OECD INTERIM ECONOMIC OUTLOOK

Will risks derail the modest recovery?
Financial vulnerabilities and policy risks

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www.oecd.org/economy/economicoutlook.htm
ECOSCOPE blog: oecdecoscope.wordpress.com
Key messages

Global growth is set to pick up modestly, but remains too slow

• Growth should be supported by current and expected fiscal initiatives
• Confidence is increasing but consumption and investment remain subdued
• Productivity growth remains sluggish and inequalities are increasingly apparent
• Policy uncertainty and low trust in government cloud the policy environment

Financial vulnerabilities and policy risks could derail the pick-up

• Disconnect between financial markets and the real economy risk a snap-back
• Volatility from interest rate and exchange rate movements expose mismatches
• Vulnerability comes from high asset prices, credit build-up, rising trade costs

Policy needs to strengthen inclusive growth and manage risks

• Implement effective fiscal initiatives to support growth and equity
• Maintain open markets complemented with domestic policies to share gains
• Step-up structural policy action to boost growth and inclusiveness
• Address financial vulnerabilities to enhance economic resilience
Global GDP growth to pick up modestly, boosted by fiscal initiatives

**Global GDP growth**

- Actual
- Growth in the absence of fiscal contribution
- Fiscal initiatives contribution

**Growth in the largest economies**

- United States
- China
- Euro area
- Japan

Note: Estimated fiscal initiatives contribution based on fiscal stimulus in China and the euro area for 2016-18 and in the United States for 2017-18. Fiscal years starting in April for India.

Source: OECD March 2017 Interim Economic Outlook; OECD November 2016 Economic Outlook database; and OECD calculations.
## Real GDP growth

### Year-on-year, %

<table>
<thead>
<tr>
<th>Region</th>
<th>2016</th>
<th>2017</th>
<th>Difference from November EO</th>
<th>2018</th>
<th>Difference from November EO</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>World</strong></td>
<td>3.0</td>
<td>3.3</td>
<td>0.0</td>
<td>3.6</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td>1.6</td>
<td>2.4</td>
<td>0.1</td>
<td>2.8</td>
<td>-0.2</td>
</tr>
<tr>
<td><strong>Euro area</strong></td>
<td>1.7</td>
<td>1.6</td>
<td>0.0</td>
<td>1.6</td>
<td>-0.1</td>
</tr>
<tr>
<td><strong>Germany</strong></td>
<td>1.8</td>
<td>1.8</td>
<td>0.1</td>
<td>1.7</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>France</strong></td>
<td>1.1</td>
<td>1.4</td>
<td>0.3</td>
<td>1.4</td>
<td>-0.2</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td>1.0</td>
<td>1.0</td>
<td>0.0</td>
<td>1.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Japan</strong></td>
<td>1.0</td>
<td>1.2</td>
<td>0.2</td>
<td>0.8</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Canada</strong></td>
<td>1.4</td>
<td>2.4</td>
<td>0.3</td>
<td>2.2</td>
<td>-0.1</td>
</tr>
<tr>
<td><strong>United Kingdom</strong></td>
<td>1.8</td>
<td>1.6</td>
<td>0.2</td>
<td>1.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>China</strong></td>
<td>6.7</td>
<td>6.5</td>
<td>0.1</td>
<td>6.3</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>India¹</strong></td>
<td>7.0</td>
<td>7.3</td>
<td>-0.3</td>
<td>7.7</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Brazil</strong></td>
<td>-3.5</td>
<td>0.0</td>
<td>0.0</td>
<td>1.5</td>
<td>0.3</td>
</tr>
<tr>
<td><strong>G20</strong></td>
<td>3.1</td>
<td>3.5</td>
<td>-0.1</td>
<td>3.8</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Rest of the World</strong></td>
<td>2.3</td>
<td>2.7</td>
<td>-0.1</td>
<td>3.2</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Note: Difference in percentage points based on rounded figures.
1. Fiscal years starting in April.
Indicators and rising confidence point to stronger but still modest growth

**OECD Composite Leading Indicator**

OECD and BRIICS, ratio to trend, amplitude adjusted
Long-term average = 100

**Business and consumer confidence**

OECD and BRIICS
Normalised index, 2012-2016

- Business confidence
- Consumer confidence

Note: Confidence indices are GDP PPP weighted averages of individual country normalised confidence series.
Source: OECD Composite Leading Indicators; OECD Main Economic Indicators database; and OECD calculations.
Improved market sentiment contrasts with low growth in consumption and investment

Consumption
Pre-recession peak = 100

Investment
Pre-recession peak = 100

Note: OECD shown. Current recovery shows since 2008Q1 including the forecasts in the dotted line. Previous 3 recoveries pre-recession peak in 1973Q4, 1980Q1 and 1990Q3. Consumption is real total consumers’ expenditure and investment is real total gross fixed capital formation.

Source: OECD November 2016 Economic Outlook database.
Productivity growth has been very slow and inequality has increased.

Labour productivity growth

Income inequality is rising in the OECD

Note: Labour productivity growth is the average annual growth rate of output per hour worked. For LHS the OECD and euro area are GDP PPP weighted averages. RHS is the unweighted average of 17 OECD countries.
Source: OECD Income Distribution database; OECD National Accounts database; OECD Productivity database; and OECD calculations.
Productivity gaps have widened and wages stagnate at laggard firms

Labour productivity
Index, 2001 = 100

Real compensation per worker
Index, 2001 = 100

Note: Frontier firms are the 5% of firms with the highest labour productivity by year and sector. Industries included are manufacturing and business services, excluding the financial sector, for firms with at least 20 employees.
Policy uncertainty is high and falling trust makes reforms more difficult

Global economic policy uncertainty
3-month moving average, index normalised for 2011-2017

Confidence in national governments
Note: Percentage who answered ‘yes’ to the question: “Do you have confidence in national government?”.
Source: Gallup World Poll; OECD Trust and Public Policy (2017).
Risks and financial vulnerabilities could derail the modest recovery

**Disconnects**
- Sentiment robust, but consumption and investment weak
- Financial markets vs. real economy, inflation and risks

**Volatility**
- Sharp changes in global interest rates
- Large exchange rate movements
- Diverging interest rates among advanced economies

**Vulnerabilities**
- House prices in some advanced economies
- Private-sector credit growth in many EMEs
- Exposure to overseas borrowing and currency mismatch

**Policy**
- Political and policy uncertainties
- Rolling back trade openness would hurt growth and jobs
- Deceleration in policy action for inclusive growth
Disconnect between the real economy and market valuations

Change in GDP growth and inflation expectations and interest rates

% pts since July 2016

Consensus long-term growth expectations

Consensus long-term inflation expectations

Market nominal interest rates

Equity prices

Index 1 Jul. 2016 = 100

United States

Euro area

Japan

Note: Change in long-term growth and inflation expectations are the change in Consensus Economics forecasts for 2017-26 for average annual real GDP growth and CPI inflation respectively. Nominal interest rates based on 10-year government bond yields.

Source: Consensus Economics; OECD Main Economic Indicators database; and Thomson Reuters.
The interest-rate cycle turned in mid-2016 with large increases in long rates globally.

Source: ECB; and Thomson Reuters.
Divergence in interest rates of major economies creates risk of exchange rate volatility.

**Overnight interest rates:**
actual and market expectations

- United States
- Euro area
- Japan

**Exchange rates against USD**

Index Jan. 2014 = 100

Note: Market expectations at 2 March 2017.

Source: OECD Exchange Rates database; OECD November 2016 Economic Outlook database; Thomson Reuters; and OECD calculations.
Vulnerabilities from high house prices and under-priced credit risks

**House prices are high in some markets**

House price-to-rent ratio

*Average since 1980 = 100*

- 2016Q4 or latest available
- Range for ratio since 1980

**Corporate bond risks spreads are low**

BBB rated bond spreads over government benchmark

*Dotted line shows average for 1997-2005*

Note: Credit spreads between Merrill Lynch corporate BBB rated bonds and government benchmark bonds. Spreads based on average yields for 5-7 years and 7-10 years.

Source: Thomson Reuters.
Vulnerabilities from rapid increases in debt, rising non-performing loans

Non-financial sector credit

% of GDP

- Advanced economies
- China
- EMEs excl. China

% of GDP

Non-performing loans

% of gross loans

- 2014Q1 or closest
- Change to 2016Q3 or latest available

Note: Threshold estimates from OECD economic resilience framework.
Source: BIS; China Banking Regulatory Commission; Hermansen and Röhn (2017); IMF; OECD Resilience database; and OECD calculations. See: www.oecd.org/economy/growth/economic-resilience.htm for further detail.
Vulnerabilities for some EMEs to debt and currency exposures

Note: External debt shows liabilities for portfolio investment, debt securities, other investment and other debt instruments. USD denominated obligations are for non-bank borrowers and include cross-border and locally-extended loans, and bonds issued by non-banks in the country and offshore affiliates of non-banks. USD denominated export revenue is given by the share of merchandise exports invoiced in US dollars in 2015. Source: Gopinath (2016); IMF International Investment Position database; McCauley et al. (2015); and OECD calculations.
Rolling back trade openness would hurt GDP and put jobs at risk

Medium-term GDP impact of increased trade costs

- World
- Major economies imposing restrictions
- Spillovers to other economies

Share of total employment embodied in foreign demand

Germany
Korea
Italy
United Kingdom
Canada
France
Mexico
India
China
Japan
Brazil
United States

Note: LHS shows the impact of a goods trade cost increase of 10 percentage points for China, Europe and the United States against all trading partners, equivalent to an average increase in tariffs to 2001 levels, when trade negotiations under the Doha Development Round started. RHS for 2011, latest available.

Source: OECD METRO model; OECD TiVA database; and OECD calculations.
Policy needs to strengthen growth and inclusiveness and manage risks
Use fiscal space to boost inclusive growth and investment

Years a permanent investment increase of 0.5% of GDP can be funded with temporary deficits

<table>
<thead>
<tr>
<th>Country</th>
<th>Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>4</td>
</tr>
<tr>
<td>Italy</td>
<td>4</td>
</tr>
<tr>
<td>United States</td>
<td>3</td>
</tr>
<tr>
<td>Canada</td>
<td>3</td>
</tr>
<tr>
<td>Spain</td>
<td>2</td>
</tr>
<tr>
<td>Germany</td>
<td>2</td>
</tr>
<tr>
<td>France</td>
<td>1</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1</td>
</tr>
<tr>
<td>Australia</td>
<td>1</td>
</tr>
<tr>
<td>Korea</td>
<td>0</td>
</tr>
</tbody>
</table>

Long-term GDP gains from a fiscal initiative

- Gains from increase in public investment
- Gains from reducing long-term unemployment
- Gains from structural reforms

- **USA**: 3% gain
- **FRA**: 2% gain
- **DEU**: 2% gain
- **ITA**: 3% gain
- **GBR**: 2% gain
- **CAN**: 1% gain

Note: RHS shows impact of a sustained public investment increase of 0.5% of GDP. Gains from structural reforms for a 10% reduction of product market regulations.

Complement with more ambitious structural reforms for inclusive growth

OECD Going for Growth recommendations implemented

Policy packages of structural reforms can deliver inclusive growth

Where are countries making complementary reforms for inclusive growth?

2015-16

Product market measures

<table>
<thead>
<tr>
<th>Little progress</th>
<th>Some progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>CHL, DEU, IDN</td>
<td>BEL, ESP, LUX, ITA</td>
</tr>
<tr>
<td>DNK, IND, JPN, POL, SVN, TUR</td>
<td>AUT, FRA, FIN, KOR, LVA</td>
</tr>
</tbody>
</table>

Labour market measures

Note: Reform progress based on responsiveness to OECD Going for Growth recommendations by policy area. Little progress is for a reform responsiveness rate of 0 to 20% and some progress is for a responsiveness rate of more than 20%. Source: OECD Going for Growth 2017, forthcoming on March 17: www.oecd.org/eco/growth/goingforgrowth.htm.
### Fiscal-structural initiatives to maximise impact on growth and inclusiveness

<table>
<thead>
<tr>
<th>Impact of spending reform</th>
<th>Growth</th>
<th>Income of the poor</th>
<th>Countries with most room for gains</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improving education</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td>CHL, GRC, MEX, PRT, TUR</td>
</tr>
<tr>
<td>Increasing public investment and R&amp;D</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td>DEU, GBR, ITA, MEX, TUR, USA</td>
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<tr>
<td>Increasing government effectiveness</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td>FRA, GRC, HUN, ITA, SVN</td>
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<tr>
<td>Increasing family benefits</td>
<td><img src="#" alt="White" /></td>
<td><img src="#" alt="Green" /></td>
<td>CHE, ESP, GRC, PRT, USA</td>
</tr>
<tr>
<td>Decreasing public subsidies</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="White" /></td>
<td>BEL, CHE</td>
</tr>
</tbody>
</table>

Policy needs to strengthen growth and equity, as well as manage risks

Address financial vulnerabilities and promote resilience

- Ensure robust early warning and recognition of risks
- Promote effective approaches to non-performing loans

Implement fiscal-structural packages to boost inclusive growth

- Increase political commitment to accelerate reforms
- Use fiscal initiatives to support demand and increase supply
- Improve labour market, skills, competition, trade policies together
- Strengthen tax and transfer systems to ensure growth with equity