The Economist

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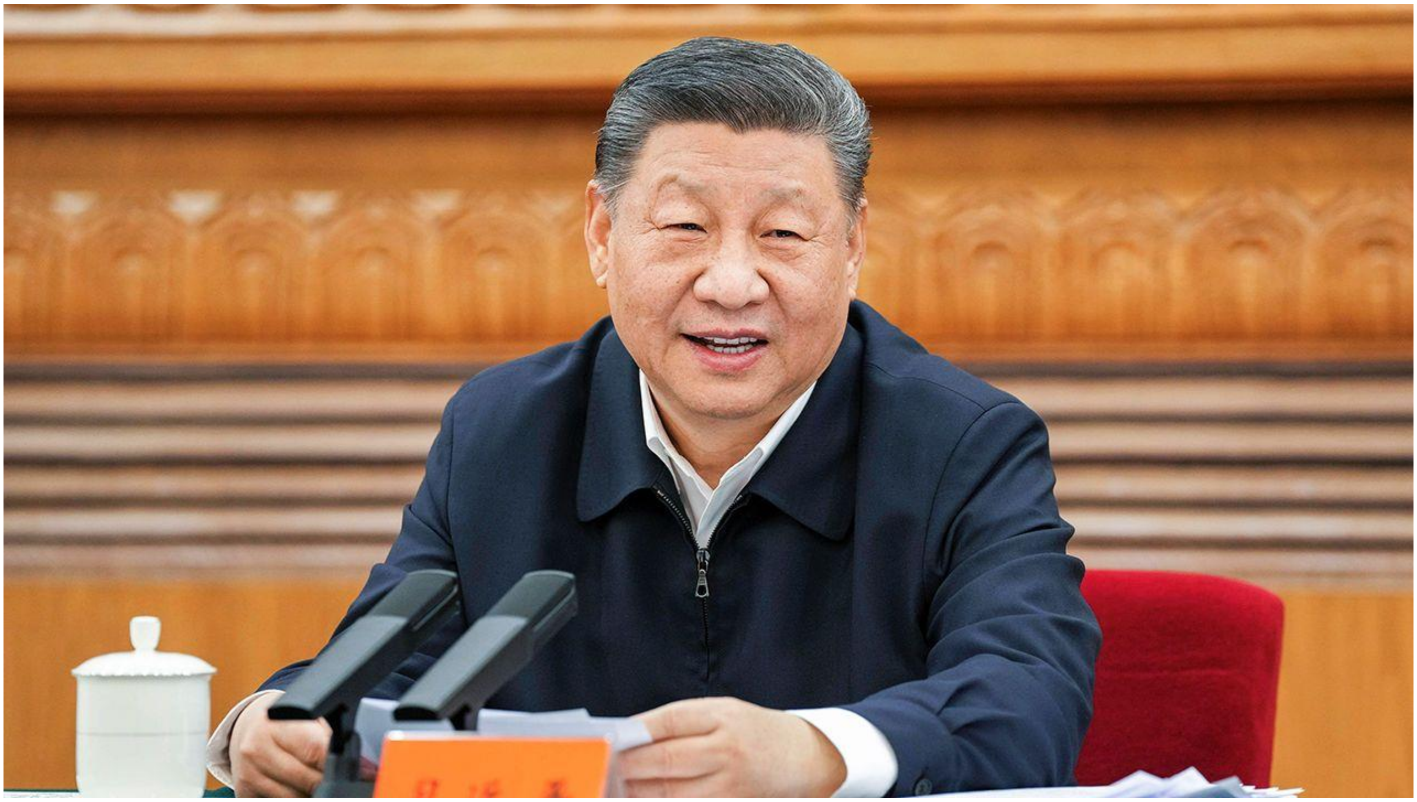
FEBRUARY 22ND–28TH 2025

The would-be king

Business



Photograph: Imago

China's leader, Xi Jinping, held a rare public meeting with the country's leading tech entrepreneurs, underscoring the government's change of heart towards an industry it had cracked down on a few years ago. Mr Xi was seen shaking hands with Jack Ma, the founder of Alibaba, who at one stage moved to Japan after criticising Chinese regulators. Liang Wenfeng, the founder of DeepSeek, was also there, as were bosses from Tencent, BYD and CATL. Baidu's share price plunged when its chief executive was not spotted at the gathering. With China's economy struggling and the rivalry with America heating up, Mr Xi has become more favourable towards private enterprise.

Meanwhile, South Korea banned further downloads of DeepSeek's generative artificial-intelligence app, claiming it doesn't comply with the country's data-privacy laws.

Apple and Google made TikTok available for download again at their app stores in America. TikTok was briefly unavailable in the country at the tail end of the Biden administration, which blocked it over claims the Chinese-owned platform poses a threat to data privacy. It was restored for users who already had the app ahead of the inauguration of Donald Trump, who gave TikTok a reprieve while a solution is found to its ownership.

Microsoft unveiled its Majorana 1 chip, which it claims would allow quantum computers capable of solving “industrial-scale problems” to be developed within years, rather than decades. The new chip is based on a substance Microsoft calls a “topoconductor”, one of a class of materials known as topological superconductors. The company claims that its topoconductor can produce more reliable and scalable qubits based on Majorana fermions, subatomic particles with intriguing quantum properties. Experts said it would take time to evaluate its impact.

Mr Trump threatened to impose tariffs of 25% or higher on all imports of cars, chips and pharmaceuticals to the United States, the latest salvo in his trade war. Like most pronouncements from the president, it was unclear whether his threat was real or a tactic to attain lower duties for American exports. He has also proposed “reciprocal” tariffs to match the tax rates that other countries charge on imports.

Inflationary pressures

In Britain the government’s imposition of a value-added tax on private-school fees was cited as a contributing element to a surprise surge in inflation. A smaller-than-expected decrease in air fares was another factor. The annual rate jumped to 3% in January from 2.5% in December, the highest level in ten months. Core inflation, which excludes volatile food and energy prices, rose to 3.7% from 3.2%. The Bank of England said recently that it expected inflation to rise, and it remained cautious about further cuts to interest rates.

Australia’s central bank lowered its benchmark interest rate to 4.1%, the first cut since November 2020. The country’s annual inflation rate has fallen to 2.4%, within the bank’s target range.

A strong rebound in business investment helped boost Japan’s economy in the last three months of 2024. GDP expanded by 2.8% at an annualised rate in the quarter.

In another blow to the London Stock Exchange, Glencore’s chief executive, Gary Nagle, said the commodities firm was considering whether to delist its shares and trade on another bourse, possibly New York. It is one of the LSE’s most valuable companies. Last year 88 companies left or transferred their primary listing from the LSE, the most since the financial crisis of 2007-09. Rio Tinto, meanwhile, urged shareholders to reject a proposal to delist its shares in London and unify them in Australia.

The High Court in London gave its approval to Thames Water's request to borrow up to £3bn ($3.8bn), as the embattled utility tries to avoid insolvency. Thames Water, the biggest provider of water and sewage services in Britain, is carrying a huge debt load and still faces legal challenges from junior creditors. KKR, a private-equity firm, has reportedly submitted a bid to take a majority stake in the company.

Now that's a zinger

Kentucky is no longer finger-lickin' good enough for KFC, which is moving its headquarters from Louisville to Plano, Texas. The decision was taken by Yum Brands, which owns KFC and wants it to share offices in Plano with Pizza Hut, another fast-food chain in its portfolio. Kentucky Fried Chicken started out in the Bluegrass State in the 1930s, when Colonel Harland Sanders developed his famous "secret recipe". To placate Kentuckians outraged by the move, KFC has promised to build a flagship restaurant in Louisville.

Finance & economics
Reciprocal tariffs really mean chaos for global trade

America has tried reciprocity before, and discovered its flaws

Photograph: picture alliance

What happens when you ditch the principles that underpinned global trade for three-quarters of a century? Donald Trump hopes to find out. He wants to levy "reciprocal" tariffs, which match the duties American exports face abroad, plus charges to offset any policy he deems unfair. A stable multilateral trade system which has, for all its flaws, fostered miraculous rises in global prosperity would give way to arbitrary judgments made in the Oval Office.

After the second world war America built a system of global commerce that sought to treat countries equally. The operating principle was the "most-favoured nation" (MFN) clause, which means that members of the World Trade Organisation must levy the same charge on a given good, no matter where it comes from (except within deep free-trade agreements, such as that between America, Canada and Mexico). As a consequence, in any given market, American firms trade on the same terms as most other foreigners. This acts as a brake against lurches towards protectionism or lobbying for special favours, because changing tariffs for one trading partner would mean changing them for everyone.

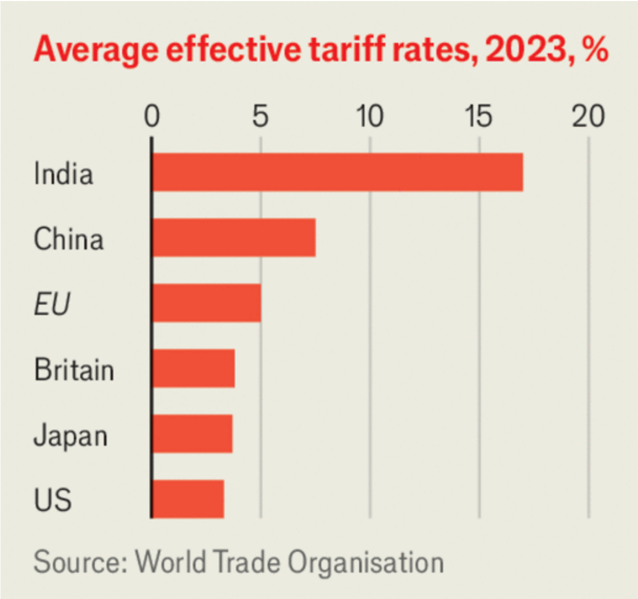


Chart: The Economist

MFN has led to asymmetries. Countries can protect powerful producers, so long as the external tariff is uniform. It also permits imbalances in average tariffs, because countries differ in their willingness to liberalise. America levied a simple average tariff of just 3.3% in 2023, lower than 5% in the eu and 3.8% in Britain. Poor countries tend to have higher levies.

That does not mean America is a victim. Its consumers benefit from cheap imports and its companies from cheap parts. In the 20th century free trade increased global stability. Still, perhaps reciprocity could nudge others to lower trade barriers, in order to increase their own access to America's market.

The problem, however, is that Mr Trump's policy would be fiddly, arbitrary and more likely to ratchet up instead of down. The administrative effort needed to implement it would range from gruelling to gargantuan, depending on how reciprocity was defined. At the very least, for each good a single tariff would be replaced by hundreds of possible bilateral levies and things would get fiendishly complex for products with supply chains spanning many countries. In the late 19th and early 20th centuries

America pursued reciprocity only to conclude that constant bargaining was cumbersome and unpredictable, leading Congress to adopt unconditional MFN in 1922.
The unpredictability would be aggravated by Mr Trump's desire to be the judge of whether a country's trading practices are unfair. His order cited value-added taxes (VATs), which are levied in most rich countries, as one such discrimination; America has no VAT, only state and local sales taxes. Yet VATs are fair, because they apply equally to imports and local goods.

Including VATs in reciprocity would lead to hefty increases in tariffs. Goldman Sachs, a bank, says that if America adopted only mirror-image tariffs without retaliation, its levies would rise by an average of two percentage points. Many European vat rates exceed 20%.

But there probably will be retaliation, so tariffs are likely to spiral upwards. The mere possibility of that will deter businesses from relying on trade. Because Mr Trump's reasoning on vat is nonsense, who knows what grievance he will dream up next? And reciprocity is only one component of his plans. If he also whacks duties of 25% on some goods, as he continually threatens to, you have a recipe for retaliation and a full-scale trade war. That might suit Mr Trump, but it would be a blow to the American and world economies alike.

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Investors fear inflation is coming back. They may be right

Is the world about to repeat the mistakes of the 1970s?

Illustration: Lehel Kovacs

After peaking in 2022 at 11% year on year, inflation across the rich world has steadily fallen. Until now. As central banks bring down interest rates, headline inflation across the rich world is edging up (see chart 1). It rose from 2.1% in September to 2.5% in December.

On February 19th Britain reported inflation for January: 3% year on year, up from a recent low of 1.7%. Polish inflation in January was 5.3%, up from 4.7% the month before. German inflation fell to 2.3%, but that was still above the 1.6% reached last summer. American consumer prices rose by 3% year on year, up from a recent low of 2.4%. Some wonder why central banks cut rates before inflation was at or below target, considering that economic growth has barely slowed. “Inflation is like cockroaches," John Cochrane of Stanford University recently wrote. "When there are only a few left [it] is not the time to let up."

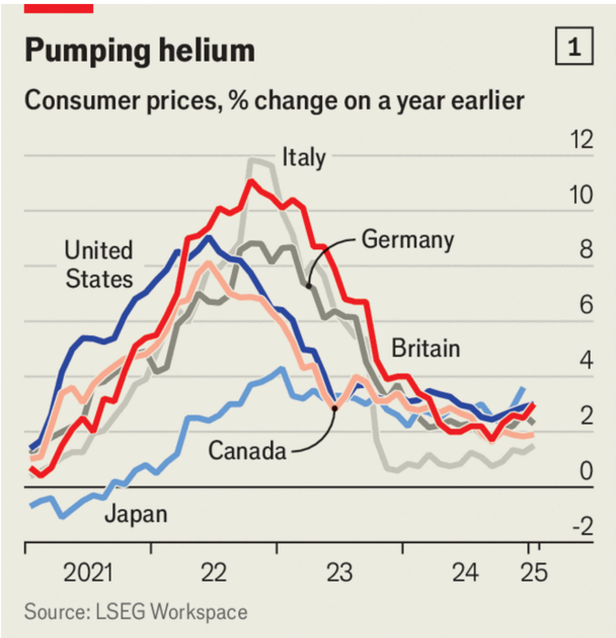

Chart: The Economist

Is the rich world about to repeat the mistakes of the 1970s? Back then, policymakers killed most of the cockroaches, but left a few of the hardiest, which then proceeded to breed ferociously. In America inflation hit 12% in 1974, fell to 5% in 1976 and then climbed to 15% in 1980. Central banks failed to adjust policy fast enough to prevent an oil-price shock in 1979 from spreading across the economy. Only with an enormous recession in the early 1980s, which policymakers engineered by using a shedload of borax, did they at last exterminate inflation for good.

Investors are unsure if high inflation will return. Market pricing points to the Federal Reserve implementing looser monetary policy in the future—and where the Fed leads, other central banks follow. In recent weeks government-bond yields have fallen, which might suggest worries about inflation have eased. On the other hand, a model from the Fed's Cleveland branch suggests market expectations for inflation over the next year have risen from about 2.2% in September to 2.7% today.

The confusion reflects intellectual disagreement. Some pundits reckon that the recent rise in inflation is a mirage. Statisticians adjust data to reflect events that happen at a particular time of the year (such as the price rises that many shops impose in January). The covid-19 pandemic, which created huge volatility, has messed up these seasonal adjustments, which could make month-on-month inflation readings in January and February higher than the “true” rate of inflation. Others point out that headline inflation always jumps about, owing to volatile commodity prices. Economists at Morgan Stanley, a bank, reckon that the recent wildfires in California may have temporarily pushed up goods prices in America. In January a number of countries, including Belgium and Norway, saw large increases in the price of food, perhaps linked to worries over a trade war. Central bankers typically ignore these blips when setting monetary policy.

Yet not everyone is so relaxed. Whatever the problems with seasonal adjustment, they cannot affect inflation as measured on a year-on-year basis—and that is clearly rising. Moreover, there is evidence to suggest that the rich world is genuinely seeing more inflationary pressure. Alternative Macro Signals, a consultancy, runs millions of news articles through a model to construct a “news inflation pressure index”. The global index, which has proved to be a useful predictor of official numbers, has recently risen sharply, especially in America.

Rich-world labour markets also remain tight. The oecd’s unemployment rate has now been below 5% for nearly three years. With companies competing hard for staff, nominal wages are rising by more than 4% year on year across the biggest economies (see chart 2). Unfortunately, though, productivity growth is weak. If employers cannot spread their higher wage costs over more output, they have to pass them on to consumers in the form of higher prices.

Chart: The Economist

We find evidence of this phenomenon occurring in the services sector, which covers everything from financial advice to physical therapy. Services prices are increasing by 4% year on year in the biggest economies, about twice the rate from before the pandemic. In the 18 rich countries that have reported reliable data for January, services inflation is off its recent low in 14 of them. In Portugal it is up by a percentage point. In Estonia, by 3.7 points.

Policymakers may add fuel to the inflationary fire. The problem is not central bankers, who should be able to resist any calls from politicians to lower interest rates. It is politicians themselves. Donald Trump plans to deport millions of undocumented workers and raise tariff barriers, which would push up prices. Leaders elsewhere are pursuing less extreme policies, but could still stoke inflation. About 40% of rich-world governments are giving their economies a fiscal boost this year, as measured by the change in the budget deficit adjusted for the economic cycle. Britain's last budget increased spending on infrastructure, while Italy recently approved one containing tax cuts. Many governments will also retaliate against Mr Trump by imposing their own tariffs on American goods, raising the price of imports.

Compared with before the pandemic, companies and workers may react more strongly to these pro-inflation forces. In 2023 a paper published by the Bank for International Settlements, a club of central banks, discussed what happens in "a transition to [a] high-inflation regime", in which rising prices become "a more focal point for workers and firms". Once people have experienced rapidly rising prices, they worry about it happening again. If workers perceive that inflation is on the march, they may be particularly quick to ask for a pay rise.

Get pest-control in

We find worrying signs in this regard, too. One is interest in inflation, as measured by Google search, which is twice as high as it was pre-2021. Other reasons to worry come from consumer surveys. Even as inflation has fallen a long way from its recent peak, people still expect hefty price rises in the months to come. In December the eu's inflation was below 3%. Yet eu citizens expect prices to rise by 10% over the next 12 months—twice as much as they expected in the 2010s. There is a similar "inflation perception gap" in America. Canada's inflation rate has been at or below 2% since August. And yet Canadians still expect inflation of 3% over the next year, compared with 2.4% before the pandemic.

Not long ago central bankers were patting themselves on the back for having brought inflation down so quickly. It was enough of a success to have made up for the error of being too late to respond to price rises in the first place. As many homeowners are aware, however, cockroaches have a nasty habit of returning.

American inflation looks increasingly worrying

Trump's tariffs are fuelling consumer concerns, which may prove self-fulfilling

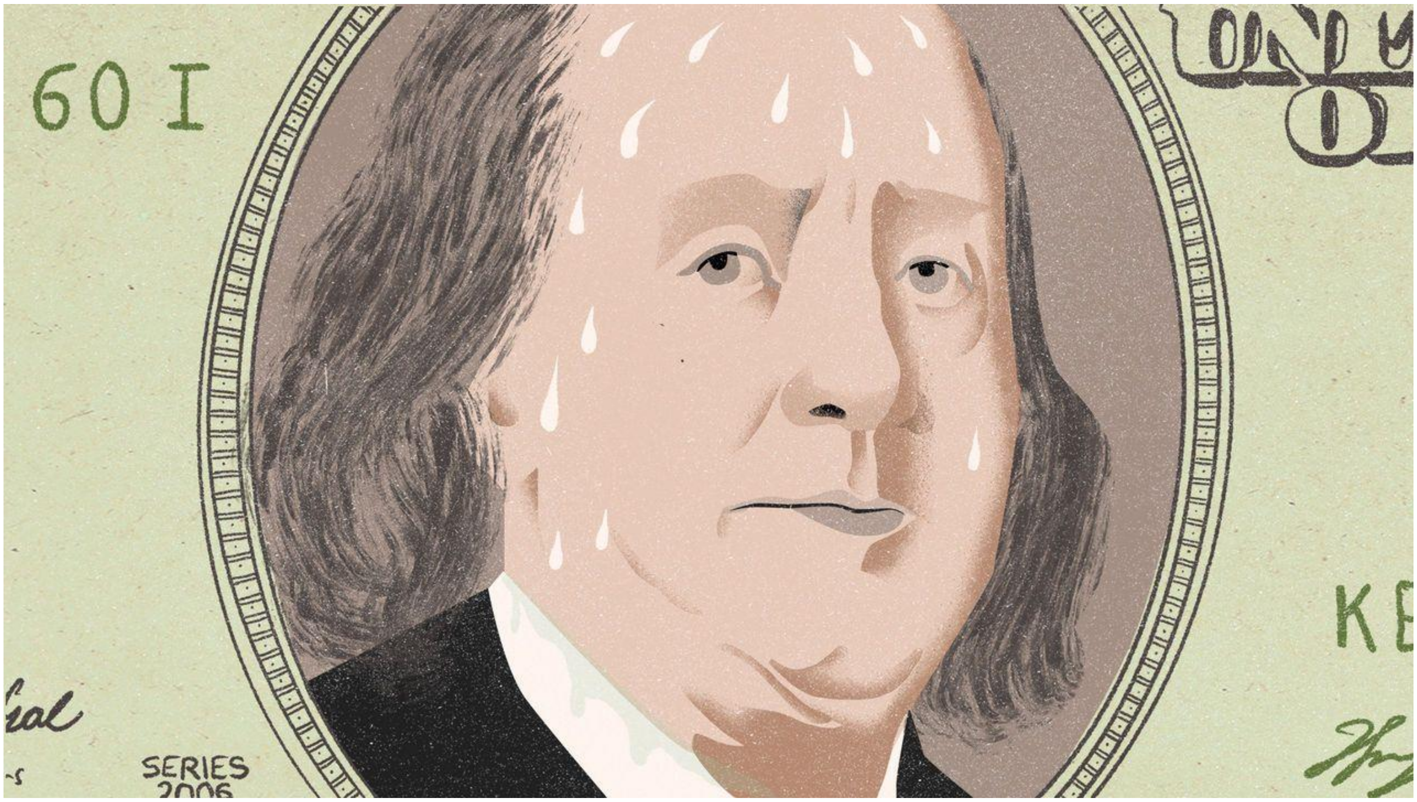

Illustration: Lehel Kovacs

Jerome Powell's press conferences—sometimes market-moving events—have attracted less notice of late. With Donald Trump in the White House, the chair of the Federal Reserve faces competition for attention. Yet a recent inflation reading has returned prices to the public eye. In January America's "core" consumer-price index, which strips out volatile food and energy costs, jumped by 5.5% at an annualised rate. In response, Larry Summers, a former treasury secretary, called this the "riskiest period for inflation policy since the early Biden administration", after which inflation rose to its highest in four decades.

Even more worrisome is that Americans are starting to expect higher inflation. In February preliminary data from the University of Michigan's consumer survey showed that the median expectation for price growth over the next year had reached 4.3%. Since Mr Trump's election, that figure has surged by 1.7 percentage points—the joint-largest three-month rise since 1979, when inflation hit double digits. Some market measures tell a similar story. The one- and two-year breakeven inflation rates, based on the difference between nominal and inflation-adjusted Treasury yields, are up by 1.7 and 0.8 percentage points respectively since November.

Chart: The Economist

What is going on? Consumer expectations reflect two main factors: current inflation and petrol prices. Indeed, in normal times, about 80% of variation in quarterly one-year-ahead inflation expectations is explained by just these two variables, according to a simple model we have built. Yet when we test the model on this year's data, it becomes unreliable. If the pre-Trump associations held, median consumer inflation expectations would be nearly a percentage point lower (see chart 1). A similar, if less pronounced, pattern can be seen with market forecasts.

This gap between expectations and the historical trend appears to be driven by Mr Trump's tariff threats. Consumers' uncertainty about inflation is elevated: the standard deviation of responses to the University of Michigan's survey is at its highest since 1980. Many appear to be taking the president at his word when he warns that "prices could go up somewhat short term". Those who are opposed to tariffs expect inflation to be nearly 5% in a year's time, yanking up the overall average.

Consumer inflation expectations are often self-fulfilling. When workers expect higher costs in the future, they seek higher pay today. Meanwhile, shoppers rush to make purchases in anticipation of price rises, increasing demand and thereby pushing up prices. Recent data show that such a dynamic may be emerging. American wages grew at an annualised rate of 5.9% in January. More than 20% of respondents to the University of Michigan's survey say that now is a good time to buy expensive items such as electronics or furniture, as prices are likely to climb soon. That is the highest share in three decades.

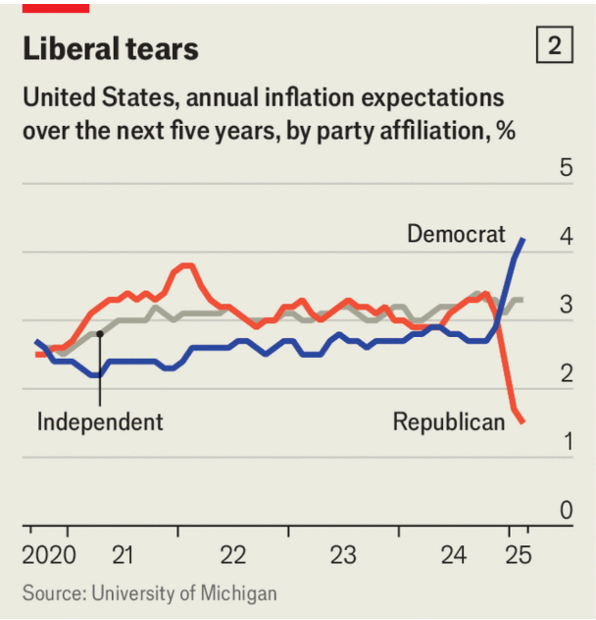

Chart: The Economist

Fed officials are paying close attention. Lorie Logan, president of the central bank's Dallas branch, has recently warned that when inflation expectations spiral out of control, restoring price stability often comes "only at a great economic cost". Current inflation uncertainty, she added, is "a reminder that expectations won't stay anchored for ever on their own".

Expectations for the long-term path of inflation are more mixed. The "five-year, five-year forward" measure, which is favoured by central bankers and derived from interest-rate futures contracts, is largely unchanged. Yet other similar measures are creeping higher. Market-based forecasts for the five-year breakeven inflation rate have edged up. Median five-year-ahead consumer expectations have also climbed, to 3.3%—above their peak during the inflation of recent years.

A divide has emerged concerning long-term expectations, too. Democrats now expect a startling 4.2% average increase in prices over the next five years (see chart 2). Research suggests that Republicans' concerns about potential price rises during the covid-19 pandemic led to additional inflation in the years that followed. Mr Trump's attacks on the Fed, insisting that Mr Powell should reduce interest rates, are almost certainly a contributing factor to Democrats' worries this time. Although the president enjoys taking on bureaucrats, he may discover that doing so can backfire.

Tecnology

It's not just AI. China's medicines are surprising the world, too

Its firms are at the forefront of cheaper, faster drug discovery

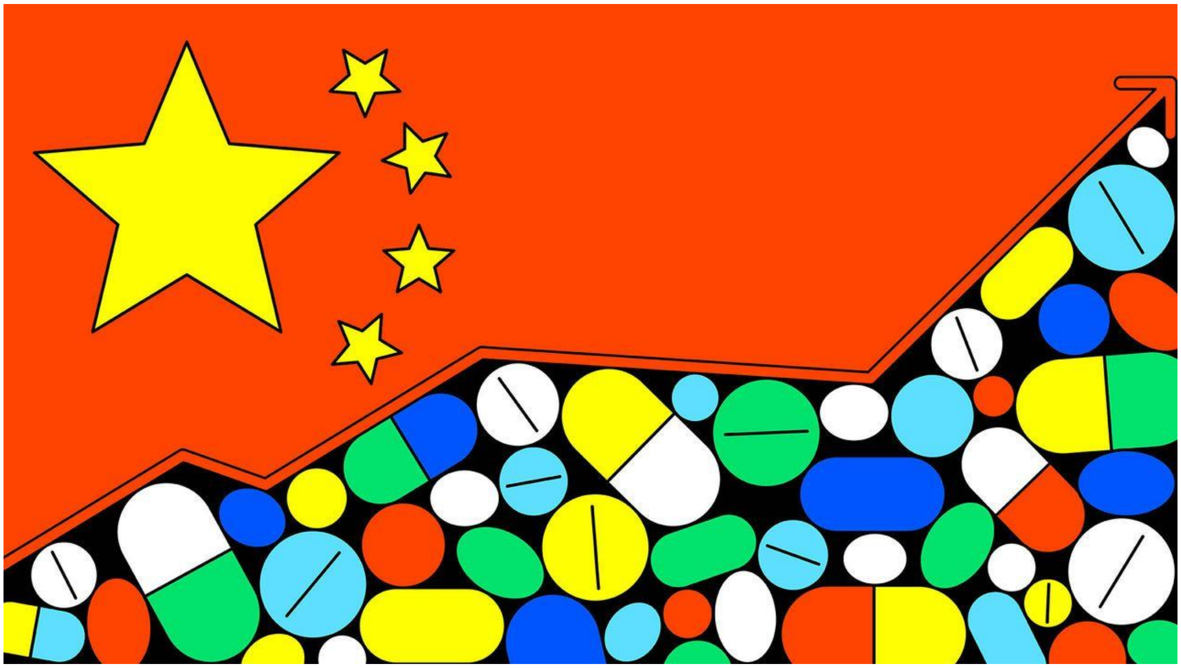

Illustration: Rose Wong

Keytruda, a cancer medicine, ranks among the most lucrative drugs ever sold. Since its launch in 2014 it has raked in more than $130bn in sales for Merck, its American maker, including $29.5bn last year. In September last year an experimental drug did what none had done before. In late-stage trials for non-small cell lung cancer, it nearly doubled the time patients lived without the disease getting worse—to 11.1 months, compared with 5.8 months for Keytruda.

The results were stunning. So too was the nationality of the biotech company behind them. Akeso is Chinese.

Chart: The Economist

In recent months China's progress in artificial intelligence has stunned the world. A quieter yet equally significant shift is under way in biotech. China has long been known for churning out generic drugs, supplying raw ingredients and managing clinical trials for the pharmaceutical world. But its drugmakers are now also at the cutting edge, producing innovative medicines that are cheaper than the ones they compete with. China has become the second-largest developer of new drugs, behind only America (see chart 1).

As a consequence, Western drugmakers are increasingly looking east for ideas. Because of expiring drug patents, they stand to lose as much as $140bn a year in sales by 2030. Last year nearly a third of the large licensing deals they struck—those worth $50m or more—were with Chinese firms, triple the share of 2020. LEK, a consultancy, estimates that during that time, the total value of drugs licensed worldwide from China rose 15-fold, to $48bn (see chart 2). In November Merck paid $588m to LaNova Medicines, another Chinese biotech firm, to secure rights to a therapy similar to that produced by Akeso.

China's government identified biotech as a strategic priority nearly two decades ago. But it was not until 2015 that things really took off, after the drug regulator launched ambitious reforms. It took on more staff and cleared a backlog of 20,000 drug applications in two years. Clinical trials were streamlined and brought into step with global standards. A study by Yimin Cui of Peking University and colleagues found that the time taken to approve the first round of human trials fell to 87 days, from 501 days before the reforms.

The changes coincided with a wave of returning "sea turtles", the term for Chinese people who studied or worked abroad. China's vast domestic market helped to attract big drugmakers to its shores, bringing know-how and talent. Easier listing rules gave biotech investors a clearer path to exit. Private funding for Chinese biotech firms rose from $1bn in 2016 to $13.4bn in 2021.

With more brains and money, Chinese firms moved beyond copying Western drugs. Instead of waiting for patents to expire and making generics, they adopted a "fast-follower" strategy—taking known drugs and modifying them to improve safety, efficacy or delivery. Drug development typically starts by identifying a target, usually a protein or gene linked to a disease. Scientists then search for molecules that can either block or boost the target's function. Since fast-followers are not starting from scratch, they can run speedier, cheaper trials.

Between 2021 and 2024 the number of Chinese drugs in development doubled to 4,391. Fast-follower and completely original treatments made up nearly 42% of the pipeline. Helen Chen from LEK notes that China's approach has been particularly effective in ADCs, a cancer medicine in which an antibody is attached to a payload of chemotherapy via a chemical linker. Since the treatment's core components already exist, success depends on combining them in the most effective way. Ms Chen believes this is where Chinese firms thrive.

Speed is another advantage, says Michelle Xia, founder of Akeso. "We can do things twice or even three times faster than anywhere else in the world," she claims. Clinical trials—the longest and most expensive stage of drug development—are faster than in the West. A large patient population makes recruitment easy, and hospitals and doctors are incentivised by the government to support research.

Faster trials have made Chinese drugs even more attractive to global drugmakers. Though the clinical information is from mostly Chinese patients, rather than a wider sample, it helps investors and pharma firms spot promising treatments. And as the quality of data from China has improved, regulators are paying attention. Results from Akeso's Chinese trials were strong enough to convince America's Food and Drug Administration to move the drug straight to late-stage trials.

Few Chinese firms sell drugs in America directly. Instead they tend to strike licensing deals: a company sells the rights to market its drug outside China for an upfront payment and other fees. Akeso's Keytruda rival was licensed to Summit Therapeutics, an American biotech, for $500m upfront, with up to $5bn in additional payments and a share of royalties.

Another approach is the "NewCo" model. This involves a Chinese pharma company spinning off its clinical assets into an American entity run by an experienced local management team. The parent firm retains partial ownership, allowing it to benefit beyond royalties if the drug succeeds. Jefferies, an investment bank, says that about eight such companies have been formed since May.

China's biotech boom is not without risks. The rise in licensing deals hides a funding crunch among young firms. Private investment in Chinese biotech fell to a seven-year low in 2024, mirroring a slowdown in global biotech markets. Investors are prioritising companies that generate cash or have strong international potential. Jimmy Zhang, an investor based in San Francisco, worries that many of today's licensing deals are a product of the past funding boom. Without fresh investment, he warns, China's drug pipeline could start to run dry.

A bigger concern is rising tensions with America. Because drug prices in the world's largest economy are less tightly controlled than they are at home, American patients are a big source of revenue for Chinese biotech firms.

So far America has only applied trade restrictions to high-tech goods; Chinese biotech has escaped similar scrutiny. An attempt to block Chinese firms from supplying some biotech services and equipment has stalled in Congress. But, with Donald Trump threatening to impose tariffs on pharmaceutical imports, biotech may not be able to escape unscathed for much longer. The approach of selling to America via licensing deals may only offer limited protection; already Chinese biotech firms are getting lower licensing fees for their experimental drugs than American counterparts, because of geopolitical risks. Impressive as the pace of Chinese innovation is, it will have to contend with some mighty geopolitical forces.

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