to get back to 2%. Over time, maybe the Fed will reconsider its inflation target, but for now, 2% is where they need to go.

Q7: Do you have any concrete prediction of the Fed's monetary policy move in 2024?

My view about the U.S. economy is that, as a result of monetary policy lags and the fact that services inflation remains challenging, there is still a recession risk in the economy. In the event of recession, the Fed is likely to be cutting fairly aggressively, I would say 100 basis points or more, most likely in the second half of 2024.

However, in the soft-landing scenario that Jerome Powell and his colleagues are envisioning, I think we've got to take them at their word that a reasonable baseline is 75 basis points of rate cuts.

Any way the Fed cuts it, regardless of where the economy goes—if it's soft landing, then three cuts as the Fed is saying; if it's recession, I'd say four cuts or maybe more than that—we should prepare ourselves for some easing of U.S. monetary conditions in 2024.

Now, an important point—it's one that the Fed has alluded to and one of the reasons why in the soft landing scenario it would have three rate cuts—is that as inflation comes down, if the Fed funds rate is not adjusted, then that implied real rate meaning the difference between the Fed funds rate and inflation will rise. So, what the Fed does is it cuts just to accommodate lower inflation. And in some sense, I think the Fed would argue that's not an easing of financial conditions and not an easing of monetary policy.

But in any of that, it is a right cut. I think people in the markets at least are not going to be differentiating adjustments due to real rates and those for other factors. So, the bottom line is that there will be rate cuts in 2024, and they're likely to be appreciable.

Q8: What is your outlook for the real rate in the U.S. in the coming 1 to 2 years?

This is a great question. One of the big debates in the U.S. regarding the economy is where "R*" has moved.

R* is the real rate that's associated with the economy being at a steady state or an equilibrium. Pre-pandemic, it was widely believed that R* was at around 0.5%. Or, with 2% inflation, a 0.5% R* suggested a neutral nominal Fed funds rate of around 2.5%.

Now, that's still what the Fed has in its projections, and so the Fed has continued to signal R* of around 0.5% and a neutral funds rate of roughly 2.5%. I think it's broadly agreed that—for various reasons, including shifts in the economy, slower pace of globalization, the demands of net-zero transition for capital, implications of aging demographics, and maybe just some normalization—R* has probably risen a bit.

My instinct is that it hasn't risen a lot. I don't think we have evidence of that. But could R* now be around 1% rather than 0.5%, suggesting that neutral debt funds rate is at around 3%? I think that's the right story.

To focus on the next year or two, through a lot of that period, I think we will see a real interest rate that's higher than that. Right now, we're having an implied real rate of at least 2.5%, with the Fed funds rate of around 5.5% and inflation running around 3%. It will be coming down, but I wouldn't expect it to fall back to that R* rate until late 2025 or early 2026.

Unless the economy slows very appreciably, this will be a period where real rates are elevated. And then once they get back as the Fed is cutting, then we will be in a better place to be able to evaluate where that R*, that equilibrium, steady-state concept really is, but it's probably a little higher than it was before the pandemic.

Q9: How are the higher interest rates influencing the economy?

The reality is that longer-term rates are very powerful channels of transmission into the economy for monetary policy. But more broadly, it really is that spot on the curve out around that 10-year point that's particularly critical.

I think the number one and the most important point of traction from rates into the economies is through the mortgage market.

Unlike many other countries, the United States has long-term fixed rate mortgages, so it's not like higher interest rates today roll in to everybody's mortgage tomorrow. But it is very impactful on the economy—anyone who needs to take out a new mortgage, anybody that needs to move, and anyone who wants to buy a house is now looking at substantially higher interest rates.

Another place where it's manifesting itself is, as a result of these 30-year mortgages that people have and the fact that rates are so much higher, many people who have low mortgage rates are unable to sell their houses and move, because they can't afford to take on a new mortgage. So, we have reduced volumes of transactions in the U.S. housing market, which is creating challenges for pricing and volume and people looking for new homes.

The principal channel of transmission is into mortgages, but higher rates along the curve also influence consumers in other ways as they seek to borrow, for example, to purchase a car, and has substantial implications for firms as they think about investment and financing their operations and growing their businesses.

Finally, this higher rate environment that we're in also creates conundrums and challenges for the banking system, as they think about managing interest rate risk on their balance sheets. Many financial institutions bought long-duration assets in that decade before the Fed's rate hikes started. Those long-duration assets that they purchased during those periods now have losses associated with them. And banks will have to manage that.

Similarly, with higher rates at various points of the curve, it also means that banks are paying more on deposits, and that creates funding pressures for the banks. That's good news for people who own those deposits, pensioners, retired households and others. And now, in the U.S., we're running more on our deposits. So, there are pluses and minuses associated with it, but it's a liquidity and financing challenge for the banks.

So, there are a number of places where these higher rates do impact families, as they think about buying houses and cars, influence what they earn on their deposits, and influence firms as they think about financing themselves, their ongoing operations, expanding their business and investing in capital.

Q10: How do you depict the trajectory of the U.S treasury yield in 2024? How do you evaluate the debt risk facing the Federal government?

The 10-year treasury yield has recently been influenced by three key macroeconomic factors.

First is shifting views on U.S. recession and the probability of a recession. Through the summer, investors were shifting to view the recession as less likely in the United States. That was a factor that was driving up Treasury yields.

Second, related to the performance of the economy, is the expectation of the markets as to how the Fed and its policies are likely to evolve. Notably, through the summer, the Fed was signaling higher-for-longer tight monetary policy. More recently, Fed policy, and relatedly inflation performance, has been easing. That's been a key explanatory variable in driving the 10-year treasury yield back down.

The third factor in play in 2023 that has influenced bond yields is concerns about the very high levels of U.S. debt and deficits in the public sector. It is notable that the 10-year Treasury yield shot upward, starting in early August, in particular following the debt ceiling standoff, following the Fitch downgrade and an announcement from the Treasury that there was going to be a lot of issuance.

As I've spoken to investors around the world over the last 3-6 months, the number one question I've heard is who's going to buy all of the debt? It is very much a front-and-center question. So, I think that there's been a risk premium reflecting concerns of that issuance and that's also been in the 10-year treasury yield.

More recently, some of that concern is abated as the 10-year treasury yield is cut back below 4%. Given where it stands today, I don't have a strong view as to where it's likely to go in 2024. These current levels don't strike me as being significantly out of line with where I see macroeconomic fundamentals.

Could there be some more volatility in perceptions of where the economy is, where the Fed is, and how the debt situation evolves? Absolutely. But I think from where we are now, there are likely two-sided risks facing the treasury yields.

Q11: What is the influence of the federal deficit on the interest rate, the real economy, the financial market and households?

We have exceptionally high deficits in the United States. U.S. government and the nonpartisan Congressional Budget Office estimates that the deficit is likely to run around 5.5-6% of GDP a year for the coming decade. If you aggregate up all of those deficits, that suggests $20 trillion of treasury issuance over that period, which is a very substantial figure.

I think your question of what does all this mean for the economy is a very important one, and classically has been described by this term of "crowding out". Specifically, as the treasury is in the markets borrowing substantially, it's taking funds that would otherwise go to other parts of the economy, including firms and households and others who might be interested in borrowing. It's taking them out, and it ultimately means that those other borrowers need to pay more. As a result of those higher costs of borrowing and potentially higher rates, the economy grows more slowly than would be the case otherwise.

Now, crowding out didn't really prevail during the decade before the pandemic, when we also had very high deficits. First, these deficits are larger. Second, the Fed's policy was very stimulative, and that helped offset a lot of the impact of the fiscal deficits and the issuance. My presumption is that the economy is going to be in a different place, and the Fed's policies will hopefully not need to be as stimulative, that inflation will be performing better, and the Fed won't need to be constantly priming the pump with more monetary policy support. So, there is a risk that we could see a crowding-out in the economy.

Let me also mention one other channel that may be at work. Households and firms, when they see very high debt levels, it tends to make them nervous. They look at those high debt levels and they say, "that could be a problem." Maybe they start worrying that increase in taxes are down the road. They start to think that since taxes are going to get higher, maybe they need to spend a little less today to be ready for that in the future. There's a macro term called Ricardian Equivalence to describe that.

Typically, U.S. consumers aren't thought of behaving in a Ricardian fashion. But we also haven't seen debt and deficits quite like that. It could also create broader uncertainties where, when the government has this vulnerability, it makes people a little bit more nervous. When I look at the macro data across a broad range of countries over decades, I detect that the private sector gets a little bit nervous when public sector debt is high, and that ends up restraining spending and aggregate demand, and results in somewhat slower growth.

There are a variety of channels, including confidence, that result in crowding out and create uncertainty. It's an overhang on the economy, and all of those are headwinds and challenges.

The final point to make is that as the government's debt is higher, that means that if you have adverse developments, the government doesn't have as much space because there are limits to how high they want to go with the debt. Similarly, there might be strategic public investments and investments in human capital and others that the government should be making. But if your fiscal policy is already out of whack with large deficits and high debt, the scope to make those kinds of investments may be more limited.

So, I do think this is a serious question mark for the U.S. that could meaningfully constrain its fiscal policy going forward.

Q12: How do you think the US dollar and its liquidity would evolve in 2024? What are the risks and opportunities facing non-dollar markets, especially the emerging markets economies?

The dollar has been a very strong currency over the last couple of years. That is reflecting both the fact that the U.S. economy has been relatively resilient, and the fact that the Fed has been relatively aggressive.

As we move into 2024, the economy is still looking pretty good. But the tone of Federal Reserve policy is starting to shift. If we also start to have a slowing in the economy, I do think that there is meaningful scope for a further downward adjustment in the dollar, and given how elevated the dollar is by several key metrics that I follow, that downward adjustment could be quite sustained and quite significant.

As regards when it's going to happen, it may be more likely in the second half of 2024, then in the first half of 2025. But once it starts, I think it's likely to be significant. So, I would say that in the not-too-distant future, we're likely to see an adjustment in currency markets.

In terms of opportunities in emerging markets, I think the reality is that emerging markets, broadly speaking, have performed quite well over the last couple of years. Some of the Latin American central banks, in particular, and some in central and eastern Europe, hiked rates more vigorously and/or earlier than the Fed did.

Specifically, in 2021 when Jerome Powell and Madame Lagarde were still talking about "transitory inflation", many of the emerging market economies central banks started to hike that allowed them to get traction on inflation. It reinforced their credibility. It's meant that inflation in those countries was coming down a little bit earlier than elsewhere. And several of those central banks have already started to cut rates. So, I think that we're in a place where sentiment toward emerging markets is pretty good.

Similarly, the global economy as a whole has benefited from a better performance of emerging Asian central banks and economies than what I would have expected. Those economies which are very heavily geared to trade have similarly benefited. As you delve down into more specific country-specific stories, including Brazil, Mexico and India, a number of those countries are very positive and encouraging.

So, I do think there are significant opportunities outside of the developed market world. And all of that is in addition to the opportunities and, admittedly, challenges that China's economy faces as well.

Q13: How do you envision global economic growth in 2024, especially the situation in Europe and Japan?

We were fairly restrained in our outlook.

When we look at the key regions, I've described the uncertainties surrounding the U.S. outlook. In Europe, the euro area is currently in a recession. The economy contracted mildly in Q3, and we think it will continue in Q4 and Q1, 2024. But even once the economy starts growing again, it's likely to be fairly restrained. There are lots of cyclical and structural challenges facing the euro area in our views. So, we're pretty cautious as we write down numbers for that part of the world.

In China, we see growth in the neighborhood of the growth target, 5% is for 2023, 4.5-5% for 2024, depending on where the growth target is set. Our sense is the Chinese consumer is now in a position where they're likely to be spending at a moderate, not strong, but a moderate pace. There will be enough stimulus to provide so that the growth target will be achieved.

That said, like many others, we're watching the property sector very carefully. That is the downside risk and the source of stress. In our baseline scenario, we think the government will successfully put a floor under it, so that the property sector is not a major driver of growth, but it's also not a driver of financial stability risk for the economy.

So, for the U.S., we see lots of uncertainty; euro area, on the downside and soft; China, somewhere in between with moderate growth.

That's also I where I would put Japan. During the first part of 2023, Japan had a very strong rebound, largely due to reopening associated with Covid. More recently, the economy is taking a breather, pointing to a slower pace of performance in 2024. The government's preparing yet another stimulus package to provide support. Putting all of that together, our view is that Japanese growth is rather likely to be around 1% or maybe a little bit below that, so that's moderate.

What I've described for Japan relative to its trend is pretty similar to China relative to its trend. And I think that's where we put Asia—it's right around-trend growth, not spectacular, but a solid performance.

As we aggregate that into the global economy, we do end up with relatively soft performance, down maybe half a percentage point or more from 2023. We aggregate global GDP a little bit differently than the IMF does, but comparably, we would be a little bit weaker than the IMF but not appreciably so. Again, the biggest free variable in my mind is what happens in the United States. And if the U.S. doesn't have a recession, then our forecast would be a little bit above the IMF.

Q14: What are the most noteworthy forces driving or threatening global growth? Will variables including geopolitical tensions and climate actions push the world economy into stagflation?

One challenge for 2024 is the geopolitics, including what's going to happen with Russian and Ukraine as well as the middle east. We're also watching as a key driver of global growth the ongoing trajectory of the U.S.-China relationship, which could have very important implications for both our economies, but also for the world more generally.

Another key development for financial markets is there are going to be dozens of elections around the world during the coming year, including an election in the United States. The outcome of those elections is going to be very important in determining geopolitics and the stance of economic policies and which central bankers are appointed and a long list of other things. That's something I'm also watching.

All in all, I'm not expecting outcomes that I characterize as stagflationary. At this stage, in the cycle, a lot of the supply shocks that we were seeing have abated. And now it's more likely to be about the strength of demand and household spending, less than about supply shocks.

There obviously are longer term forces that are in play. You mentioned the net-zero effort, which if governments got really serious about and imposed a carbon tax, there could have a supply shock aspect to it. It's also going to require a lot of demand for investment goods, and a lot of spending on investment, and that's likely to strengthen aggregate demand. So, putting it all together, it becomes more complicated. But my sense is it'll still probably takes some years down the road before net-zero considerations really mature and become front and center in our forecast.

For now, it's more about demand, geopolitics, domestic politics, and their spillovers into the global economy. Those are some of the things that I'm thinking about watching closely for the year ahead.

Q15: What suggestions would you give to global central banks to enhance coordination in response to the risks and challenges?

The number one suggestion I'd have for central banks is to stay focused on their mandates. And their mandates are for price stability, first and foremost. The Fed has a dual mandate for price stability and full employment.

It's very easy as a policymaker in a central bank to become distracted on a lot of other things. Bottom line: the way that central banks can deliver the best outcomes for the public is to stay riveted on those issues.

In terms of coordination, I think that focus on inflation and gearing policy to address it also frames out nicely the kind of coordination that needs to happen. The good news there is that central bankers meet regularly and exchange views and perspectives on what's happening in the global economy and updated each other. So, in the Fed's meeting, it has a pretty good idea as to how Madame Lagarde is thinking about things, as to how the ECB, the PBOC and the BOJ are viewing the world, and vice versa. I think that's the right degree of coordination.

Given these domestic mandates that various central banks have, more formal coordination of policy is probably not feasible and may not even be desirable. But, stay focused on those domestic mandates for inflation, and talk to each other and keep each other apprised on policy developments in various countries and economic developments, so that they can formulate policy with a broad set of information that's consistent with each other. That's what I'd emphasize in response to your question about the guidance for global central bankers.

Q16: Do you think it's likely that the BOJ will shift its monetary policy substantively in 2024? And how will it influence the global interest rate system of financial market if Japan is to exit from the negative interest rate policy?

I see the BOJ policy as having two principal prongs. The first prong is the yield curve control (YCC) strategy, where they've already taken some significant steps to back away from.

The exit from YCC is conceptually a very tricky endeavor. Indeed, 15 years ago during the global financial crisis, the Fed considered a policy that was very similar to YCC and ultimately decided not to adopt that kind of a strategy, because, as they were debating it, they couldn't figure out what the exit strategy would look like. How do you get out of it? So, the BOJ deserves many kudos for being able to make as much progress to exit from YCC as they have over the last year, to be able to do it in a relatively non-disruptive way.

Similarly, Japan has negative interest rates. My sense is that the BOJ would like to normalize policy, at least to the extent of bringing the policy rate back up to zero or just slightly positive. The exact timing of when that's going to happen depends a lot on the global economy, the trajectory of exchange markets, and maybe even how the Fed's policies evolve.

As a result of that, we see a broad range of possibilities as being in play as to when the BOJ will finally take the last step of exit from YCC and lift rates to zero. My sense is that it could happen as soon as imminently to as late as in the spring of 2025, depending on global conditions and how things evolve.

I do think, though, that the markets are looking to the BOJ to act in these respects. Once you're inside a central bank and the markets, eyes are upon you to do something, and it's clear what needs to be done. That tends to be a mechanism that accelerates action.

I personally would be surprised if it was sooner rather than later. Our formal call is a later exit, maybe as late as early 2025. There is lots of uncertainty around this, but it will happen. It's just a question of when, and that's going to be determined by the global economy, pressures on the exchange rate, Fed policy, and the like.