Flash Economics

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Will Kevin Warsh's theory on productivity and inflation prove to be correct?

Kevin Warsh argues that the development of artificial intelligence will lead to very rapid productivity gains, which will drive down inflation; lower inflation will allow the Federal Reserve to cut interest rates sharply. Recent developments do not contradict this thesis: strong GDP growth and weak employment growth show, implying very significant productivity gains and a decline in core inflation. This thesis, however, differs significantly from the view held by the majority of FOMC members.

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The development of artificial intelligence is likely to lead to rapid productivity gains

Productivity gains have been very high in the United States since the second quarter of 2025, as evidenced by the rapid pace of GDP growth (**Chart 1**) and the sluggish growth in employment (**Charts 2A/B**), which has increased by an average of less than 0.2% year-over-year.

In addition, GDP growth was trimmed by 1 percentage point (on an annualised basis) due to the government shutdown in the fourth quarter of 2025.

Chart 1
United States: Real GDP growth (Q/Q annualized, %)

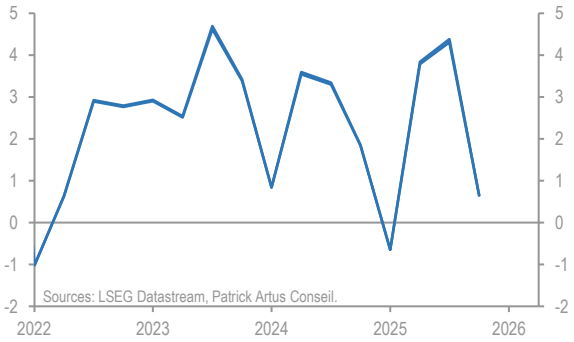


Chart 2A
United States: Change in private payrolls (M/M, thousands of persons)

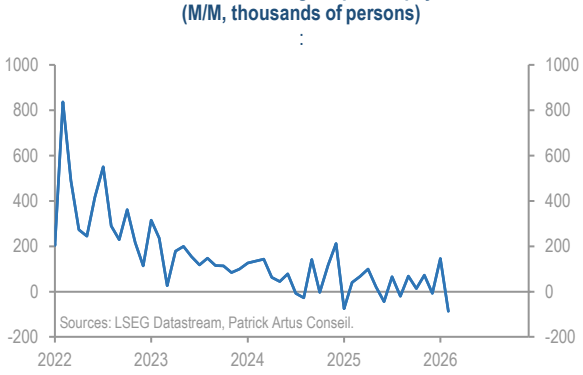
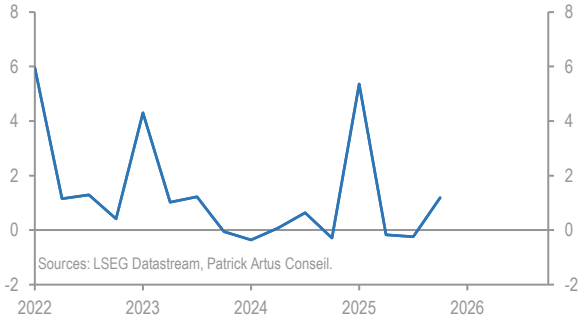


Chart 2B
United States: Employment (Q/Q annualised, %



It is likely that the **development of artificial intelligence accounts, at least in part, for this rapid rise in productivity in the United States**. Indeed, we see that in sectors where artificial intelligence has significantly changed production techniques (retail, transportation and logistics, business and financial services, and information), employment stagnated or declined in 2025 (**Charts 3A/B**).

Chart 3A
United States: Employment change in retail, wholesale trade and logistics (M/M, thousands of persons)

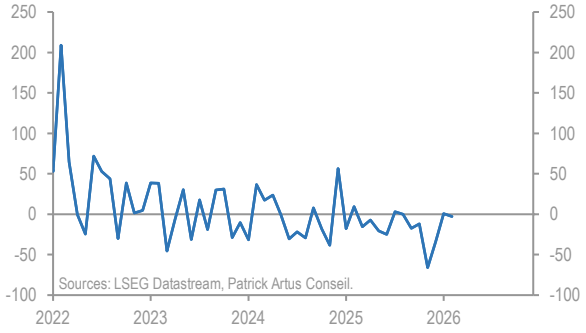
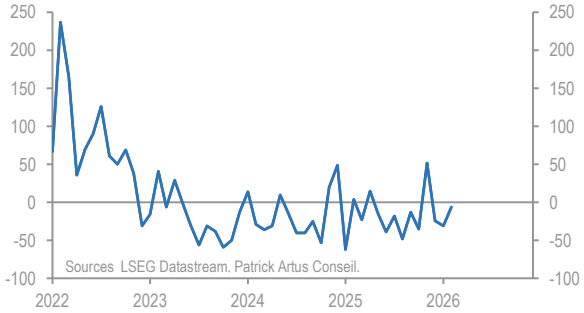


Chart 3B
United States: Employment change in information, business services and financial services (M/M, thousands of persons)



Rapid productivity gains are leading to a decline in core inflation

Chart 4A shows the trend in inflation excluding energy and food, which is declining, as are service prices (Chart 4B).

Chart 4A
United States: Core inflation
(CPI excl. food and energy, Y/Y as %)

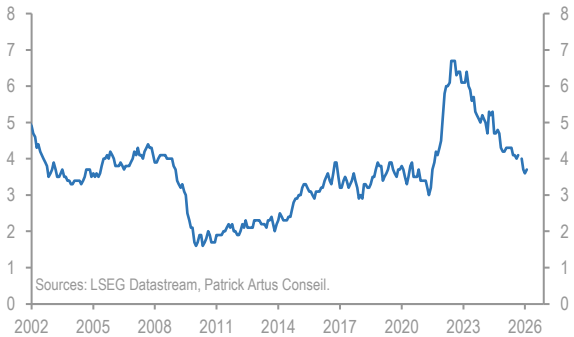


Chart 4B
United States: Consumer price index - services less energy services (Y/Y as %)



Given wage increases (Chart 5) and productivity gains, unit labour costs have been rising at a rate of only 0.5% per year since the second quarter of 2025, which explains the slowdown in inflation.

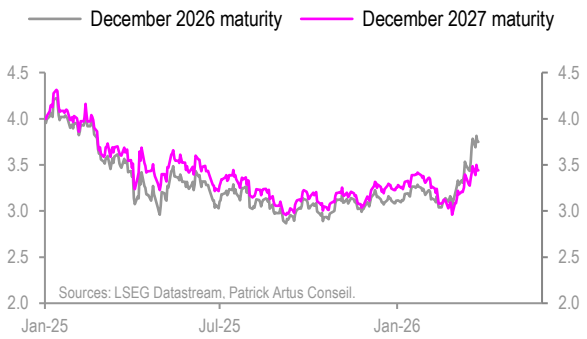
Chart 5
United States: Nominal per capita wage (Y/Y as%)



Opportunity for the Federal Reserve to lower interest rates

Financial market participants currently expect the Federal Reserve to keep the lower end of the federal funds rate target range unchanged, in response to inflation stoked by the war in the Middle East (Chart 6). However, once the war ends, **if inflation continues to decline, the Federal Reserve will likely be able to cut interest rates significantly**: productivity gains made possible by the development of artificial intelligence will lead to a **decoupling between GDP growth and inflation**.

Chart 6
United States: Eurodollar contracts (3-month)

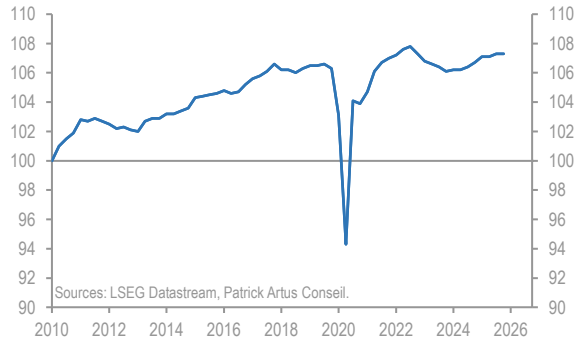


Summary: is the effect of core inflation also evident in the euro zone?

In the United States, it is therefore possible (and likely) that Kevin Warsh's argument - that artificial intelligence leads to productivity gains that reduce inflation and allow the Federal Reserve to lower interest rates - is correct.

In contrast, productivity gains are virtually non-existent in the euro zone (Chart 7).

Chart 7
Euro zone: Productivity per head (2010.Q1 = 100)



Disinflation in the euro zone is therefore not driven by productivity gains. It is understandable that artificial intelligence has a much smaller impact in the euro zone than in the United States, since only 13% of European companies use artificial intelligence. Furthermore, while 61 AI language models have been developed in the United States, only 21 have been developed in the European Union. The United States uses 70% of the world's computing power for AI, while the European Union uses only 4%.

Kevin Warsh's view clearly does not reflect that of the vast majority of FOMC members, who are concerned about the persistence of inflation. The inflation figures released between now and Kevin Warsh's arrival at the Federal Reserve will likely provide an opportunity to verify whether artificial intelligence actually leads to a decline in inflation thanks to significant productivity gains.

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