

15 September 2014

## Moderate global growth is set to continue, but weak demand in the euro area remains a concern

*The global economy is continuing to expand at a moderate and uneven pace. The tepid rate of growth means that a substantial degree of labour market slack remains, especially in the euro area, and world trade growth remains sluggish. Global growth should be somewhat more vigorous in the second half of 2014 and into 2015 given continued policy support, favourable financial conditions and growing confidence, alongside rising employment.*

*There is a growing degree of divergence between the major economies. The recovery in the United States is solid, growth is around trend in Japan and China, and strengthening in India after the recent weak patch. By contrast, growth in the euro area looks set to remain subdued in the near term and Brazil is expected to make only a slow recovery from recession.*

### OECD Interim Economic Forecasts

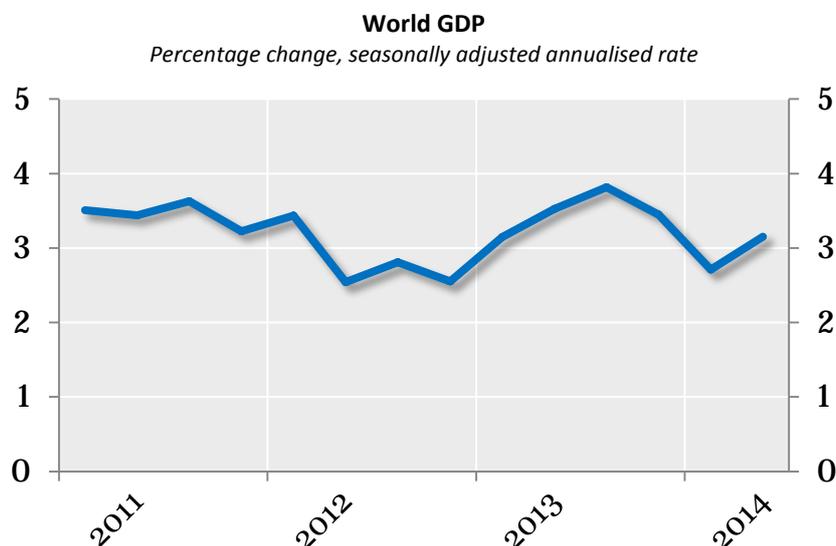
|                       | 2013 | 2014 | 2015 |
|-----------------------|------|------|------|
| <b>United States</b>  | 2.2  | 2.1  | 3.1  |
| <b>Euro area</b>      | -0.4 | 0.8  | 1.1  |
| <b>Japan</b>          | 1.6  | 0.9  | 1.1  |
| <b>Germany</b>        | 0.2  | 1.5  | 1.5  |
| <b>France</b>         | 0.4  | 0.4  | 1.0  |
| <b>Italy</b>          | -1.8 | -0.4 | 0.1  |
| <b>United Kingdom</b> | 1.8  | 3.1  | 2.8  |
| <b>Canada</b>         | 2.0  | 2.3  | 2.7  |
| <b>China</b>          | 7.7  | 7.4  | 7.3  |
| <b>India</b>          | 4.7  | 5.7  | 5.9  |
| <b>Brazil</b>         | 2.5  | 0.3  | 1.4  |

Note: GDP at market value adjusted for working days. For Germany and India, this measure may show different growth rates from national headline measures.

*The fact that major economies' positions in the economic cycle are becoming less synchronised is reflected in diverging macroeconomic policy requirements. Nonetheless, it remains true that monetary conditions ought to remain supportive in all the major advanced economies, while most countries need to make further progress on fiscal consolidation to ensure that debt burdens remain sustainable. To raise growth sustainably, some countries are grasping structural reform opportunities and must ensure effective implementation, while others need to be more ambitious in measures to boost competition and employment to achieve stronger and more inclusive growth.*

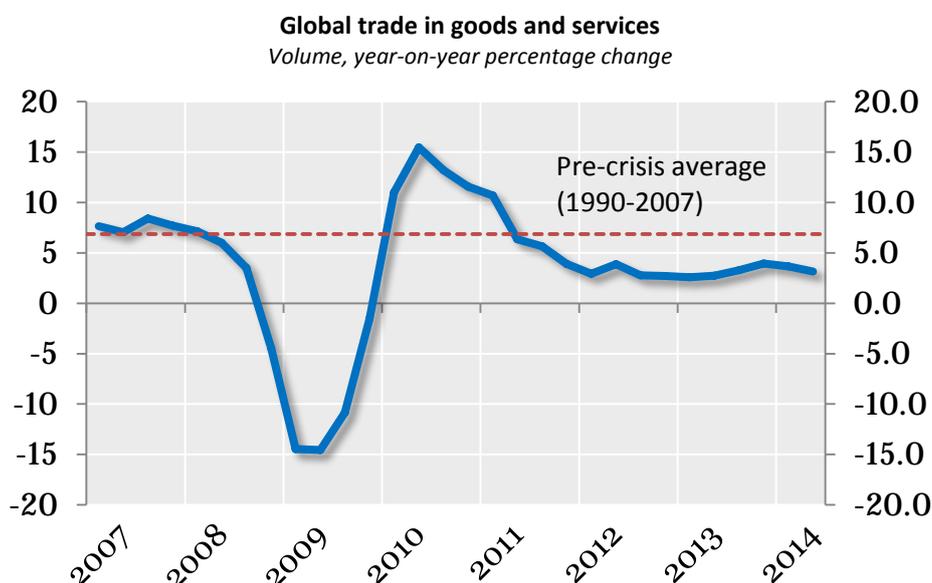
**Moderate and bumpy global growth has been reflected in weak trade growth and a slow pace of improvement in labour markets**

- Growth among the major economies was uneven in the first half of 2014, largely reflecting a number of one-off factors including unusual weather patterns in several countries and the strong effect of consumption tax hike in Japan. The world economy has been growing at a rate similar to that of the last three years, but well below the pre-crisis pace and slower than during the initial rebound from the global crisis.



Source: OECD National Accounts database.

- The continued moderate pace of global growth, with subdued growth of trade-intensive investment, is reflected in the persistence of sub-par world trade growth.

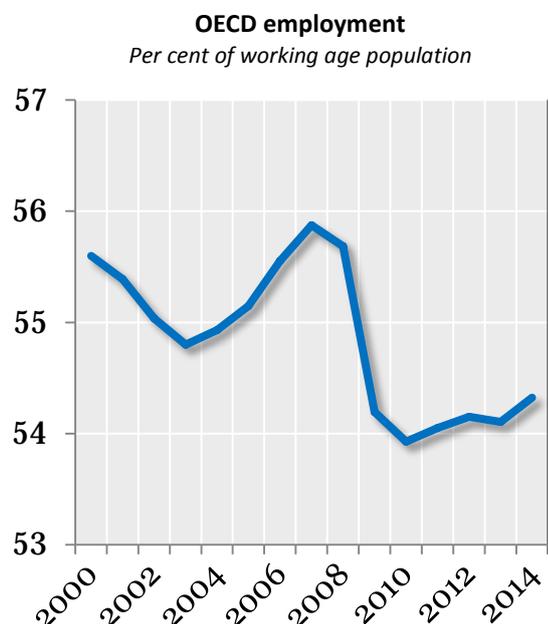


Source: OECD National Accounts database.

- The recovery in the labour market in the OECD region as a whole remains at an early stage, although in the North America and the United Kingdom employment growth is now solid and unemployment is falling steadily, while in Japan unemployment is back to pre-crisis levels and vacancies per job-seeker have surpassed the peaks reached in 2007. By contrast, unemployment in the euro area has only just begun to retrace from its post-crisis peaks. Employment rates across the advanced economies have increased only slightly in recent years and remain well below pre-crisis levels. Labour market data for

emerging economies are more partial, but employment gains in those countries as a group are below pre-crisis trends.

- Another sign that labour market conditions have yet to tighten significantly is that real wage growth remains very weak in many countries. While this helped contain job losses during the crisis and was necessary in some euro area countries in order to regain competitiveness, it is now holding back a stronger recovery in consumer spending.



Source: OECD May 2014 Economic Outlook database.



Note: Real wage is employee compensation divided by total hours worked in the economy, deflated by the CPI. Labour productivity is real GDP divided by hours worked.  
Source: OECD calculations based on quarterly national accounts.

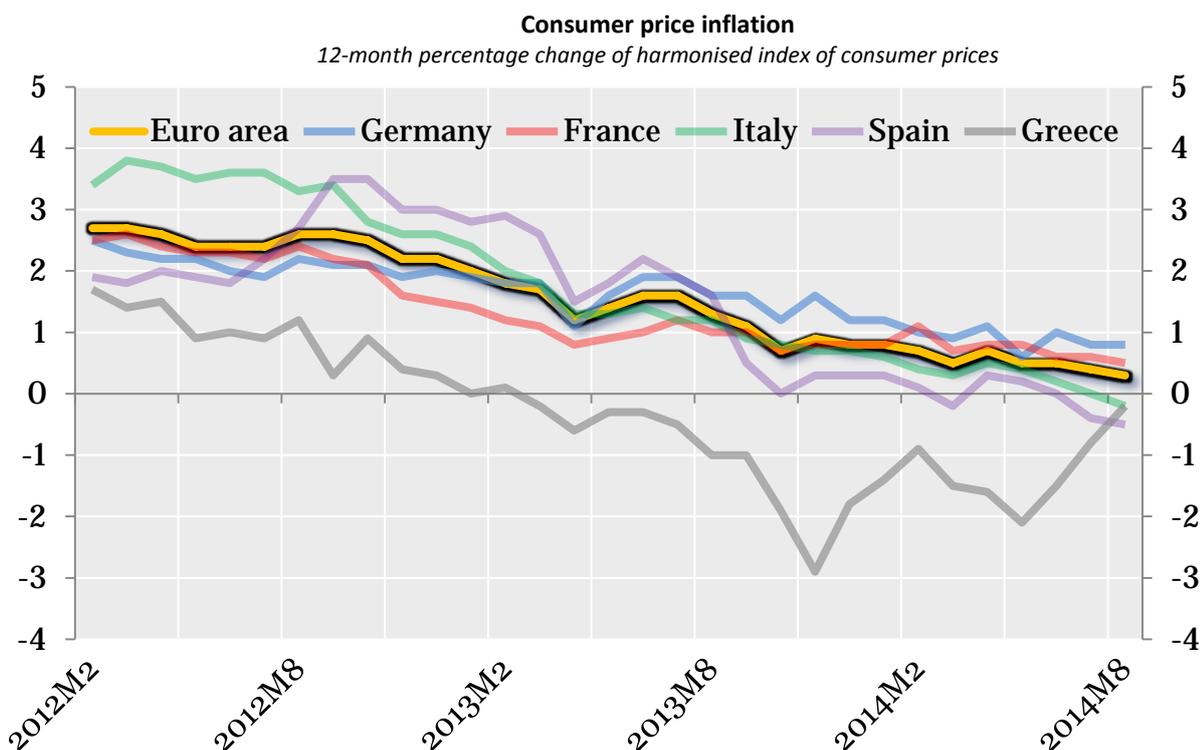
### ***Continued slow growth in the euro area is the most worrying feature of the projections***

- In most of the major economies a moderate expansion looks set to continue, even if growth prospects are in some cases less positive than projected in the May 2014 *Economic Outlook*:
  - In the **United States**, the moderate underlying expansion remains broadly on track, after the weather-affected first quarter of 2014 and sharp second quarter rebound. Employment gains are set to continue, with business investment likely to strengthen.
  - Growth has remained solid so far this year in the **United Kingdom** and **Canada**, and is expected to continue at a healthy pace through 2015.
  - In **Japan**, the sales tax increase in April resulted in volatile demand in the first half of 2014, but beginning in the second half of the year the underlying recovery is expected to reassert itself, reflecting improved confidence, growing employment and a reversal of the decline in real wages.
  - **China** has so far managed to achieve an orderly growth slowdown to more sustainable rates. Growth rebounded in the second quarter after weakness early in the year, helped by a range of mini-stimulus measures, supported by significant structural reform measures.
  - In **India**, confidence and spending have improved markedly during 2014 as a result of progress to control inflation and the perception that the new government will reinvigorate growth-oriented reform. Growth is expected to pick up in both 2014 and 2015.

- In contrast to these economies, the Interim Forecasts indicate a significantly more negative appraisal in two cases:
  - The recovery in the **euro area** has remained disappointing, notably in the largest countries: Germany, France and Italy. Confidence is again weakening, and the anaemic state of demand is reflected in the decline in inflation, which is near zero in the zone as a whole and negative in several countries. While the resumption in growth in some periphery economies is encouraging, a number of these countries still face significant structural and fiscal challenges, together with a legacy of high debt.
  - **Brazil** fell into recession in the first half of 2014. Investment has been particularly weak, sapped by uncertainty about the direction of policy after the coming elections and the need for monetary policy to restrain above-target inflation. A moderate rebound can be expected as these factors unwind, but growth is projected to remain below potential in 2015.

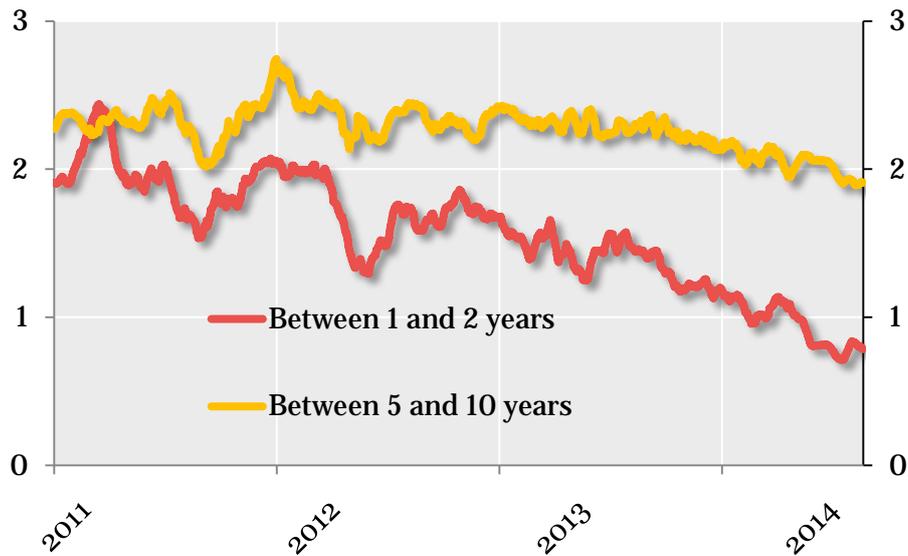
***The possibility that euro area inflation will stay low and exacerbate weak demand is a key risk***

- Inflation has been falling steadily in the euro area for nearly three years. As demand strengthens, inflation is expected to turn back up and gradually converge on the EBC’s target range. But the succession of downward surprises has increased the risk that inflation remains far below the ECB’s target for a more extended period or declines further.
- Excessively low inflation makes it more difficult to achieve the relative price adjustments that remain necessary to rebalance euro area demand without having to endure a prolonged period of slow growth and high unemployment. Inflation near zero also clearly raises the risk of slipping into deflation, which could perpetuate stagnation and aggravate debt burdens.
- Some reassurance on the risk of excessively low inflation has been provided by the fact that, until recently, long-term inflation expectations appeared well-anchored around the ECB’s definition of price stability. As actual inflation has continued to fall, however, implied expectations from swap rates over the 6-10 year horizon have drifted downward somewhat. Moreover, the experience of Japan in the 1990s is a reminder that such expectations measures can be poor predictors of the actual future rate of inflation: 6-10 year consensus expectations in Japan were similarly near 2% in the early 1990s, failing to foresee the descent into deflation.



Source: Eurostat.

**Inflation expectations in the euro area**  
*From inflation swaps; 10-day moving average, per cent*

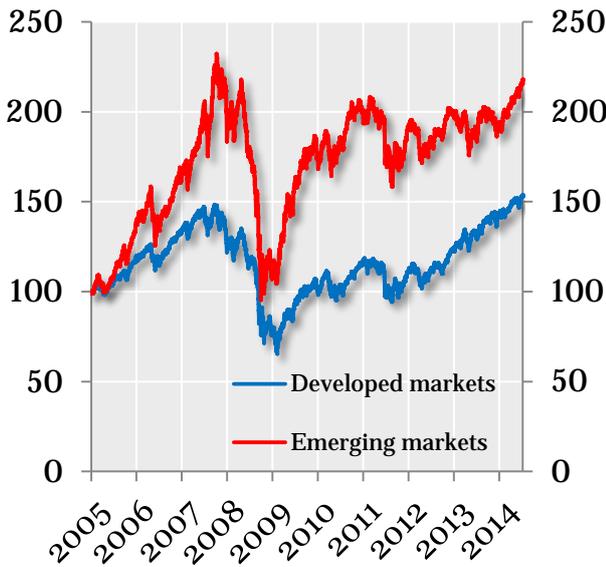


Source: Datastream.

### ***Important risks hang over the recovery, despite financial market bullishness***

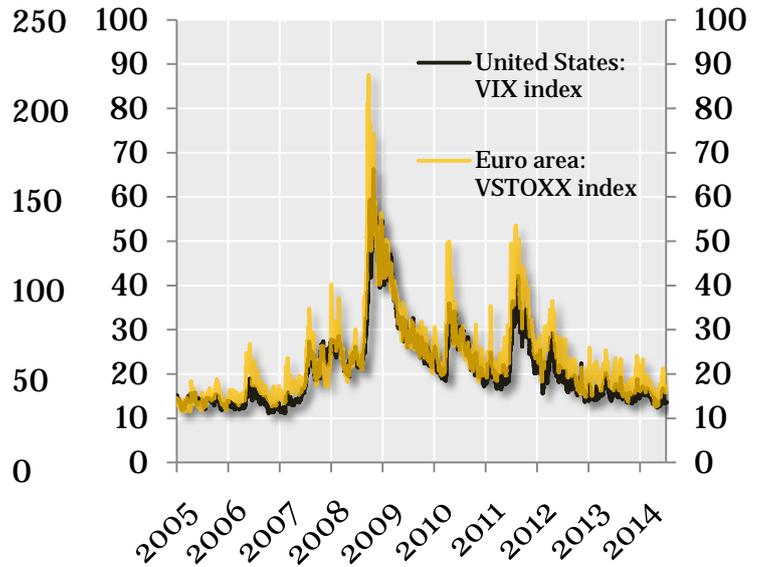
- Even apart from the possibility that entrenched low inflation feeds further negative growth surprises in the euro area, there are many significant risks to the near-term outlook. Notably, geopolitical risks have grown in recent months, with an intensification of conflicts in Ukraine and the Middle East and increasing uncertainty about the outcome of the referendum on Scottish independence. Also, many emerging economies remain vulnerable to financial market shocks given the build-up of debt, particularly corporate debt, in recent years. The anticipated tightening of US monetary policy could lead to shifts in international financial flows and sharp exchange rate movements that would be disruptive, especially for some emerging economies. Of course, not all risks are on the downside. For example, successful implementation of the comprehensive assessment of banks in the euro area could be associated with faster-than-expected improvements in credit flows.
- The bullishness of financial markets appears at odds with the intensification of several significant risks. A number of equity markets are reaching record highs, sovereign bond yields in several countries are near all-time lows and implied share price volatility in the United States and Europe is around pre-crisis levels. This highlights the possibility that risk is being mispriced and the attendant dangers of a sudden correction.

**Share prices**  
Indices, Jan 2005 = 100



Note: Series shown are the MSCI World and Emerging Markets indices. The MSCI World Index covers 23 developed markets and the MSCI Emerging Markets Index 23 emerging markets.  
Source: Datastream.

**Implied share price volatility**  
Per cent

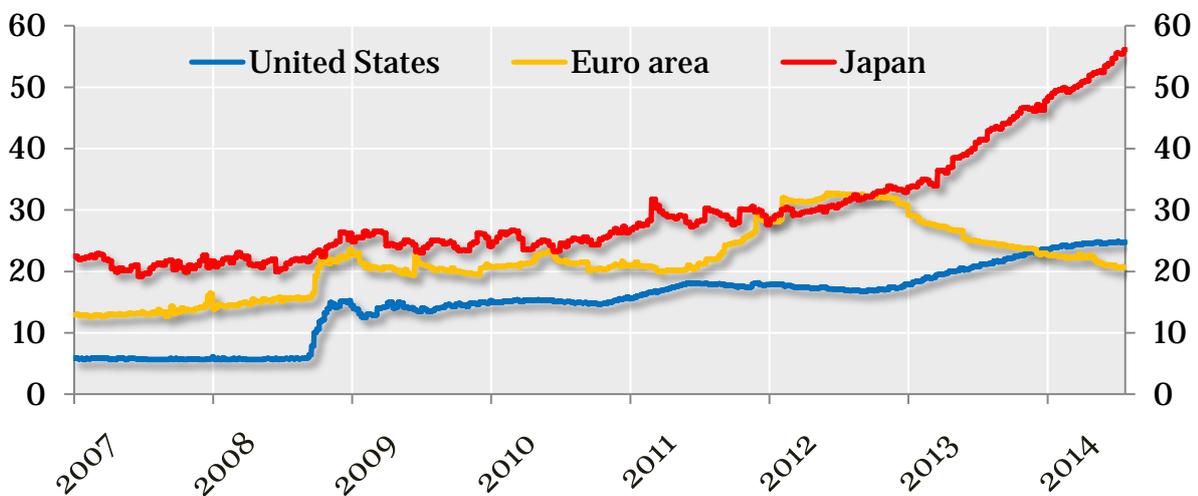


Source: Datastream.

**The global recovery needs continued support for demand, but macroeconomic policy needs are increasingly diverse across countries**

Increasingly varied cyclical positions means that the necessary macro policy settings are diverging. The euro area needs more vigorous monetary stimulus, whereas the United States and the United Kingdom are moving to the end of their unconventional monetary easing. Japan still needs quantitative easing to secure a lasting break with deflation. Policy settings in China are consistent with achieving an orderly growth slowdown, with ebbing inflation pressures providing ample room for stimulus if needed. By contrast, inflation remains above target in Brazil and India and monetary policy will need to remain restrictive.

**Other major central banks have eased more aggressively than the ECB**  
Central bank assets as per cent of GDP



Source: Datastream.

- Government debt burdens remain heavy in most major advanced economies but considerable progress has been made in fiscal consolidation. Given the weakness of demand, the flexibility within the EU fiscal rules should be used to support growth. In Japan, by contrast, the necessary consolidation is only beginning and the challenge to ensure debt sustainability is substantially greater. The planned second round of consumption tax increases in 2015 should be implemented, supported if necessary by other measures, particularly further monetary expansion, to manage demand. In the United States, consolidation needs are less pressing, but medium-term consolidation plans are still needed to keep public debt on a sustainable path.
- Among emerging economies, China's broadly neutral fiscal stance is appropriate. The main challenge pertains to local government debt. Recently announced policy changes go in the right direction: enhanced transparency, lower fiscal risk stemming from sub-national borrowing through local government financing vehicles and reduced pro-cyclicality of the budget.
- In India and Brazil, durable improvement in fiscal situations is still needed. In India, the quality of consolidation should be improved, with a reduction in subsidies and a shift in expenditure to social and physical infrastructure. Redesigning the fiscal rule in Brazil to take account of the business cycle, for example by adopting an expenditure rule, would make a credible commitment to the necessary improvement in the primary balance as the economy recovers.

***Structural reforms are a key part of comprehensive strategies for strong and inclusive growth***

- The global recovery from the crisis has been inadequate in several ways. Economic slack has persisted, potential growth has slowed, and inequality has risen. Meanwhile, external imbalances and threats to financial stability have remained. To address these various, often inter-related, problems, structural policies have a key role to play. In the euro area, for example, structural weaknesses in the banking system have hindered the effectiveness of easing monetary policy as a means to support demand. The completion of the banking union and a credible comprehensive assessment of banks will help to repair the transmission mechanism of monetary policy, making stimulus measures more effective. In the United States, stepped-up infrastructure investment would boost potential growth, while tax and labour market reforms could help to address the rise in inequality.
- Strengthening competition would help stimulate innovation and improve the allocation of resources in many economies. To that end, lower barriers to trade and reduced administrative burdens on firms would often be important for emerging economies, while liberalisation of services is a common priority among advanced economies.
- Tax simplification in developing countries like India and Brazil would remove a brake on investment. Employment could be boosted in countries with large tax wedges on labour, like France, by reducing employer social security contributions. In order to prevent the increased incidence of long-term unemployment from being reflected in a lasting rise in the structural unemployment rate, activation policies in a range of developed economies will need to be strengthened. Removing barriers to female participation in education and the labour force has considerable potential to boost output and well-being, especially in emerging economies.
- The continued failure of the global economy to generate strong, balanced and inclusive growth underlines the urgency of ambitious reform efforts.

## The OECD *Interim Economic Assessment*

The OECD *Interim Economic Assessment* is a partial update each September and March of the OECD's twice-yearly *Economic Outlook* published in November and May/June. Revised forecasts for annual GDP growth are provided for the G7 economies and Brazil, China and India.

The revised forecasts are based on a simplified version of the process used to prepare the *Economic Outlook*, based on models and judgement. Near-term developments are assessed using the OECD's short-term indicator models.

### Revisions in growth projections vis-à-vis the May 2014 Economic Outlook

#### GDP growth Per cent

|                | 2013   | 2014                            |                                   |            | 2015                            |                                   |            |
|----------------|--------|---------------------------------|-----------------------------------|------------|---------------------------------|-----------------------------------|------------|
|                | Actual | May 2014<br>Economic<br>Outlook | September<br>Interim<br>Forecasts | difference | May 2014<br>Economic<br>Outlook | September<br>Interim<br>Forecasts | difference |
| United States  | 2.2    | 2.6                             | 2.1                               | -0.5       | 3.5                             | 3.1                               | -0.4       |
| Euro area      | -0.4   | 1.2                             | 0.8                               | -0.4       | 1.7                             | 1.1                               | -0.6       |
| Japan          | 1.6    | 1.2                             | 0.9                               | -0.3       | 1.2                             | 1.1                               | -0.1       |
| Germany        | 0.2    | 1.9                             | 1.5                               | -0.4       | 2.1                             | 1.5                               | -0.6       |
| France         | 0.4    | 0.9                             | 0.4                               | -0.5       | 1.5                             | 1.0                               | -0.5       |
| Italy          | -1.8   | 0.5                             | -0.4                              | -0.9       | 1.1                             | 0.1                               | -1.0       |
| United Kingdom | 1.8    | 3.2                             | 3.1                               | -0.1       | 2.7                             | 2.8                               | +0.1       |
| Canada         | 2.0    | 2.5                             | 2.3                               | -0.2       | 2.7                             | 2.7                               | 0.0        |
| China          | 7.7    | 7.4                             | 7.4                               | 0.0        | 7.3                             | 7.3                               | 0.0        |
| India          | 4.7    | 4.9                             | 5.7                               | +0.8       | 5.9                             | 5.9                               | 0.0        |
| Brazil         | 2.5    | 1.8                             | 0.3                               | -1.5       | 2.2                             | 1.4                               | -0.8       |