OECD INTERIM ECONOMIC OUTLOOK

Global Growth Warning: Weak Trade, Financial Distortions

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www.oecd.org/economy/economicoutlook.htm
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Key messages

Weak trade growth exacerbates low-growth trap

- Global trade growth has slowed dramatically
- Structural and cyclical factors are reducing demand and productivity growth
- This self-reinforcing low-growth trap hurts long-term prospects

Exceptionally low interest rates lead to financial distortions and risks

- Valuations are high despite weak growth prospects and ongoing uncertainties
- There are risks of volatility and sharp reversals across asset markets
- This environment will undermine financial institutions in the long term

Stronger fiscal, structural and trade policy action is required

- Overburdened monetary policy raises financial risks
- Use fiscal space to catalyse private activity now and boost long-term growth
- Implement structural policy packages to ensure trade and investment promote growth and inclusiveness
Global GDP growth remains low

Global GDP growth in 2016 is projected to be lower than 2015, with only a slight pick-up in 2017.

Note: World GDP measured at purchasing power parity exchange rates.
Source: OECD Economic Outlook database.
### Interim Economic Outlook Forecasts

#### Real GDP growth (%)\(^1\)

<table>
<thead>
<tr>
<th>2015</th>
<th>2016 Projections</th>
<th>September 2016 Projections</th>
<th>difference from June EO(^2)</th>
<th>2017 Projections</th>
<th>difference from June EO(^2)</th>
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</thead>
<tbody>
<tr>
<td><strong>World</strong></td>
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<td>3.2</td>
<td>-0.1</td>
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<td><strong>United States</strong></td>
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<td>1.8</td>
<td>0.2</td>
<td>1.5</td>
<td>-0.2</td>
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<tr>
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<td>-0.1</td>
<td>1.3</td>
<td>-0.2</td>
</tr>
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<td><strong>Italy</strong></td>
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<td>-0.2</td>
<td>0.8</td>
<td>-0.6</td>
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<tr>
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<td>0.7</td>
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<td>-0.5</td>
<td>2.1</td>
<td>-0.1</td>
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<tr>
<td><strong>United Kingdom</strong></td>
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<td>1.8</td>
<td>0.1</td>
<td>1.0</td>
<td>-1.0</td>
</tr>
<tr>
<td><strong>China</strong></td>
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<td>6.5</td>
<td>0.0</td>
<td>6.2</td>
<td>0.0</td>
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<tr>
<td><strong>India(^3)</strong></td>
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<td>7.4</td>
<td>0.0</td>
<td>7.5</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Brazil</strong></td>
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<td>-3.3</td>
<td>1.0</td>
<td>-0.3</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Rest of the World</strong></td>
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<td>2.3</td>
<td>-0.1</td>
<td>2.8</td>
<td>-0.2</td>
</tr>
</tbody>
</table>

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1. Year-on-year. GDP at market prices adjusted for working days.
2. Difference in percentage points based on rounded figures.
3. Fiscal years starting in April.
UK growth is slowing following the EU referendum and risks are to the downside

Sterling has weakened significantly

Growth is slowing, although stronger data for early 2016 help support 2016 forecast

A strong policy response from the Bank of England helped to stabilise markets

The 2017 GDP forecast is revised down significantly, although projections are unusually uncertain

Source: Thomson Reuters; and UK Office for National Statistics.
World trade growth is exceptionally weak

World trade growth has slowed to a pace associated with very low growth

Note: World trade is goods plus services trade volumes measured at market exchange rates in US dollars. World GDP volumes measured at market exchange rates in US dollars. Source: OECD Economic Outlook database; and OECD calculations.
Reasons for weak world trade

2015 trade slowdown is due to weak demand and changes in China

Much of the weakness may be structural, including changes in GVCs, and some due to a tightening of trade policies

Note: Estimated impact of different factors on the annual growth rate of the ratio of world exports plus imports to GDP. World trade and world GDP measured at market exchange rates. For further detail see OECD Economic Policy Paper “Cardiac Arrest or Dizzy Spell: Why is World Trade So Weak, What Can Policy Do About It?”.
Source: OECD June 2016 Economic Outlook database; Fraser Institute; and OECD calculations.
Global value chains are unravelling

The rapid expansion of global value chains in the 1990s has slowed and they are now unravelling

Note: Structural global value chain indicator shown which adjusts for the economic cycle and changes in commodity prices.
For further detail see OECD Economic Policy Paper “Cardiac Arrest or Dizzy Spell: Why is World Trade So Weak, What Can Policy Do About It?”.
Source: OECD June 2016 Economic Outlook database; OECD STAN Bilateral Trade database; and OECD calculations.
Raising trade intensity would boost productivity growth

Note: Scenario in which world and OECD trade intensity (exports plus imports as a share of GDP) increases by 1.3 percentage points per annum (the average from 1986-2007) from 2017. The effect of this increase on OECD total factor productivity growth is shown. For further detail see OECD Economic Policy Paper “Cardiac Arrest or Dizzy Spell: Why is World Trade So Weak, What Can Policy Do About It?”. Source: OECD June 2016 Economic Outlook database; Égert and Gal (2016); and OECD calculations.
Exceptionally low interest rates distort financial markets and raise risks
Monetary policy support has become overburdened and creates risks

Central bank balance sheets are growing significantly

A high share of government debt is trading at negative yields

Source: Thomson Reuters; Bloomberg; US Federal Reserve; Bank of Japan; ECB; and OECD calculations.
Exceptionally low and negative interest rates on long-term sovereign bonds

Yield curves for government bonds

United States
- 2010
- 2016

Euro area
- 2010
- 2016

Japan
- 2010
- 2016

Note: Bond yields are for the average in August.
Source: Bloomberg.
Lower long-term growth prospects contrast with asset price inflation

Long-term GDP growth expectations

Equity prices

Note: Difference between April 2011 projections of average annual GDP growth over 2012-2021 and April 2016 projections of average annual GDP growth over 2017-2026. OECD and World estimates based on weighted average of countries shown, using 2015 PPP shares. Source: Consensus Forecasts; Thomson Reuters; and OECD calculations.
Search for yield and price distortions in some markets add to risks

Quality of corporate bonds has declined
Average value-weighted rating index for newly issued bonds

Corporate bond yield spreads have tightened
Bank of America Merrill Lynch Global Corporate indices, % pts

Source: FactSet; OECD Business and Finance Scoreboard; Bloomberg; and Thomson Reuters.
Real estate price increases in advanced economies; high corporate debt exposures in some EMEs

Real house prices

Corporate debt in EMEs

Index 2002q1 = 100

Note: RHS for non-financial corporations.
Source: BIS; and OECD Analytical House Price database.
Sustained low growth and low interest rates challenge financial institutions’ business models

Bank shares have underperformed
(Bank equity prices relative to overall market)

Pension funds have struggled
(Billion USD, 2015 prices)

Note: The funding status on the RHS is the difference between the projected pension obligations and assets of the 100 largest US corporate defined benefit pension plans.
Source: Milliman; OECD Economic Outlook database; and Thomson Reuters.
Stronger collective fiscal and structural policy action is needed
Use fiscal space provided by low interest rates

Canada, China, Japan and the US have recently announced fiscal expansion

Euro area fiscal policy should do more to support growth, easing the application of the SGP and considering to exclude net investment from compliance calculations

Note: Based on general government debt at the end of 2014, assuming that 15% of this initial debt stock matures each year, comparing the interest rate on 10-year government bonds in 2014 with the interest rate for 2015 and the 2016 average until August for 2016 and 2017.
Source: OECD June 2016 Economic Outlook database; and OECD calculations.
Choose fiscal spending to maximise impact on growth and inclusiveness

Impact of spending areas

<table>
<thead>
<tr>
<th></th>
<th>Growth</th>
<th>Equality</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Short-term</td>
<td>Long-term</td>
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<tr>
<td>Education</td>
<td></td>
<td></td>
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<tr>
<td>Childcare and family</td>
<td></td>
<td></td>
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<tr>
<td>Health services</td>
<td></td>
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<tr>
<td>Unemployment benefits</td>
<td></td>
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<tr>
<td>Public investment</td>
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Source: Cournède, Goujard and Pina (2014).

- Significant positive impact
- Small positive impact
- Uncertain impact
- Small negative impact
More ambition is needed to increase the pace of pro-growth and inclusive growth reforms.

Impact of G20 structural reforms

G20 GDP by 2018, per cent deviation from baseline

- Committed
- Implemented

Reforms by G20 countries add an estimated 1% to G20 GDP by 2018

Almost half of G20 countries’ commitments have not been implemented

Fewer commitments to liberalise trade; down from 14% two years ago

Source: OECD and IMF calculations.
Boosting trade and removing trade restrictions would raise growth

Trade restrictions rising in G20 countries
Number of discriminatory trade related measures in-force since the crisis

Trade policy recommendations:

Avoid new trade and investment protectionist measures

Roll back protectionist measures introduced following the crisis

Reduce unnecessary trade costs by:

- Improving border and customs procedures, incl. implementing the trade facilitation agreement
- Removing tariff and non-tariff barriers at borders
- Remove regulatory restrictions on trade in services, particularly logistics
- Reduce costly regulatory differences between countries

Remove impediments and distortions for cross-border investment

Policy packages are needed to share the benefits of globalisation more widely

People in advanced economies are more negative about globalisation

*Views on trade and foreign investment, 2014*

- Trade creates jobs
- Trade raises wages
- Foreign acquisitions are good

Trade policies should be accompanied by:

- Social protection and support for workers in transition
- Investing in human capital and infrastructure
- Active labour market policies to promote skills upgrading and matching
- Product market reforms to promote competition and firm entry

Source: Pew Research Center.
Stronger collective action is needed on fiscal, structural, and trade policies

Use increased fiscal space from low interest costs

- Focus on quality investment to boost human capital and physical infrastructure
- Combine with policies to promote demand now, long-term potential output, and inclusiveness

Implement ambitious policy packages to boost trade and inclusiveness

- Stand still on new protectionist measures and roll back existing measures
- Tackle trade costs and barriers more urgently
- Deploy policy packages to support adjustment and share the benefits

Monetary policy is overburdened and creating risks

- Reduce over-reliance on monetary policy with greater fiscal and structural policy action
- Carefully evaluate the costs and benefits of increasing unconventional support