AI – New Economy 2.0?

The designated chair of the Federal Reserve Board, Kevin Warsh, expects artificial intelligence to curb inflation and drive growth, similar to what information technology did in the years around the turn of the millennium. With these hopes for a return of the New Economy, he wants to push through significant interest rate cuts at the Fed. We assess the significance of AI for the US economy and compare the current situation with that of the past.

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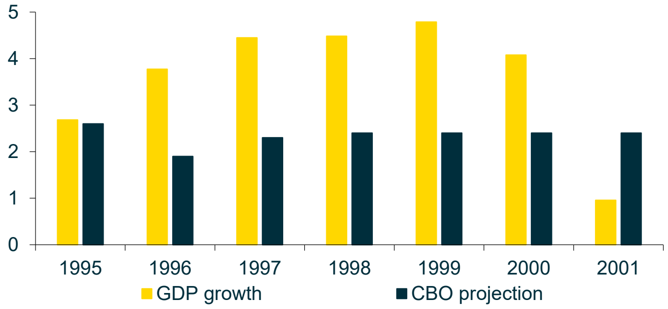
Kevin Warsh bets on the beneficial effects of high-tech

Donald Trump has made it clear that he expects Kevin Warsh, the designated chair of the Federal Reserve Board, to cut interest rates significantly as soon as he takes the helm at the Fed in May. However, finding serious reasons for this is not easy given an inflation rate of around 3% and a relatively low unemployment rate. Warsh will likely use the growing influence of artificial intelligence (AI) on the US economy as his main argument. In an opinion piece in the Wall Street Journal in November, Warsh wrote: *"AI will be a significant deflationary force, increasing productivity and strengthening US competitiveness."*

New Economy as a model

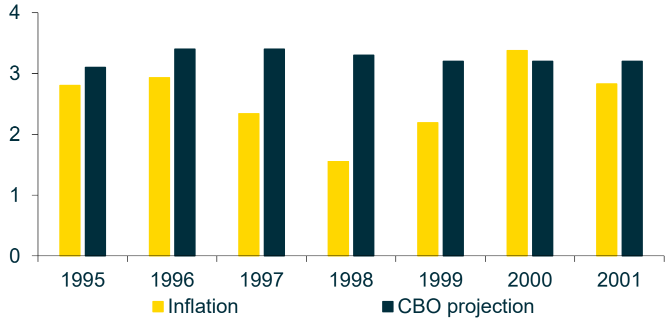
Warsh is clearly banking on AI having a similar effect to the advances in information technology at the turn of the millennium. At that time, the US economy grew much more strongly than had been generally expected, partly due to a massive increase in productivity. In its economic projection published in the summer of 1995, the Congressional Budget Office (CBO) assumed real economic growth of 2.3% on average and an inflation rate of 3.3% for the following five years. In fact, growth was a full two percentage points higher at 4.3% per year (Chart 1). In contrast, the inflation rate was significantly lower than expected at 2.5% (Chart 2).

Chart 1 - Growth was underestimated
Real GDP, annual rate of change in %, actual data and Aug 1995 CBO projection



Source: CBO, S&P Global, Commerzbank Research

Chart 2 - ... and inflation overestimated
CPI, annual rate of change in %, actual data and Aug 1995 CBO projections



Source: CBO, S&P Global, Commerzbank Research

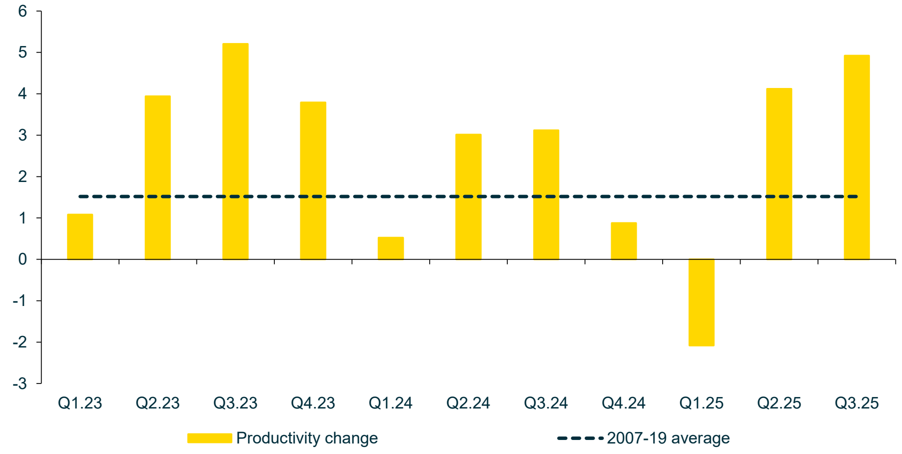
Now, high-tech investments are also skyrocketing...

There are obvious parallels between then and now. Investments in high-tech rose significantly last year, especially in AI infrastructure. In the fourth quarter, price-adjusted investment in information technology and software was almost 20% higher than in the previous year and, measured in terms of gross domestic product, was even slightly higher than at the peak of the IT boom at the turn of the millennium (title chart). Taking into account investments in R & D and construction spending on data centers, high-tech investments boosted economic growth by around 1 percentage point in 2025.

... but productivity growth has lagged behind so far ...

However, the resulting boost in productivity has yet to materialize. Although productivity has improved significantly in recent quarters, with labor productivity growth rates most recently in the range of 4% annualized (Chart 3; Q4 figures will be released next week), it is still too early to speak of a trend. This is because there have been repeated phases of temporary high productivity growth in recent years, for example in 2023. It is therefore not yet possible to say with certainty that productivity is now growing faster than the approximately 1.5% per year achieved before the pandemic, either permanently or at least for a longer period of time.

Chart 3 - Will strong productivity increases continue?
Real output per hour, annualized quarterly rates of change, average change 2007-19, in %



Source: BLS, Commerzbank Research

… which is not unusual, however

However, it is by no means unusual for a fundamental technical innovation to take some time to become apparent in macroeconomic statistics. The actual launch of AI only took place a few years ago with the release of the first widely usable AI chatbot in 2022. A similar phenomenon was observed in the New Economy. PCs were introduced on a broader basis during the 1980s, and the internet gained momentum with the first browsers in 1994. Only then did the sharp rise in productivity begin.

This effect when innovations are introduced into the economy is known as the “J-curve effect.” The introduction of a basic innovation—a technical innovation that has a broad impact on the entire economy and can drive growth for a long time—requires significant initial investment. It is usually not enough to simply install new technology. Rather, entire production processes must be reorganized in order to leverage the potential of the innovation. Experience shows that this requires a longer learning phase. It may be necessary to operate old and new systems in parallel for a transitional period. Initially, productivity development is therefore on the downward slope of the “J”; higher expenditure does not immediately translate into a disproportionate increase in output. In the longer term, however, the teething problems are overcome and companies and their workforces get to grips with the new technology. Productivity then increases sharply, reaching the upward slope of the “J.”

How steep will the J curve be?

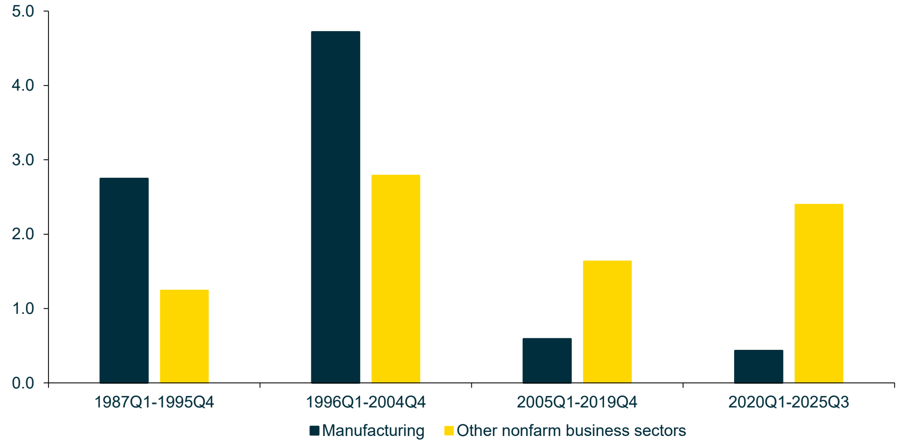
Opinions vary widely on how much AI will ultimately improve productivity and thus reduce inflation. In 2024, Nobel Prize winner Daron Acemoglu **analyzed** which activities could be performed more productively using AI. With many jobs for example in health care and the crafts unlikely to benefit much from AI, he estimated a productivity boost of less than 0.1% per year for the economy as a whole over a ten-year period. The US Congressional Budget Office (CBO) also recently assumed an “AI effect” of this magnitude in its **ten-year projections**. **Researchers at the OECD** were more optimistic, believing that AI could deliver an additional productivity gain of up to 0.6% per year over this period.

Some factors significantly worse today

Another argument against overly high expectations for productivity growth is that the very positive development around the turn of the millennium was probably not only due to advances in information technology, but also to a number of other positive factors that boosted productivity and suppressed inflation:

- **Globalization vs. deglobalization:** A look at productivity trends at that time shows that productivity grew most strongly in industry (Chart 4). The radical liberalization of world trade at that time and a productivity-enhancing expansion of the international division of labor are likely to have contributed to this. As a result, low-productivity production was outsourced on a large scale to countries with lower wages, such as China and Mexico. This increased the average productivity of domestic production and suppressed inflation. In contrast, the US market is currently being sealed off from international competition in order to bring production back to the US. In addition, many production chains are no longer aimed at achieving the highest possible efficiency, but are instead geared toward resilience aspects. This suppresses productivity and drives up prices.

Chart 4 - Manufacturing boosted productivity in the New Economy
Real output per hour in manufacturing and in other nonfarm business sectors, average annual change in %



Source: BLS, Commerzbank Research

- **No more peace dividend:** After the end of the Cold War, US defense spending was significantly reduced in the 1990s, from 5-6% of GDP in the late 1980s to around 3% in 2000. Resources could therefore be redirected to more productive uses. Now, however, military spending is expected to rise, which will push up demand and thus prices through higher deficits and rising debt.
- **Less favorable demographics:** At that time, the age structure was more favorable. In 1995, for example, there were almost twice as many 5-14-year-olds as 55-64-year-olds. This meant that significantly more younger people were entering the workforce than older workers were leaving. Today, however, the older age groups are more numerous than the younger ones. This dampens the supply of labor more than consumer demand. This tends to lead to rising prices.

… so you shouldn't put all your eggs in the AI basket

An important prerequisite for the New Economy in the 1990s was certainly the favorable environment at the time. This now looks less inviting: demographics, deglobalization, and excessive government debt no longer point to disinflationary developments, unlike in the 1990s. At the same time, the productivity- and thus growth-enhancing effect of AI is still more of a forecast than a description of reality.

If the designated Fed chairman Kevin Warsh is counting on AI to solve his inflation problems, he is probably making a policy mistake. We expect him to be able to push through interest rate cuts of 100 basis points by spring 2027. However, this will make monetary policy too expansionary and create inflation risks.

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