Getting the world economy into higher gear

Global growth is projected to strengthen but will remain modest by past standards. There are important differences across countries: the US recovery looks more robust, but the euro area faces an increasing risk of stagnation and Japan’s escape from deflation is not yet assured. Growth in emerging economies will remain stronger, but also reveals important differences: GDP will slow in China, but pick-up in India and remain sluggish in Brazil and Russia.

There are substantial downside risks to the outlook. Risks of financial instability remain high, while volatility may increase, notably for emerging markets, as monetary policy and economic activity differ across the major economies. Debt levels are high by past standards and some emerging economies have significantly increased external financial exposure. Because the growth of potential output has slowed in major economies since the crisis, future trend growth may be weaker than anticipated.

It is essential that macroeconomic and structural policies support growth. Monetary policy needs to remain accommodative in most countries, and become more so in the euro area. Fiscal consolidation has progressed significantly, leaving room in many economies to slow the pace of adjustment. With dangerous downside risks to global economic activity and confidence, all room to engage fiscal policy must be exploited. Modest global growth and the slowdown in potential growth call for ambitious structural reforms to boost investment, trade and job creation. Efforts by G-20 countries to develop comprehensive growth strategies for the Brisbane summit are key underpinnings to raise the level of ambition on structural reform, thus leading to higher productivity, more high-quality jobs, and sustained and balanced growth.

The projections in this pre-release will be updated for incoming data and published on 25 November 2014 in the complete Economic Outlook release.
**GDP**

*Volume, percentage change*

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*Note:* GDP at market value adjusted for working days. In India, this measure differs from the factor cost and fiscal year national headline measure.

**GDP growth**

*Volume, per cent*

*Source:* Preliminary November 2014 OECD Economic Outlook database.
Global growth will strengthen but remain modest, with trade offering little support

- Global growth has been subdued, but is projected to accelerate from the second half of 2014 onward as improved financial conditions, continued monetary policy stimulus and a slower pace of fiscal consolidation facilitate stronger activity in advanced economies. World GDP growth rates in 2015 and 2016 will nevertheless remain modest relative to the strong pre-crisis expansion and somewhat below the long-term average. Emerging economies will continue to outpace the advanced economies but less than in past decades.

World GDP growth
Per cent, seasonally adjusted annualised rate

Source: Preliminary November 2014 OECD Economic Outlook database.

- Global trade growth remains sluggish. In a marked break with pre-crisis norms, trade volumes in most economies are only keeping pace with GDP rather than expanding more rapidly. This downshift partly reflects weakness in spending on import-intensive consumption and investment goods. But the causality probably runs both ways, with a lack of dynamism in global trade also hindering world GDP growth.
There are widening differences in cyclical positions

- In the United States, there is a sustained impetus to private spending from solid increases in employment, favourable financial conditions and monetary policy support, and the slowing pace of fiscal consolidation. Unemployment continues to fall, but pockets of labour market slack remain, and price pressures remain weak. The United Kingdom, Korea and Australia are also projected to grow at a relatively robust pace.

- In Japan, output growth slowed in 2014, reflecting the impact of the consumption tax hike. Despite further fiscal consolidation, the expansion is projected to continue, though at a slower pace, supported by improving labour market conditions, monetary easing and export growth, reflecting the weaker yen. These factors will contribute to underlying inflation getting durably closer to the 2% target.

- In the euro area, growth has slowed, as weakness in Germany, France and Italy has offset improvements in the periphery, and inflation has continued to drift down. The planned slowdown in the pace of fiscal consolidation, stronger financial conditions (related in part to progress on the banking union) and further monetary stimulus should support the recovery. Absent this macroeconomic support, the growth performance of the euro area will be much weaker than projected here. Demand, regardless, will remain below potential due to continued credit weakness and private sector deleveraging. Unemployment will stay high and inflation will remain below target.

1. Index of sum of exports and imports as a ratio of GDP.
Source: Preliminary November 2014 OECD Economic Outlook database.
• In China, growth has slowed modestly as the property cycle has turned, leading to weaker activity in construction-related activities and contributing to slower consumption growth. The economy is rebalancing towards a more service-sector based growth model, helping to create new jobs. Mini-stimulus packages should help to smooth the transition to slower growth in the coming years.

• In India, the pick-up in growth after the sharp slowdown in 2012-13 will continue despite the tight monetary and fiscal stance. Investment will be the main growth engine, after several quarters of subdued growth. Improved business sentiment resulting from reduced political uncertainty, deregulation, and the government commitment to cut red tape should boost growth. The output gap is projected to remain negative, and inflation is expected to continue to drift down as inflations expectations anchor lower.

• Growth in Brazil will resume after the brief recession experienced in the first half of 2014, but will remain sluggish, with growing economic slack helping inflation to ease to around 5% by 2016, from nearly 7% at present.

• Growth will also remain very weak in Russia, reflecting lower oil prices and depressed trade flows.

The euro area faces an increasing risk of stagnation, while Japan’s escape from deflation is not yet assured

• In the euro area, growth has consistently disappointed in recent years. Consumer spending per head is below its level ten years ago. Private-sector investment is weak. Governments have reduced spending and raised taxes. Subdued demand has contributed to inflation remaining well below the ECB’s target for some time and continuing to fall. Until recently, unemployment continued to drift up, and it remains at a high level.

• This leaves the euro area at risk of a still more prolonged period of stagnation with low employment and investment. This would be aggravated if it led to further declines in inflation expectations and further weakness in consumption.

• Japan experienced prolonged deflation and periods of low growth over the past two decades. Since the launch of Abenomics in early 2013, investment has strengthened and inflation has returned to positive territory. The unemployment rate has continued to fall and there are growing signs of labour tightness, although wages have yet to catch up with higher inflation. Nevertheless, challenges remain for Japan to meet the inflation target, slow down the growth of government debt, and implement reforms to boost productivity and boost the size of its workforce.

United States

<table>
<thead>
<tr>
<th>Investment and private consumption per capita</th>
<th>Inflation</th>
<th>Unemployment rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Index, 1990 = 100</td>
<td>CPI, 12-month percentage change</td>
<td>Per cent of labour force</td>
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Source: Preliminary November 2014 Economic Outlook database; OECD National Accounts database; U.S. Bureau of Labor Statistics (BLS); and OECD calculations.
Growth of potential output has slowed in most major economies, risking future trend growth

- The growth rate of potential output has been trending downward, but decelerating further in the post-crisis period as productivity growth stalls. While employment and participation have fallen in advanced economies, these effects were smaller than what could have been expected based on past experience as a result of unusual real wage restraint. Shortfalls in potential output are especially large in economies experiencing the strongest pre-crisis booms and deepest banking crises. While trend productivity growth in advanced countries is projected to recover as investment improves, growth will nevertheless be slower.

- In emerging economies, potential growth also has been slowing. While this partly reflects the convergence towards advanced-country living standards, in some countries potential growth is increasingly limited by structural obstacles to higher investment and labour market participation. In
the absence of reforms to remove these bottlenecks, these countries face the risk of falling into a middle-income trap.

- In addition, there is a risk that weakness in demand will be more damaging to potential output than assumed or that structural obstacles to growth are more severe. This would lead to further reductions in global growth, especially through slow catch-up by emerging economies.

### Potential GDP growth

*Annual average, per cent*

![Potential GDP growth chart](chart.png)

*Source: Preliminary November 2014 OECD Economic Outlook database.*

### Risks of financial instability remain high

- Debt levels remain high by historical standards. Household and government debt levels are high in many advanced economies, despite post-crisis private-sector deleveraging in the United States. In many emerging economies, debt levels have increased rapidly since the crisis, fuelled by capital inflows.

### Debt excluding the financial sector

*Per cent of GDP*

![Debt excluding the financial sector chart](chart.png)

*Source: Preliminary November 2014 OECD Economic Outlook database; ECB; and OECD Financial Accounts database.*
In China, there has been a significant build-up in credit, with still-rapid growth in lending by non-bank entities to the nonfinancial private sector.

**China: credit to the non-financial sector**

*Per cent of GDP*

![Graph showing credit to the non-financial sector in China](image)

*Source: CEIC.*

- The necessary increase in US interest rates likely will lead to renewed volatility in emerging markets, as reflected in exchange rates and capital flows, as already experienced in May 2013 when the Federal Reserve first announced its intention to start tapering.

- Despite weak real investment and high uncertainty, market valuations and risk appetite for financial assets have been high over the past year. While recent price declines and exchange rate adjustments are consistent with some re-assessment of risks, rapid changes in sentiment could raise volatility, which would jolt the global growth recovery process.

**Emerging market bonds**

*Total return index, January 2013=100*

![Graph showing emerging market bonds](image)

*Source: JP Morgan; Federal Reserve, United States; Datastream.*

**Net portfolio inflow in selected EMEs**

*Per cent of GDP, USD Billion*

![Graph showing net portfolio inflow in selected EMEs](image)

*Note: Selected EMEs are Brazil, India, Indonesia, Russia and South Africa. Source: IMF Balance of Payments database; OECD National Accounts database; and OECD calculations.*
Monetary policy needs to remain accommodative in most places, but countries’ circumstances are increasingly varied

- Subdued inflation is likely to continue for some time given ongoing weaknesses in demand, low wage pressures and the fall in key commodity prices. Inflation is generally expected to move towards central banks’ targets in the coming years, but only slowly.
- Monetary policy needs to support demand in most big economies, but will need to be more differentiated than in recent years given the divergence in countries’ position in the cycle, as well as differing risks to financial stability.
  - In the United States, the Federal Reserve’s large-scale asset-purchase programme ended in October. Policy rates should remain at their current low level through mid-2015 and then, assuming that the recovery remains on track, be raised gradually as labour-market slack is eliminated and wage gains become more apparent.
  - In Japan, the Bank of Japan's "quantitative and qualitative monetary easing", which was expanded last week, should continue until the inflation target has been sustainably achieved.
  - In Brazil, ensuring a convergence of inflation towards target and keeping inflation expectations anchored may require a continuation of the monetary tightening cycle next year, even as the economy still expands at a slow pace.
  - In India, still-high inflation expectations call for a continuation of the tight monetary policy stance.
  - In China, selective measures have been used to ease monetary conditions since the start of 2014 in an effort to balance support for activity while bringing about an orderly slowdown in credit growth. If inflation were to fall further, additional selective measures would be warranted.

Source: Chicago Board Options Exchange (CBOE); Datastream.
Given the very weak economy and the risk of deflation, the ECB should expand its monetary support beyond currently announced measures, building on the positive effects to date. This should include a commitment to sizeable asset purchases (“quantitative easing”) until inflation is back on track. Further asset purchases could include lower-rated asset-backed securities, corporate bonds and government bonds.

Flexible and well-designed fiscal policy could better support growth

Significant progress has been made in strengthening the fiscal position in many advanced G-20 economies and the pace of fiscal consolidation is set to slow sharply in the coming years, helping to support recovery. The major exception is Japan, where the debt-to-GDP ratio is set to exceed 230% of GDP.

![Improvement in underlying primary balance](chart)

**Source:** Preliminary November 2014 Economic Outlook database.

- In the euro area, easing the pace of consolidation would help to support demand and help already-agreed structural reforms. All available room under the EU fiscal rules should be used to avoid pro-cyclical fiscal contraction and allow the automatic stabilisers to operate fully.
In Japan, a detailed and credible fiscal consolidation plan to achieve the target of a primary budget surplus by FY 2020 remains a top priority. With the economic expansion projected to continue, the consumption tax rate should be raised to 10% in 2015 as planned.

In the United States, past improvements warrant a slower pace of fiscal adjustment and the priority should be to make public spending more favourable to growth. In addition, a medium-term fiscal programme needs to address long-term structural pressures.

In China, the government has ruled out large-scale fiscal stimulus and has taken steps to keep in check sub-national debt, notably with the revision of the Budget Law in August 2014.

In Brazil, unfavourable debt dynamics (deteriorating primary surplus, slow growth and rising interest rates) call for a tighter fiscal stance.

India needs to continue fiscal consolidation, but should also improve its quality, rebalancing expenditures away from subsidies and toward public investment.

Modest global growth and risks of a deeper slowdown call for ambitious structural reforms

- The slowing of potential growth that has already occurred, together with the risk that weak demand will aggravate that slowdown, calls for more ambitious reforms in combination with continued support for demand. Over the past two years the pace of reform in advanced economies has slowed overall, while emerging economies, including India, have begun to pick up their pace of reforms.

![Responsiveness to Going for Growth reform priorities](image)

Note: preliminary data for 2013-14. The reform responsiveness rate measures the share of total policy recommendations on which governments in each country have taken some action since the previous edition of Going for Growth, considering only legislated as opposed to announced changes. For more details see Box 2.2 and Annex 2.A1 in Economic Policy Reforms 2010: Going for Growth, OECD Publishing (OECD, 2010).

Source: Going for Growth (2015, forthcoming).
Some important obstacles to growth remain to be addressed including: Removing regulatory distortions on domestic and foreign firms, improving educational provision and incentives for innovation, strengthening active labour market programmes and implementing reforms to benefit systems and labour market regulations. These are key to enhance resilience and inclusiveness, strengthen both potential output and job growth, and ease long-term fiscal burdens. Of course, the specific priorities differ for each economy.

The euro area countries that faced the severest crises have made considerable progress in removing barriers to competition and investment, while undertaking difficult labour market reforms that will help to support future job creation. Italy and France have more recently begun the process of reform to boost growth and create better employment opportunities for lower-skilled workers. The key challenge will be to follow through on existing announcements to implement successfully reforms that are already underway.

The comprehensive national growth strategies developed by the G-20 for the Brisbane summit are a key contribution to raising the level of ambition on structural reform, leading to higher productivity, more jobs, and 2% higher GDP by 2018 (USD1.6 trillion). The nearly 1000 structural reform commitments made by G-20 members mean in particular that reform efforts are no longer isolated individual steps, but increasingly part of a global strategy to achieve stronger, more sustainable and balanced growth.