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Conventional signs

$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mb/d	Million barrels per day	Trillion	Thousand billion
. .	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		

Editorial

Policy changes to turn the tide

For the past two years, global growth outcomes and prospects have steadily deteriorated, amidst persistent policy uncertainty and weak trade and investment flows. We now estimate global GDP growth to have been 2.9% this year and project it to remain around 3% for 2020-21, down from the 3.5% rate projected a year ago and the weakest since the global financial crisis. Short-term country prospects vary with the importance of trade for each economy though. GDP growth in the United States is expected to slow to 2% by 2021, while growth in Japan and the euro area is expected to be around 0.7 and 1.2% respectively. China's growth will continue to edge down, to around 5.5% by 2021. Other emerging-market economies are expected to recover only modestly, amidst imbalances in many of them. Overall, growth rates are below potential.

The mix between monetary and fiscal policies is unbalanced. Central banks have been easing decisively and timely, partly offsetting the negative impacts of trade tensions and helping to prevent a further rapid worsening of the economic outlook. Thereby, they have also paved the way for structural reforms and bold public investment to raise long-term growth, such as spending on infrastructure to support digitalisation and climate change. However, to date, other than a few countries, fiscal policy has been only marginally supportive, and not especially of investment, while asset prices have been buoyant.

The biggest concern, however, is that the deterioration of the outlook continues unabated, reflecting unaddressed structural changes more than any cyclical shock. Climate change and digitalisation are ongoing structural changes for our economies. In addition, trade and geopolitics are moving away from the multilateral order of the 1990s. It would be a policy mistake to consider these shifts as temporary factors that can be addressed with monetary or fiscal policy: they are structural. In the absence of clear policy directions on these four topics, uncertainty will continue to loom high, damaging growth prospects.

The lack of policy direction to address climate change issues weighs down investment. The number of extreme weather events is on the rise and insufficient policy action could increase their frequency. They may lead to significant disruptions to economic activity in the short term, and long-lasting damage to capital and land, as well as to disorderly migration flows. Adaptation plans are in their infancy, while mitigation, moving away from fossil fuels, through measures such as carbon taxes, has proved technically and politically challenging. Governments must act quickly: without a clear sense of direction on carbon prices, standards and regulation, and without the necessary public investment, businesses will put off investment decisions, with dire consequences for growth and employment.

Digitalisation is transforming finance, business models and value chains, through three main channels: investment, skills and trade. So far, only a small fraction of businesses appear to have successfully harnessed the strong productivity potential of digital technologies, which partly explains why digitalisation has been unable to offset other headwinds on aggregate productivity. Reaping the full benefits of digital technologies requires complementary investments in computer software and databases, R&D, management skills and training, which remains a challenge for too many firms. Digitalisation is also affecting people and work, because it confers a huge advantage to people whose main tasks require cognitive and creative skills, and penalises those whose work has a large routine element, and at the same time generates new forms of contractual arrangements that escape traditional social protection. But the policy environment to harness new technology – concerning skill upgrading, social protection, access to communication infrastructure, digital platform development, competition in digital markets and regulation of cross-border data flows – lags behind, making it difficult to reap the benefits of digitalisation in full.

The Chinese economy is structurally changing, rebalancing away from exports and manufacturing towards more consumption and services. Increasing self-sufficiency in core inputs for certain manufacturing sectors is reflecting a desire to move away from importing technology towards national production. A shift in energy utilisation to address pollution, and the rise in services also induce additional changes in Chinese demand for imports. China's traditional contribution to global trade growth is set to slow and change in nature. While India is set to grow rapidly, its growth model is different and its contribution to global trade growth will not be enough to substitute for China as a global engine for traditional manufacturing.

Trade and investment are also structurally changing, with digitalisation and the rise of services, but also with geopolitical risks. The rise in trade restrictions is nothing new. About 1500 new trade restrictions have been implemented by G20 economies since the global financial crisis in 2008. Yet, the past two years have seen a surge in trade-restricting measures and an erosion of the rules-based global trading system, which is deep-rooted. Coupled with rising government support across a range of sectors, this induces disruptions in supply chains and reallocations of activities across countries that both exert a drag on current demand by reducing incentives to invest and undermine medium-term growth.

Against this backdrop, there is scope and an urgent need for much bolder policy action to revive growth. Reducing policy uncertainty, rethinking fiscal policy, and acting vigorously to address challenges raised by digitalisation and climate change, all have the potential to reverse the current slippery trend and lift future growth and living standards.

First, a clear policy direction for transitioning towards sustainable growth amidst digitalisation and climate challenges would trigger a marked acceleration of investment. Governments should focus not only on the short-term benefits of fiscal stimulus, but primarily on the long-term gains and to this end they should review their investment policy frameworks. The creation of national investment funds, focused on investing in the future, could help governments design investment plans to address market failures and take account of positive externalities for society as a whole. A number of governments already have dedicated funds of the sort, but their governance could be improved to ensure higher economic and social returns on investment.

Second, greater trade policy predictability and transparency could go a long way to reduce uncertainty and revive growth. For instance, there is a need to bring more transparency to the numerous forms of government support that distort international markets and to agree global rules on the transparency, predictability, reduction and prevention of such support (Focus Note 1).

Third, fiscal and monetary policies can be better activated, and to powerful effect if coordination prevails. There is scope to strengthen automatic stabilisers to preserve household income and consumption (Focus Note 5). Active coordination across the euro area would contribute to lift growth now (Focus Note 3). Moreover, should the outlook deteriorate more than we project, coordinated fiscal and monetary action across the G20, even allowing for the limited policy space some central banks have, could efficiently avert a recession, not least because coordination would bolster confidence (Focus Note 4).

The current stabilisation at low levels of economic growth, inflation and interest rates does not warrant policy complacency. The situation remains inherently fragile, and structural challenges – digitalisation, trade, climate change, persistent inequalities – are daunting. Rather, there is a unique window of opportunity to avoid a stagnation that would harm most people: restore certainty and invest for the benefit of all.

21st November 2019

Laurence Boone

OECD Chief Economist

1 General assessment of the macroeconomic situation

Introduction

The global outlook is fragile, with increasing signs that the cyclical downturn is becoming entrenched. GDP growth remains weak, with a slowdown in almost all economies this year, and global trade is stagnating. A continued deepening of trade policy tensions since May is taking an increasing toll on confidence and investment, further raising policy uncertainty. Supportive labour market conditions continue to hold up household incomes and consumer spending, at least in the near term, although survey measures point to weakness ahead. Moves towards a more accommodative monetary policy stance in many economies are keeping asset prices high, though the benefits for real activity appear to be less powerful than in the past. In many countries fiscal easing remains limited, with scope to take further advantage of low interest rates to support growth. Overall, given the balance of these forces acting, global GDP growth is projected to remain at around 3% in 2020 and 2021, after having declined to 2.9% this year, the weakest pace since the financial crisis (Table 1.1). Inflation is expected to remain mild. Global trade growth is projected to pick up only slowly given continued trade tensions, with trade intensity over 2019-21 remaining low. These developments raise concerns that growth expectations continue to decline in the absence of policy action. The induced reallocation of activities across countries and adjustment to supply chains that results from persisting trade tensions is both a drag on demand and a source of weaker medium-term growth by reducing productivity and incentives to invest.

Growth could be weaker still if downside risks materialise or interact, including from a further escalation of trade and cross-border investment policy restrictions, continued uncertainty about Brexit, a failure of policy stimulus to prevent a sharper slowdown in China, and financial vulnerabilities from the tensions between slowing growth, high corporate debt and deteriorating credit quality. A persistent upward spike in oil prices, if geopolitical tensions were to strengthen again, would also weaken growth prospects. On the upside, decisive actions by policymakers to reduce policy-related uncertainty and improve medium-term growth prospects, including measures to restore trade policy certainty, would boost confidence around the world. In particular, a full or partial reversal of the trade restraints implemented or announced this year would boost growth, though uncertainties about future trade policy would likely linger.

The subdued economic outlook and mounting downside risks call for immediate policy actions to reduce policy-related uncertainty, ensure sufficient support for demand, enhance resilience against risks and strengthen prospects for medium-term living standards. Trade policy unpredictability needs to give way to more orderly collective approaches that restore a transparent and rules-based system that encourages businesses to invest. Monetary policy has already become more accommodative this year in most major economies, with some scope for further easing in those emerging-market economies with declining inflation and limited macroeconomic imbalances. In many advanced economies, particularly the euro area, using fiscal and structural policies alongside monetary policy would give more support for growth and create fewer financial risks than continuing to rely mainly on monetary policy. Exceptionally low interest rates provide an opportunity for fiscal policy to be used more actively to invest in measures that support near-term demand and enhance the prospects for sustainable medium-term growth. Greater structural reform ambition is required in all economies to help offset the impact of the negative supply shocks from rising restrictions on trade and cross-border investment, enhance confidence and facilitate the measures necessary to strengthen living standards and opportunities. If downside risks materialise and global growth looks set to be significantly weaker than projected, co-ordinated policy action within and across all the major economies would provide the most effective and timely counterweight.

Table 1.1. Global growth is set to remain weak

OECD area, unless noted otherwise

	Average 2012-2019	2018	2019	2020	2021	2019 Q4	2020 Q4	2021 Q4
				Per cent				
Real GDP growth[1]								
World[2]	3.3	3.5	2.9	2.9	3.0	3.0	2.9	3.1
G20[2]	3.6	3.8	3.1	3.2	3.3	3.2	3.2	3.3
OECD[2]	2.1	2.3	1.7	1.6	1.7	1.8	1.7	1.7
United States	2.4	2.9	2.3	2.0	2.0	2.3	1.9	2.0
Euro area	1.5	1.9	1.2	1.1	1.2	1.1	1.2	1.2
Japan	1.1	0.8	1.0	0.6	0.7	1.0	0.8	0.5
Non-OECD[2]	4.4	4.6	3.9	4.0	4.0	3.9	3.9	4.1
China	6.9	6.6	6.2	5.7	5.5	6.1	5.5	5.5
India[3]	7.1	6.8	5.8	6.2	6.4			
Brazil	-0.1	1.1	0.8	1.7	1.8			
Unemployment rate[4]	6.6	5.3	5.2	5.1	5.1	5.1	5.1	5.1
Inflation[1,5]	1.6	2.3	2.0	2.1	2.1	1.9	2.1	2.1
Fiscal balance[6]	-3.6	-2.9	-3.2	-3.3	-3.3			
World real trade growth[1]	3.4	3.7	1.2	1.6	2.3	1.1	1.9	2.4

1. Percentage changes; last three columns show the increase over a year earlier.
2. Moving nominal GDP weights, using purchasing power parities.
3. Fiscal year.
4. Per cent of labour force.
5. Private consumption deflator.
6. Per cent of GDP.

Source: OECD Economic Outlook 106 database.

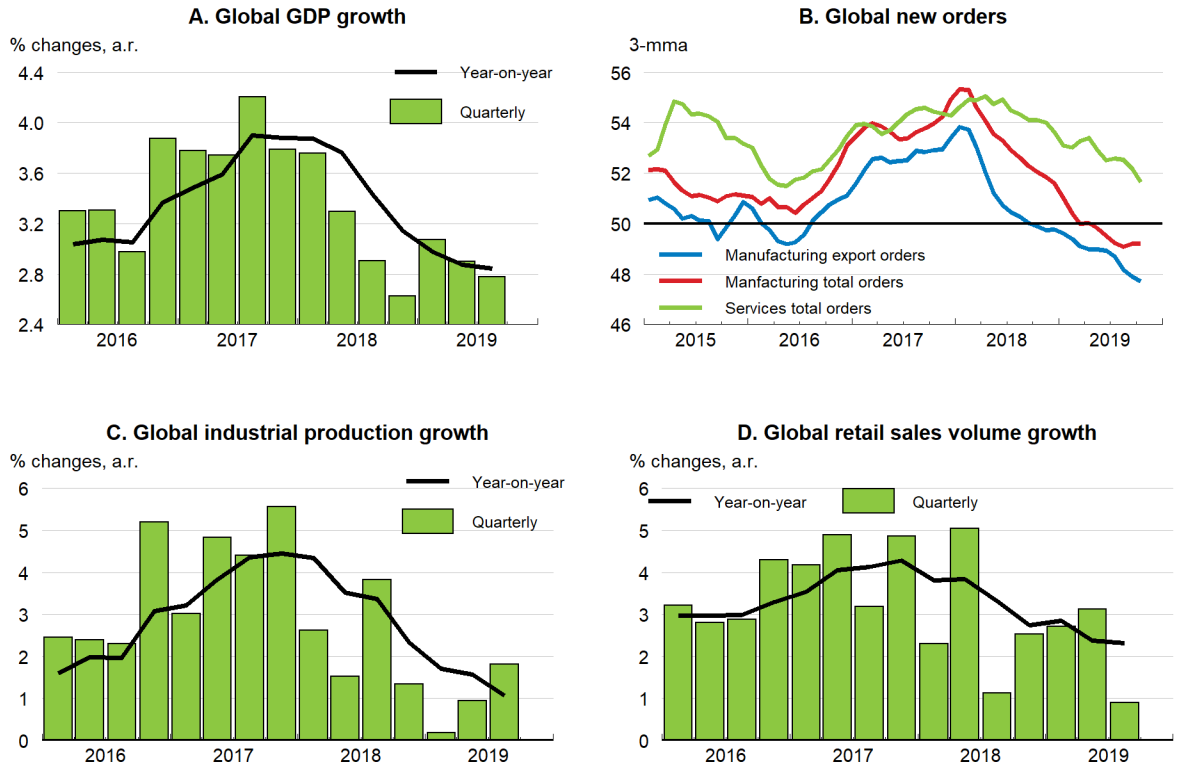
StatLink https://doi.org/10.1787/888934044784

Global growth will be held down by high uncertainty

Global GDP, trade and investment growth have continued to slow

Global economic prospects remain subdued, and downside risks have intensified amidst growing policy uncertainty and weakening business sentiment. Global GDP growth has eased to around 3% this year (Figure 1.1, Panel A), with a broad-based slowdown in both advanced and emerging-market economies. Growth has held up in the United States, helped by strong consumer spending, as well as in many Central European economies, but has proved weaker than anticipated in those advanced economies more strongly exposed to the slowdown in global trade. Residential investment has also continued to moderate in some economies with cooling housing markets, including Canada, Australia and Korea, and construction output has declined in the euro area. Growth in many emerging-market economies remains modest, with the recovery from recessions proceeding slowly in some economies, and domestic uncertainties having weighed on activity in others, including Mexico, India and Argentina. GDP growth in China continues to ease gradually, but import demand has slowed more sharply.

Figure 1.1. Global activity has slowed sharply



Note: GDP, industrial production and retail sales aggregation use PPP weights. Data in Panel D are for retail sales in the majority of countries, but monthly household consumption is used for the United States and the monthly synthetic consumption indicator is used for Japan. Data for India are unavailable for Panel D.
Source: OECD Economic Outlook 106 database; Markit; OECD Main Economic Indicators database; Refinitiv; and OECD calculations.

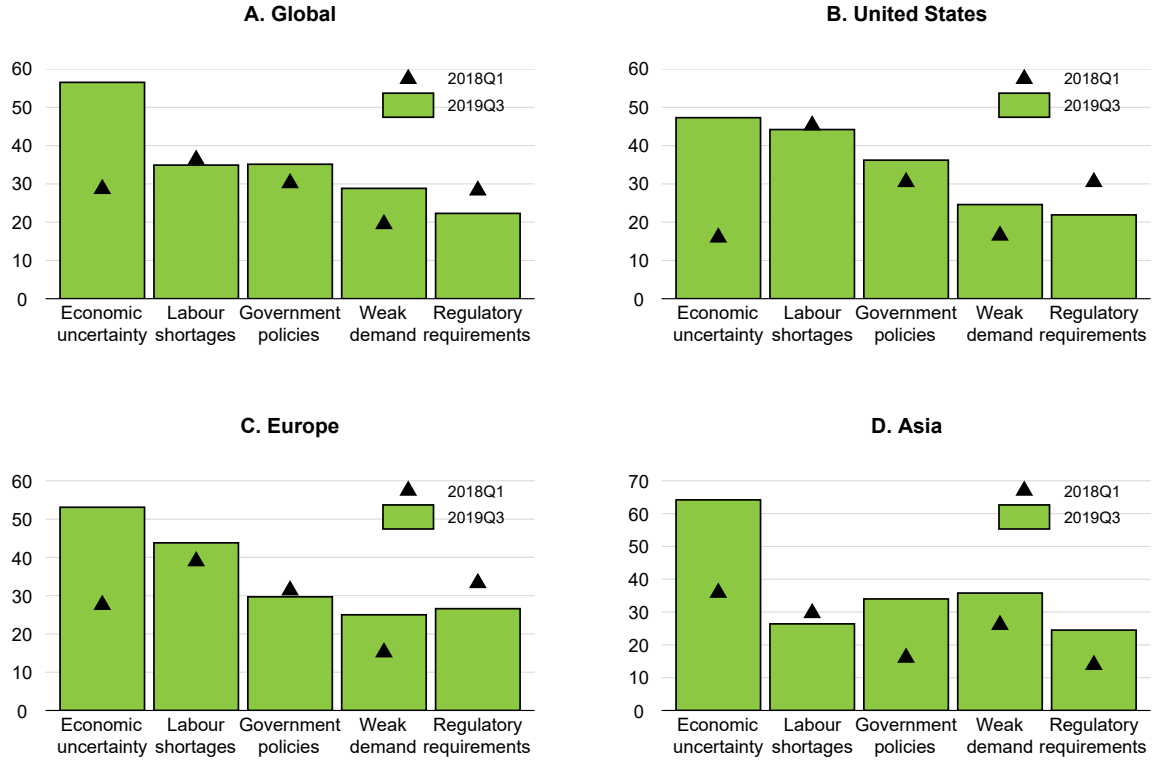
StatLink https://doi.org/10.1787/888934044290

Survey measures of business activity have continued to decline (Figure 1.1, Panel B), particularly in manufacturing, where global indicators of output and new orders have dropped to their lowest level for seven years. Trade tensions are weighing heavily on industrial sectors (Figure 1.1, Panel C), especially in the advanced economies, where industrial production has declined this year. Service sector output has held up for much of the year, helped by steady growth in consumer spending (Figure 1.1, Panel D), but there are growing signs of softer developments from survey data. A further period of weakness in industrial sectors would intensify the downturn in hiring intentions and reduced working hours already underway in some countries, placing downward pressure on household incomes and spending, and the demand for services.

Economic uncertainty has become the most pressing concern for firms around the world in the eighteen months since the start of US-China trade tensions (Figure 1.2). Given the increasing unpredictability of trade policies, high uncertainty is likely to be a persisting drag on activity for a prolonged period. A rising share of firms also point to weak demand as a concern. The impact of heightened policy uncertainty is increasingly apparent in capital investment and household spending on some consumer durables, particularly cars, where global demand has declined sharply over the past year. These developments particularly affect Germany, reflecting the relative importance of manufacturing for overall activity, a specialisation in capital goods production and the difficulties of adjusting to structural challenges in the car industry.

Figure 1.2. Uncertainty has become the major concern for firms around the world

Per cent of firms citing factor as a concern



Note: Share of firms citing the factors shown as the most pressing concern of senior management over the past quarter. Based on surveys from March 2018 and September 2019. The factors shown are the ones most heavily cited globally. Firms are allowed to choose more than one factor.
Source: Duke CFO Global Business Outlook; and OECD calculations.

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Global trade remains exceptionally weak. Trade volume growth (goods plus services) stalled at the end of 2018 and has remained subdued in the first nine months of 2019 (Figure 1.3, Panel A).[1] High-frequency indicators generally suggest that near-term trade prospects remain soft. Uncertainty about trade policies has reached a new high and PMI (Purchasing Managers Index) surveys suggest that manufacturing export orders are contracting in around two-thirds of the economies with available data (Figure 1.3, Panel B). Air freight traffic and air passenger traffic have also continued to soften in recent months, although container port traffic has picked up a little. Increasing trade restrictions, the weakness of fixed investment (a trade-intensive category of expenditure) and the supply-chain impact of subdued import demand in China (see below) are all bearing down on global trade growth. In Europe, uncertainty about Brexit has also resulted in considerable trade volatility and contributed to weak trade data in recent months, with a surge in euro area exports to the United Kingdom in early 2019, ahead of the original date for exit from the EU, and a sharp reversal in subsequent months.[2]

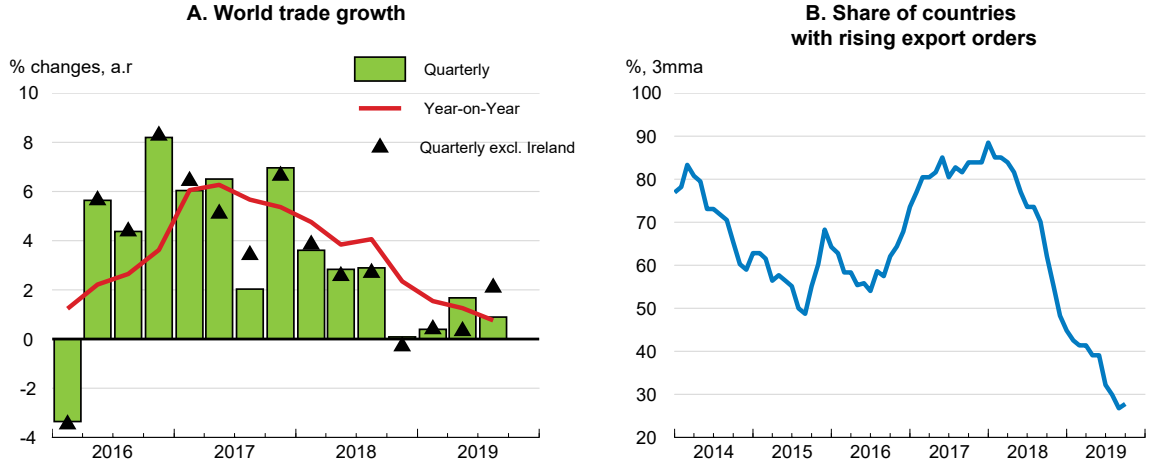
[1] A large one-off transaction in Ireland, involving the import of intellectual property assets, raised recorded global trade growth by almost 1½ per cent in the second quarter of 2019, at an annualised rate. A similar transaction occurred in 2017. Adjusting for this, world trade growth was largely flat in the quarter.

[2] In the four months to July, Eurostat estimates suggest that euro area merchandise export volumes to the United Kingdom were 14½ per cent lower than in the previous four-month period (non-annualised).

The disruption to trade and cross-border investment and supply chains from rising trade tensions is a direct drag on demand and adds to uncertainty. It also harms supply and weakens medium-term growth prospects, with the induced reallocation of activities across countries and adjustment to supply chains reducing productivity. Lower expectations of future growth also reduce the incentives to invest at present. Aggregate investment growth in the G20 economies (excluding China) slowed from an annual rate of 5% at the start of 2018 to only 1% in the first half of 2019.

The bilateral tariff measures introduced by the United States and China since the start of 2018 are an important factor behind the weakness of global demand. The deferral of the US tariff increases that were set to take effect in mid-October and ongoing trade talks on the remaining trade issues between the United States and China are positive developments. Nonetheless, the measures implemented this year, including those still planned at the end of 2019, will continue to exert a significant drag on global activity and trade over the next two years, particularly given the additional uncertainty that they create (Figure 1.4). All told, the US-China measures introduced this year could reduce global GDP growth by between 0.3-0.4 percentage point in 2020 and 0.2-0.3 percentage point in 2021. These effects are incorporated in the projections. China and the United States are most affected by these shocks, but all economies are adversely affected by the trade slowdown and rising uncertainty, with business investment impacted severely in the major economies (Figure 1.4). If these measures were to be scaled back fully or partially in the near term, GDP growth could be stronger than currently projected.

Figure 1.3. Global trade growth is very weak



Note: Countries with rising export orders are ones with a PMI manufacturing export orders survey indicator at or above 50. Based on a sample of 29 countries.
Source: OECD Economic Outlook 106 database; Markit; and OECD calculations.

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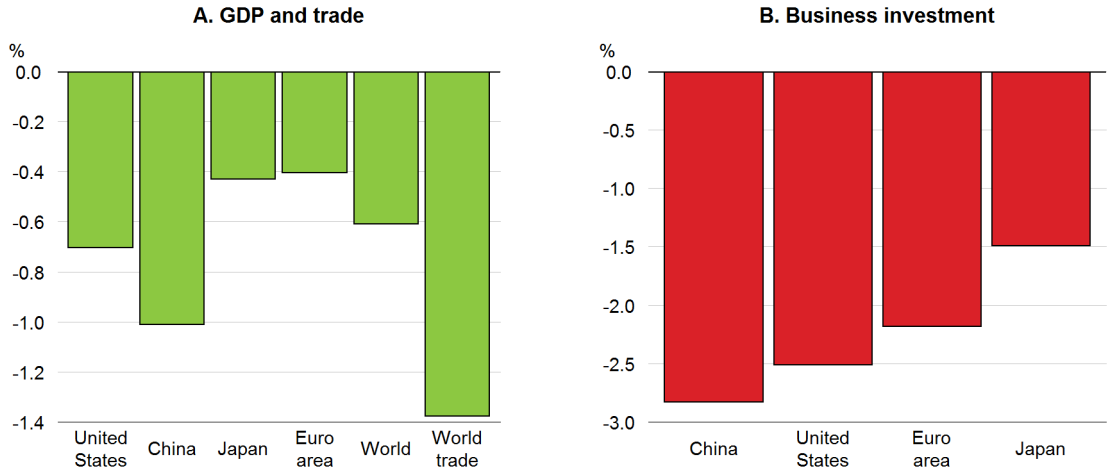
Figure 1.4. The adverse effects from higher US-China tariffs are expected to intensify

Per cent difference from baseline by 2021-22



Note: Total investment for China. The simulation shows the combined impact of the changes in bilateral tariffs implemented by the United States and China in 2019 (including those planned for the remainder of the year) and a global rise of 50 basis points in investment risk premia that persists for three years before slowly fading thereafter. All tariff shocks are maintained for six years. Based on simulations on NiGEM in forward-looking mode.
Source: OECD calculations using the NiGEM global macroeconomic model.

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The ongoing slowdown in global growth has also been reflected in financial markets and commodity prices. Long-term interest rates on government bonds have declined in recent months, reflecting a stronger demand for safe assets and more accommodative monetary policy in most major advanced and emerging-market economies (Box 1.1). Oil prices have moderated since the early part of the year. Supply restrictions by OPEC and Russia, with production in Iran and Venezuela declining sharply this year, help to underpin prices, but oil demand has weakened.[3] At the USD 60 per barrel assumed in the projection period (Annex 1.A), prices are 6% lower than the average level in the first ten months of 2019, and 15½ per cent lower than in 2018.

Box 1.1. Recent financial market developments

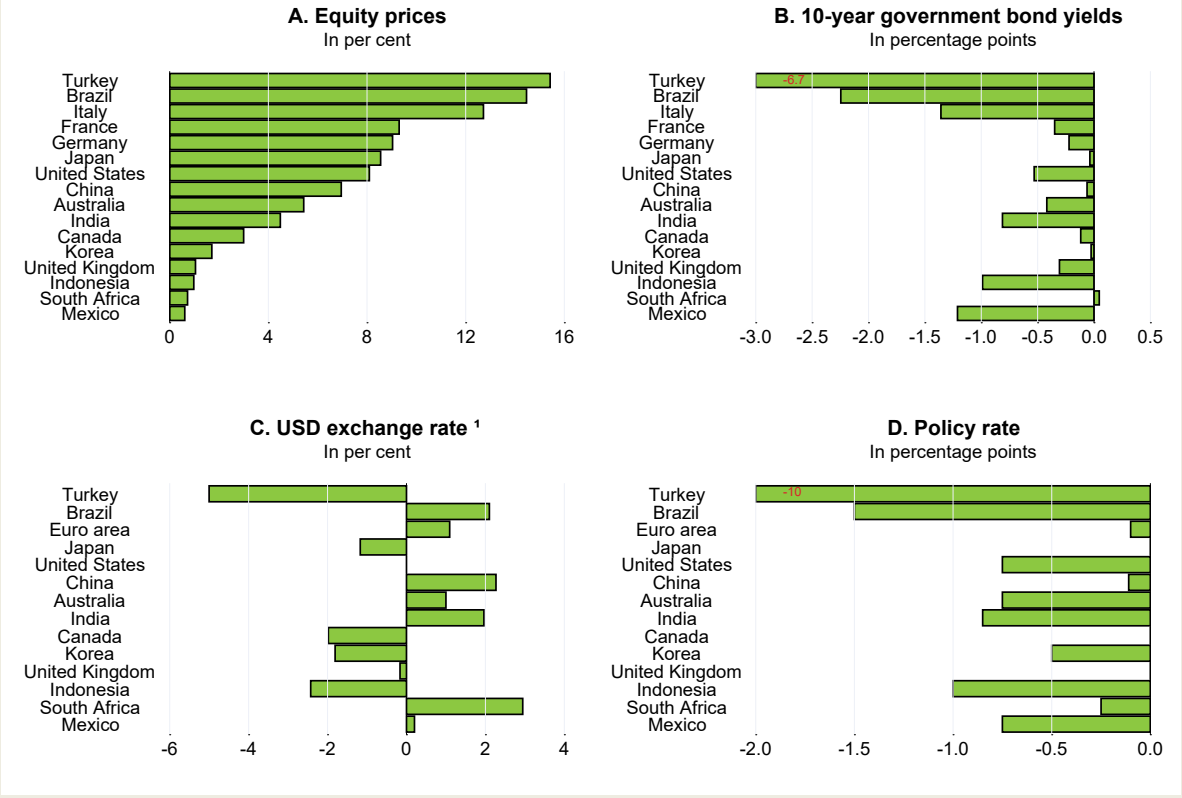
The trade conflict between China and the United States, as well as an easing in the stance of monetary policy by major central banks, have driven fluctuations in financial markets over recent months. Idiosyncratic geopolitical risks also contributed to an increase in financial market volatility during the summer. US money markets experienced unusual turbulence in September, prompting the Federal Reserve to intervene (Box 1.3).

[3] IEA estimates suggest that total OPEC oil supply in the first nine months of 2019 was 4.6% lower than the same period in 2018.

- Equity prices in advanced economies have increased from the lows in May (Figure 1.5, Panel A). There was, however, a broad-based and sharp fall in equity prices in early August on the back of the further escalation of trade tensions, but the increase in short-term measures of volatility at that time was lower than during previous spikes in 2015 and 2018.

Figure 1.5. Recent changes in financial conditions

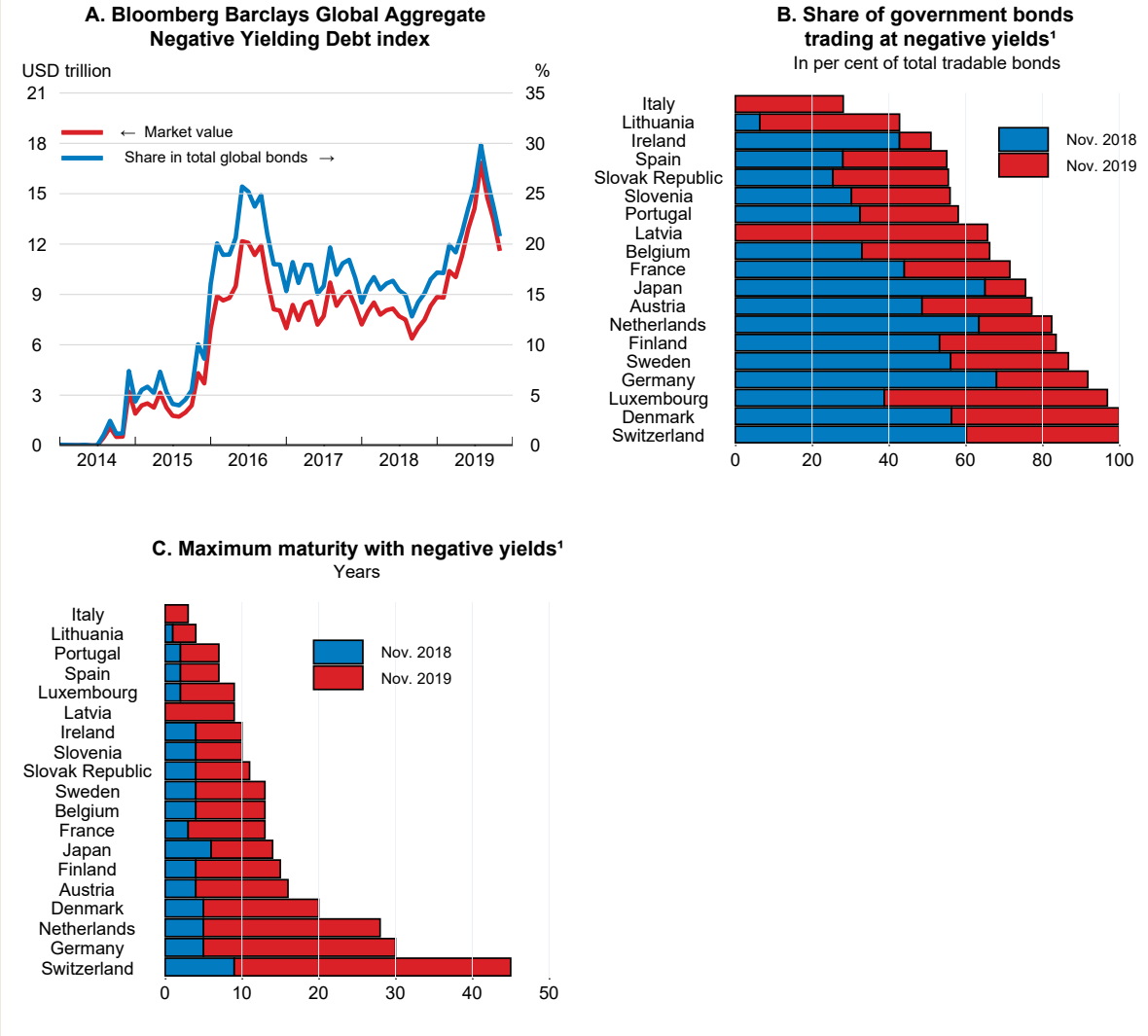
Change between May and November 2019



Note: For Panels A-C, change between monthly averages of available data; for Panel D, change between 17 May and 14 November 2019.
1. A decline corresponds to an appreciation of the domestic currency relative to the US dollar.
Source: Refinitiv; and OECD calculations.

StatLink https://doi.org/10.1787/888934044366

Figure 1.6. More government bonds have been trading at negative yields in Europe and Japan



1. Calculations are based on tradable government bonds and available average government benchmark yields, as reported by Bloomberg.
Source: Bloomberg; and OECD calculations.

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- Government bond prices have increased (Figure 1.5, Panel B), reflecting stronger demand for safer assets and expectations of monetary policy easing, with a rising implied risk of a global recession. Since May, 10-year yields have declined, from already low levels, by around 30-50 basis points in the United States, the euro area and the United Kingdom. The global value of government and corporate bonds trading at negative yields is estimated at USD 11.6 trillion, i.e. about 21% of the total stock of global bonds, down from the record high value of USD 17 trillion in August (Figure 1.6, Panel A). Ten-year government bond yields are near record negative values in several European countries. Moreover, in many European countries and Japan, the share and the maximum maturity of all government bonds trading at negative yields have increased substantially over the past year (Figure 1.6, Panels B and C). Lower longer-term interest rates may not stimulate economic growth if they reflect only heightened uncertainty and higher perceived risks of a recession (see below).

- The Japanese yen and the Swiss franc – the two usual safe-haven currencies – appreciated against the US dollar during the summer, prompting the Swiss National Bank to intervene to prevent the Swiss franc from appreciating further. The pound sterling depreciated against the US dollar during the summer given rising risks of a no-deal Brexit, but has rebounded more recently as the likelihood of such an occurrence ebbed. The US dollar exchange rates of the other main advanced economies have changed little (Figure 1.5, Panel C).
- Financial market developments have varied among the large emerging-market economies, with some signs of lower risk appetite but no general deterioration in market sentiment. In most emerging-market economies, yields on long-term government bonds in local currencies have declined, helped by cuts in monetary policy interest rates (Figure 1.5, Panel D). Bilateral US dollar exchange rates have generally depreciated since May in most emerging-market economies, notably in China and South Africa.
- In Turkey, following the severe financial shock in August 2018, financial conditions have improved, with relatively lower interest rates, higher equity prices and the stronger lira. The recourse to quasi-fiscal stimulus announced on 30 September 2019 is expected to help lift economic activity in the near term, even though it risks eroding the resilience of public banks and distorting capital allocation.
- In Argentina, the financial crisis has intensified amid increased political uncertainty related to the general elections held in October, resulting in a sharp currency depreciation. Access to new market funding has dried up, which has resulted in delays in debt repayments and the imposition of controls to contain capital flight.

Global growth is projected to remain subdued

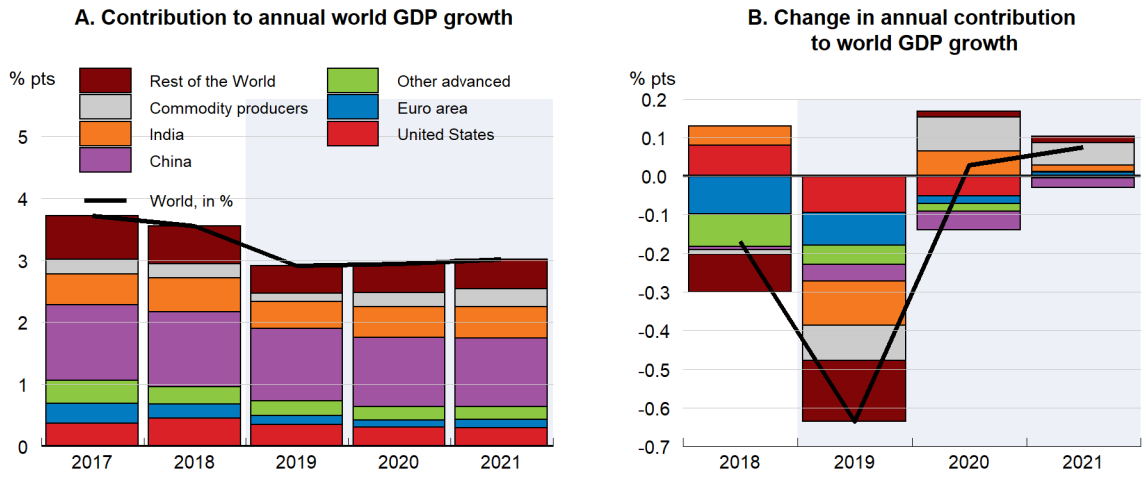
Overall, recent economic and financial developments and substantial downside risks point to a sustained period of subdued global growth. Global GDP growth is estimated to have eased to just under 3% this year and is projected to remain at a similar pace in 2020-21, amidst persistent high policy uncertainty and weak trade and investment (Figure 1.7). These would be the weakest annual global growth rates since the financial crisis and around 0.3-0.4 percentage point below estimated global potential output growth.

Lower interest rates should help to cushion the extent of the slowdown, although the impact of recent and projected changes in policy interest rates is likely to be modest, especially in the advanced economies. Fiscal policy easing will help to underpin activity in some economies, but in most countries it appears likely to offer less support than desirable given weak growth prospects and low borrowing rates. In the median OECD economy, hardly any fiscal easing is projected in 2020 or 2021 (see below). Household spending has held up this year, helped by real wage increases and macroeconomic policy support, but slowing job creation is likely to weigh on income growth and persistent weak productivity and investment will check the strength of real wage gains. A gradual, albeit modest, recovery in emerging-market economies is also projected in 2020-21, helped by the positive impact of reforms in India and Brazil, substantial policy easing in Turkey that will boost growth but add to imbalances, and a gradual stabilisation of output in some OPEC members and Argentina, where output has contracted sharply this year.

Prospects in the major economies are as follows (Table 1.1):

- GDP growth in the United States is projected to moderate from 2.3% this year to 2% in 2020-21, with the support from fiscal easing fading slowly. Rising real wages and accommodative monetary policy should continue to support household spending and housing investment, but higher tariffs and ongoing uncertainty will continue to restrain the growth of business investment and exports.

Figure 1.7. Global growth is set to remain low



Note: Calculated using PPP weights. Commodity producers include Argentina, Brazil, Chile, Colombia, Russia, Saudi Arabia, South Africa and other non-OECD oil-producing economies.
Source: OECD Economic Outlook 106 database; and OECD calculations.

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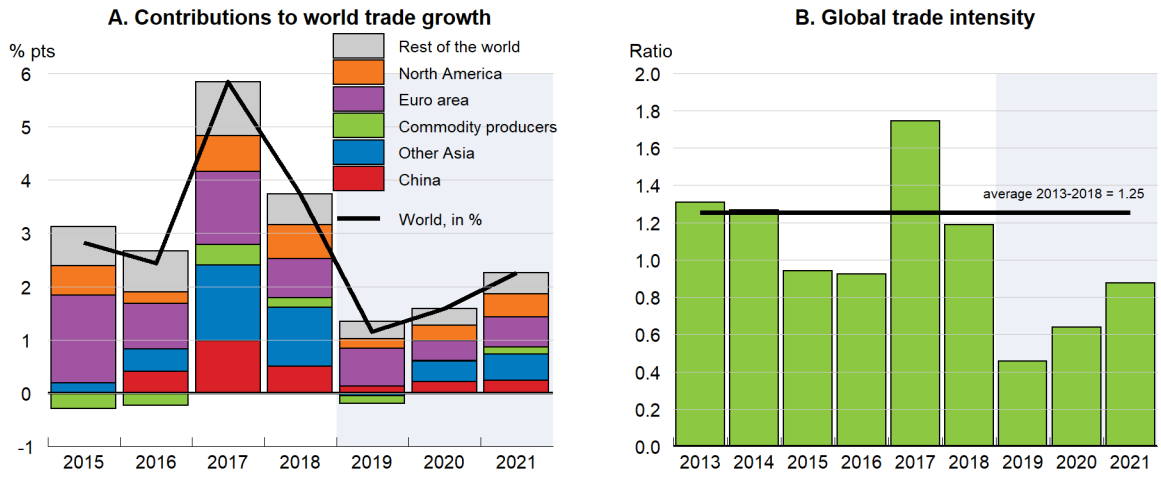
- GDP growth in the euro area is projected to remain subdued, at between 1 and 1¼ per cent in 2020-21. Wage growth and accommodative macroeconomic policies are supporting household spending, but high uncertainty, weak external demand and low confidence are weighing on investment and exports. Outcomes in Germany and Italy are set to remain weaker than in France and Spain, in part reflecting their greater dependence on the industrial sector and global trade.
- In Japan, GDP growth is set to slow from 1% in 2019 to around 0.6% in 2020-21. Stronger social spending should help to support demand following the recent consumption tax increase, but fiscal consolidation efforts will resume in 2020 and 2021. Labour shortages and capacity constraints should continue to stimulate private investment, and export growth is projected to pick up as global trade recovers.
- GDP growth in China is projected to moderate further to around 5¾ per cent in 2020 and 5½ per cent in 2021. Escalating trade tensions are weighing on investment and adding to uncertainty, but fiscal and quasi-fiscal stimulus measures and reductions in reserve requirements should help to cushion credit growth and demand as the economy continues to rebalance.
- GDP growth in India is projected to pick up from just under 6% in FY 2019 to 6½ per cent by FY 2021. Reductions in corporate borrowing costs and taxes, along with continued reform efforts should help investment growth to strengthen, and moderate oil prices and income support schemes for rural farmers will help underpin private consumption.
- A gradual recovery is set to continue in Brazil, with GDP growth projected to pick up from 0.8% this year to around 1¾ per cent in 2020-21. Lower real interest rates provide support for private consumption, and further progress towards implementing reforms should help to support sentiment and investment.

Global trade volume growth (goods plus services) is estimated to have slowed to 1.2% this year, the weakest rate since 2009. A modest recovery is projected over 2020-21, to around 1½ per cent next year and 2¼ per cent in 2021, helped by a stabilisation of trade in Asia (Figure 1.8, Panel A). Even so, at this pace, trade intensity would not only remain low by pre-crisis standards, but would be below the 2013-18 average (Figure 1.8, Panel B). The slowdown in trade growth this year has been broad-based, with the sharpest declines occurring in Asia and North America, together with a mild further easing in Europe and

Figure 1.8. Global trade growth is set to remain very weak



Note: Commodity producers include Argentina, Brazil, Chile, Colombia, Indonesia, Russia, Saudi Arabia, South Africa and other oil-producing countries. World trade volumes for goods plus services; global GDP at constant prices and market exchange rates. Period averages are the ratio of average annual world trade growth to average annual GDP growth in the period shown.
Source: OECD Economic Outlook 106 database.

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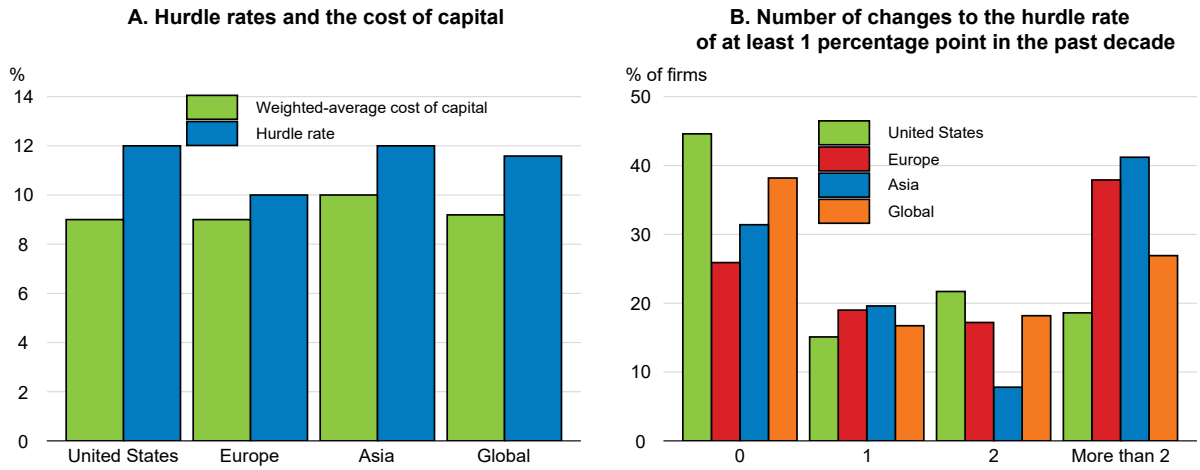
a continued slowdown in many commodity-producing economies. Import volume growth is estimated to have been negative in China this year, in part reflecting large declines in the early part of the year (see below).

The weak projected pace of trade growth is consistent with the subdued outlook for investment in many economies. Continued policy uncertainty, a step-down in expectations of future global GDP growth, infrastructure shortages, and declining business dynamism in many countries (Calvino and Criscuolo, 2019) are all factors reducing incentives to invest. Corporate hurdle rates for new investment (i.e. the minimum rate that a company expects to earn before investing in a new project) also remain high and above the cost-of-capital, with many firms rarely adjusting them by a substantial amount (Figure 1.9). This suggests that the recent declines in long-term interest rates may have only modest direct effects on business investment, although the downturn in mortgage rates could start to spur housing market investment in some countries, particularly in the United States and Canada. Overall, in the major advanced economies, business investment growth is projected to ease from around 1.9% per annum during 2018-19, to just over 1¼ per cent per annum on average over 2020-21. Stronger outcomes are projected in some emerging-market economies, especially India, helped by the impact of ongoing reforms, including to corporate taxes.

A further prolonged period of subdued investment in the advanced economies enhances the risks of weak output growth becoming entrenched. While the ratio of gross investment to GDP has risen in recent years in some countries, albeit more slowly than might be anticipated given very low interest rates, net investment (the addition to the productive capital stock after allowing for depreciation) remains weak. In the median OECD economy, net investment (business plus government) is projected to be 4¼ per cent of GDP over 2020-21, down from 4½ per cent of GDP over 2015-19, and 2½ percentage points below the net investment rate in the decade prior to the global financial crisis.

Figure 1.9. Corporate hurdle rates remain high and are adjusted rarely



Note: Global aggregates are a weighted average of responses in the United States, Europe and Asia.
Source: Duke CFO Global Business Outlook Survey, March 2019; and OECD calculations.

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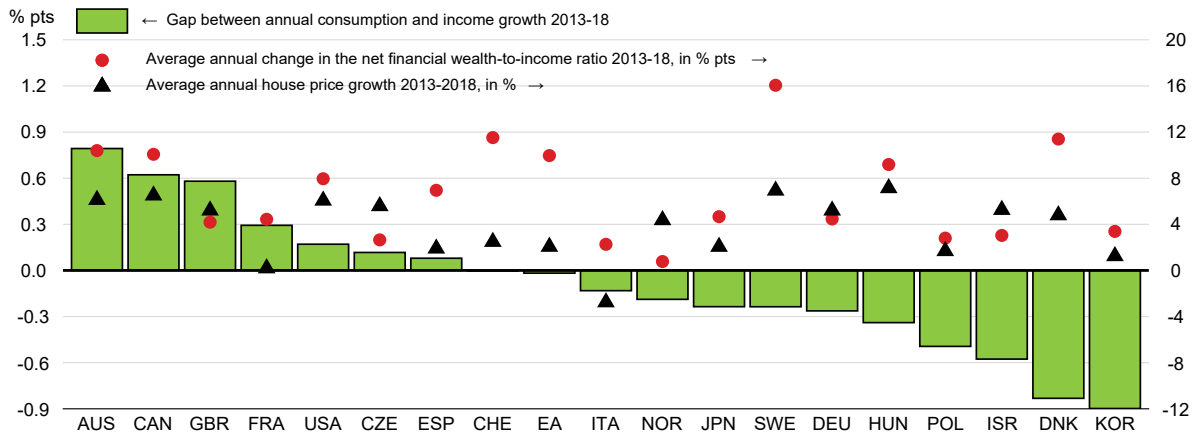
Figure 1.10. Household saving has risen in many countries despite strong wealth gains



Note: Data for aggregate household disposable income, consumption and house prices are average annual growth rates over 2013-18. The change in the wealth-to-income ratio is the average annual change in the ratio of household net financial assets to household disposable income between the end of 2012 and the end of 2018, with income given by the average of household disposable incomes in the fourth quarter of the respective year and the first quarter of the following year.
Source: OECD Economic Outlook 106 database; OECD Financial Accounts; OECD Analytical House Price database; European Central Bank; Bank of Japan; and OECD calculations.

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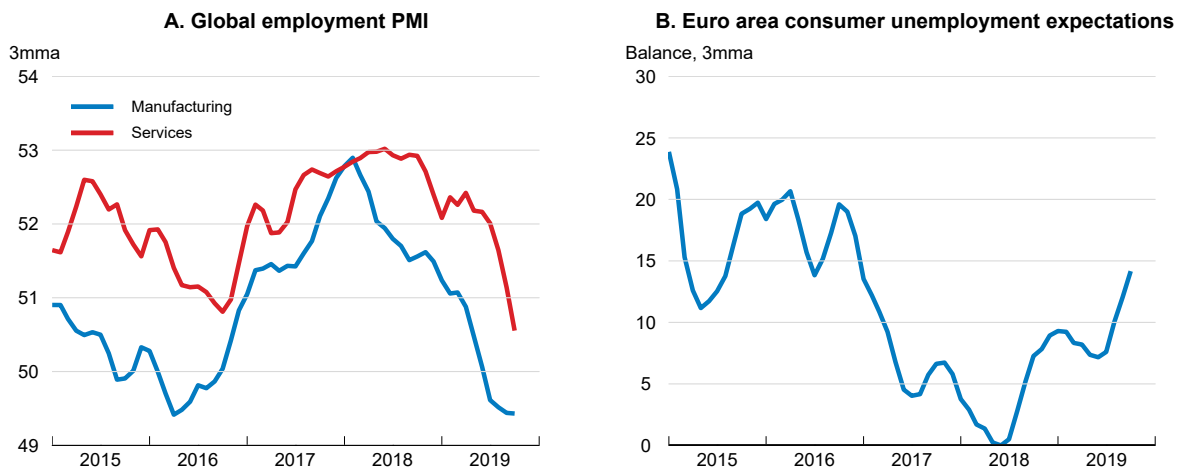
Household incomes and spending continue to be supported by labour market conditions in most OECD economies, despite moderating output growth. The OECD-wide unemployment rate remains at a 40-year low and unemployment rates are below estimated sustainable rates in many economies, helping to push up real wage growth over the past two years. Fiscal measures have boosted household income growth in some countries, particularly in lower income households, including sizeable increases in minimum wages in Spain, Korea, Mexico, Turkey and a number of economies in central Europe. Low interest rates continue to hold down debt service burdens and foster stronger financial and housing market prices, but their impact on household spending is less clear. In many countries, strong asset price growth has not resulted in sizeable declines in household saving ratios (Figure 1.10), especially in the euro area.

Signs of easing labour market pressures are becoming increasingly apparent. Job vacancy rates have started to turn down in many countries (Box 1.2), albeit from a relatively high level, hours worked and labour shortages have started to ease, and survey evidence points to a declining pace of job growth. Weakness is particularly apparent in manufacturing surveys (reflecting the weakness of sectoral output), but is also increasingly spreading to services. The downturn in survey indicators has yet to be matched fully in job data, but points to risks of a sharper slowdown (Figure 1.11, Panel A) and is starting to affect consumer expectations of future unemployment changes in some economies (Figure 1.11, Panel B). In the median OECD economy, job growth is projected to slow to around 0.6% per annum on average over 2020-21, less than half the pace in 2018-19 (Figure 1.12, Panel A). However, real wage growth is projected to remain broadly unchanged over 2020-21, reflecting the underlying tightness of labour markets even with slowing job growth and a mild projected improvement in labour productivity (Figure 1.12, Panel B). The implied slowing in overall household labour income growth is in turn an important factor behind a projected easing in household spending growth in the major advanced economies to a 1½ per cent annual pace in 2020-21, from 2% per annum in 2018-19.

Figure 1.11. Survey measures point to a further labour market slowdown



Note: Panel B shows consumer survey expectations of changes in the number of people unemployed over the next 12 months.
Source: Markit; European Commission; and OECD calculations.

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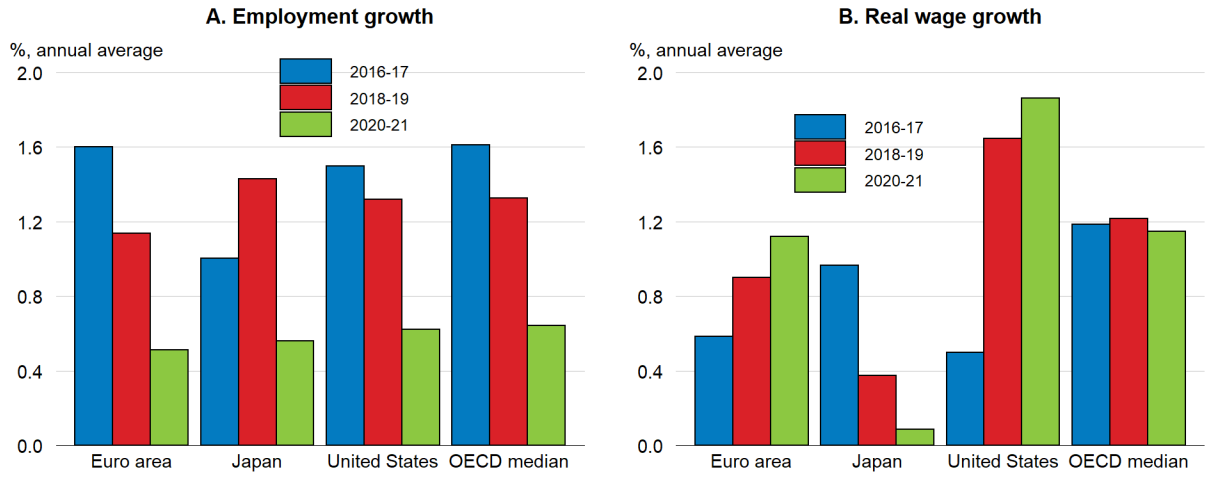
Figure 1.12. Household labour income growth is set to slow



Note: Based on a sample of 33 OECD economies. Real wages are measured as compensation per employee deflated by the private consumption deflator.
Source: OECD Economic Outlook 106 database; and OECD calculations.

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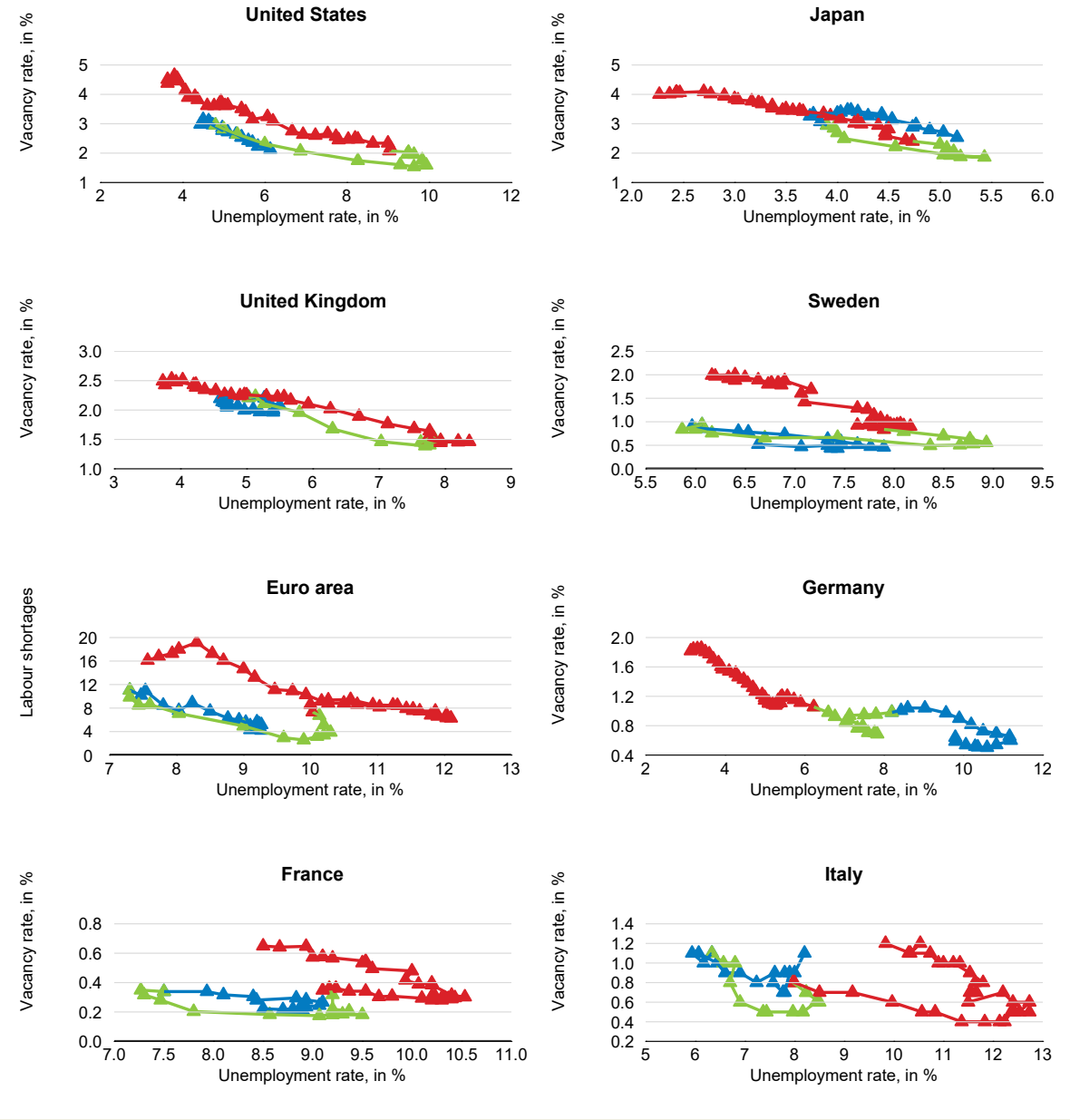
Box 1.2. Evolution of the Beveridge curve in selected OECD countries

The Beveridge curve illustrates the relationship between the unemployment rate and the job vacancy rate, providing useful information about the state and the functioning of the labour market. It is expected to have a negative slope, as unemployment usually declines as vacancies increase. An upward move along the Beveridge curve indicates an increase in market tightness, defined as the ratio of the job vacancies rate to the unemployment rate, while a shift in the curve, i.e. a change in the unemployment rate for a given vacancy rate, is an indicator of a change in matching efficiency in the labour market. When the Beveridge curve moves outward, unemployment is higher for a given number of vacancies, signalling a reduction in matching efficiency. This box reports Beveridge curves from 2003 to the latest quarterly available data in eight OECD economies (the United States, Japan, the euro area, Germany, France, Italy, the United Kingdom and Sweden).

In all countries, there has been a shift along the Beveridge curve over the past few years, suggesting a general increase in market tightness as the cyclical upturn has progressed. This trend seems to have slowed recently, with the first signs that the vacancy rate has begun to turn down in some countries. However, market tightness generally remains at a high level (Figure 1.13).

- In the United States, the United Kingdom and Japan there was an initial outward shift during the early phase of recovery, indicating deteriorating matching efficiency. This has proved transitional, however, as the more recent relationship between the unemployment and vacancy rates appears much closer to the pre-crisis curve. For the United States, Petrosky-Nadeau and Valletta (2019) highlight that the current higher job-finding rates for disadvantaged groups is one driver of improved job matching efficiency in recent years.

Figure 1.13. Evolution of the Beveridge curve in selected OECD countries



Note: Blue line: pre-crisis period (2003Q3-2007Q3); green line: crisis period (2007Q4-2010Q4); red line: post-crisis period (2011Q1-2019Q3 or the latest data available). Data on unemployment are OECD estimates of harmonised unemployment. Vacancy rates are sourced from the OECD when available. National statistics have been used for France (DARES) and Japan (Ministry of Health, Labour and Welfare). Italian data are taken from Eurostat. For France and Italy, vacancy rates only cover firms with more than 10 employees. The European Commission series of employers' perceptions of labour shortages in manufacturing, taken from the European Commission's regular survey of Business Confidence, is used to proxy the vacancy rate in the euro area as a whole, given the short time series available for the official vacancy rate series. The survey measure is well correlated with vacancy movements in the Eurostat series, and has a similar cyclical pattern, but is available for a longer period and is seasonally adjusted.

Source: OECD Labour Force Statistics; Eurostat; DARES; Japan Ministry of Health, Labour and Welfare; and OECD calculations.

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- Data point to a more pronounced and durable outward shift in the euro area as a whole and specifically in France and Italy, as well as in Spain (Consolo and Dias de Silva, 2019), implying more labour market shortages at a given rate of unemployment. The Beveridge curve in Sweden follows a similar path. Studies of the evolution in the euro area labour market suggest that country-specific sectoral developments, particularly the heavy employment losses in the construction sector, as well as a relatively high share of lower-skilled workers in the labour force are an important determinant of this shift (Bonthuis et al., 2016). OECD estimates show an above OECD-average proportion of low-skilled adults in the French, Spanish and Italian labour force (OECD, 2016a). In the context of the increased polarisation of the job market (OECD, 2017), this may have resulted in a more pronounced outward shift of the curve. In Sweden, the workforce is, on average, highly skilled, but the difficulties in fully integrating rising numbers of lower-skilled immigrants into the labour force have made it more difficult to fill vacant positions (OECD, 2019a) even if integration into the labour market has recently improved. The sizeable skill mismatches in Italy and Spain documented in the OECD Survey of Adult Skills may have also contributed to the shift in these countries.
- In Germany, on the other hand, matching efficiency improved from 2005 to 2008 and has not subsequently deteriorated. Such improvement is likely related to the substantial labour market reforms implemented during the early 2000s, which both reduced the level of unemployment insurance benefits for long-term unemployed and improved active labour market policies. The widespread reliance on short-time working during the financial crisis may also have helped to prevent a sharp change in job matching efficiency at that time.

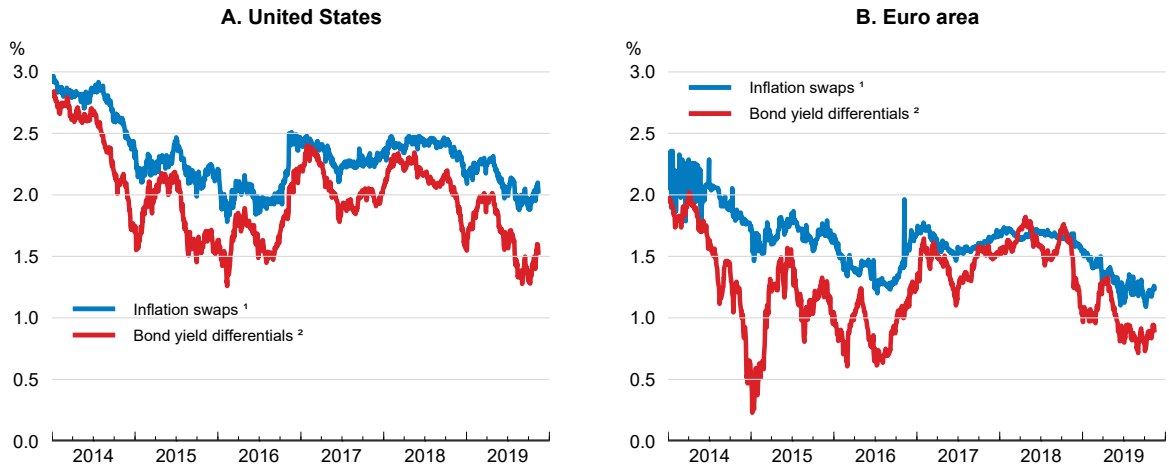
Price inflation will remain mild

The annual rate of headline consumer price inflation has eased this year in the major advanced economies, helped by a downturn in energy price pressures. Core inflation has remained broadly stable and below target in many economies, at around 1¾ per cent in the United States, 1% in the euro area and 0.5% in Japan. Consistent with perceptions of rising recession risks, market-based measures of expected inflation compensation have declined in the United States and the euro area (Figure 1.14), raising the risk that inflation will remain below target for a persistent period (Chapter 2, Focus Note 2). However, it is unclear if this development reflects a genuine fall in inflation expectations.[4] Long-term inflation projections by professional forecasters point to stable inflation expectations in the United States, but have declined in the euro area.

Inflationary pressures are set to remain mild given the subdued growth outlook and rising global slack. Over 2020-21, headline and core inflation in the median advanced economy are projected to edge up to 1¾ per cent, largely as a result of a gradual upward drift in inflation in many economies that currently have the lowest inflation rates (Figure 1.15, Panel A). However, the announced spread of new tariff restrictions to many consumer products by the end of this year will also push up price pressures in the United States,

[4] In recent years, the decline in inflation compensation has been in part due to falling inflation risk premia – possibly to negative levels – rather than declining inflation expectations (Chen et al., 2016; ECB, 2019). Measures of inflation compensation derived from bond yield differentials and inflation swap rates consist of expected inflation, the inflation risk premium and other factors, like the liquidity premium. According to asset pricing theory, the risk premium is determined by the covariance of the asset return and investors' consumption or wealth. Chen et al. (2016) show that the correlation between 10-year forward consumption growth and long-run inflation in the United States has turned positive since the great recession, implying a negative inflation risk premium.

Figure 1.14. Expected market-based inflation compensation has declined



1. Expected average annual inflation compensation 5 to 10 years ahead, based on 5-year and 10-year inflation swaps.
2. Expected inflation compensation implied by the yield differential between 10-year government benchmark nominal bonds and 10-year inflation-indexed government bonds.
Source: Refinitiv; and OECD calculations.

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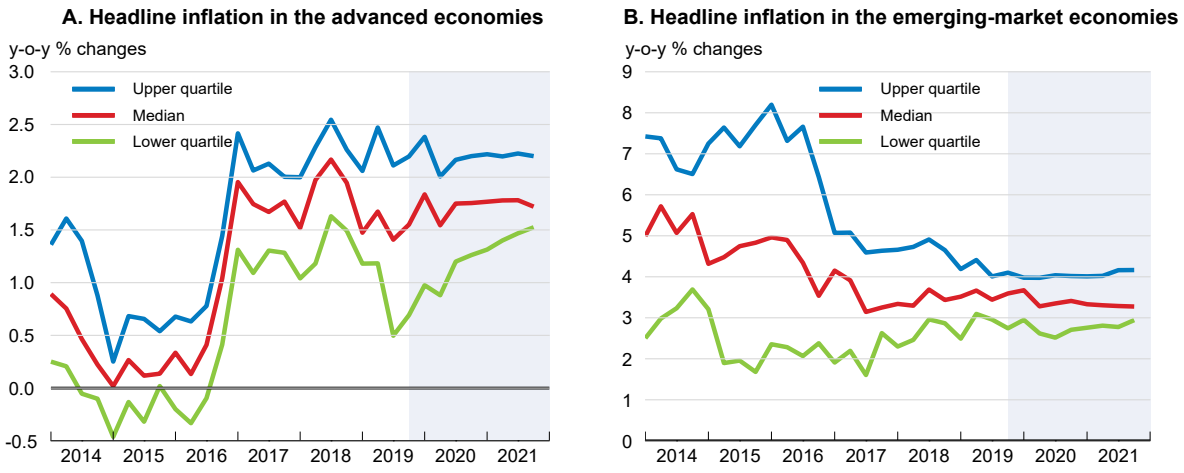
Figure 1.15. Inflation is set to remain mild



Note: Based on samples of 33 advanced economies and 14 emerging-market economies.
Source: OECD Economic Outlook 106 database; and OECD calculations.

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at least temporarily, with core inflation projected to peak at around 2¼ per cent next year. In most emerging-market economies headline inflation remains moderate, with the notable exception of Argentina, facilitating recent decisions to lower policy interest rates. Agricultural price pressures remain in some, with swine flu and adverse weather conditions keeping food prices elevated in some countries, particularly in East Asia. Moderate demand growth is projected to result in a modest downward drift in headline inflation in the median emerging-market economy in 2020-21 (Figure 1.15, Panel B).

Key issues and risks

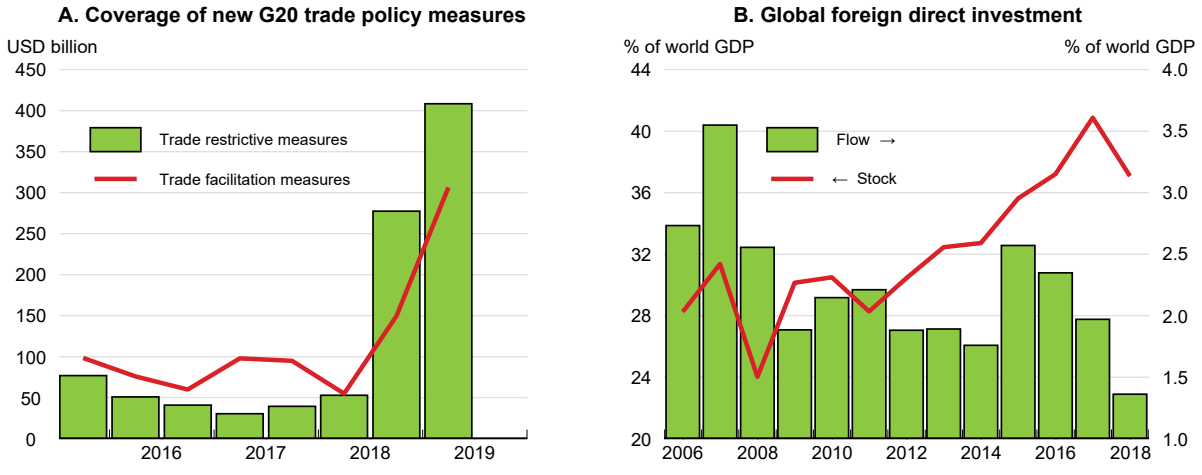
Trade and investment tensions continue to rise and could spread further

The risk of further escalation in trade and investment policy restrictions around the world is a serious concern. Such measures disrupt global supply networks, lower productivity, reduce and distort trade, and weigh on confidence, jobs and incomes. They come on top of long-standing market-distorting border and government support measures (Chapter 2, Focus Note 1). The coverage of new trade-restricting measures has risen sharply over the past year, particularly amongst some of the largest economies, and outweighs the coverage of new trade facilitation measures (Figure 1.16, Panel A).[5] At the same time, the share of new investment policy changes accounted for by restrictions and regulations on investors has begun to rise (UNCTAD, 2019) and the global stock and flow of foreign direct investment (FDI) have declined (Figure 1.16, Panel B).

Even if most of US-China merchandise trade becomes subject to new tariffs by end-2019 under current plans, tariff rates could be raised further. Moreover, given the breadth of their economic relationship, other bilateral US-China relationships could be increasingly affected:

- Some components of services trade could be detrimentally affected by direct or informal restrictions. US travel-related exports to China, including expenditure by Chinese tourists and foreign students in the United States, represented around one-fifth of total US goods and services exports to China in 2018. After rising rapidly for some years, visitor numbers from China to the United States declined in 2018 and have fallen further this year.

Figure 1.16. Trade restrictions are rising and global FDI has declined



Note: Data in Panel A are two period moving averages. These figures are estimates and represent the trade coverage of the new measures undertaken in each reporting period. Coverage is defined as the annual imports of the product concerned from economies affected by these new measures. Data in Panel B are averages of inward and outward FDI flows and stocks.
Source: OECD-UNCTAD-WTO (2019), *21st Report on G20 Trade and Investment Measures*, June 2019; OECD (2019), *FDI in Figures*, October 2019; and OECD calculations.

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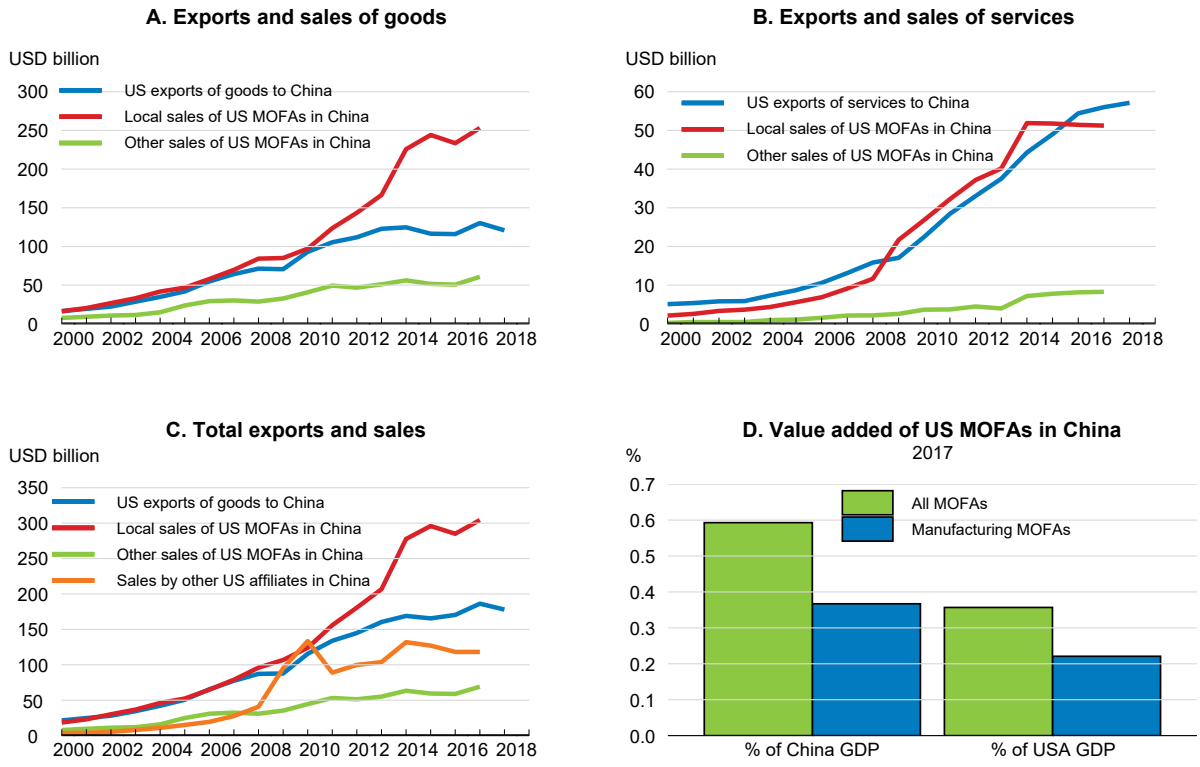
[5] Trade facilitation measures include the elimination or reduction of import tariffs and export duties, and the elimination or simplification of customs procedures for exports.

Figure 1.17. The sales of US-owned affiliates in China are larger than US exports to China



Note: MOFAs denotes majority-owned foreign affiliates. Other US affiliates in China are ones in which the US ownership is between 10-49 per cent.
Source: Bureau of Economic Analysis; and OECD calculations.

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- Additional pressures could be exerted directly on businesses. A rising number of Chinese companies have been placed on the US Entity List, requiring US suppliers to obtain a special licence to sell to them, and administrative burdens have been raised on some affiliates of US multinational companies operating in China. As the sales of US-owned affiliates in China are now considerably larger than US direct exports to China, particularly in goods producing sectors, restrictions on their activities could be costly (Figure 1.17). Around one-fifth of US-owned companies in China have already experienced some non-tariff retaliatory measures, such as increased inspections and greater difficulties in obtaining licences (American Chamber of Commerce in China, 2019). As a result, around one-third of these companies also reported delaying or cancelling investment decisions or seeking to make changes to their supply chains.

Bilateral trade tensions could also spread to other economies, including between the United States and the European Union, or to specific trade-sensitive sectors such as motor vehicles and parts or aeronautics. A decision by the US authorities is pending on whether to impose tariffs on imports of motor vehicles and parts from countries outside North America. If agreements with key partners are not reached, including over the investment plans of specific producers, tariffs could be imposed on US imports of cars and automotive parts. Given the complexity of cross-border supply chains, the costs of higher tariffs would be

felt widely, particularly in Europe.[6] Aeronautics also remains a key area of potential trade tension between the United States and the European Union in the near term, with the United States being authorised by the WTO in October to impose USD 7.5 billion of tariffs on imports from the European Union to offset EU subsidies.

Global FDI flows declined for the third successive year in 2018 (as a share of GDP), and the global FDI stock fell for the first time since 2011. Further declines have occurred this year, with global FDI flows in the first half of 2019 20% lower than in the latter half of 2018 (OECD, 2019d). The impact of the US corporate tax reform in 2017 was a major factor behind the decline in 2018, but the stock of inward FDI also fell in the United States and China. There is a rising concern that *de facto* restrictions on cross-border business investment may increase, with a more frequent usage of controls related to national security considerations. The OECD FDI Regulatory Restrictiveness Index, which is available up to 2018 and scores the extent of discrimination between foreign and domestic private investors based on statutory measures, provides little evidence of a widespread backtracking in investment policy reforms. Indeed, there have been continued reforms to liberalise FDI in some countries that were previously the most restrictive. Over the recent years, however, FDI screening has become more prevalent, and in the past year at least five G20 members have brought into force new policy measures related to national security concerns or changes to existing ones (OECD-UNCTAD, 2019). The sectors covered on national security grounds have gradually broadened, with these considerations now being used to safeguard domestic core technologies and knowledge considered essential for the competitiveness of domestic businesses (UNCTAD, 2019).[7]

Uncertainty remains about the future UK-EU trade relationship

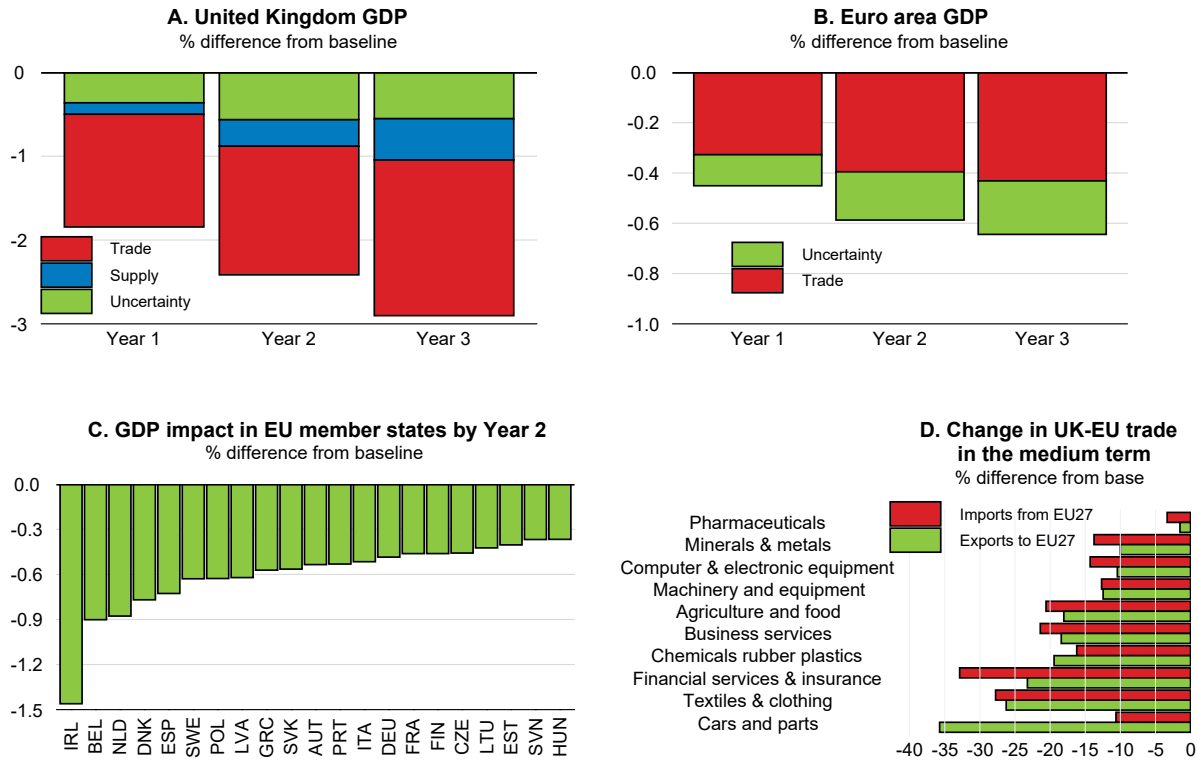
A withdrawal deal between the United Kingdom and the European Union was agreed in October, but is still to be ratified by the UK and European Parliaments. Ratification would remove the immediate risks of a no-deal withdrawal of the United Kingdom from the European Union (Brexit), but uncertainty would still remain about the nature of the future UK-EU trading relationship and about whether agreement can be reached before the end of the transition period set out in the withdrawal deal (currently set at the end of 2020). The possibility that a formal trade deal will not be agreed remains a downside risk and a source of policy uncertainty. If trade between the United Kingdom and the European Union were to revert to WTO terms after 2020, the outlook would be significantly weaker and more volatile than otherwise, particularly in the short term. Such effects could be stronger still if preparations to border arrangements fail to prevent significant delays, or if financial market conditions and consumer confidence were to deteriorate considerably.

Even a relatively smooth change in UK-EU trade arrangements, with fully operational border infrastructure, would potentially have large costs in the event of trade between the United Kingdom and the European Union reverting to WTO Most-Favoured-Nation (MFN) terms. UK exporters would face higher tariff and non-tariff costs in EU and non-EU markets. EU exporters may also face higher costs in accessing the UK market (OECD, 2019c). These additional trade costs can be expected to build up over time. Some changes, such as higher tariffs and additional border checks, start to take effect immediately. Others would gradually accumulate as regulations diverge between the United Kingdom and the European Union. In such circumstances, OECD estimates suggest that:

[6] US imports of cars and car parts totalled USD 184 billion in 2018 (0.9% of US GDP). Imports from the European Union were USD 62 billion in 2018, of which USD 28 billion came from Germany.

[7] Empirical evidence suggests that FDI screening policies can significantly curb cross-border investment (Mistura and Roulet, 2019).

Figure 1.18. The potential impact of Brexit without a trade deal



Note: The trade shock assumes that UK export volumes decline by 8% immediately on exit and by over 15% in the medium-to-longer term due to higher tariff and non-tariff barriers, with total export volumes in the EU economies declining by close to 1¼ per cent on average. The impact of a 5% depreciation of sterling is included in the reported trade effects in Panels A and B. The UK supply shock involves a decline in labour-augmenting technical progress of 1.6% after five years (due to lower trade openness) and migration and term-premia effects. Term premia on UK and Irish government debt rise by 25 bps and 10 bps in other EU economies. The uncertainty shock assumes: an increase in the UK investment risk premia by 100 bps in the first year of the shock, with the equity risk premium rising by 25 bps, before slowly fading thereafter; and 25 bps higher investment and equity premia in other EU economies for a period. Monetary policy does not react to the shocks initially and fiscal authorities attempt to maintain a pre-shock budget path. The sectoral effects in Panel D arise only from the trade shock, reflecting both initial border disruption from tariffs and administrative checks and gradual regulatory divergence.
Source: OECD calculations using the NiGEM global macroeconomic model and the METRO model.

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- UK GDP could be 2-2½ per cent lower than otherwise in the first two years if trade shifts to being on WTO terms (Figure 1.18, Panel A). These effects would add to weaker-than-expected growth in the UK economy since the referendum in 2016. UK exports would be reduced due to higher tariff and non-tariff barriers with the European Union and elsewhere, higher uncertainty would weigh on investment, and the longer-term supply-side costs of exit from lower inward migration and the adverse impact of the decline in trade on productivity (Kierzenkowski et al., 2016) would slowly start to emerge. Business investment would be weakened further, declining by close to 9% in the first year, reflecting the headwinds to trade and higher uncertainty. Consumer price inflation would rise by close to ¾ percentage point in the first year, driven by higher import prices and an assumed small depreciation of sterling.
- There would also be sizeable negative spillovers in other EU economies. Euro area GDP would be over ½ per cent lower than otherwise in the first two years following trade becoming subject to WTO MFN terms. The largest effects would be experienced in smaller economies with relatively strong trade links with the United Kingdom, including Ireland, the Netherlands, Belgium and

Denmark (Figure 1.18, Panels B and C). Consumer price inflation would also decline, by around 0.2 percentage point per annum in both the first and second year of the shock.

- In the medium-to-longer term, there would be considerable reductions in UK-EU trade in some sectors where trade costs would rise significantly, particularly cars and car parts, textiles and financial services (Figure 1.18, Panel D).

Policy responses could cushion part of these short-term costs. In the United Kingdom, the Bank of England could face a difficult choice if inflation were to be pushed up by a sterling depreciation, but should look through this given the need to react to a much weaker growth outlook, and reduce policy interest rates or buy bonds. An immediate and sustained reduction of 50 basis points in the policy interest rate might mitigate around one-fifth of the impact on UK GDP by the second or third year of the trade shock. Exit without an agreed trade deal would already add to pressures on the public finances (OBR, 2019), but fiscal policy could also be eased further from what is already planned.

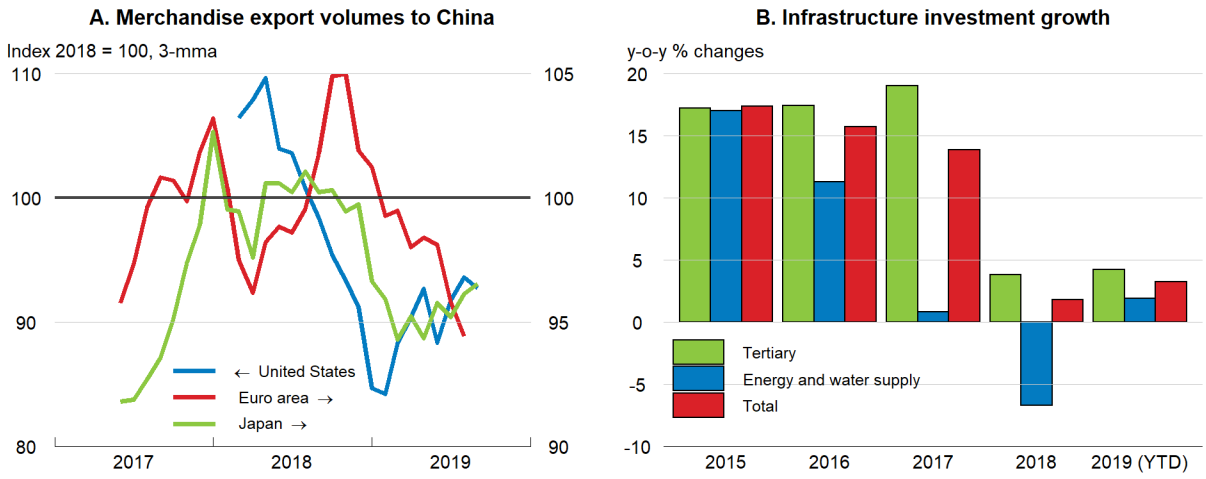
In European economies faced with a deflationary shock, monetary policy could become more accommodative. However, a more effective approach would be to implement targeted and temporary fiscal measures to support investment in some sectors, and to assist with the retraining of displaced workers and new job creation in those countries most affected. The European Union has announced that support is available from funds set up to provide assistance, such as the European Globalisation Adjustment Fund and the European Union Solidarity Fund (European Commission, 2019). While important, the available funds are modest, suggesting that other measures may be needed. It might also prove possible to adapt temporarily the state aid framework to provide broader support, as was done at the height of the financial crisis in 2008-09, or to allow more leeway within the EU fiscal rules to affected economies, in recognition of the exceptional circumstances. Should the situation be substantially worse, a more broad-based co-ordinated fiscal stimulus by EU member states, particularly ones that trade relatively intensively with the United Kingdom, could offer a timely and larger support for demand.

Growth in China could slow more sharply than expected

The risks of a sharper slowdown in China have intensified. Expectations that Chinese GDP growth will continue to slow only gradually reflect an assumption that the macroeconomic policy stimulus measures that have been announced over the past year, and the scope for further action if needed, will offset any underlying softness in trade and private demand. However, Chinese demand for goods and services produced in the rest of the world has slowed considerably over the past year or so. Export volumes to China from many major advanced economies this year have been substantially weaker than in 2018 (Figure 1.19, Panel A), adversely affecting trade and growth in the rest of the world. Commodity exporting economies around the world have also been affected by slowing import growth in China, reflecting supply-chain linkages.

Import weakness in China is in part attributable to structural changes in the Chinese economy, such as the rebalancing from investment to consumption, the substitution of domestically produced brands for imported goods, and moves to limit environmental damage. Potential output growth is also moderating, in part due to demographic effects. However, the slowdown in import growth also raises concerns about the effectiveness of the macroeconomic policy stimulus measures that have been announced over the past year, and the extent to which this can moderate the underlying structural slowdown in the growth of output and the demand for foreign goods and services. The fiscal support implemented this year is difficult to gauge but appears to be less than 1% of GDP, with tax reductions and increases in the special bond quota for local governments to finance infrastructure spending and urban redevelopment. The impact of these

Figure 1.19. Import demand is weak in China and infrastructure investment growth remains modest



Note: Export volume data for the United States calculated using seasonally unadjusted data on nominal exports to China and the price of exports to China. Infrastructure investment in the tertiary sector includes investment in transport and communications, plus investment in water management and environmental conservation. Estimates for 2019 are for the first ten months relative to the first ten months of 2018.
Source: Eurostat; Bank of Japan; Census Bureau; Bureau of Labor Statistics; National Bureau of Statistics of China; and OECD calculations.

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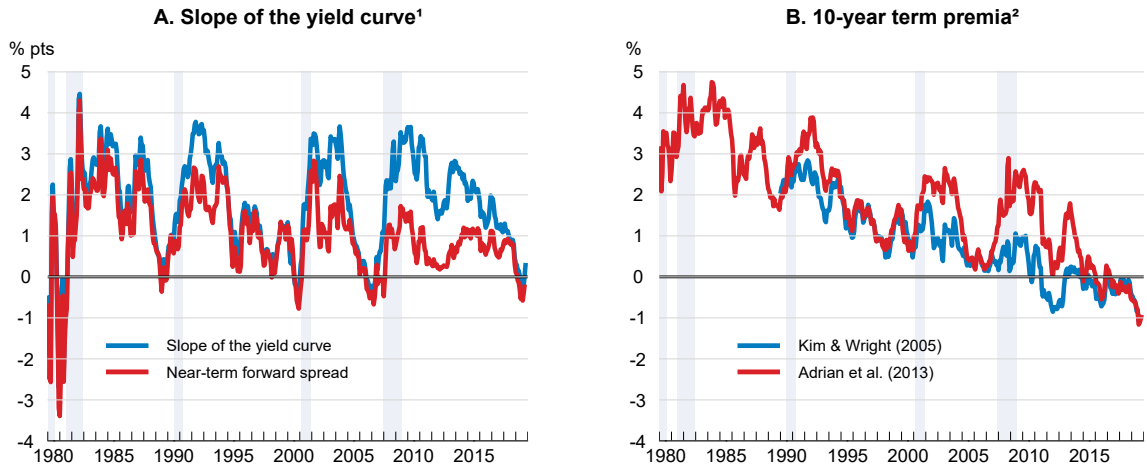
measures has also been modest. Household income tax reductions take time to feed through to consumer spending, and investment in infrastructure has picked up only slowly (Figure 1.19, Panel B), suggesting that total infrastructure spending could decline as a share of GDP for the second successive year. Reductions in reserve requirement ratios have however helped to support the flow of credit to businesses.

OECD estimates suggest that a sustained decline in domestic demand growth of 2 percentage points per annum in China would result in a significant slowdown in global growth, particularly if accompanied by a deterioration in global financial conditions and heightened uncertainty, as in the previous slowdown in China in 2015-16 (OECD, 2019b). In such circumstances, global GDP growth could be lowered by 0.7 percentage point per annum on average in the first two years of the shock and global trade growth by close to 1½ per cent per annum, with the strongest effects being felt in neighbouring economies in Asia. The effects would be larger still if macroeconomic policies were not able to respond fully to offset the shocks, due to limited policy space.

Risks to economic growth and financial stability interact

The inverted or very flat US yield curve (i.e. when long-term bond yields are below or close to short-term interest rates) observed since the end of 2018 could be pointing to heightened risks of a recession, given that this has preceded past recessions, albeit with a varying lead (Figure 1.20, Panel A). The same implications stem from the near-term forward spread, which may capture near-term monetary policy expectations and predict recessions better than the slope of the yield curve based on ten-year government bond yields (Engstrom and Sharpe, 2018). However, the current signal from the inversion of the yield curve may be distorted by very low term premia (Brainard, 2018). Estimated term premia are significantly below

Figure 1.20. Evolution of the US yield curve and term premia



Note: The shaded areas refer to the recessions dated by the NBER's Business Cycle Dating Committee.
1. The slope of the yield curve is the difference between the 10-year government bond yield and the 3-month Treasury bill rate. The near-term forward spread is the difference between expected six quarters ahead and current 3-month Treasury bill rates.
2. Term premia on a 10-year zero coupon bond based on the Kim and Wright (2005) and Adrian et al. (2013) methodologies.
Source: NBER; Federal Reserve Bank of New York; Federal Reserve Bank of St. Louis; Refinitiv; and OECD calculations.

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levels observed prior to past recessions (Figure 1.20, Panel B).[8] Thus, an inversion of the yield curve is now more likely even if there is a modest monetary tightening.[9] Moreover, in contrast to past recessions, the recent inversion of the yield curve has not coincided with aggressive monetary policy tightening that could undermine economic growth.[10]

High debt of non-financial corporations and its deteriorating quality in recent years could amplify a recession or a further sharp growth slowdown, if it were to occur (OECD, 2019b). A marked reduction in revenue growth could cause corporate stress, triggering a change in investors' risk appetite and a widespread sell-off of corporate bonds. In this respect, corporate debt in the United States appears to be more sensitive to stressed economic conditions compared with Europe, reflecting the high volume of low-quality credit of US corporates. Even a limited market shock would have the potential to produce large price corrections because non-investment-grade corporate debt is typically much less liquid. The current composition of corporate bonds may also increase the risk of fire-sales, as a high share of corporate bonds is rated just above non-investment grade (Çelik et al., 2019). If these bonds were downgraded to non-investment grade following a negative economic shock, institutional investors who are bound by rating-based regulatory requirements would be obliged to sell them.

[8] US term premia, which are estimated to have been around or below zero in recent years, have been pushed down by strong demand for longer-term government bonds. The impact on premia of the temporary unwinding of Federal Reserve holdings of US Treasuries has been offset by strong demand for US Treasury bonds by price-inelastic investors, possibly reflecting safe-haven effects given the increase in policy uncertainty.

[9] Indeed, accounting for term premia in probit regressions based on the slope of the yield curve reduced the implied risk of a recession in 2018 (Johansson and Meldrum, 2018).

[10] Given current estimates of the neutral interest rate and the current level of real interest rates, monetary policy does not seem extremely restrictive. However, assessment of the monetary policy stance is complicated by highly uncertain estimates of neutral interest rates, which makes it difficult to use them reliably in practical policy applications (Clark and Kozicki, 2005), especially when the investment-saving and Phillips curves are flat (Fiorentini et al., 2018).

Heightened financial market volatility and financial losses are also possible if recession risks were to abate and current expectations of increasingly accommodative monetary policy are not met. Despite elevated bond prices, many investors still expect further increases and a sudden change in market sentiment could lead to an abrupt unwinding of investment positions. Amplification of market volatility could also arise from the rising importance of non-bank financial institutions. Mutual funds and exchange-traded funds are exposed to risks similar to bank runs by offering liquid claims on illiquid underlying assets, with implications for broader financial stability (Chen et al., 2010; IMF, 2015a). Life insurance companies, especially in the European Union, have accumulated long positions in interest rate swaps in order to hedge interest rate risks embedded in insurance contracts (ESRB, 2015). A sharp rise in market interest rates would generate losses on posted collateral and trigger margin calls on interest rate swaps, potentially forcing these companies to sell credit assets and propagating the shock to other asset classes.

Policy requirements

The subdued economic outlook and significant downside risks call for policy responses that strengthen confidence, stimulate aggregate demand and boost potential growth. In the absence of near-term confidence-building measures that calm trade policy tensions, the need for additional macroeconomic policy support has risen in most economies. Monetary policy has already moved in this direction, with widespread cuts in interest rates and forward guidance that policy easing will be forthcoming in both advanced and emerging-market economies. However, this might not provide the stimulus that is required in some countries to lift demand, with policy interest rates low or negative, large asset holdings already on central banks' balance sheets and elevated uncertainty. In the advanced economies, fiscal policy needs to be used more actively to support near-term demand and enhance medium-term prospects by taking advantage of exceptionally low interest rates to invest in infrastructure and other measures. Some discretionary fiscal easing is being undertaken in a number of countries with fiscal space, including within the euro area. A rebalanced policy mix, using co-ordinated fiscal and structural policies as well as monetary policy, would be more effective for macroeconomic stabilisation in the euro area than relying solely on monetary policy and would also enhance longer-term living standards and limit asset price inflation (Chapter 2, Focus Note 3). In the event of the global economy being much weaker than projected, a co-ordinated response across all major economies would be the most effective and timely counterweight (Chapter 2, Focus Note 4).

Monetary policy considerations

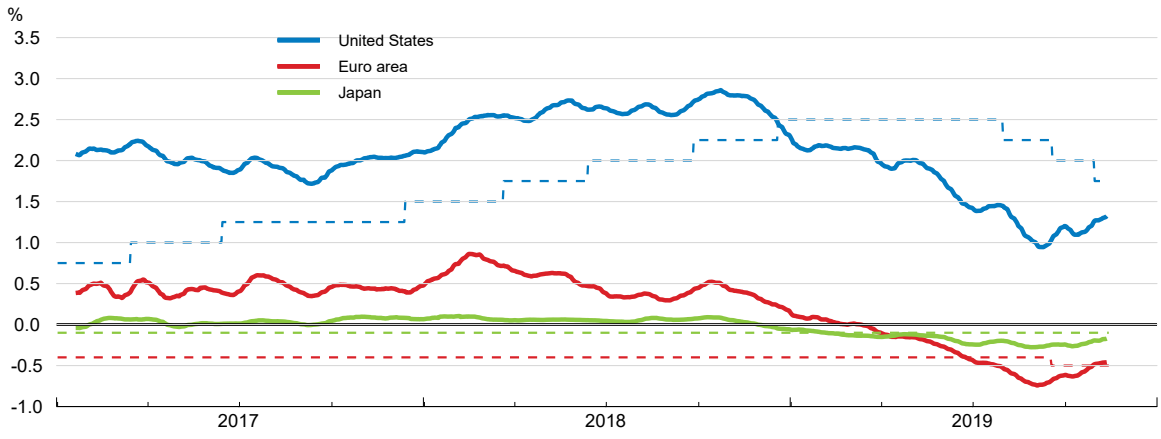
Since May, the risks of an economic slowdown and of persistent below-target inflation that undermines inflation expectations have increased (Chapter 2, Focus Note 2), prompting central banks in the main economic areas to ease monetary policy or communicate their readiness to act if the outlook were to deteriorate further.

- The US Federal Reserve has lowered the target range for the federal funds rate three times, by cumulatively 75 basis points, to 1.5-1.75%. Market participants expect some further interest rate cuts in the United States (Figure 1.21), but these would be warranted only if the economy is weaker than projected here. Conditional on the projections for inflation and activity, the monetary authorities are expected to leave the federal funds rate unchanged until end-2021. The Federal Reserve has also ended the reduction of its aggregate securities holdings two months earlier than previously indicated,[11] leaving it with total assets of USD 4 trillion as of early-November 2019 compared with peak asset holdings of USD 4.5 trillion in early 2015 and the pre-crisis level of USD 0.9 trillion. More recently, for banks' reserve management purposes, the Federal Reserve resumed purchases of Treasury bills at least into the second quarter of 2020, by around USD 60 billion per month, and decided to maintain term and overnight repurchase agreement operations at least through January (Box 1.3).

[11] The Federal Reserve will continue to reduce its holdings of agency debt and agency mortgage backed securities, whose principal payments up to USD 20 billion per month are reinvested in Treasury securities.

Figure 1.21. Market expectations of policy interest rates

15-day moving average of expectations for the end of 2021



Note: Expected overnight interest rates derived from Overnight Index Swap rates. The dashed lines refer to the prevailing relevant policy interest rates (15-day averages are not applied).
Source: Bloomberg; and OECD calculations.

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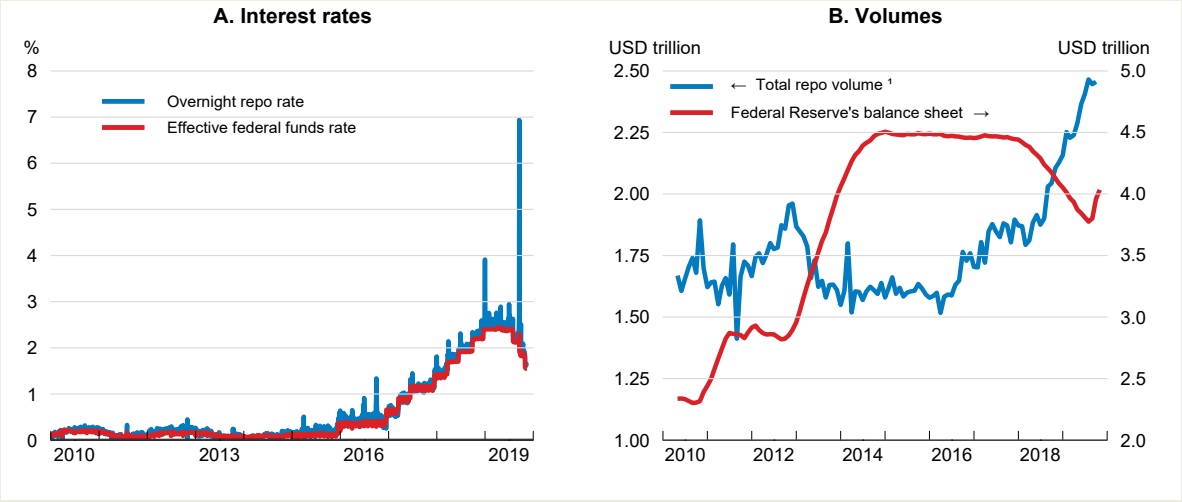
Box 1.3. Turbulence in the US repo market

US money markets experienced unusual volatility in the middle of September. This reflected temporary factors – such as quarterly corporate tax payments and the settlements of Treasury auctions – as well as the longer-term normalisation of the Federal Reserve's balance sheet. Some market participants also underlined the role of tighter liquidity regulations applied on large banks as a structural factor contributing to liquidity shortages in short-term money markets. Secured lending rates rose sharply on 17 September, with knock-on effects on unsecured markets such as federal funds (Figure 1.22, Panel A). Against this backdrop, the Federal Reserve conducted operations in the repurchase agreement (repo) market to alleviate funding pressures in the money markets and to keep the federal funds rate within the Federal Reserve's target range (Williams, 2019). Moreover, the Federal Reserve will continue to conduct overnight and term repo operations at least through January 2020. These are the first repo interventions by the Federal Reserve since the global financial crisis, because it has been operating in a regime of ample supply of bank reserves. To maintain reserve balances at or above the level that prevailed in early September 2019, the Federal Reserve has also restarted purchases of Treasury bills at an initial pace of about USD 60 billion per month at least through the second quarter of 2020.

Figure 1.22. Developments in the US repo market



1. Values shown refer to the entire population of securities allocated in tri-party repurchase transactions by the two clearing banks (JPMorgan Chase and the Bank of New York Mellon). The data do not account for any bilateral repo trades, and thus do not reflect the entire US repo market.

Source: Federal Reserve Bank of New York, https://www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo#; and Federal Reserve Bank of St. Louis.

StatLink https://doi.org/10.1787/888934044689

Money markets are central for the transmission of monetary policy and financial stability given their key role in reallocating cash between market participants (Brunnermeier and Pedersen, 2009; Ritz and Walther, 2015). The repo market is an important financial market because it is a crucial source of short-term funding for securities dealers and critical for liquidity in the secondary market for Treasury bonds and other securities (Copeland et al., 2014). Moreover, repo rates are important in the much-needed transition away from LIBOR (Duffie and Stein, 2015), since the US authorities' preferred alternative to the US dollar LIBOR – the Secured Overnight Financing Rate (SOFR) – is partly based on repo rates. The volume of US repo market transactions has increased substantially since early 2018 with the unwinding of Federal Reserve assets (Figure 1.22, Panel B), further underlining the importance of the repo market for financial conditions and the transmission of monetary policy.

Going forward, a better understanding of the factors driving financial institutions' demand for reserves will be key for determining the appropriate size of the Federal Reserve's balance sheet (and therefore the suitable level of reserves in the banking system). This requires enhanced efforts to collect data and gather information across the market for a more comprehensive monitoring of the trends and risks across repo and securities lending markets (IMF, 2015b). However, there is considerable uncertainty regarding the appropriate minimum level of reserves. This complicates decisions about the suitable expansion of the Federal Reserve's balance sheet for reserve management purposes. The announced increase in reserve balances and the maintenance of repo operations in the near term should prevent the repeat of the turbulence observed in September. Adopting a standing fixed-rate repo facility to provide any amount of overnight repo transactions to the market at the rate set by the Federal Open Market Committee could also be considered. This would help to control short-term interest rates more effectively and provide backstop liquidity under extraordinary circumstances (Gagnon and Sack, 2014).

- The ECB has cut the negative deposit interest rate by 10 basis points to -0.5% and introduced a two-tier system for remunerating excess liquid holdings to reduce the costs for banks (Box 1.4). It has also strengthened interest rate forward guidance by announcing that policy rates would remain at present or lower levels until the inflation outlook robustly converges to a level sufficiently close to, but below, 2%. The cost of the new targeted longer-term refinancing operations (TLTROs) has also been lowered.[12] Net asset purchases (EUR 20 billion per month) have also restarted from November, for as long as necessary. All these measures are warranted, given the economic outlook and the absence of stronger fiscal support than currently planned.
- The Bank of Japan has maintained very stimulative monetary policy measures (including the negative interest rate and yield curve control). It has also strengthened forward guidance on interest rates. The Bank also announced that it would implement additional easing if there was a greater possibility that the momentum towards achieving the price stability target would be lost. With inflation projected to increase only slowly towards the target, the current monetary policy stance is expected to be maintained over the coming two years.

If growth and inflation were to slow significantly more than currently projected, monetary policy should be eased, but the required extent of such easing would depend on the strength of any counter-cyclical fiscal stimulus being adopted at the same time (Chapter 2, Focus Note 4). The room to increase monetary accommodation is larger in the United States than in the euro area and Japan, and would primarily involve unconventional measures.

- The US Federal Reserve can cut the policy interest rate, but to a lesser extent than during the past three recessions.[13] It could also restart large-scale asset purchases. Yield curve control could also be implemented, as in Japan, controlling longer-term interest rates and thus financial conditions more directly (Bernanke, 2016a; Brainard, 2019). Targeting yields at medium-term maturities, when credible, would not necessitate large purchase of government bonds by the Federal Reserve. Introducing small negative interest rates that might potentially have a positive impact on growth and inflation could also be considered (Cúrdia, 2019). However, their side effects on financial markets could be more pervasive than in Europe and Japan, given the greater importance of money market funds in the United States.[14]
- The ECB could lower interest rates further, making them increasingly negative, and raise monthly net purchases of assets. Larger purchases of private assets might be considered if self-imposed limits on purchases of government bonds were to bind.[15] However, they would likely affect the overall economy by less than purchases of government bonds, involve higher risks for the ECB, and cause distortions in particular markets. Government bond purchases tend to affect prices of a broad range of financial assets, which are priced based on the risk-free rate, in contrast to purchases of private assets.

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[12] Banks can borrow up to 30% of their stock of eligible loans as of end-February 2019 (including the outstanding amounts borrowed under the TLTRO II) at a quarterly frequency between September 2019 and March 2021 for two years. They will not be able to repay the funds before maturity. Banks will pay the average interest rate of the main refinancing operations over the duration of each of the TLTRO operations. For banks that exceed their benchmark stock of eligible loans by 2.5% by the end of March 2021, the interest rate will be reduced to the average prevailing interest rate at the ECB deposit facility. Initially, the cost of borrowing was set to be 0.1 percentage point higher.

[13] In the past three recessions, the US policy rate was cut by more than 5 percentage points; now it could be reduced at most by only around a third of this, if the rate was to remain above zero.

[14] The risks include increased risk-taking by money market funds and consequently higher risks of runs on the funds (Bernanke, 2016b; Bua et al., 2019).

[15] The ECB has already bought around EUR 466 billion (4% of the euro area GDP) of corporate bonds, asset-backed securities and covered bonds.

- In Japan, options could include strengthening forward guidance and making interest rates increasingly negative both on the short and long end (i.e. by adjusting policy interest rates and the yield curve control).

In general, the effectiveness of additional monetary policy easing could be limited, especially if the slowdown is caused by disruptive trade policies that raise uncertainty. Given the experience with monetary policy over the past years, a renewed unconventional monetary policy stimulus would likely help boost asset prices but its impact on inflation and GDP growth may be less certain.

- A muted impact on productive investment and consumption is more likely with heightened uncertainty about future trade and economic policies and with expectations that interest rates will remain low for long. Persistently low interest rates blunt incentives to bring spending forward, and uncertainty reduces the willingness of households and businesses to consume and invest. Corporate hurdle rates for investment remain high, despite a decade of very accommodative monetary policy, and household saving rates have remained stable in many countries despite strong household wealth gains, notably in the euro area (Figures 1.9 and 1.10). Also, in many jurisdictions, debt – in particular of non-financial corporations – is higher than prior to the great recession, potentially limiting the ability to borrow.
- Similarly, inflation may not increase further as monetary policy is eased, unless the domestic currency depreciates significantly. Inflation has been persistently below target despite prolonged monetary stimulus and currently tight labour markets. In addition to the impact of low inflation on expectations (Chapter 2, Focus Note 2), this may reflect the impact of longer-term trends related to globalisation, technological progress, market concentration and pricing policies targeted at gaining market shares. All of these lower the impact of the business cycle on inflation and thus the effectiveness of monetary policy.
- As has been the case in the past (BIS, 2019), recent monetary policy easing has improved financial conditions, with asset prices reacting as expected even if prices of many assets, including government bonds and equities, are already high. Further monetary policy support could lead to even more market distortions and rebalancing of investment portfolios with little boost to productive investment and consumption. Firms could choose to buy back their shares or undertake mergers and acquisitions, and asset valuation gains could be concentrated among higher-income households with a small propensity to consume out of wealth.

While the adverse side effects on banks from negative interest rate policies in the euro area and Japan do not seem to be material so far, the marginal positive effects of even higher and more protracted negative interest rates may decline and risks could increase (Box 1.4). This is more likely with continued asset purchases by central banks and weak macroeconomic performance.

Box 1.4. The effectiveness of a prolonged negative interest rate policy

A negative interest rate policy (NIRP) has been in place for at least five years in some European economies and for close to four years in Japan. Sweden made the interest rate less negative at the beginning of 2019, while the ECB made its deposit rate more negative in September. This box discusses the effectiveness of negative interest rates.

Negative effective interest rates differ across countries

At present, a NIRP is effectively applied in five economies, with negative rates on banks' deposits at central banks (or other short-term bank claims on central banks) varying from -0.75% to -0.1% (Table 1.2). However, because of the widespread use of different exemptions or offsets, whereby excess reserves up to a certain level are exempted from negative rates or subject to less negative interest rates, the effective

average interest rate is less negative than the stated policy interest rate. For example, in Japan only 5% of banks' excess reserves at the central bank are subject to the -0.1% interest rate, with the remainder carrying zero or positive rates, so that the average rate is positive. Also, in the euro area, the recently decided tiering system will imply that 40% of all bank deposits at the ECB will be exempted from the -0.5% deposit rate, and that the effective average rate will become less negative even as the policy rate has become more negative. Indeed, the combination of more negative deposit rates and the establishment of a tiering system removed the incentives for banks with excess reserves under the threshold level to reduce such reserves, but strengthened the incentives for other banks to do so. In general, exemption levels imply that the impact and incentives of a NIRP will vary across individual banks, depending on whether they are above or below the levels.

How does the negative interest rate policy work?

Lowering central bank interest rates below zero should reduce the cost of bank credit and thus stimulate demand by borrowers. In this respect, setting negative interest rates works exactly the same way as conventional cuts to positive policy interest rates (the interest rate channel). At the level of an individual bank, charges on excess liquidity may also induce banks to extend more credit (the bank lending channel).

Negative interest rates at a sufficiently low level – the so-called reversal interest rate – can, however, undermine the bank lending channel and have negative implications for the cost and availability of credit and thus the real economy (Brunnermeier and Koby, 2016; Borio and Gambacorta, 2017; Eggertsson et al., 2019). With increasingly negative interest rates, banks can reduce the cost of lending to households and businesses but cannot fully pass them to interest rates on deposits, as depositors could choose to keep cash. Consequently, this lowers banks' net interest margins and (if not offset by other measures) profits, with possible negative implications for capital buffers. Such negative effects are stronger for banks that depend heavily on retail deposits. To compensate these effects, commercial banks can increase interest rates on their loans or fees at the expense of their customers. In either case, the supply and cost of bank credit may be affected negatively. Different sorts of exemptions and offsets – as discussed above – can mitigate the negative effects on banks' profits. However, they also dampen the interest rate channel and thus weaken the rational for such a policy mix.

Banks could also engage in lending to riskier borrowers to boost their profits (the risk-taking channel). While stronger risk-taking is desirable in a weak growth environment, prolonged and excessive risk-taking may ultimately undermine banks' resilience during a future downturn.

Beyond the banking sector, negative interest rates, if passed through to households, may also induce them to spend out of their savings to limit the impact of the implicit tax. However, if they lead to perceptions of higher economic uncertainty and a likely loss of future income from accumulated assets, households may reduce consumption. Similarly, investors holding assets that yield negative returns could be inclined to invest in assets with higher yields, thus helping to lower interest rates and to increase the supply of financing in the wider economy, but at the cost of higher risk.

Empirical evidence so far

A comprehensive assessment of the effects of a NIRP is complicated due to the difficulties of separating the impact of negative interest rates from that of other unconventional monetary policy measures (in particular asset purchases, longer-term funding schemes for banks and forward guidance) and in adjusting for credit demand.

The pass-through of negative policy rates to bank lending rates and money market rates in countries with a NIRP was initially high (Bech and Malkhozov, 2016; Eggertsson et al., 2019; Erikson and Vestin, 2019). However, bank lending rates seem to have stabilised in recent years. Retail deposit rates have been insulated from negative rates, though in some cases negative rates have been applied to retail deposits of companies (Eisenschmidt and Smets, 2019; Demiralp et al., 2019).[1] In Denmark and Switzerland, several

banks have already announced or are considering applying negative deposit rates to a wider range of clients.

So far, banks' profitability in countries with a NIRP does not seem to be adversely affected, reflecting lower wholesale and deposit funding costs, higher non-interest income and lower non-performing loans (Turk, 2016; Lopez et al., 2018; BIS, 2019; Stráský and Hwang, 2019). This is despite the sizeable costs for the banking sector in some jurisdictions. In 2018, Swiss and euro area banks paid 16.3% and 4.2% of their realised profits, respectively, to the central bank (Table 1.2).[2] In contrast, in Japan, banks earn positive net income on their excess reserves (see above and Table 1.2), but bank profits have been declining given protracted and very narrow net interest rate margins.

In the euro area, the bank lending channel has been operating smoothly from the perspective of individual banks, as banks with more excess liquidity have tended to increase their lending (Eisenschmidt et al., 2019; Demiralp et al., 2019). However, parts of the banking sector in the euro area continue to exhibit weak profitability, reflecting the weak macroeconomic environment and structural challenges, such as overcapacity and cost inefficiencies that predated the NIRP policy (de Guindos, 2019).

Table 1.2. Negative interest rate policy frameworks and their impact on bank profits

	Total volume / average IR	Current accounts (CAs)			Negative-rate claims		2018 interest payments to the CB, % of bank profits
		IR > 0	IR = 0	IR <0	overnight	one-week	
Denmark	*Individual current account limits*						
Volume	231	0	31	-	-	200	2.4%
Interest rate	-0.65	-	0.00	-	-	-0.75	
Euro area	*Required reserves exempted from negative interest rates. The exempt tier introduced in Oct. 2019*						
Volume	1842 (2128)	0 (0)	133 (933)	1710 (1195)	-	-	4.2% (3.3%)
Interest rate	-0.37 (-0.29)	-	0 (0)	-0.50 (-0.50)	-	-	
Japan	*Three-tiered system; the BoJ maintains the balance of negative-interest tier in the 10 to 30 trillion-yen range*						
Volume	387	208	156	23	-	-	-3.8%
Interest rate	0.05	0.10	0.00	-0.10	-	-	
Sweden	*Negative costs mitigated by the use of term claims remunerated at less negative interest rates*						
Volume	435	-	-	55	0	380	1.6%
Interest rate	-0.26	-	-	-0.35	-0.35	-0.25	
Switzerland	*Individual exemption thresholds - raised from 20 to 25 times reserve requirements in Nov. 2019*						
Volume	574	0	305	269	-	-	16.3%
Interest rate	-0.35	-	0.00	-0.75	-	-	

Note: IR stands for interest rate as of end-October 2019. Volumes are monthly averages of September 2019 for Japan, October 2019 for Denmark, the euro area, Sweden, and end-December 2018 for Switzerland. Volumes are in trillions of yen for Japan and billions of national currency for the remaining areas. Current accounts for the euro area include the deposit facility. The last column shows OECD estimates of 2018 banks' interest payments related to the NIRP to central banks (CB) as per cent of gross annual operating profits in 2018 for Denmark, the euro area, Sweden and Switzerland and of 2018H1 annualised profits for Japan. Domestic banks and foreign banks and institutions are included. For the euro area, figures in parentheses show the estimates in 2020 assuming that the ECB maintains the deposit interest rate at -0.5% and continues with net asset purchases of EUR 20 billion per month until the end of 2020.
Source: Bank of Japan; Danmarks Nationalbank; European Central Bank; Japan Banker's Association; Swiss National Bank; Sveriges Riksbank; and OECD calculations.

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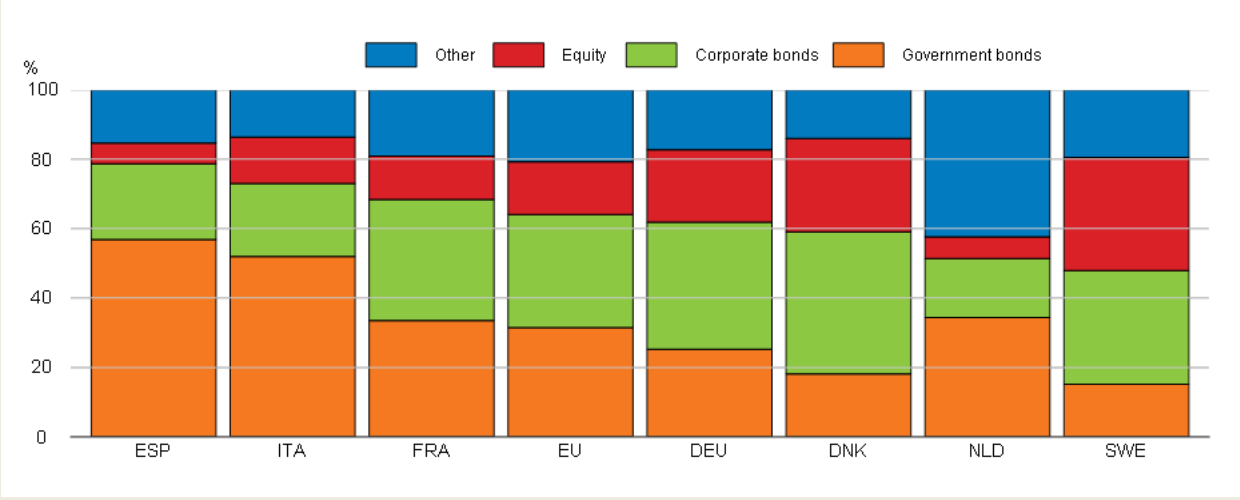
The adverse impact on banks' profits of negative deposit rates could increase if central banks continue to purchase assets or further lower negative interest rates. For instance, in the euro area, banks' payments on excess reserves will gradually increase over time if net monthly asset purchases by the ECB of EUR 20 billion per month translate proportionally to higher excess reserves. Under this assumption, banks payments could increase in 2020 by 17% compared with a scenario of unchanged excess reserves, partly mitigating the positive effect of tiering.

Financial stability risks in the non-bank financial sector

If negative policy interest rates are passed through to returns on safe assets with longer maturities, the solvency of defined-benefit pension funds and financial institutions offering life insurance policies that promise fixed nominal returns is undermined, unless they take offsetting measures (OECD, 2016b). These negative effects are bigger, the higher the levels of guaranteed returns/benefits, the higher the amount of liabilities with fixed returns or fixed benefits, the more difficult it is to renegotiate contracts, and the higher the share of fixed income investments in total investment. Insurance companies have already started to lower guaranteed returns, but the adjustment of the stock of all outstanding contracts is slow.[3] Government bonds account for up to one-third and corporate bonds around 20% of EU insurance companies' investment assets (Figure 1.23). Sustained negative interest rates at longer maturities would likely incentivise insurers and pension funds to rebalance their portfolio from safe assets into risky assets, with ensuing risks for their clients. This would increase the chances of incurring financial losses, in particular during a downturn. This risk-taking channel is also relevant for money market funds, which can lengthen the term and reduce the liquidity of their investments in order to improve their returns (Bua et al., 2019). However, this raises the risk of runs on money market funds.

Figure 1.23. Composition of insurance companies' assets in selected European countries



Note: As of end-2018.
Source: EIOPA (2019), Financial Stability Report, June.

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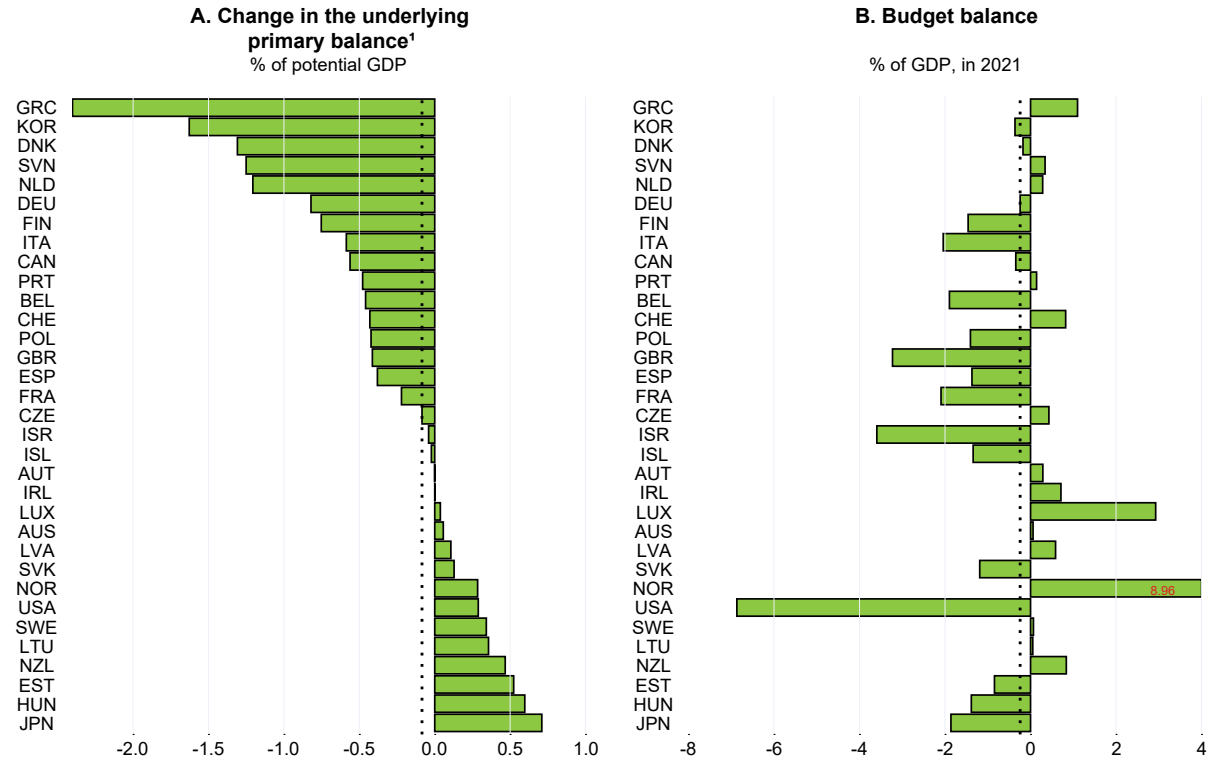
1. For instance, in Denmark, around 60% of corporate deposits are subject to negative rates.
2. In the euro area, this was over twice as much as in 2015, despite a 28.6% nominal increase in total profits since then. The excess liquidity and thus costs for banks have been concentrated in Germany, France, the Netherlands and Luxembourg, in contrast to Italy where excess liquidity has been very small.
3. For example, average guaranteed interest rates on all outstanding contracts guaranteed by insurance companies are around 3.8% for Finland, 3.5% for the Netherlands and 2.5% for Germany, while for new products, they are around 0.5%, 1% and 0.5%, respectively.

Fiscal policy considerations

Based on current information (Annex 1.A), the fiscal policy stance in the median OECD economy is expected to be broadly neutral over 2020-21 (Figure 1.24, Panel A), following an estimated median stimulus in 2019 of around 0.3% of potential GDP. A relatively large discretionary stimulus is expected in 2020 in Korea and a few EU countries, ranging from 1 to 2¼ per cent of potential GDP. In many of these economies this is a desirable counter-cyclical measure in view of projected low or slowing growth and, in some cases, underutilised resources (Figure 1.25, Panel B). The fiscal stance is expected to be slightly contractionary only in a few countries (Figure 1.24, Panel A).

The future fiscal policy stance should depend, among other things, on the need to boost short-term demand and longer-term potential growth, taking into account debt sustainability considerations. While recent and expected differentials between effective interest rates paid on net debt and nominal GDP growth alleviate public debt sustainability concerns in most OECD countries (Figure 1.25, Panel C), other aspects related to the scope and the need for additional fiscal easing vary considerably across economies (Figure 1.25, Panels A and B).

Figure 1.24. Fiscal policy is expected to be eased in many OECD economies



Note: Dotted vertical lines show medians.
1. Change between 2019 and 2021.
Source: OECD Economic Outlook 106 database; and OECD calculations.

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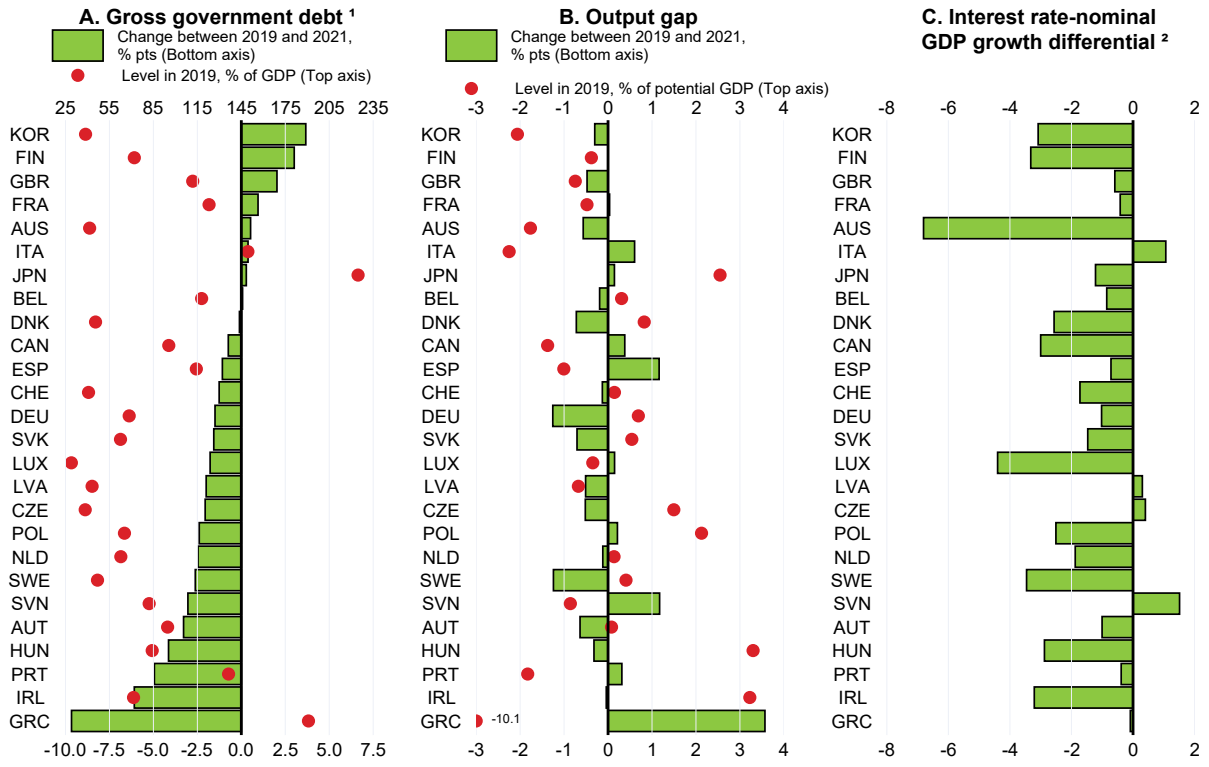
- Under the current projections, a few European countries with relatively low debt and with deteriorating or stable output gaps, including Germany, the Netherlands and Sweden, could implement an even stronger discretionary stimulus than currently planned. Given a projected decline in government gross debt relative to GDP, an additional stimulus of around ½ per cent of potential GDP per year would be possible without increasing gross debt, and also desirable. Such stimulus could help to raise future potential growth if public investment is increased from currently low levels and also help sustain employment and household consumption growth, at a time when the scope for additional monetary policy easing is limited. In many European countries, negative yields on longer-dated government debt offer a low-risk opportunity to address serious infrastructure shortages and strengthen longer-term growth (Blanchard, 2019).

Figure 1.25. Selected indicators of possible changes in the fiscal stance



1. National accounts definition.
2. The average difference between the effective interest rate paid on net debt (r) and nominal GDP growth (g) for 2016-21 (the so-called r-g). r is the weighted difference between the implied interest rate paid on government financial liabilities and the implied interest rate earned on government financial assets, where the weights are the share of financial liabilities and assets in net debt, respectively.
Source: OECD Economic Outlook 106 database; and OECD calculations.

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- In contrast, in those OECD countries where relatively high debt is not projected to decline over the next two years (like in Belgium, France, Japan, Italy, the United Kingdom and the United States[16]), or is expected to fall but still remain very high (like in Greece, Portugal and Spain), the scope for discretionary fiscal easing is limited. Further easing could undermine future debt sustainability and reduce the fiscal room to combat future recessions. In the case of some EU countries, significant policy easing might not be in line with EU fiscal rules. However, in all these countries, the authorities could still support economic activity by changing the structure of spending and taxes towards areas that are more conducive to economic growth. For example, a budget-neutral policy could increase spending on growth-enhancing components – like education and public investment in infrastructure, health, and research and development – while cutting growth-reducing spending – such as subsidies in sectors that restrict competition and distort effective resource allocation (OECD, 2016c; and Chapter 2, Focus Note 1).
- If growth were to slow sharply or turn negative, countries with lower levels of government debt could easily let automatic stabilisers operate fully and add discretionary stimulus. In countries with high debt and high budget deficits, the fiscal response could be limited if national governments act by themselves, especially if there are risks of government bond yields increasing, and the monetary authorities may also have little room to ease monetary policy. In such a case, a closer formal co-ordination between fiscal and monetary authorities both within and across countries may be needed to avoid a sharper contraction in economic activity and disinflation (see below). A co-ordinated policy stimulus in many economies would enhance the benefits of action because of the additional output gains that would result (Chapter 2, Focus Note 4).

Current fiscal frameworks tend to stabilise households' disposable income effectively in many advanced economies, though with important cross-country differences and with possibly less effectiveness in stabilising household consumption (Chapter 2, Focus Note 5). Making automatic stabilisers more effective, especially in countries with less powerful stabilisers, would help to make fiscal responses timely, targeted and temporary during downturns, improving longer-term debt sustainability. Possible options include making automatic certain direct payments to qualified households; making the generosity of unemployment benefits (amount and duration) dependent on the severity and duration of downturns; increasing public infrastructure spending during recessions; increasing the progressivity of household income taxes; introducing automatic investment tax deductions; providing fiscal support for short-time working schemes; and implementing measures that avoid pro-cyclical fiscal policy in sub-national governments from requirements to run balanced budgets at all times (Boushey et al., 2019; Mohl et al., 2019). Any decisions to change the parameters of the tax and revenue system should also focus on efficiency in providing public goods and services, distributional consequences and incentives to work and invest.

Options for domestic fiscal and monetary policy co-ordination

In response to the extraordinary macroeconomic circumstances following the global financial crisis, with policy rates at or close to their effective lower bounds, several central banks purchased government bonds to provide monetary policy stimulus and improve the transmission of monetary policy. As long as central banks hold these bonds on their balance sheet and excess reserves are not remunerated, these operations imply, in an economic sense, a *de facto* monetisation of budget deficits (McCulley and Pozsar, 2013).[17]

[16] In the United States, federal debt is also expected to increase in relation to GDP over the next ten years with unchanged policies (CBO, 2019). This increase could be significantly larger if temporary tax provisions were to be extended and if non-defence discretionary outlays were to rise not only with inflation but also with the rate of population growth (Auerbach and Gale, 2019).

[17] When excess reserves held at central bank are not remunerated, government debt servicing costs on that part of bonds held by the central bank are virtually zero as central bank earnings on government bonds are remitted back to the government. When the central bank remunerates excess reserves, debt-service costs go up. However, with the

In the current context of diminishing returns to additional monetary policy stimulus, more explicit forms of domestic monetary-fiscal co-ordination may be an option to deal with severe downturns during which risks of high inflation are low. For example, it could involve an arrangement – set up in advance – in which the central bank decides on the timing, the duration and the amount of money created and credited to a government account and the government decides whether and on what to spend this money (Bernanke, 2016c; Bartsch et al., 2019).[18] Such a division of responsibilities would be consistent with the central bank's objective of maintaining stable inflation and with democratically elected authorities deciding on fiscal policy with distributional consequences. This particular arrangement would avoid the need for the government to issue debt and for the central bank to purchase it.

So far, no central bank has such an arrangement, as the existing legal framework does not allow central banks to monetise public debt, and none has committed to hold purchased government bonds indefinitely. Under any form of effective debt monetisation, governments should still make careful choices about spending and taxes, prioritising measures that are effective in stimulating the economy in the short run, when needed, and in addressing structural bottlenecks and other policy priorities.

Macroeconomic policy requirements in the emerging-market economies

Reductions in US interest rates, weaker-than-expected growth and diminished inflationary pressures have provided scope for several emerging-market economies to lower policy interest rates (Figure 1.5, Panel D). However, weak global trade exacerbates persistent vulnerabilities, including high corporate debt denominated in foreign currency, in many countries.

Policy requirements differ across the individual economies depending on their situation:

- In China, both fiscal (including quasi-fiscal) and monetary policies have been eased, as appropriate given demand weakness. Scope remains for additional measures if growth weakens further or if policy instruments are less effective than in the past, but careful choices are needed to avoid adding to high indebtedness and deleveraging challenges that require structural solutions in the longer term.
- Other emerging-market economies with flexible exchange rate frameworks and manageable exposures to foreign currency denominated debt, including India and Brazil, have some scope to further ease monetary policy as inflation declines, while taking the opportunity to strengthen their fiscal positions and progress with the implementation of necessary structural reforms.
- To retain investors' confidence, a tight policy stance, including constraints on the use of quasi-fiscal measures, remains necessary in those emerging-market economies where concerns persist about the sustainability of fiscal or external positions, or the health of the banking sector.

Many emerging-market economies, including China, India, Russia and Turkey, would benefit from increased fiscal and quasi-fiscal transparency, which might help to reduce the risk premia they face in global financial markets. They do not publish estimates of the general government budget balance and debt according to international accounting standards, preventing an objective assessment of public finances for the total government sector, including local governments. Moreover, in many of them, quasi-fiscal measures, involving state-owned banks and companies and various contingent liabilities, have

usual situation of an upward sloping yield curve, with short-term interest rates are lower than longer-term interest rates, financing of government debt will be lower than implied by market interest rates. In the rare circumstances when the yield curve is inverted, i.e. when short-term interest rates are higher than long-term interest rates (and also where both ends of the yield curve are below zero), the central bank would incur losses on their holdings of government bonds.

[18] The central bank may consult with independent fiscal councils and governments.

been increased significantly. Reporting such measures would be welcome as it would allow a better assessment to be made of the fiscal risks faced by these countries.

Greater structural reform ambition is called for in all economies

The prospects for strong and sustained improvement in living standards and incomes in the medium term remain weaker than prior to the crisis, and real per capita growth in recent years has been well below pre-crisis norms in most economies. As set out in the latest OECD *Going for Growth*, structural reform efforts have stabilised in both advanced and emerging-market economies in recent years, but at a level below that achieved in the aftermath of the crisis. Greater reform ambition in both advanced and emerging-market economies would help to offset the impact of the negative supply shocks from rising restrictions on trade and cross-border investment, strengthen medium-term prospects for investment and productivity, enhance living standards and allow the benefits of growth to be distributed more widely.

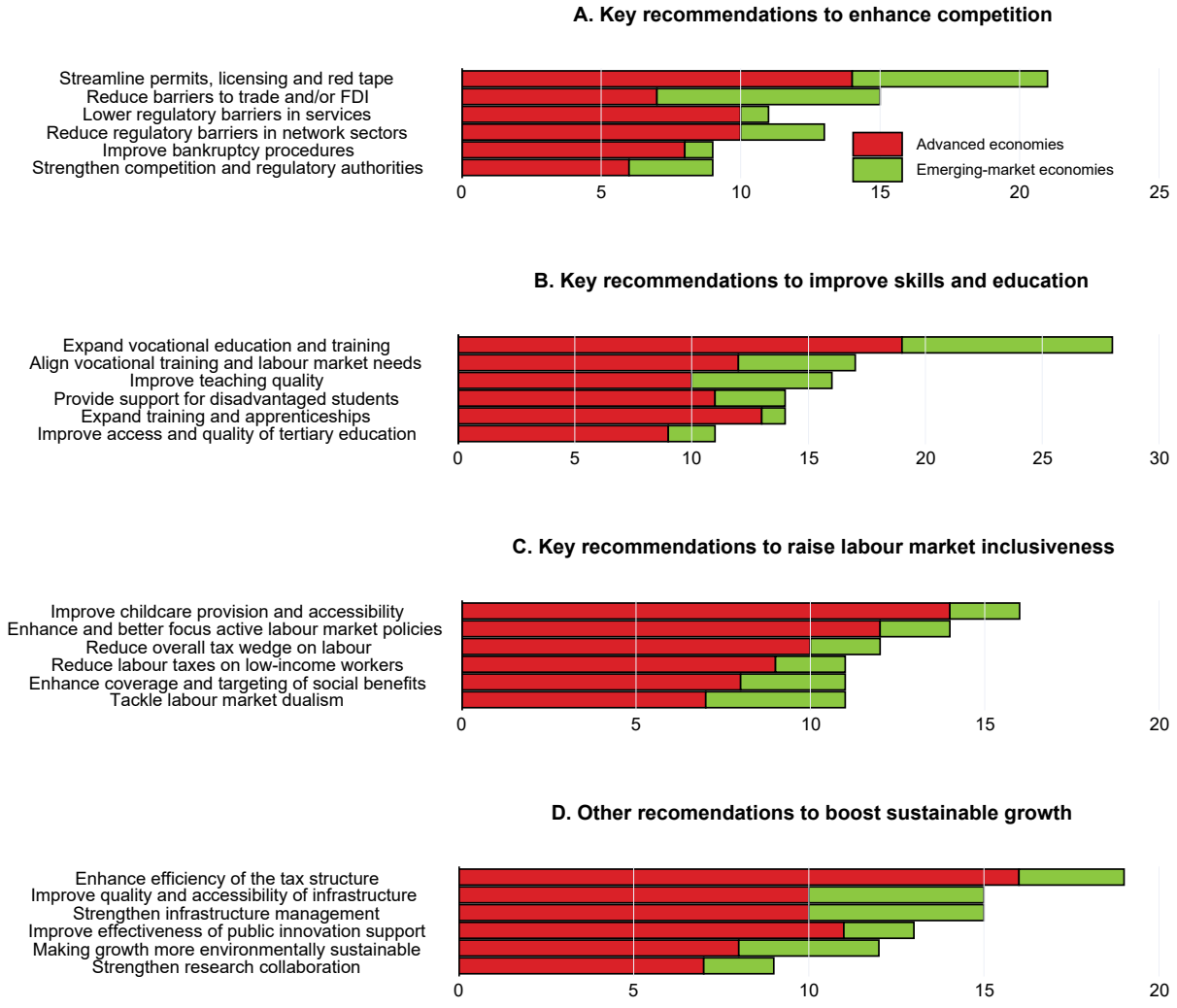
In both advanced and emerging-market economies, the most frequent priorities to be addressed by reforms are in the areas of skills and education and product market regulation.

- Enhanced efforts to strengthen competition and open up product markets are essential for innovation, the diffusion of digital technologies and ultimately productivity growth and social inclusion (Figure 1.26, Panel A).
- Amongst the key reforms to take are steps to help workers acquire skills by expanding vocational education and training, measures to better target resources on disadvantaged students and schools, and reforms to reduce market segmentation and improve opportunities for women, migrants and older workers (Figure 1.26, Panel B).
- Enhanced childcare provision and improved efficiency and targeting of tax and transfer policies also need to be an integral part of well-designed policy packages to respond to people's concerns about public services and social benefits, and to enhance participation and make the labour market more inclusive (Figure 1.26, Panel C).
- Further measures to actively improve the quality and accessibility of infrastructure, refocus public support for innovation and enhance the efficiency of the tax systems, by shifting towards property, consumption and environmental taxation, are also needed in many economies to strengthen the prospects for sustainable growth (Figure 1.26, Panel D).

At a time of weak global growth there is also a case for prioritising and packaging reforms that help to support short-term demand, and ensuring that these are implemented with supportive macroeconomic policies. Part of this package should be a rapid move to reduce restrictions and distortions on cross-border activities, including costly market-distorting government support in agricultural and industrial sectors (Chapter 2, Focus Note 1), and return to collective action on trade policy issues. This would help to reduce trade policy tensions and the uncertainty that is currently undermining growth prospects in the short and medium term. Going further, a renewed push for trade liberalisation could yield substantial benefits for medium-term living standards, particularly if measures to lower tariff and non-tariff barriers are taken simultaneously (OECD, 2019e).

Figure 1.26. Key structural reform priorities

Number of economies



Note: Going for Growth contains structural reform recommendations for 45 economies, plus the European Union.
Source: OECD Going for Growth, 2019, OECD Publishing, Paris.

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Annex 1.A. Policy and other assumptions underlying the projections

Fiscal policy settings for 2019-21 are based as closely as possible on legislated tax and spending provisions and are consistent with the growth, inflation and wage projections. Where government plans have been announced but not legislated, they are incorporated if it is deemed clear that they will be implemented in a shape close to that announced. Where there is insufficient information to determine budget outcomes, underlying primary balances are kept unchanged in relation to potential GDP, implying no discretionary change in the fiscal stance. In the euro area countries, the stated targets in Stability Programmes are also used.

Regarding monetary policy, the assumed path of policy interest rates and unconventional measures represents the most likely outcome, conditional upon the OECD projections of activity and inflation, which may differ from the stated path of the monetary authorities.

Structural reforms that have been implemented or announced for the projection period are taken into account, but no further reforms are assumed to take place.

The projections assume unchanged exchange rates from those prevailing on 28 October 2019: one US dollar equals JPY 108.7, EUR 0.90 (or equivalently one euro equals USD 1.11) and 7.07 renminbi.

The price of a barrel of Brent crude oil is assumed to remain constant at USD 60 throughout the projection period. Non-oil commodity prices are assumed to be constant over the projection period at their average levels from September 2019.

The projections for the United Kingdom use a technical assumption of a smooth Brexit with a transition period lasting until after 2021, following a formal exit from the European Union. The end of the transition period is assumed to occur smoothly, but the final outcome of the agreement on the future relationship between the European Union and the United Kingdom is assumed to be uncertain through 2020-21.

Tariffs that have been introduced or announced by the United States and China on their bilateral trade in 2018 and 2019 are maintained throughout 2020 and 2021 in the projections, and no other new tariff measures are assumed.

The cut-off date for information used in the projections is 14 November 2019.

2 Focus Notes on selected macroeconomic and structural issues

Focus Note 1: Addressing current trade tensions: Market-distorting government support

The causes of current trade tensions are complex, but have their roots in widespread frustration that the international rulebook has not kept pace with economic and technological changes, and not everyone is playing by the existing rules. While there is no shortage of concerns – from border restrictions, and behind-the-border regulations that can impose unnecessary costs on traders, to new restrictions on the cross-border data flows that underpin trade in the digital era – particular attention has focused on government support that distorts international markets. This support is both long-standing – in the case of agriculture – and more recent - in the case of industrial products – but in both cases appears to be sizeable.

A first step in addressing market distorting government support is understanding its nature and scale. What do we know about government support?

Agriculture

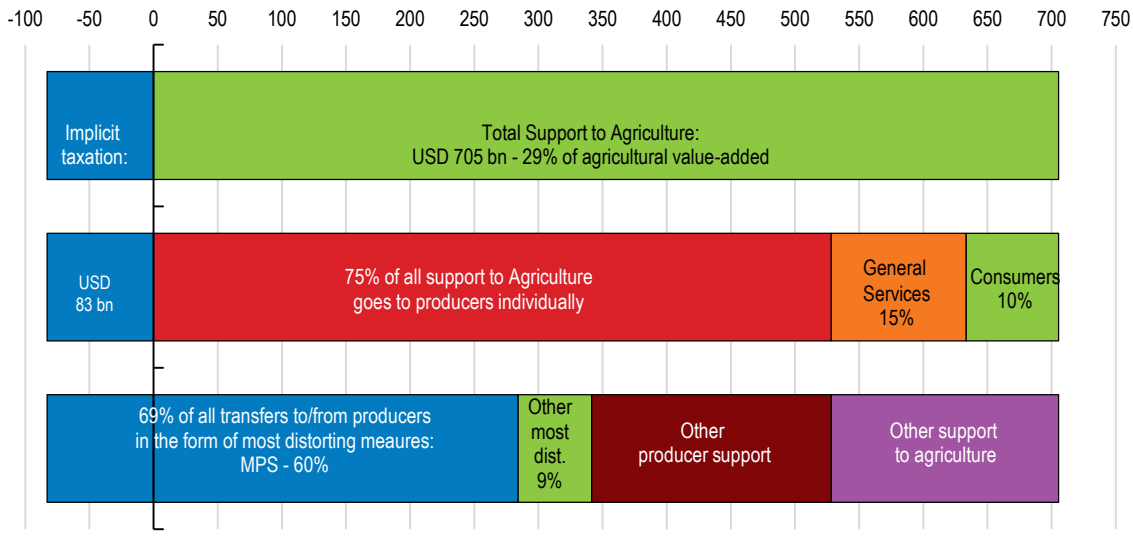
In the late-1980s, the OECD introduced a methodology to identify and estimate government support in agriculture, providing governments with the necessary information to begin to remove the most egregious forms of trade distorting support - including by integrating agriculture, for the first time, into the international trade rule-book. This has led to reduced government support, notably in some OECD countries to which all multilateral disciplines applied, and reduced trade distortions. However, reform in this area has now largely stalled across the OECD and much remains to be done. Moreover, some key emerging-market economies have increased their support to farmers, albeit from a low base, and have tended to rely relatively more on measures that are particularly market distorting (OECD, 2019a).

In agriculture, government support currently stands at over USD 700 billion per year for the 53 countries,[1] covering 74% of global value added in the sector, covered by OECD monitoring (Figure 2.1). Only a quarter of this provides general services to the sector (such as research and development) or support to consumers (e.g. food stamps); three-quarters (USD 530 billion) goes directly to individual producers. And of this USD 530 billion, over two-thirds takes the form of the most distorting support – including in the form of agricultural policies that raise domestic prices above world market levels (market price support), sustained by market access barriers that prevent cheaper competitive imports from entering. At the same time, a few emerging-market economies apply policies that lower producer prices relative to international markets, thereby implicitly taxing their producers to the tune of USD 83 billion a year.

[1] The countries covered in those estimates are the OECD members, non-OECD EU member states and 12 emerging-market economies (Argentina, Brazil, China, Colombia, Costa Rica, India, Kazakhstan, the Philippines, Russian Federation, South Africa, Ukraine and Viet Nam).

Figure 2.1. Support to agriculture, 2016-18

USD billion per year, 2016-18



Source: OECD (2019a), *Agricultural Policy Monitoring and Evaluation 2019,* OECD Publishing, Paris; OECD Agriculture statistics (database).

Industrial sectors

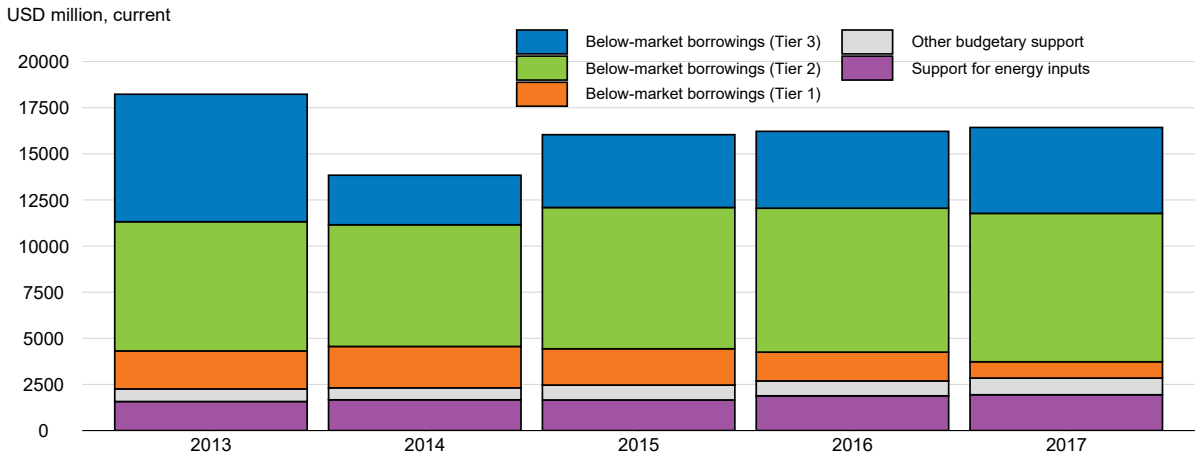
While support to agriculture is relatively well understood, attention is only now turning to support benefitting industrial sectors. Much less is known about the nature and scale of this support. The limited evidence available suggests it is common and sizeable in manufacturing, and that it is highly distorting to international markets. This support also takes a variety of forms, from relatively well understood input subsidies to less transparent and harder to measure support conferred through the financial system - as shown, for example, in recent OECD work on the aluminium value chain (Figure 2.2; OECD, 2019b).

The aluminium study and new work on semiconductors (OECD, forthcoming) both highlight the important role of support provided by central and local governments through their state enterprises. This support is complex and includes below-market loans from state banks; equity that state investment funds inject in companies on below-market terms (and which in turn creates channels for other forms of support, such as implicit state guarantees, and financial assistance with acquisitions or capacity addition); and a range of inputs (e.g. electricity) sold to manufacturers at below-market prices by state utilities and suppliers. These forms of support, and more generally a porous relationship between firms and the state, can make it difficult to identify individual support measures.

The effects of support in industrial sectors propagate through entire value chains that span multiple industries and countries. Measures that lower the cost of capital, and encourage the construction of more plants than market conditions would warrant, distort global markets and may also end up benefitting suppliers of equipment to those plants. Likewise, subsidised inputs for aluminium smelters can translate into cheaper products downstream that are then used to produce cars, aircraft and high-voltage transmission lines. Government support in a world of global value chains needs to take account of the way that support can accumulate along the supply chain. Support thus matters not just for particular industries, but also for the entire global trading system, which points to the need for policy solutions that address the issue in a holistic fashion.

Figure 2.2. Government support for 17 of the largest firms in the aluminium value chain

By type of support



Note: Below-market borrowings under Tier 1 are estimated by comparing actual interest rates paid by firms with a market benchmark that comprises a risk-free base rate and spreads reflecting the risk profile of USD-denominated debts, taking into account individual company credit ratings. Tier 2 further considers the risk profile of debts denominated in the local currency (e.g. the Chinese yuan or the Indian rupee). Tier 3 considers the additional interest that would have been charged absent the implicit government guarantee enjoyed by some firms. Data for two firms in the sample (SPIC and QPIG) are for the period 2012-16.
Source: OECD (2019b), "Measuring Distortions in International Markets: The Aluminium Value Chain", *OECD Trade Policy Papers*, No. 218, OECD Publishing, Paris.

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Not all producer support is equally harmful; there can be good public policy reasons for applying targeted support to address market failures (for example, support for basic research). Determining which support policies meet this test, and which are wasteful and market-distorting requires information. Transparency is thus a fundamental first step: only with adequate information can analysis help distinguish benign forms of support from more harmful policies, and in turn enable more informed policy discussions on how best to tackle government support, including in a trade context. Yet, industrial subsidies in particular are marked by a lack of transparency, especially for complex forms of support, stemming not just from insufficient disclosure by governments, but also from the difficulty of measuring such support in the absence of a market benchmark.

What can be done about government support?

Effectively addressing market-distorting government support requires disciplines across four fronts:

- Transparency (understanding the "what, how, when and where" of support): The essential starting point for levelling the playing field. Rules require objective, comparable information on the nature and scale of government support. While OECD monitoring helps to clarify the means of agricultural support and to measure them consistently across countries and time, there is a need for similar transparency exercises for government support in industrial sectors.
- Predictability (knowing that support will not increase further): An understanding of the nature and scale of existing support enables the development of rules to bind that support at existing levels. This can be critical in preventing harmful subsidy competition.
- Reduction (remove the most egregious and discipline others): Support measures differ in their impacts on markets and trade. The priority is to identify and reduce those measures that have

particularly harmful impacts on international markets. This is not an easy task in view of the variety of ways that support is provided to industrial sectors.

- Prevention (for tomorrow's sectors and tomorrow's subsidisers): While binding and reducing existing support would create a more level playing field today, effective rules need to prevent the use of new trade distorting measures, by new actors, in new sectors.

While some of these elements may be achieved bilaterally, only multilateral rules can deliver all four for all sectors. The critical first step is transparency – and not just for the development of rules. In the absence of transparency about the nature and scale of government support, businesses are reluctant to make new investments. And just as trade policy uncertainty is hampering global growth, failure to address some of the underlying causes of the current trade tensions is bringing its own costs in terms of heightened uncertainty about the future environment, leading to reduced business investment and, ultimately, lower growth.

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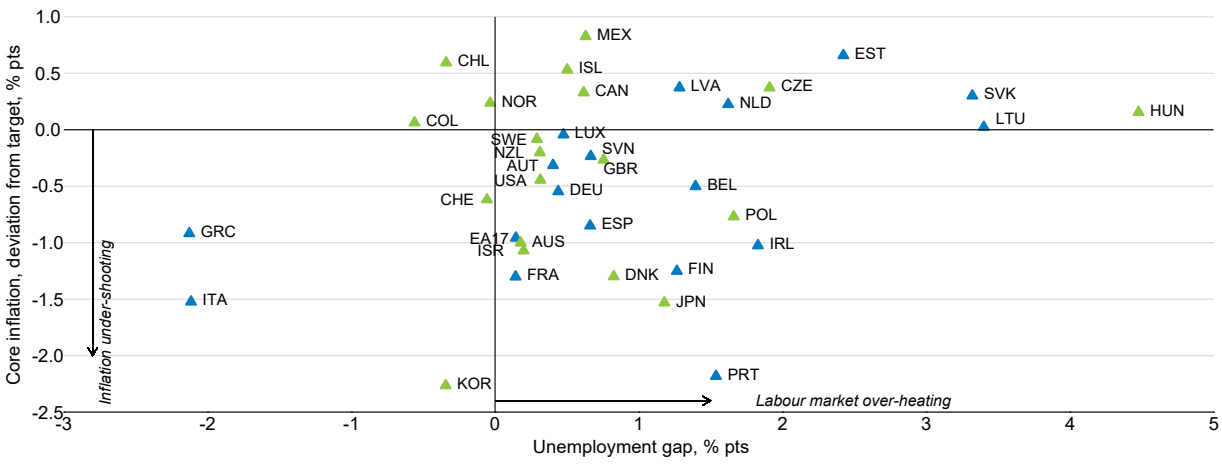
Focus Note 2: Escaping the low-inflation trap[1]

Inflation has remained weak in many OECD countries, particularly in the euro area and Japan, despite the prolonged recovery and despite a broad range of indicators, including the OECD's own unemployment gap measures, suggesting little labour market slack (Figure 2.3). These outcomes appear to contradict a standard Phillips curve – a long-standing workhorse of macroeconomic analysis – which predicts that as slack is eliminated, inflation should approach "expected" inflation, usually assumed to be anchored at, or close to, the central bank's inflation target.[2] While there are various possible explanations for this puzzle, including that labour market slack is mis-measured, two possibilities explored in this note are: firstly, that a prolonged period of low inflation has resulted in inflation expectations slipping well below central banks' inflation targets; and secondly, that inflation responses to slack are non-linear. These two possibilities taken together point to the need for renewed policy action in some countries, most notably in Japan and the euro area, in order to escape the low-inflation trap.

Figure 2.3. In many countries core inflation remains low despite closed unemployment gap



Note: The scatter plot shows the deviation of annual core inflation in 2019Q2 from the inflation target plotted against OECD estimate of the unemployment gap averaged over the year to 2019Q2 (where a positive number indicates over-heating of the labour market) . The inflation puzzle is then illustrated by the preponderance of countries in the south east quadrant. For countries where the target is a range, the mid-point is assumed, and for all euro area countries, the target is assumed to be 2% per annum, although formally the target is specified as being close to, but just below, 2% for the area as a whole. Euro area countries are distinguished from other countries by the use of a different colour.
Source: OECD calculations.

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[1] The issues discussed in this note are developed at greater length, based around empirical analysis of estimated Phillips curve relationships for all OECD countries, in Turner et al. (2019).

[2] The difficulty of explaining recent low inflation is confirmed by a recent ECB study in which not one of the 550 versions of an area-wide Phillips curve is able to explain low inflation outcomes in the euro area since mid-2017 (Bobeica and Sokol, 2019).

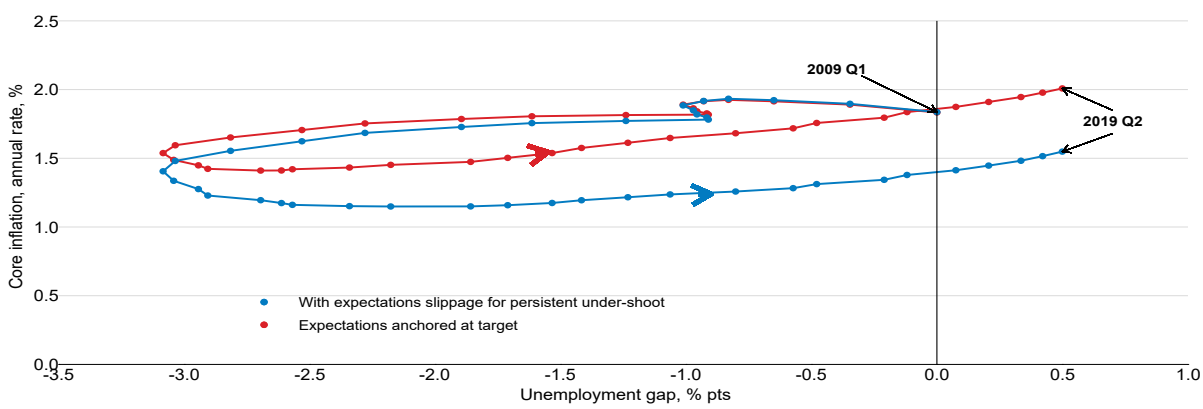
The slippage of inflation expectations

Japan provides a salutary example of the danger of allowing inflation expectations to become entrenched at very low levels. A recent sectoral study suggests that Japan is an outlier compared to other countries with a default expectation that prices remain unchanged, so that expected inflation is essentially zero (Watanabe and Watanabe, 2018). This is confirmed in estimated Phillips curves for Japan and, while the introduction of the 2% inflation target in 2013 does appear to have impacted inflation, the effect seems to have been temporary and is difficult to perceive beyond 2015.

Empirical work suggests that a "slippage" variable, which captures persistent past under or over-shooting of the inflation target, helps to explain recent inflation developments across most OECD countries. This slippage term performs better empirically than survey measures of professional forecasts, which are more often used in empirical work to proxy for expectations. The addition of a slippage effect to other potential determinants of inflation also has a clear policy implication because it directly tests for “the risk that a too prolonged period of low inflation becomes embedded in inflation expectations” (Draghi, 2014). The strength of the slippage effect suggests that for most euro area countries, expectations have indeed slipped below target.

The role of the slippage term can be demonstrated by simulating the euro area inflation response to the unemployment gap shock experienced following the Great Recession, with and without the slippage effect (Figure 2.4). In a first simulation, inflation expectations are anchored to the inflation target, which is assumed to be 2% per annum, whereas in a second simulation, expectations are also influenced by persistent deviations of inflation from the target according to an estimated slippage effect. While the initial fall in inflation is quite similar across the two simulations, the long-term effects are strikingly different. In the first simulation, inflation returns quite quickly to the target once the unemployment rate returns to its pre-crisis level. However, in the second simulation, which better approximates what has actually happened, persistent under-shooting of the inflation target leads to slippage in inflation expectations and inflation remains below target, even after unemployment is back to where it started.

Figure 2.4. Simulation of the Great Recession unemployment shock on euro area inflation



Note: The chart compares the simulation properties of the two estimated Phillips curves for the euro area to the unemployment gap shock experienced following the Great Recession, which is here taken to be exogenous. In the first simulation, represented by the red line, inflation expectations are anchored on the inflation target assumed to be 2% per annum. In the second simulation, represented by the blue line, expectation deviate from the target as a result of persistent deviations of core inflation from the target where the magnitude of this effect is determined by estimation.
Source: OECD calculations.

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Evidence of non-linear effects

The Phillips curve is typically modelled as a linear relationship linking a measure of economic slack to inflation. However, a strand of research has also explored the possibility that the Phillips curve may be non-linear, which could help to explain why inflation has remained weak. The non-linearity may be a function of inflation itself, or a function of economic slack.

Non-linearity depending on inflation

Low sensitivity of inflation to unemployment at low levels of inflation could be due to the presence of downward nominal wage rigidities. If workers resist nominal wage cuts, then excess capacity may have a weaker effect on prices when inflation is already low. It is difficult to carry out convincing tests for this form of non-linearity because most OECD countries have had relatively few years of very low inflation. However, Japan is an important exception because it has a much longer experience of low inflation and tests decisively confirm the presence of downward rigidities when core inflation is below 1% per annum. If this form of downward nominal rigidity were widespread among other countries, it would help to explain why inflation did not fall more following the Great Recession and might also help to explain why inflation has been slow to recover since. The slow recovery of inflation could be a consequence of firms' inability to cut real wages in the immediate aftermath of the Great Recession having carried over into reluctance to grant wage increases in the recovery phase.

Non-linearity depending on the degree of slack

Another potential form of non-linearity in the Phillips curve may stem from capacity constraints introducing convexity into the effect of economic slack and reducing the sensitivity of inflation to negative output or unemployment gaps (Clark and Laxton, 1995; Macklem, 1997). Spare capacity in depressed conditions may allow firms to satisfy higher demand without abrupt price increases, whereas during strong expansions firms may increase prices more readily as capacity constraints bite and marginal costs increase. Thus, as economic conditions strengthen, inflation may become increasingly sensitive to economic slack, imparting a convex shape to the Phillips curve. According to a survey of dozens of studies published in the last two decades, the slope of Phillips curves is two to three times steeper in boom phases than in contractionary phases (St-Cyr, 2018). Evidence for a similar form and scale of non-linearity is found in the largest OECD economies when adapting a baseline Phillips curve specification to allow for a non-linear effect from the unemployment gap.

Given that linear Phillips curves imply very weak unemployment gap effects, the policy implications of having two to three times larger effects in boom phases are not necessarily alarming. Such a conclusion is supported by an entirely different type of study by Babb and Detmeister (2017), who find strong statistical support for a non-linear Phillips curve for the United States using metropolitan-wide data, but also calculate that the inflation implications are "only slightly different to the linear version over the next couple of years".

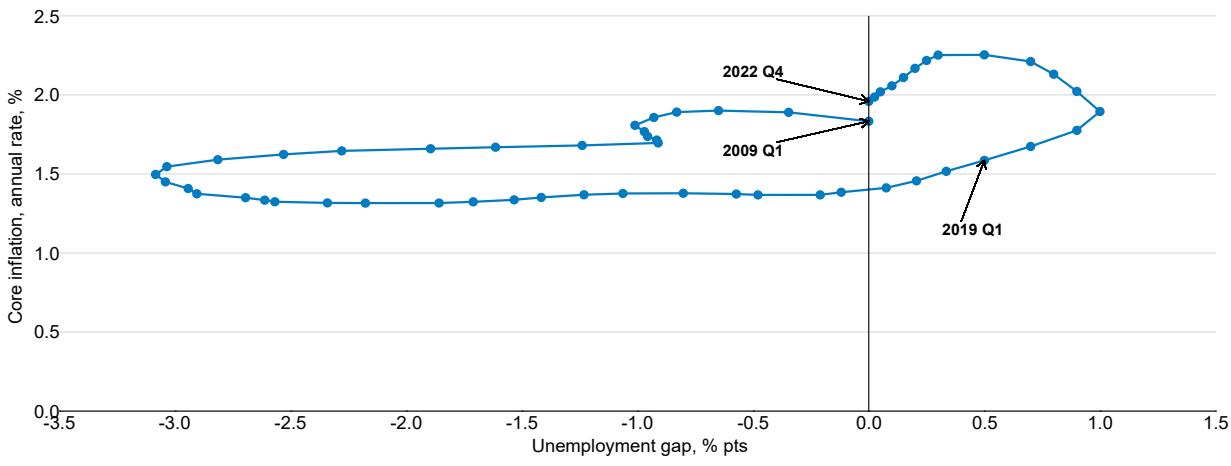
Summary and possible policy implications

Persistent low inflation outcomes, particularly with unemployment close to pre-crisis levels, raise concerns that the prolonged period of low inflation has become embedded in inflation expectations, particularly in euro area countries and in Japan. Models allowing for the possibility that persistent under-shooting of the inflation target lowers inflation expectations suggest that expectations may be closer to 1% than 2% in many euro area countries. The euro area may be particularly vulnerable to such risks because the commitment to inflation is area-wide and does not apply to any individual country. A lack of close integration of product and, especially, labour markets throughout the euro area means that persistent low national

inflation may more easily come to be reflected in national inflation expectations than would be the case if there were an explicit target for national inflation. This slippage of inflation expectations is a cause for concern. With nominal interest rates close to their effective lower bounds, persistently low inflation keeps real interest rates higher than they would otherwise be, which may explain why recoveries have been tepid in some countries. Moreover, if faced with another large negative demand shock, the scope for conventional monetary policy to lower nominal interest rates would be highly constrained.

A linear Phillips curve, incorporating a mechanism by which persistent under-shooting of the inflation target leads to slippage of expectations, if taken literally, would carry the surprising implication that to re-anchor expectations over any medium-term horizon would require a "Great Boom" to mirror the effects of the "Great Recession". However, evidence of non-linearities in the Phillips curve, whereby positive gaps have a larger inflationary effect than the weak disinflationary effect of negative gaps, would suggest that a more modest period of over-heating might be required, as illustrated by the simulation of a euro area Phillips curve that incorporates such non-linearities (Figure 2.5). Japan is in a similar, but more extreme, situation with inflation expectations more entrenched and even further below the official target and so is likely to require a more prolonged period of over-heating to jump-start inflation expectations, as well as clear communication regarding the permanent commitment to the inflation target as is currently the case.

Figure 2.5. Simulated effect on euro area core inflation of the Great Recession and hypothetical recovery based on non-linear Phillips curve



Note: The chart simulates an estimated non-linear euro area Phillips Curve to the unemployment gap shock experienced following the Great Recession followed by a hypothetical recovery where the unemployment gap is treated exogenously. Inflation is anchored by expectations, which are initially equal to the inflation target (assumed to be 2%) but also influenced by persistent deviations of core inflation from the target. The estimated non-linearity allows for the possibility that inflationary effects of a positive unemployment gap are larger than the disinflationary effect of a negative unemployment gap.
Source: OECD calculations.

StatLink https://doi.org/10.1787/888934044898

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Focus Note 3: Rebalancing the policy mix in the euro area

With euro area GDP growth projected to remain weak for an extended period, and downside risks continuing to mount, additional policy measures are required to support near-term demand and strengthen growth prospects in the medium term. In the years following the financial and euro area crises, monetary policy has been used as the main policy instrument to support demand. Rebalancing the policy mix in the euro area would be even more effective for macroeconomic stabilisation and lower the risks to financial stability from a prolonged period of very accommodative monetary policy.

To illustrate these issues, this note summarises the outcomes of simulations that contrast the impact of an extended period of quantitative easing (QE) in the euro area with that from an alternative policy mix that combines a more active use of fiscal policy, greater structural policy ambition and a more modest increase in monetary policy accommodation.

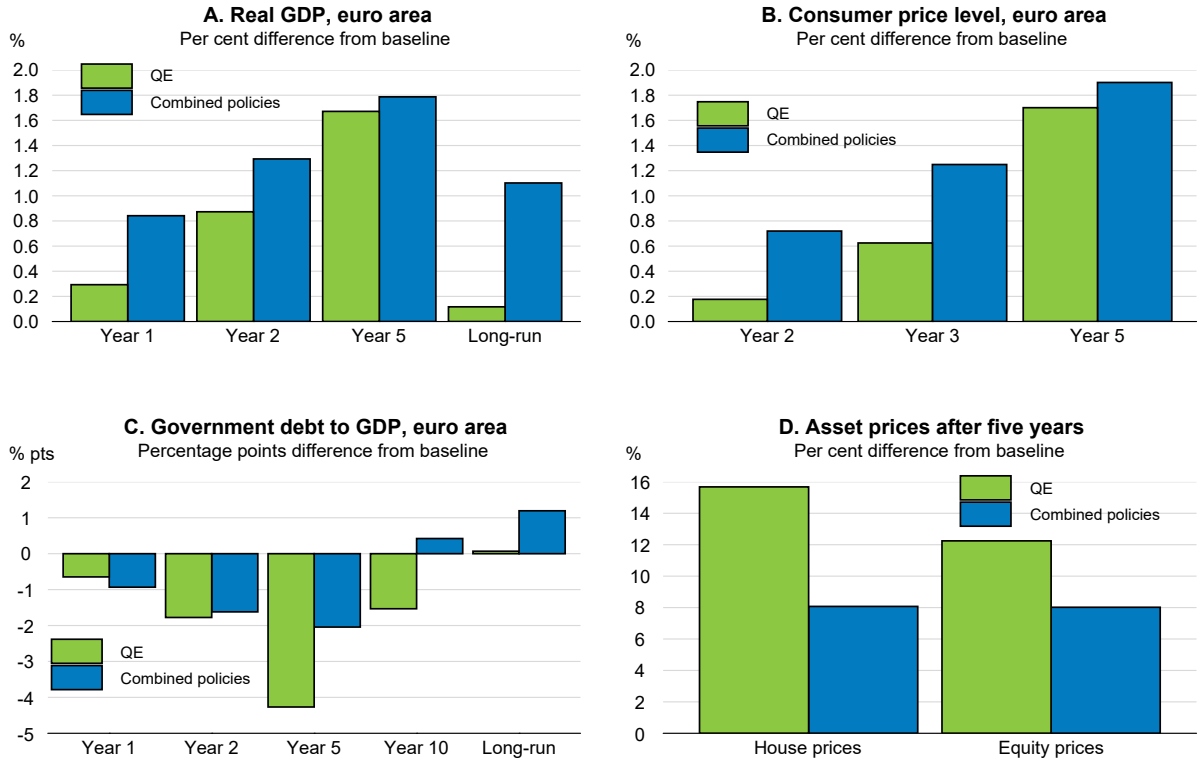
In the QE-only scenario, the term premium on 10-year government debt in the euro area is lowered for an extended period, calibrated on ECB estimates of the impact of the Asset Purchase Programme (APP) following its expansion to include public sector asset purchases in 2015 (Eser et al., 2019). At its peak, in years 3 to 5 of the simulation, the term premium is reduced by 100 basis points relative to baseline, with this effect fading slowly thereafter. Euro area policy interest rates are also held fixed for five years. An (imperfect) allowance is also made for the impact of the targeted longer-term refinancing operations (TLTROs) that have been implemented alongside the APP to support bank lending to the private sector in recent years. Interest rates on borrowing for house purchase are lowered by an additional 100 basis points for five years, over and above the impact of the term premia shock on private borrowing rates.

The different policy measures considered in the alternative combined policy scenario are:

- All euro area countries raise public investment by ¾ per cent of GDP for five years. This offsets the large and persistent reductions in public investment after the financial crisis (Blanchard, 2019). Euro area general government net investment (investment less capital consumption) averaged around 0.7% of GDP per annum over 1999-2008, but has declined to zero since 2013. Countries such as Germany, the Netherlands, the Slovak Republic and the Baltic States have scope to implement this type of policy through additional debt issuance. Their headline budget deficits are well below 3% of GDP, and debt levels are on a declining trajectory. Other countries, including France, Italy, Spain and Belgium, have less space available for fiscal easing, with still sizeable budget deficits and high government debt-to-GDP ratios. In these countries, the additional public investment spending is assumed to be offset fully by higher direct taxes, so that the *ex ante* budget impact is neutral.
- All countries are assumed to undertake productivity-enhancing structural reforms that raise total factor productivity (TFP) growth by 0.2 percentage point per annum over five years, with the 1% higher level of TFP being maintained permanently thereafter. Such reforms offset part of the slowdown in euro area TFP and potential output growth experienced since the crisis, in part due to the fading of reform ambition (OECD, 2018).
- A smaller QE programme is undertaken, reducing the term premium on 10-year government bonds by 50 basis points at its peak, with the profile of the shock over time similar to that in the QE-only scenario. Policy interest rates are again held fixed for five years and the allowance for the TLTROs is scaled down proportionately. Further ahead, monetary policy is assumed to be set in a way that takes into account the longer-term supply-side gains that arise from enhanced structural reforms. In effect, forward guidance is being used to help interest rates stay low for longer.

Figure 2.6. The impact of alternative policy approaches in the euro area

Differences from baseline



Note: See text for details of the shocks applied in the QE and combined policy scenarios.
Source: OECD calculations using the NiGEM global macroeconomic model.

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The simulations are undertaken on the NiGEM global macroeconomic model. Key features of the QE-only and the combined policy scenarios include:

- After five years, the impact on euro area output and the price level in both scenarios is close, and broadly similar to the estimates by Hammermann et al. (2019) of the impact of the non-standard monetary policy measures implemented by the ECB since mid-2014. The level of euro area GDP is raised by around 1¾ per cent relative to baseline (Figure 2.6, Panel A), and the consumer price level is pushed up by between 1.7-1.9% (Figure 2.6, Panel B), with marginally stronger effects from the combined policy mix.
- In the near term, the impact of the combined policy mix is noticeably stronger, reflecting the direct effect of higher public investment on GDP, the normal lags for monetary policy to take full effect (even in a model with forward-looking behaviour), and the extent to which accommodative macroeconomic policies help to bring forward some of the effects from structural reforms.
- Over time, the QE impact on output gradually fades, whereas area-wide GDP is up by just over 1% in the longer term (after 15 years) with the combined policy mix, reflecting the higher TFP level and a small boost to the public capital stock.

- Even with a sustained fiscal expansion over five years in the combined policy simulation, the area-wide government debt stock relative to GDP remains below its baseline level for some years (Figure 2.6, Panel C), helped by higher nominal GDP as well as lower debt-servicing costs. However, the larger decline in government bond yields in the QE-only scenario results in stronger reductions in debt-servicing costs.
- Asset prices are substantially lower with the combined policy mix than with sole reliance on monetary policy (Figure 2.6, Panel D), reducing potential financial stability risks. Both scenarios raise household and corporate incomes, but the asset price responses are stronger in the QE-only scenario due to the larger decline in long-term interest rates.

Overall, these results suggest that a balanced policy mix is more effective for macroeconomic stabilisation than relying solely on monetary policy. These issues are particularly relevant at the current juncture. A well-designed combination of country-specific fiscal and structural policy actions, along with continued low interest rates, is needed in the euro area for growth prospects to be strengthened durably.

The simulations also shed light on the possible policy choices that the euro area could have made in 2014-15, when the burden of macroeconomic stabilisation was left primarily to monetary policy. Many countries, including Germany, already had scope even then to ease fiscal policy, with low government budget deficits and government debt-to-GDP ratios on a declining trajectory. If the euro area had implemented a balanced policy mix at that time, it would have mitigated some of the stimulus provided to asset prices by a very accommodative monetary policy stance over a sustained period without adding substantially to public debt, and also enhanced longer-term living standards, something beyond the scope of monetary policy.

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Focus Note 4: Global policy co-operation is needed in the event of a deeper downturn

Global economic growth has slowed substantially over the past eighteen months. If downside risks materialise, and growth weakens further than currently projected, governments will be faced with the challenge of having to respond to significant weakness at a time when domestic policy space is limited. The analysis reported in this note looks at the impact of an illustrative set of co-ordinated policies across the G20 economies, as was undertaken following the Washington and London G20 Leaders Summits in 2008 and 2009 at the height of the global financial crisis.

The results suggest that co-ordinated action, involving timely fiscal and monetary policy support and renewed structural reform efforts in all countries, offers a better prospect for restoring growth and improving living standards over time in all countries. A well-designed package of mutually supporting macroeconomic and structural policies can reinforce the benefits of each policy measure and mitigate the short-term side effects of others, to the benefit of the G20 economies as a whole. This is because co-ordinated action creates positive spillover effects through trade and improved confidence, resulting in a larger overall output gain in each country than if they acted alone.

Policy choices

A continued weakening of output growth could be expected to add to uncertainty and raise concern about the effectiveness of the policy tools available to national governments and central banks to respond. Indeed, this concern may already be contributing to uncertainty at present, even with GDP growth stuck at a subdued but stable below-trend pace in many countries. An effective response to a further slowdown in growth requires both timely and well-targeted measures to lift demand in the near term and actions that durably improve the prospects for living standards in the medium-to-longer term. A balanced policy package of this kind will help the potential synergies from complementary actions across different policy areas to be realised.

Illustrative scenarios using the NiGEM global macroeconomic model highlight the benefits that can be obtained from all of the G20 economies collectively undertaking co-ordinated supportive macroeconomic and structural policy actions. The different policy measures considered are:

- Each country undertakes additional debt-financed public expenditure of 0.5% of GDP for three years. In the advanced economies, this is assumed to occur via an increase in the volume of government investment. In the emerging-market economies, this occurs via an *ex ante* rise in nominal government expenditure of 0.5% of nominal GDP (reflecting smaller and less detailed country models). This contributes to slightly smaller multiplier effects in many emerging-market economies, as higher inflation from the initial demand stimulus reduces the real value of the additional nominal government expenditure.
- Monetary policy is allowed to become more accommodative in those economies with sufficient policy space.
    - Policy interest rates are lowered by 100 basis points for three years in all economies apart from Japan and the euro area, where interest rates are held unchanged at their baseline values for three years, and the United Kingdom, where the policy rate is lowered by 50 basis points for three years.

  - Thereafter, monetary policy is set to operate in a way that takes into account the longer-term supply-side gains that arise from enhanced structural reforms discussed below. In effect, this means that forward guidance is being used to help interest rates stay low for longer, inducing private sector investment to strengthen more quickly than it otherwise might have.
- Productivity enhancing structural reforms are assumed to occur in all economies.
  - In the advanced economies, these consist of measures that raise labour-augmenting technical progress (TFP) growth by 0.2 percentage point per annum for five years, with the 1% higher level of TFP being maintained permanently thereafter. In the emerging-market economies, the reforms consist of measures that raise potential output by 1% over a decade, with the increase accumulating gradually over time.
  - Stronger structural reforms may help emerging-market economies to both expand their own productivity and to catch-up to the productivity frontier. The latter mechanism is not embodied directly in the scenario set out here, potentially underestimating the long-term impact on these economies.

Significant co-ordinated policy actions by all G20 economies at a time when growth is slowing rapidly will also help to improve the confidence of consumers and investors and reduce uncertainty. In the scenario below, this effect is modelled by a 50-basis-point reduction in investment risk premia for two years that fades slowly thereafter. This approach is the mirror image of the shock to uncertainty incorporated in the simulations of US-China trade tensions reported in Chapter 1.

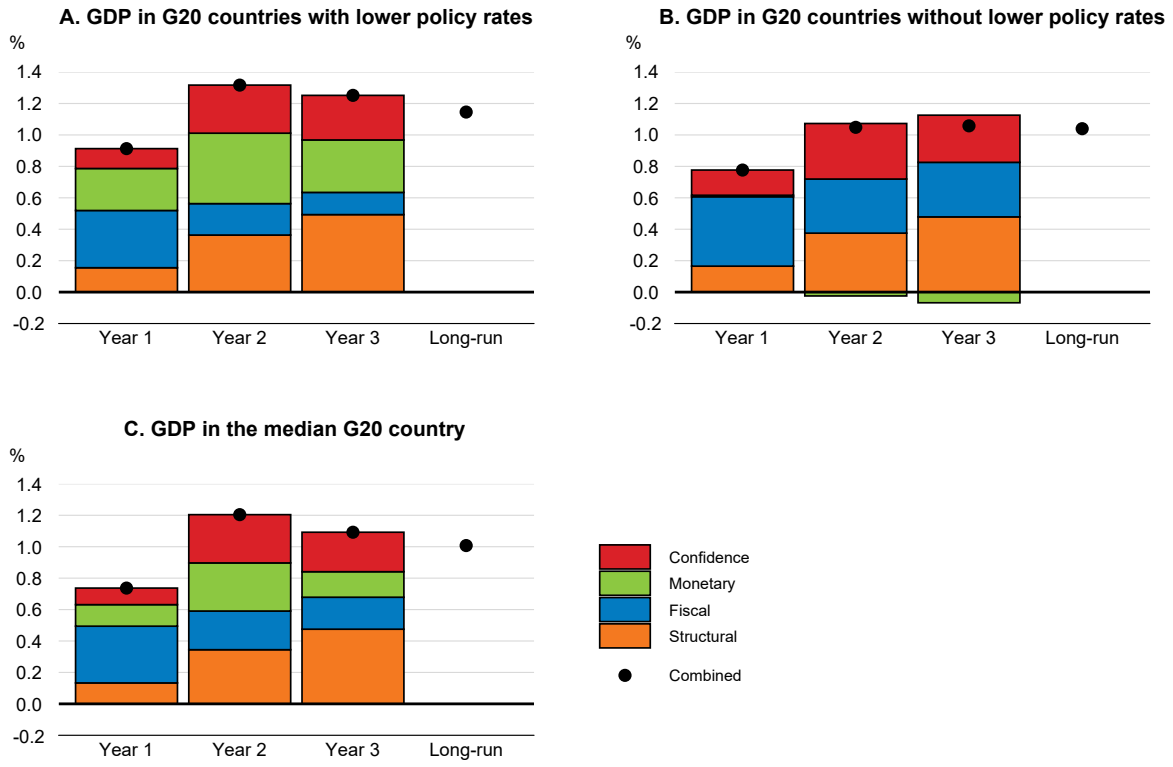
Results

Key features of the scenario in which all G20 countries simultaneously undertake policy measures (Figure 2.7) include:

- The short-term impact of the co-ordinated actions raises the level of G20 GDP by over ¾ per cent in the first year of the shock and by 1¼ per cent in the second year. In the longer term (after 15 years), the level of GDP is just over 1% higher in the median G20 economy (Figure 2.7, Panel C).
- The near-term boost to output primarily results from the collective gains from more supportive macroeconomic policies, but the structural reform measures also raise G20 GDP growth by between 0.15-0.2 percentage point in both the first and second years in the median economy. Thereafter, the impact of structural reforms on output continues to build over time, even as the impact of the macroeconomic stimulus measures wanes, with investment and real wages responding to the improvement in labour efficiency and the capital stock rising gradually. There are also additional small positive effects on long-run output from a higher public sector capital stock.
- The near-term impact on GDP is higher in those G20 economies that have space to reduce policy interest rates (Figure 2.7, Panels A and B). In addition to the positive effects on demand and investment, these economies also benefit slightly from an exchange rate depreciation relative to those economies in which policy interest rates remain unchanged. Nonetheless, there are strong output gains in the economies without policy rate reductions, reflecting the direct impact of stronger public investment and the benefits from improved confidence that stem from joint action across countries.
- The smaller impact of fiscal policy in the countries that lower policy interest rates reflects the lower *ex post* real stimulus in the emerging-market economies.

Figure 2.7. The impact of G20 policy co-ordination

Differences from baseline, collective policy simulation



Note: Scenario with all G20 economies simultaneously undertaking changes to fiscal, monetary and structural policies. See text for details of the shocks applied. PPP weighted averages in Panels A and B. The countries without lower policy rates are Japan, France, Germany and Italy.
Source: OECD calculations using the NiGEM global macroeconomic model.

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In all G20 countries, there are clear gains from collective action relative to those from each country acting by itself (Figure 2.8). These positive spillovers arise from two sources:

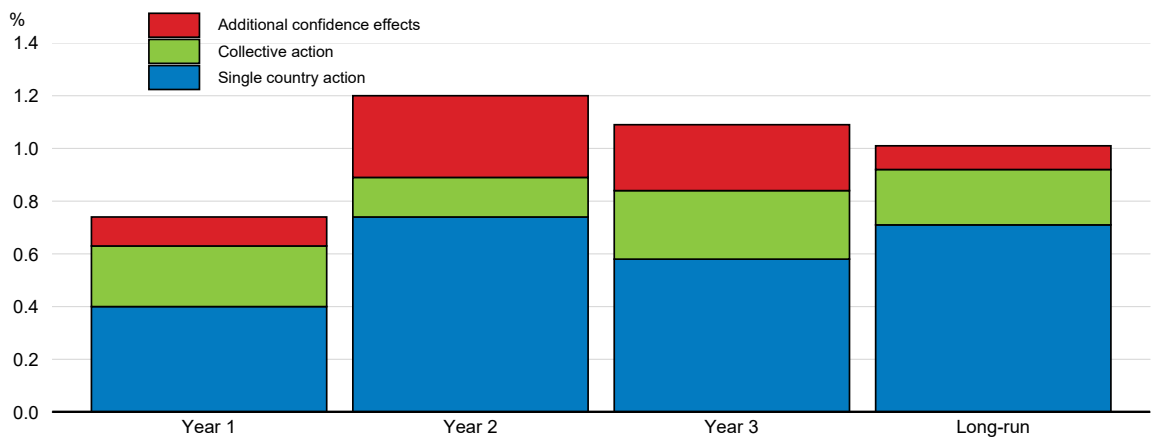
- First, each country is better off in the co-ordinated scenario above than if they are the only country to undertake policy measures, even in the absence of the gains from improved confidence. Acting together enhances the spillovers through stronger trade growth and higher financial asset prices. In the median G20 economy, the output gains in the first three years are significantly higher when all countries act together than when only one country acts by itself, reflecting the boost to exports and incentives to invest that result from stronger external demand (Figure 2.8). Acting together also raises the pace at which economies achieve the longer-term boost to output from structural reforms; in the typical economy, the longer-term impact on output is around one-quarter higher when all countries undertake co-ordinated action. This is because domestic investment is stronger, helping the capital stock adjust more quickly to a new and higher long-run equilibrium.

- Second, there are additional gains for each country from the boost to global confidence and reduction in uncertainty that comes from acting together to tackle a common problem. In the co-ordinated scenario above (Figure 2.7), enhanced confidence contributes significantly to the near-term output gains from collective action. This adds one-sixth and one-third respectively to the output gains in the median G20 economy in the first and second year of the co-ordinated scenario across countries (Figure 2.8). It also has a positive impact on the longer-term outcome, as there is a permanent (though small) additional boost to the capital stock due to stronger business investment.

These results suggest that co-ordinated policy action across countries would provide the most effective and timely counterweight in the event of an even sharper or more protracted global growth slowdown than currently projected. In practice, it may either not be possible for all countries to undertake the same actions, or countries may simply choose to undertake a different mix of fiscal, monetary and structural responses. Nonetheless, it is important that all countries participate in a co-ordinated effort to support growth, as this will maximise the collective gains and the benefits for each economy.

Figure 2.8. There are sizeable spillovers from co-operative actions

GDP in the median G20 economy, differences from baseline



Note: The blue panel shows the impact on GDP in the median G20 country from undertaking the package of fiscal, monetary and structural measures by itself. The green panel shows the additional boost to GDP if all G20 countries undertake these policy measures at the same time. The red panel shows the additional gains from an improvement in confidence when all countries undertake actions at the same time.
Source: OECD calculations using the NiGEM global macroeconomic model.

StatLink https://doi.org/10.1787/888934044822

Focus Note 5: How effective are automatic fiscal stabilisers in preserving household income?[1]

Fiscal policy helps to stabilise the economy over the business cycle via automatic changes in government spending and revenues that result from current laws and entitlements - the so-called automatic stabilisers. Higher spending on unemployment benefits when unemployment increases or lower direct taxes when wages decline are examples of such automatic stabilisers. Countries with large and effective automatic fiscal stabilisers need smaller discretionary changes in public spending and revenues to stabilise the economy. By design, automatic fiscal stabilisers are temporary and do not affect the structural fiscal position. Increased reliance on automatic stabilisers would help make fiscal responses to economic cycles more timely, targeted and temporary.

This note reports estimates of the overall effectiveness of automatic fiscal stabilisers, and the importance of different fiscal instruments in automatic fiscal stabilisation, in 23 OECD economies. The focus is on the extent to which automatic changes in selected government spending and revenue components following a negative shock to wages help to stabilise aggregate household disposable income.[2] Current fiscal frameworks tend to stabilise household disposable income effectively in many advanced economies, primarily via direct taxes. However, there are important cross-country differences and stabilisation of household consumption may be less effective.

Assessing automatic fiscal stabilisation of household disposable income

The automatic fiscal stabilisers covered in this note are direct personal income taxes, social security contributions and unemployment, housing and family benefits. These are all directly affected when employment or wages change.[3] The strength of the link between these individual components and market income changes depends on the design of the different tax and social expenditure systems, such as the degree of progressivity of income taxes and the extent of means-testing of social benefits.

The effectiveness is assessed for a specific case of a decline in private sector employment and in the wage rate, in equal proportion, that lowers market income. In this framework, automatic stabilisers are fully effective if the induced changes in direct taxes, social security contributions and the three categories of social benefits offset the impact of a negative market income shock, leaving aggregate household disposable income unchanged. The value of the indicator does not depend on the size of the shock. However, a different type of shock would affect the measured effectiveness.[4]

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[1] This note is based on Maravalle and Rawdanowicz (2019).

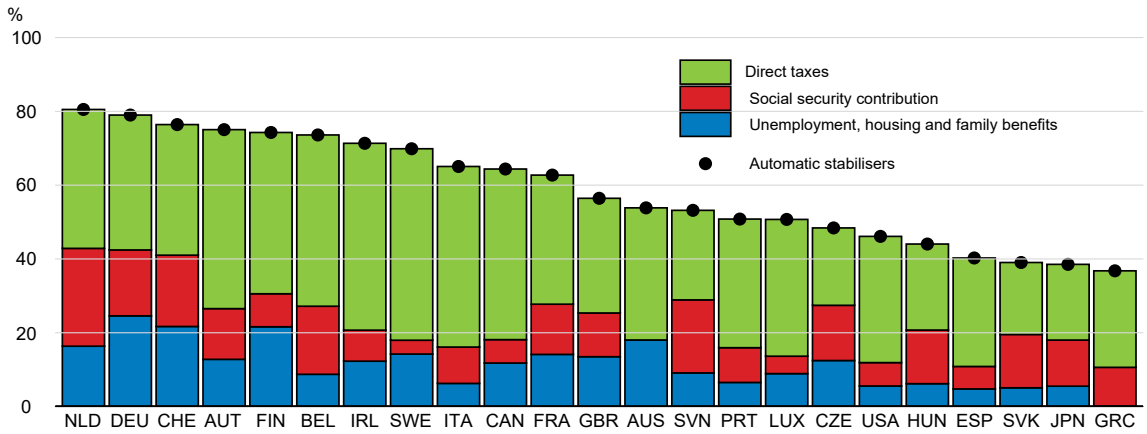
[2] Household disposable income covers all market income in the economy (primarily wages and self-employed income) plus social benefits minus direct taxes and social security contributions.

[3] The induced changes in aggregate direct taxes, social security contributions, and family and housing benefits arebased on the estimated sensitivity of changes in their levels with respect to changes in household market income (Price et al., 2015) and on the estimated sensitivity of changes in unemployment benefits with respect to changes in the number of unemployed.

[4] For instance, for a given decline in aggregate market income, the more it stems from lower wage rates rather than from lower employment, the weaker will be the stabilisation effect of unemployment benefits.

Figure 2.9. Automatic stabilisation of shocks to household market income is generally strong

The percentage share of an income shock offset by automatic stabilisers



Note: The percentage share shows by how much the income decline is offset by automatic stabilisers one year after the shock. A share of 100% implies that automatic stabilisers offset completely the shock to income, leaving aggregate household disposable income unchanged, while a share of 0% implies no automatic stabilisation at all, with disposable income falling by as much as market income. The calculations are based on the accounting identity of aggregate household disposable income. It is a sum of wages and self-employed income, automatic stabilisers (AS), and other net income received by households. AS account for changes in social benefits (unemployment, housing and family), and - with a negative sign - direct taxes on income and social security contributions paid by households. A 0.5% fall in private employment and in the wage rate is assumed in each country compared to baseline. Changes in household direct taxes, social contributions, and family and housing benefits are derived from the elasticities of each relevant category with respect to its base as estimated in Price et al. (2015). Changes in unemployment benefits are calculated based on an estimated equation, linking unemployment benefits with the number of unemployed. Other components of social security benefits and other net income received by households are assumed to remain unchanged. Simulations are based on the 2016 structure of aggregate household disposable income and labour market outcomes.
Source: OECD Economic Outlook 106 database; OECD Social Expenditure database; and OECD calculations.

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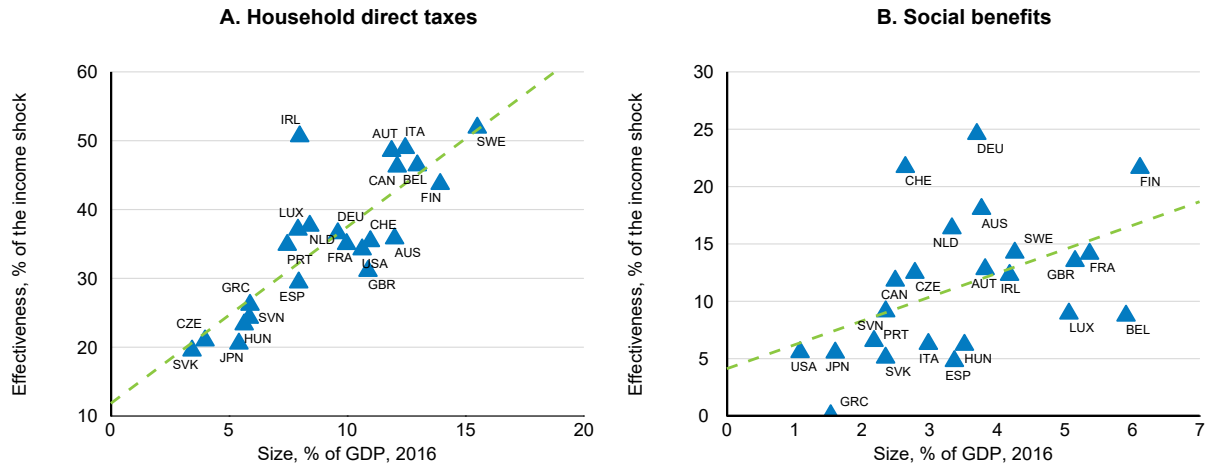
Automatic stabilisers appear to be effective in stabilising household disposable income in all the 23 analysed OECD countries (Figure 2.9). They absorb on average just over a half of the specific shock to market income (in absolute terms), with the overall effectiveness measure ranging from close to 80% in the Netherlands, Germany and Switzerland to below 40% in Greece, Japan and the Slovak Republic.

In most of the countries covered, the stabilisation of household disposable income is mainly driven – in absolute and relative terms – by direct taxes (which decline by more than income). The absolute stabilisation effect of direct taxes is particularly large in Austria, Ireland, Italy and Sweden, whereas it is relatively low in the Czech Republic, Japan and the Slovak Republic. Rising unemployment, housing and family benefits and falling social security contributions paid by households also help to buffer the decline in disposable income, on average in roughly equal proportions. Social benefits play a particularly large role (in absolute terms) in income stabilisation in Germany and Switzerland, given the relatively large percentage increase in unemployment[5] and the high sensitivity of benefits to income, and in Finland, due to the large share of unemployment benefits in household disposable income.

[5] For the same reduction in employment of 0.5% in all countries, the percent change increase in unemployment is higher in Germany and Switzerland because of the low unemployment rate in these countries at the time of the shock.

Figure 2.10. The size and effectiveness of specific components of automatic stabilisers



Note: The dashed green lines show the linear regression lines.
Source: OECD Economic Outlook 106 database; OECD Social Expenditure database; and OECD calculations.

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The varying effectiveness of these specific automatic stabilisers reflects cross-country differences in the sensitivity of the different household income components to the economic cycle and differences in the structure of disposable income and initial labour market conditions. In general, the effectiveness of direct taxes and of the three types of social benefits is positively correlated with their size relative to nominal GDP (Figure 2.10).

Household income vs consumption stabilisation

Strong automatic fiscal stabilisation of household income may not necessarily imply the same level of stabilisation of household consumption and, in turn, GDP growth. Even if negative shocks to employment and wages are to a significant extent compensated by lower taxes and higher social benefits, households may increase precautionary saving. This seems to be more likely when income stabilisation is due to lower taxes rather than higher social benefits. There is extensive evidence that social transfers reduce the need for precautionary saving by diminishing idiosyncratic income risks due to unemployment (Kotlikoff, 1988). It is less clear whether progressive taxation might be equally effective, as part of the reduction in taxes at higher income levels might be saved.[6] Moreover, the offset to market income from lower taxes may be realised with a significant delay, which is not accounted for in the simulations above, leading initially to a larger decline in household consumption. In contrast, social benefits, particularly unemployment benefits, may be paid faster to households though they may subsequently decline over time.

[6] McKay and Reis (2016) show that unemployment benefits are more effective than progressive taxation in stabilising the business cycle (though not explicitly household income).

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3 Developments in individual OECD and selected non-member economies

Argentina

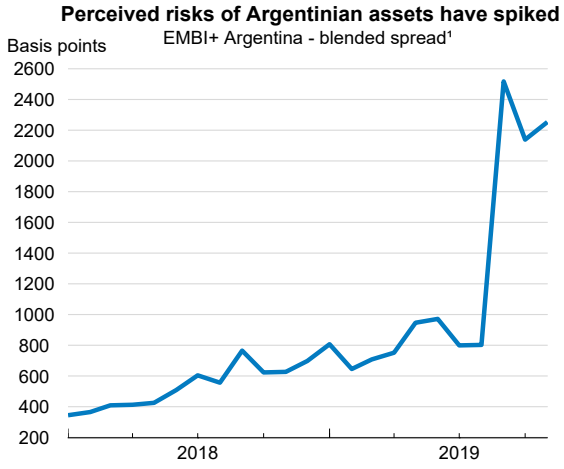
The economy is in recession against the background of internal and external imbalances. Uncertainty about future policy priorities has triggered capital outflows and a strong currency depreciation. The resulting liquidity challenges have led to a re-profiling of short-term debt and the reinstatement of currency controls. Recent volatility is weighing on growth and increasing unemployment.

Monetary policy will need to remain tight to reduce inflation, which currently exceeds 50%. Strengthening the independence of the central bank would make monetary policy more effective. Reducing the fiscal deficit will be key to lowering public debt, but preserving the real value of well-targeted social benefits remains important to cushion the impact of the recession on vulnerable groups. Reforms of taxes, regulations and administrative procedures could boost productivity. Lower trade barriers, including a phase-out of export taxes as scheduled, are key to foster a stronger integration into the global economy.

The economy is in recession and policy uncertainty is high

Following improvements in activity and a stabilisation of the exchange rate, policy uncertainty spiked after the August primary elections. Market demand for Argentine assets dropped sharply, triggering a currency depreciation that further added to high inflation. Access to new market funding dried up in late August and the authorities decided to change the payment schedule on some short-term public bonds. Public debt is highly sensitive to exchange rate movements as over 75% of it is denominated in foreign currency. Currency restrictions, which has been abolished in late 2015, have been reinstated and a parallel exchange market has emerged. Disruptions in payment chains have led to stalling investment, while rising inflation has reduced household purchasing power. Following general elections in October, a new administration will take over in early December. Unemployment has risen since mid-2018. Recent improvements in the current account are likely to continue.

Argentina



1. "EMBI + Argentina – blended spread" shows the yield difference over US Treasuries of a JPMorgan Argentina bond index (EMBI), including any credit enhancements such as principal and/or interest collateral.
Source: INDEC; CEIC; and Refinitiv.

StatLink https://doi.org/10.1787/888934044974

Argentina: Demand, output and prices

Argentina	2016	2017	2018	2019	2020	2021
	Current prices ARS billion	Percentage changes, volume (2004 prices)				
GDP at market prices	8 228.2	2.7	-2.5	-3.0	-1.7	0.7
Private consumption	5 407.7	4.0	-2.4	-6.7	-1.4	0.9
Government consumption	1 452.6	2.7	-3.3	0.1	-1.4	-0.6
Gross fixed capital formation	1 174.4	12.2	-5.7	-14.8	-4.2	0.1
Final domestic demand	8 034.7	4.9	-3.1	-6.8	-1.8	0.6
Stockbuilding[1]	279.0	1.1	-0.5	-2.5	-0.2	0.0
Total domestic demand	8 313.7	6.0	-3.4	-8.8	-2.0	0.5
Exports of goods and services	1 030.7	1.7	-0.7	6.2	-1.0	1.2
Imports of goods and services	1 116.3	15.4	-4.7	-18.2	-2.2	0.4
Net exports[1]	- 85.5	-1.9	0.6	3.9	0.1	0.2
Memorandum items						
GDP deflator	_	26.0	40.7	51.5	46.2	41.8
Current account balance (% of GDP)	_	-5.0	-4.9	-1.4	0.7	0.9

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046095

Stabilising the economy requires tight macroeconomic policies

With gross public debt on an unsustainable path and expected to exceed 90% of GDP by end-2019, interest payments on foreign currency bonds rising and revenues trailing inflation, further fiscal consolidation or debt restructuring will be inevitable to stabilise the economy. Efforts to increase the efficiency of public spending and cut ineffective outlays should continue. Recent increases in well-targeted social benefits will help to shield low-income households from the recession, but regular readjustments are required to preserve their real value.

Maintaining a tight monetary policy will be necessary to ensure that inflation, currently at 50%, declines. High inflation is particularly hurting low-income households who lack the means to protect their purchasing power. Monetary policy could be made more effective by securing greater formal independence of the central bank. Currency controls have helped to stabilise the exchange rate, but limiting future real appreciation will be key for exports to lead the economic recovery. Due to low currency mismatch of domestic banks and low levels of financial intermediation, the banking sector seems to be coping with the volatile economic environment for now.

More progress in structural reforms is needed to improve productivity, boost exports and raise growth and inclusiveness. Taxes continue to be highly distortive, weighing on productivity, and could be made more progressive to strengthen redistribution. Competition remains weak in many sectors, owing to domestic restrictions on firm entry and barriers to entrepreneurship and trade. Lower consumer prices resulting from stronger domestic and foreign competition would particularly benefit poorer households. Better access to intermediate inputs would raise productivity and competitiveness of domestic producers, allowing firms to create better-paying and formal jobs. More professional training would help workers prepare for these new opportunities, while more effective unemployment insurance could provide better income support for workers. About a third of the workforce is currently in informal employment, lacking any employment protection.

Reducing policy uncertainty is key to revive the economy

Domestic demand is projected to remain subdued until end-2020 as stabilising the economy will take time and macroeconomic policies remain tight. Unemployment is expected to rise due to the recession. Exports, stimulated by the more competitive exchange rate, are projected to lead the recovery, with a return to positive growth projected in 2021. Fiscal risks are substantial given the high debt levels and difficult access to market financing. Current levels of inflation imply risks of inflation getting out of control if monetary policy were to be relaxed. A reversal of productivity-enhancing structural reforms would aggravate the recession and the fragile fiscal situation. On the upside, a continued commitment to sound economic policies and progress in productivity-enhancing structural reforms could lead to a faster recovery than currently projected.

Australia

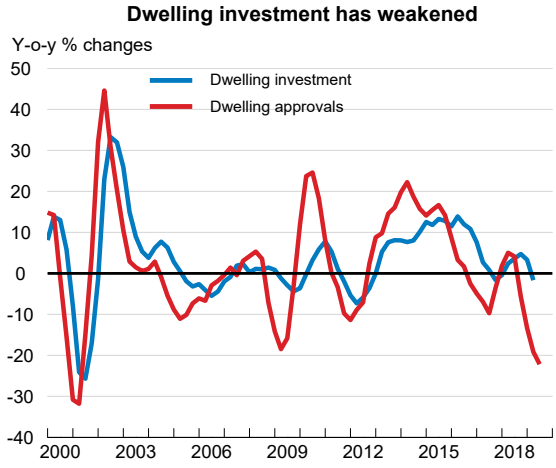
Economic growth is projected to firm to about 2¼ per cent in 2020-21. While weaker trading partner growth and a downturn in domestic dwelling investment will weigh on economic conditions, recent household tax cuts and monetary policy easing should provide some support to activity. Subdued output growth and lingering uncertainty will weaken the recent strong labour market conditions.

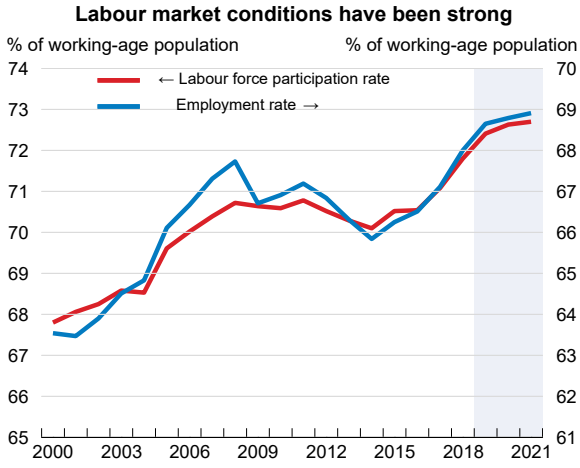
Monetary policy is accommodative and the central bank is projected to make a further cut in the policy rate in its attempt to achieve the inflation target. Macroprudential policies may need to be tightened if lower interest rates fuel house prices, which would create imbalances and expose the economy to downside vulnerabilities. Fiscal policy, which on current plans is expected to exert a broadly neutral influence, may need to play a more active role in strengthening economic growth.

Economic activity has been weak

Economic growth has moderated. Housing investment activity has slowed in response to past declines in property prices, with a continued slump in dwelling approvals indicating further weakness ahead. Private business investment in the non-mining sector has also eased, with the slowdown in the global economy and domestic drought conditions reducing exports and business confidence. Employment growth has been surprisingly robust given the modest pace of output growth, and is encouraging higher labour force participation. Despite this, private consumption spending has been sluggish, weighed down by slow wage growth and an increase in taxes paid by households.

Australia





Source: OECD Economic Outlook 106 database; and Australian Bureau of Statistics.

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Australia: Demand, output and prices

Australia	2016	2017	2018	2019	2020	2021
	Current prices AUD billion	Percentage changes, volume (2016/2017 prices)				
GDP at market prices	1 705.2	2.5	2.7	1.7	2.3	2.3
Private consumption	984.1	2.4	2.6	1.6	2.1	2.0
Government consumption	319.4	3.9	4.1	5.3	4.2	3.7
Gross fixed capital formation	418.0	3.6	2.5	1.1	1.1	1.8
Final domestic demand	1 721.6	3.0	2.8	2.2	2.3	2.3
Stockbuilding[1]	- 2.5	-0.1	0.1	-1.5	-0.3	0.0
Total domestic demand	1 719.1	2.9	2.9	0.7	2.0	2.3
Exports of goods and services	337.1	3.7	4.9	3.2	2.6	2.4
Imports of goods and services	351.0	7.8	4.1	-1.0	2.9	3.7
Net exports[1]	- 13.9	-0.9	0.2	1.0	0.0	-0.2
Memorandum items						
GDP deflator	_	3.5	2.2	3.2	1.3	1.1
Consumer price index	_	2.0	1.9	1.6	1.6	1.6
Core inflation index[2]	_	1.7	1.7	1.6	1.7	1.6
Unemployment rate (% of labour force)	_	5.6	5.3	5.2	5.3	5.2
Household saving ratio, net (% of disposable income)	_	4.5	3.4	3.4	3.2	2.9
General government financial balance (% of GDP)	_	-0.8	0.0	0.2	0.2	0.1
General government gross debt (% of GDP)	_	43.6	43.5	41.5	41.7	42.0
Current account balance (% of GDP)	_	-2.6	-2.1	0.8	0.9	0.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046114

Fiscal policy could be loosened

The stance of monetary policy has become even more expansionary, with cuts to the key policy rate totalling 75 basis points since May 2019. Both business and household credit growth remain modest. However, house prices in some major markets have begun to rise again. High household indebtedness means that the authorities should stand ready to tighten macroprudential policy settings if lower interest rates fuel house price inflation through a sharp pick-up in credit.

Fiscal policy is expected to provide little support to economic growth, in accordance with the federal government's commitment to future budget surpluses. The rollout of government services under the National Disability Insurance Scheme and recent tax cuts for low and middle-income earners should provide some support to household spending and reduce income inequality over the projection period. Nevertheless, a more expansionary fiscal stance may be warranted given that the economy is growing well below its potential and the relatively low public debt burden. The government should consider further public investment in green infrastructure and bringing forward shovel-ready capital projects from the government's Infrastructure Investment Programme. At the same time, growth-enhancing tax reforms should be prioritised. These include shifting the tax mix away from direct taxes and inefficient taxes like real-estate stamp duty to the goods and services tax (GST) and land taxation.

Economic growth is projected to be stable

The economy will grow at a stable rate. Export growth will decline in line with the slowdown in major trading partner economies. This will continue to have an impact on business investment, though mining investment has now troughed and will gradually rise over the projection period. Given the outlook for GDP growth, the unemployment rate is unlikely to decline much further and inflation will remain below target. As a result, the central bank is projected to provide further monetary policy stimulus.

The risks to the economic outlook are tilted to the downside. As a small open economy, Australia is particularly exposed to the global growth slowdown. Investment activity has moderated in China, Australia's main trading partner, and trade policy tensions are further threatening economic activity in the region. High indebtedness of the household sector could exacerbate the transmission of an economic shock. In contrast, an easing in global trade policy tensions could improve consumer and business confidence, with positive effects on spending activity.

Austria

Economic growth is projected to edge down over the 2020-21 period as the global slowdown and trade tensions weaken export growth and business investment. Employment will continue to increase and a tight labour market will support income growth. Domestic demand will be the key driver of growth. Inflation will remain subdued.

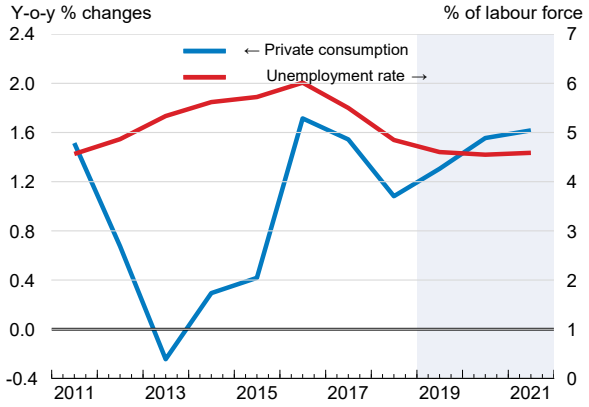
Following an increase in pension entitlements, the budget balance will deteriorate slightly over 2019-21 with fiscal policy otherwise broadly neutral. The authorities should let the automatic stabilisers operate and consider more active measures to further stimulate long-term growth. The government should address the sluggish productivity performance in business sectors by promoting more competition in services.

Growth has moderated

As confidence of manufacturing firms has fallen sharply, business investment growth has slowed. The strong slowdown in major export markets has also reduced export growth. However, recent sentiment indicators suggest that the construction and service sectors remain resilient. Long-term unemployment is finally edging down. The tight labour market has supported wage growth and domestic demand.

Austria

Labour market conditions continue to support private consumption



Weak external demand is dragging down growth

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045012

Austria: Demand, output and prices

Austria	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices*	357.4	2.6	2.3	1.5	1.3	1.3
Private consumption	186.9	1.5	1.1	1.3	1.6	1.6
Government consumption	70.3	1.1	0.8	0.1	0.2	0.9
Gross fixed capital formation	82.5	3.9	3.9	2.9	1.7	1.5
Final domestic demand	339.7	2.0	1.7	1.5	1.3	1.5
Stockbuilding[1]	3.8	0.1	0.1	0.1	0.3	0.0
Total domestic demand	343.4	2.1	1.8	1.6	1.6	1.4
Exports of goods and services	187.8	5.2	5.6	3.3	1.4	1.3
Imports of goods and services	173.8	4.9	4.3	3.4	2.0	1.5
Net exports[1]	14.0	0.3	0.8	0.1	-0.2	-0.1
Memorandum items						
GDP deflator	_	1.1	1.7	1.6	1.4	1.4
Harmonised index of consumer prices	_	2.2	2.1	1.5	1.6	1.7
Harmonised index of core inflation[2]	_	2.1	1.8	1.6	1.5	1.4
Unemployment rate (% of labour force)	_	5.5	4.8	4.6	4.5	4.6
Household saving ratio, net (% of disposable income)	_	7.3	7.7	7.7	8.0	7.9
General government financial balance (% of GDP)	_	-0.7	0.2	0.3	0.4	0.3
General government gross debt (% of GDP)	_	101.9	96.6	94.7	93.0	91.4
General government debt, Maastricht definition (% of GDP)	_	78.1	73.9	72.0	70.3	68.7
Current account balance (% of GDP)	_	1.5	2.3	1.4	0.7	0.6

* Based on seasonal and working-day adjusted quarterly data; may differ from official non-working-day adjusted annual data.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046133

Policy measures should address still high labour taxes and boost productivity through structural reforms

The authorities need to make the revenue structure of the general government more growth-friendly and more conducive to social inclusion, for example by further reducing labour taxes on low-income earners and finance it with green taxes. The new government can also help to strength fiscal sustainability by improving the cost-efficiency of public services by better exploiting economies of scale and harmonising spending and taxing powers across Federal, Länder and local governments. High-quality independent public spending reviews could further help to improve the design and delivery of public services. In order to alleviate pressures from population ageing, the government should aim to lift the average effective retirement age.

To better leverage productivity gains from digitalisation, remaining barriers to competition in service sectors and in digital trade and investment should be reduced. The quantity and quality of life-long learning programmes in digital technologies could also be enhanced by involving employer organisations more directly in the design and administration of such programmes. Ensuring sufficient provision of equity capital for young and innovative firms would help them to scale up and strengthen business dynamism. Tackling the gender gaps in career opportunities and salaries by making high-quality childcare and full-day schooling a legal entitlement in the whole country would help to make growth more inclusive. Strengthening German language learning opportunities could help to better integrate low-skilled migrants and refugees and their families.

Uncertainty over trade is a downside risk for the export-driven economy

Output growth is set to be broadly stable at around 1.3% in 2020-21. Household consumption will remain the key driver of the expansion, as the weak external environment weighs on exports. Investment will slow as well, even though financial conditions are still favourable. Employment growth is projected to continue, albeit at a slower pace, stabilising the unemployment rate at around 4.6%.

Given the strong ties with the German car manufacturing industry and general high involvement in global value chains, Austria would be exposed to a more prolonged and deeper economic weakness than currently projected for Germany and the euro area. Exports and investment may surprise on the upside if trade disputes and uncertainty dissipate.

Belgium

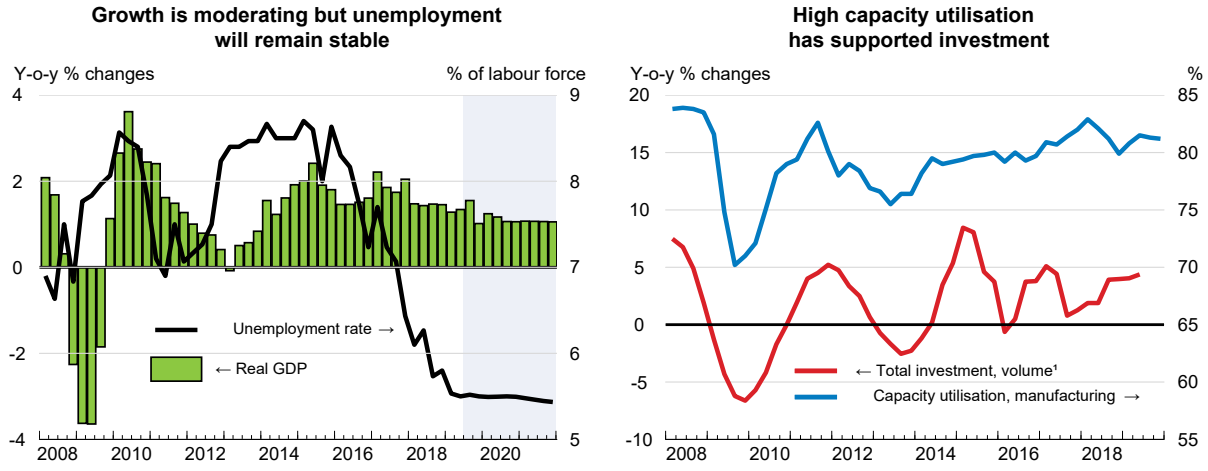
Economic growth is projected to moderate to around 1% in 2020-21. External headwinds will weigh on exports and business investment, despite supportive financing conditions. Private consumption will be more resilient on the back of past tax cuts and wage growth that will increase household disposable income. The job market is set to remain tight, with the unemployment rate at 5.4% at the end of 2021.

Fiscal policy will support growth moderately in 2020-21, which is appropriate in the current economic slowdown. However, the public debt-to-GDP ratio remains high and the government should stick to prudent medium-term fiscal targets. Loose financial conditions have fuelled credit growth, which could require additional and binding borrower-based macroprudential instruments. Competition in some professional services and incentives for firm creation should be enhanced, and the efficiency of public support to innovation and policies to re-skill workers should be improved to boost productivity growth.

Economic growth has eased

In an environment of rising uncertainty, trade tensions and sluggish euro area growth, business confidence has declined, hurting investment. Nevertheless, domestic demand remains the main driver of growth. Private consumption is still supported by past reductions in income taxation. Labour costs have gradually started to increase, with the end of the wage moderation and tighter labour market conditions. Headline inflation has fallen recently, following a decline in energy prices, but core inflation is gradually rising.

Belgium



1. Four-quarter moving average.
Source: OECD Economic Outlook 106 database; and National Bank of Belgium.

StatLink https://doi.org/10.1787/888934045031

Belgium: Demand, output and prices

Belgium	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	430.4	2.0	1.5	1.3	1.1	1.1
Private consumption	221.1	1.8	1.5	1.1	1.4	1.3
Government consumption	100.0	0.3	0.9	1.9	1.4	1.1
Gross fixed capital formation	99.9	1.3	4.0	3.8	1.7	1.4
Final domestic demand	421.0	1.3	1.9	1.9	1.5	1.3
Stockbuilding[1,2]	4.2	-0.1	0.3	-5.9	0.0	0.0
Total domestic demand	425.2	1.2	2.2	-3.9	1.4	1.3
Exports of goods and services	341.6	5.3	1.2	1.2	0.9	1.2
Imports of goods and services	336.5	4.4	2.1	1.3	1.3	1.5
Net exports[1]	5.1	0.7	-0.7	-0.1	-0.3	-0.2
Memorandum items						
GDP deflator	_	1.7	1.5	1.6	1.1	1.4
Harmonised index of consumer prices	_	2.2	2.3	1.3	1.1	1.5
Harmonised index of core inflation[3]	_	1.5	1.3	1.5	1.4	1.5
Unemployment rate (% of labour force)	_	7.1	6.0	5.5	5.5	5.5
Household saving ratio, net (% of disposable income)	_	5.2	4.8	5.1	5.2	5.2
General government financial balance (% of GDP)	_	-0.7	-0.7	-1.7	-2.0	-1.9
General government gross debt (% of GDP)	_	120.6	118.6	117.9	118.1	118.0
General government debt, Maastricht definition (% of GDP)	_	101.8	100.0	99.3	99.5	99.4
Current account balance (% of GDP)	_	1.2	-1.0	-1.2	-1.5	-1.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy. Statistical discrepancy contributes to 5.3% in 2019 percentage changes.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046152

Further reforms are needed to boost productivity growth

The budget deficit is set to increase to 1.7% of GDP in 2019 from 0.7% of GDP in 2018, driven by the end of some temporary factors related to corporate taxation. Fiscal policy is projected to loosen in 2020-21, which will support growth in the current slowdown. In the medium term, it is important to adhere to fiscal consolidation targets to ensure a gradual durable reduction of the debt-to-GDP ratio and to use windfall revenues to reduce the debt ratio further. Significant measures will be needed to reach a structural budget balance in the medium term.

Ongoing accommodative euro area monetary policy is also supporting economic activity, but could create some risks eventually. The strong growth in bank credit to the corporate sector, at 6.9% in 2018, has prompted the National Bank of Belgium (NBB) to introduce some macroprudential measures, notably a countercyclical capital buffer rate of 0.5% in June 2019. In addition, the NBB established lending thresholds in October 2019, such as loan-to-value limits for a significant share of new loans, that banks are expected to meet to reduce risks. This is a welcome measure. In case the current measures prove ineffective, additional and stricter macroprudential tools, such as binding limits on loan-to-value and debt-service-to-income ratios, should be implemented.

Achieving more dynamic long-term growth requires boosting productivity growth, which remains subdued, especially in the service sector. Despite recent reforms, a complex permits and licence system continues to create administrative burdens on start-ups, weakening business entry rates. Stringent regulations in several professional services hinder competition. Public support to R&D investment is high, but direct support could better support long-term research in areas with a high potential for spillovers.

Consumption will continue to support growth, but risks are high

GDP growth is projected to moderate in 2020 and 2021. Business investment and export growth will ease in 2020, in line with the deterioration in global economic conditions. Private consumption will continue to be the main driver of growth, supported by past reductions in labour taxation, robust job creation and wage growth. Inflation is projected to progressively rise to 1.6% at the end of 2021. The main risks include a further slowdown in the euro area and uncertainty related to Brexit, which could adversely affect economic activity, notably in Flanders, which has close trade ties to the United Kingdom. In addition, a slow formation of a new federal government could delay reforms. On the upside, growth could be stronger if tax reductions enhance private consumption more than expected.

Brazil

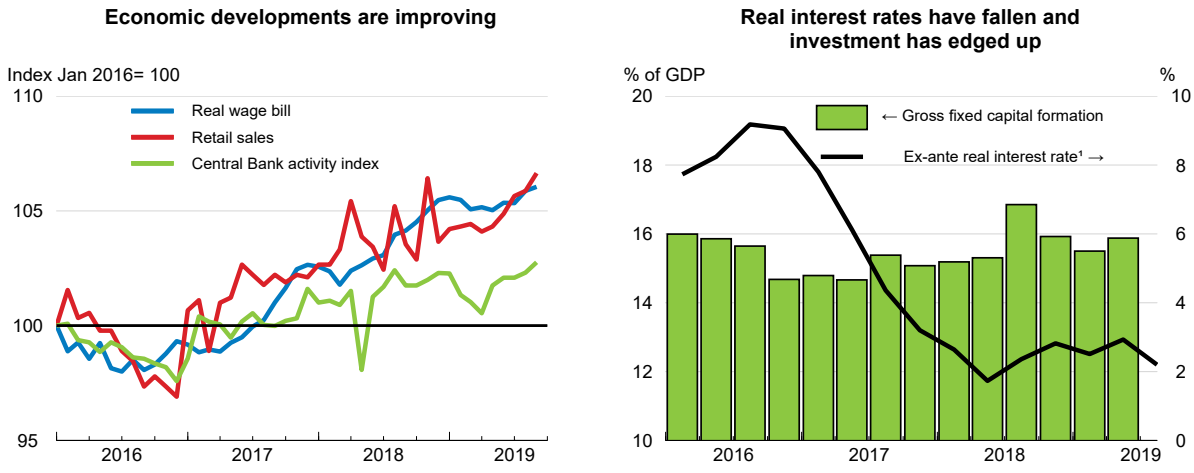
The economy is recovering gradually. A pension reform has been approved, and better prospects for progress on structural reform are lifting confidence and supporting investment, which is also buoyed by easier financial conditions. Low inflation and easier withdrawal of funds in individual unemployment insurance accounts will underpin stronger consumption. On the assumption that the reform agenda continues to advance, growth is projected to gain momentum in 2020. However, high unemployment is falling only slowly, and newly created jobs are of low quality, including many informal jobs.

Monetary policy has been relaxed, which is appropriate as inflation is expected to remain below target during 2020 and 2021. Some scope for additional easing remains. Ensuring fiscal sustainability and compliance with fiscal rules will require further adjustments on mandatory spending, while safeguarding effective social transfers and public investment. Raising productivity will hinge on improving the business climate through reforms in taxes, regulation and lower trade barriers. Preserving natural assets will require more determined enforcement efforts.

The expansion is gaining momentum

The recovery is gaining momentum on the back of domestic factors. Confidence is improving following progress on the approval of economic reforms in Congress, and investment has regained force after falling for two quarters. Private consumption and retail sales are strengthening. Inflation and core inflation are below target and financial conditions have eased. This, together with moderate wage growth, is supporting private consumption, although unemployment has yet to fall visibly. In particular, the composition of jobs created has been of low quality so far, with a disproportionate number of jobs created in the informal sector.

Brazil 1



1. The ex-ante real interest rate is derived as the difference between the Selic rate and inflation expectations 12 months ahead (IPCA).
Source: CEIC ; Central Bank of Brazil.

StatLink https://doi.org/10.1787/888934045050

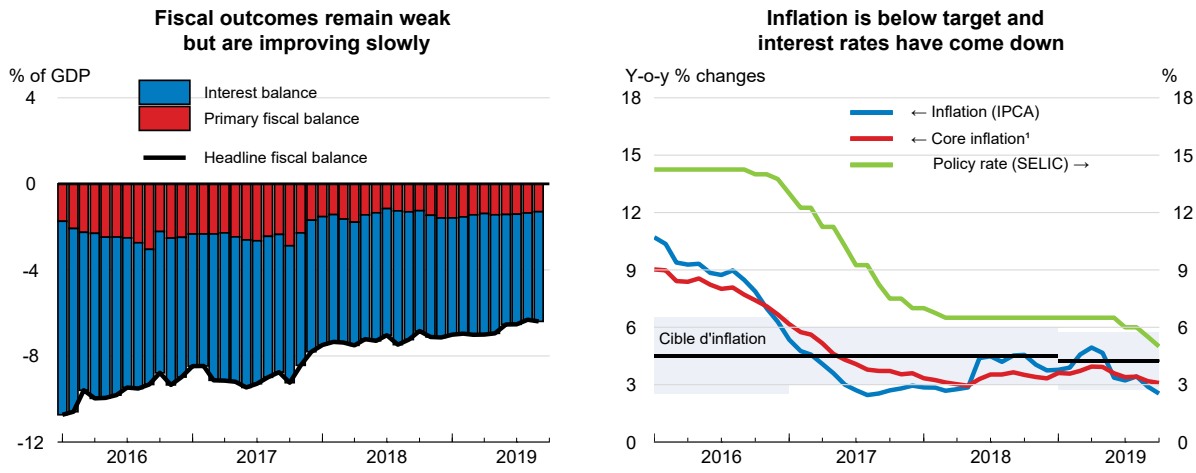
Brazil: Demand, output and prices

Brazil	2016	2017	2018	2019	2020	2021
	Current prices BRL billion	Percentage changes, volume (2000 prices)				
GDP at market prices	6 265.0	1.1	1.1	0.8	1.7	1.8
Private consumption	4 024.0	1.3	1.9	1.3	1.3	1.5
Government consumption	1 273.5	-0.9	0.0	-0.3	0.6	0.8
Gross fixed capital formation	974.5	-2.6	4.1	2.9	5.2	5.2
Final domestic demand	6 272.0	0.3	1.9	1.3	1.8	2.0
Stockbuilding[1]	- 33.6	0.6	-0.4	-0.3	0.1	0.0
Total domestic demand	6 238.4	1.0	1.5	1.0	1.9	2.0
Exports of goods and services	784.8	5.7	3.4	0.5	2.4	3.2
Imports of goods and services	758.3	5.5	7.6	1.7	4.1	4.4
Net exports[1]	26.6	0.1	-0.4	-0.2	-0.2	-0.2
Memorandum items						
GDP deflator	_	3.5	3.0	3.9	3.1	3.5
Consumer price index	_	3.4	3.7	3.7	3.1	3.6
Private consumption deflator	_	2.8	2.8	3.6	3.0	3.4
General government financial balance (% of GDP)	_	-7.8	-7.1	-6.2	-5.6	-5.3
Current account balance (% of GDP)	_	-0.7	-1.2	-2.4	-2.5	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046171

Brazil 2



1. Core inflation is defined as the average of the three core inflation measures published by the Central Bank of Brazil.
Source: Central Bank of Brazil; OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045069

The fiscal outlook remains challenging, but monetary policy is supportive

A pension reform has been approved by Congress and will help to contain rising pension spending. Nonetheless, the fiscal outlook continues to be challenging, leaving fiscal policy no additional room to support the incipient recovery. Gross public debt remains high at almost 80% of GDP and the primary deficit of 1.4% of GDP falls short of the estimated 1.5% surplus required to stabilise public debt.

The deficit continues to be driven by mandatory expenditure items, including wages, pensions and other social security benefits. Discretionary spending has receded to achieve the necessary consolidation, but at only 6% of total spending it now has little scope for further reductions. Reforming mandatory spending and indexation rules has become crucial to ensure compliance with fiscal rules. So far, the expenditure rule adopted in 2016 has not generated the expected political momentum for such reforms. In particular, reducing the public sector's high wage bill is instrumental, as is revisiting widespread tax expenditures.

Recent expenditure trends have also reduced the quality of public spending. Indexed to the minimum wage, rising social security benefits have benefitted mostly middle-class households, leaving fewer resources for well-targeted social benefits to fight poverty, which is concentrated among children and youth. Raising income thresholds in the conditional cash transfer programme Bolsa Família, which costs only 0.5% of GDP, would broaden eligibility and raise benefit levels. This would lift more people out of poverty, reduce income inequality and strengthen incentives for school attendance and medical check-ups, thus reducing inequalities with respect to education and health. Public investment has also been crowded out, but would potentially have high pay-offs.

Scope for further monetary easing has arisen in the short term as inflation is projected to remain below target in 2020. Real interest rates have already reached a long-time low. Rising credit is improving household liquidity, and new rules to access individual unemployment insurance accounts will continue to reinforce this in 2020. However, corporate credit continues to decline. Current reform plans to strengthen competition in the financial sector are a promising step to reduce borrowing costs.

Productivity growth will be the main engine of growth in the longer term, but is currently held back by low levels of competition in many sectors. More competition-friendly domestic regulation and closer integration into the global economy, including through a ratification of the EU-Mercosur trade agreement, could address this, while simultaneously reducing the cost of intermediate and capital goods. Improving contract enforcement by enhancing judicial efficiency and reducing tax compliance costs through a substantial overhaul of the fragmented indirect tax system, with a view towards a unified value added tax, would also raise productivity. Preserving valuable natural assets such as the Amazon rainforest for future generations will require stronger efforts to enforce existing laws, building on past progress in enforcement.

Growth is projected to gain momentum

On the assumption of continued reform momentum, growth is projected to accelerate during 2020 and 2021. Unemployment will decline slowly, including through the creation of more formal jobs. Low inflation, stronger wage growth and improving liquidity conditions will support private consumption, while favourable financial conditions, growing confidence and productivity-enhancing structural reforms are projected to sustain investment.

Risks are mainly related to the implementation of reforms. A fragmented political landscape makes it difficult to build political consensus for key reforms, which often require supermajorities in Congress. Without a retrenchment of mandatory spending items, the expenditure rule could be violated as early as 2020, likely resulting in higher financing costs, a loss of confidence, lower growth outcomes and possibly a return into recession. An aggravating crisis in neighbouring Argentina could reduce manufacturing exports. On the other hand, a stronger reform momentum could improve the business climate and accelerate growth. Worsening global trade tensions may divert trade to the benefit of Brazil in the short run, but at the cost of hurting future import demand from China and the United States, Brazil's two major trading partners.

Bulgaria

Economic growth has been robust, but is projected to weaken somewhat in 2020 and 2021. Exports have been hit by slowing demand from key trading partners. Higher growth of private consumption and investment compared to exports is expected going forward. Private consumption – the most important driver of growth – is set to continue to expand due to rising real wages.

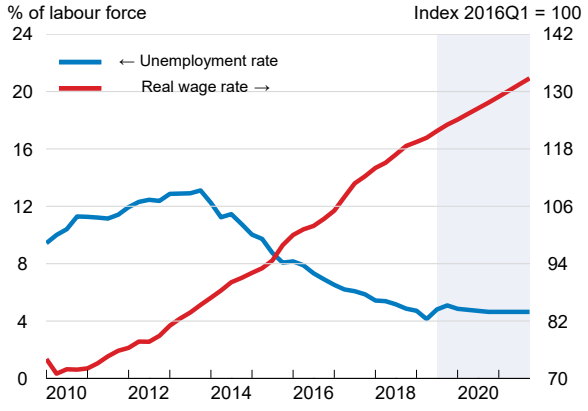
The currency-board arrangement with the euro has resulted in historically low interest rates, fuelling consumer, mortgage and corporate credit growth. Inflation will remain above 2% given high wage growth due to the tight labour market. Growth will be supported in 2020 by a projected rise in public investment due to one-off expenditures.

Economic growth remains strong

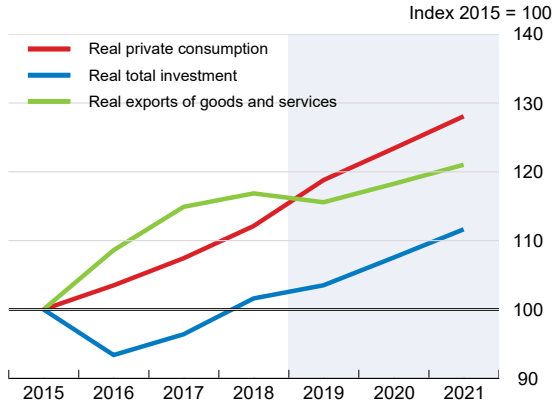
The economy is set to expand by 3.4% in 2019 and unemployment has fallen to a post-crisis low. Growth has been driven by a large rise in domestic demand, with private consumption expanding by 6% in 2019 on the back of a substantial rise in real wages due to tight labour market conditions and a sizable rise in public sector pay. Consumer and mortgage credit growth has been strong, benefitting from an increase in demand due to high wage rises and historically low interest rates. Exports have contracted, hit by the slowdown in the country's main trading partners. Inflation remained elevated in the first half of the year, but then began to moderate due to a deceleration in food prices and lower rises in regulated energy tariffs.

Bulgaria

The tight labour market has led to rising wages



Private consumption has become the main contributor to growth



Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045088

Bulgaria: Demand, output and prices

Bulgaria	2016	2017	2018	2019	2020	2021
	Current prices BGN billion	Percentage changes, volume (2015 prices)				
GDP at market prices	95.1	3.5	3.1	3.4	2.8	2.8
Private consumption	57.4	3.8	4.4	6.0	3.9	3.8
Government consumption	14.9	4.3	5.3	3.4	4.5	3.3
Gross fixed capital formation	17.6	3.2	5.4	1.9	3.9	3.8
Final domestic demand	89.9	3.8	4.7	4.7	4.0	3.7
Stockbuilding[1]	0.5	0.6	1.1	-1.2	0.1	0.0
Total domestic demand	90.4	4.4	5.8	3.4	4.0	3.7
Exports of goods and services	60.9	5.8	1.7	-1.1	2.3	2.3
Imports of goods and services	56.2	7.4	5.7	0.2	4.1	3.7
Net exports[1]	4.7	-0.7	-2.4	-0.9	-0.9	-0.7
Memorandum items						
GDP deflator	_	3.9	4.0	6.0	3.1	3.4
Consumer price index	_	2.1	2.8	3.0	2.5	2.3
Core consumer price index[2]	_	-0.5	2.1	2.1	2.5	2.3
Unemployment rate (% of labour force)	_	6.2	5.2	4.7	4.7	4.6
Household saving ratio, net (% of disposable income)	_	-0.8	1.2	0.4	-0.7	-1.9
General government financial balance (% of GDP)	_	1.1	1.8	-0.1	0.0	0.0
General government gross debt (% of GDP)	_	35.6	31.8	31.7	31.6	31.4
General government debt, Maastricht definition (% of GDP)	_	25.3	22.3	22.2	22.0	21.9
Current account balance (% of GDP)	_	3.5	5.4	5.2	4.1	3.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046190

More effective government spending and structural reforms would boost productivity

Monetary conditions are expansionary due to the hard peg to the euro, and rising public investment is estimated to have provided a positive impulse to growth in 2019 due to one-off expenditures on the infrastructure network and military equipment. Fiscal buffers should be adequate to deal with a deeper-than-expected slowdown given that public debt is low and the government plans to be close to a budget balance over 2020-21. It will be important not to underspend on the capital side and to increase public investment by more than currently planned if growth is not as strong as expected. Improving the effectiveness of government spending, particularly on education, health and pensions, will be critical to increasing potential growth, particularly given the rapidly ageing population.

High emigration and an ageing resident population have led to a shrinking labour force, which has worsened labour shortages and skills mismatches, and contributed to rapidly increasing real wages. While recent wage growth has been associated with a rising labour force, the working-age population is due to continue to shrink by about 1% a year. A critical policy agenda is to implement labour and social reforms to support increased integration in the labour force of left-behind groups: women, the elderly, the young and minorities. Reversing the slowdown in labour productivity growth will also be key to compensate for demographic developments. This will require broad structural reforms, ranging from improving skills to strengthening the environment for investment, competition and innovation.

Growth is projected to moderate

Growth is due to moderate slightly to just below 3% in 2020 and 2021. Continued economic expansion will rely on increased private consumption and investment due to rising wages, cheap credit and a rise in public investment. Exports are expected to expand, though not at the high rates seen prior to 2018. External risks dominate, but domestic vulnerabilities, particularly related to competitiveness, are present. The main domestic risk is excessively high wage growth, which could bring higher inflation and reduce competitiveness. Lower-than-expected public investment is a further factor that could weaken growth. Private sector credit is projected to continue to expand following a period of muted growth since the last economic crisis, but credit expansion could be slower than expected if global financial conditions tighten, despite the increase in domestic banking sector profitability and asset quality.

Canada

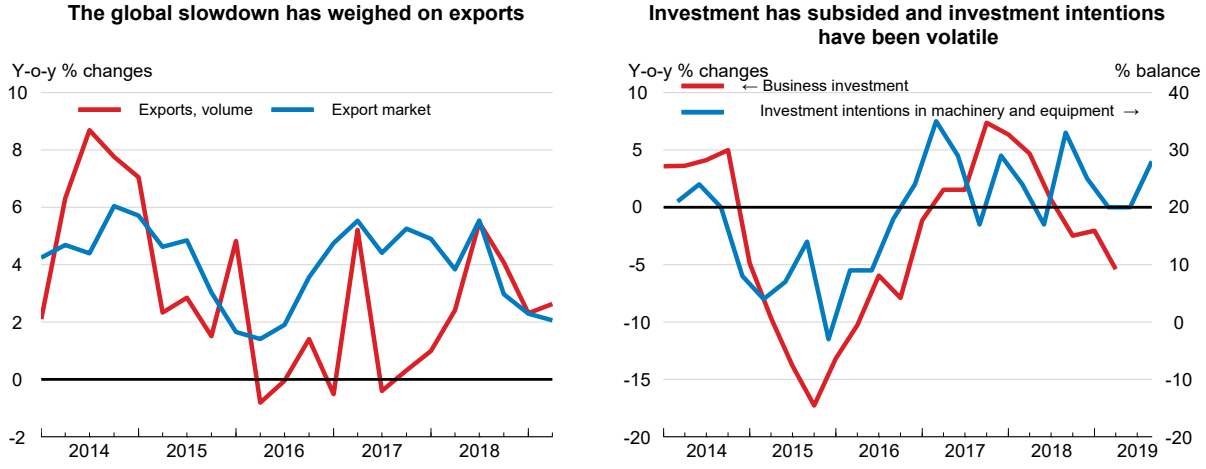
The economy will go through a period of subdued growth. A slowdown in external trade and ongoing trade policy uncertainty are weakening exports and damping business investment. The labour market has been strong, supporting incomes, but employment growth will slow. The unemployment rate will stop falling, but remain at a low level.

The Bank of Canada should reduce rates modestly in the coming quarters to support demand. This will help keep inflation near the mid-point of the target band. Modest structural fiscal easing will support the economy. Risks remain in the housing market, which shows signs of a rebound after a period of stabilisation that was helped by macroprudential measures. The supply of affordable housing should be increased and social housing should be better maintained and targeted.

Economic growth has slowed

Greater global trade policy uncertainty and lower growth in trading partners have slowed exports. Mandatory oil production cuts in Alberta further dented export growth but have now been eased, triggering a temporary bounce back in exports. Domestic demand remains weak. Business investment has declined, due to cuts in the oil and gas sector and heightened uncertainty. Companies' investment intentions for machinery and equipment have been volatile. Residential investment, on the other hand, has picked up in light of the resumption of house price growth.

Canada 1



Source: OECD Economic Outlook 106 database and Bank of Canada.

StatLink https://doi.org/10.1787/888934045107

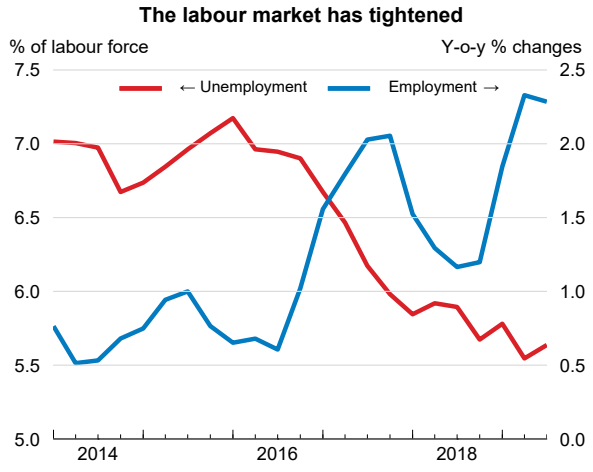
Canada: Demand, output and prices

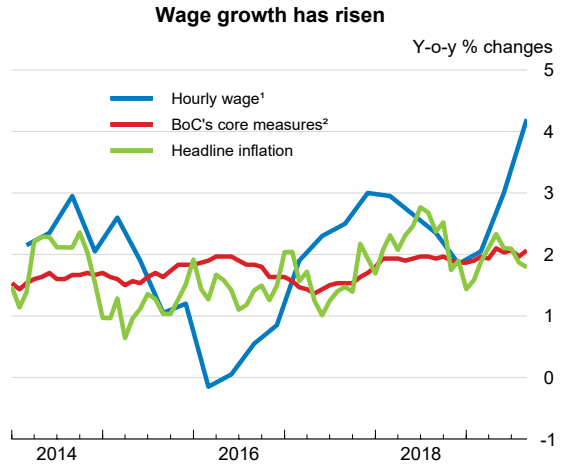
Canada	2016	2017	2018	2019	2020	2021
	Current prices CAD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	2 028.2	3.0	1.9	1.5	1.6	1.7
Private consumption	1 187.8	3.5	2.1	1.7	1.5	1.5
Government consumption	426.3	2.1	2.9	2.0	1.4	1.3
Gross fixed capital formation	464.6	3.0	1.2	-2.4	1.0	2.1
Final domestic demand	2 078.7	3.1	2.0	0.9	1.4	1.5
Stockbuilding[1]	- 1.8	0.8	-0.3	0.1	-0.1	0.0
Total domestic demand	2 076.9	3.9	1.8	1.0	1.3	1.5
Exports of goods and services	632.4	1.1	3.2	2.5	2.3	2.7
Imports of goods and services	681.2	4.2	2.9	0.7	1.1	1.9
Net exports[1]	- 48.7	-1.1	0.0	0.6	0.4	0.2
Memorandum items						
GDP deflator	_	2.5	1.7	2.1	2.0	1.9
Consumer price index	_	1.6	2.2	1.9	1.9	2.0
Core consumer price index[2]	_	1.6	1.9	2.1	2.0	2.0
Unemployment rate (% of labour force)	_	6.3	5.8	5.6	5.8	5.8
Household saving ratio, net (% of disposable income)	_	1.5	1.4	1.6	1.9	2.1
General government financial balance (% of GDP)	_	-0.3	-0.4	-0.6	-0.5	-0.3
General government gross debt (% of GDP)	_	94.3	93.7	95.5	95.2	94.7
Current account balance (% of GDP)	_	-2.8	-2.6	-1.6	-1.1	-0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046209

Canada 2





1. Median of hourly wage growth measures from the Labour Force Survey, National Accounts, Productivity Accounts, and Survey of Employment, Payrolls and Hours.
2. Average of the Bank of Canada's three preferred core inflation measures (CPI-trim, median and common).
Source: OECD Economic Outlook 106 database; Refinitiv; and Bank of Canada.

StatLink https://doi.org/10.1787/888934045126

Employment growth has increased markedly, along with strong rises in population and labour force participation. The unemployment rate has continued falling to record lows. Wage growth is gathering momentum. Consumer spending is nevertheless growing more slowly than income as highly indebted households are becoming more cautious and credit growth has slowed. Consumer price inflation increased over the year, only to recede recently, in part due to falling energy prices. The average of the Bank of Canada's underlying inflation measures has been steady at around 2%. A clear majority of businesses now anticipate inflation to be in the lower half of the 1-3% medium-term target band over the next two years.

Policy should support the economy

Notwithstanding slower growth and a deteriorating global economy, the Bank of Canada has kept the policy rate unchanged at 1.75% since late 2018. With projected continued weak growth, soft global trade and easing global financial conditions, the official rate is projected to be cut by the end of 2019 and once more in the first half of 2020, to 1.25%. Despite contractionary measures in Ontario's 2020 budget and the Federal Budget for 2021, the overall general government fiscal stance is estimated to lend slight support to the economy, with the overall underlying primary surplus diminishing in the coming two years. The easing is appropriate given slower growth.

Housing activity has picked up, and house prices show signs of recovering on the back of robust population growth, a strong labour market and lower mortgage rates. This comes after the market stabilised from steep house price rises. Household indebtedness remains high by international standards, but households are expected to start deleveraging and household credit growth has slowed. As monetary policy is projected to ease, close attention needs to be paid to housing market developments. Macroprudential policy should be tightened again if needed. Furthermore, to make housing more affordable and shorten waiting lists for social housing, the supply of affordable housing should be increased and the stock of social housing should be better maintained and targeted.

Growth will remain subdued

Heightened global uncertainty is set to persist for longer than previously expected and trade will remain weak. Business confidence and investment in Canada are projected to recover only gradually. Exports and imports will remain subdued. Private consumption will support growth, but households will remain reluctant to spend from their income due to uncertainty, a slowing labour market and deleveraging. The unemployment rate will remain low, inflation will stay close to the mid-point of the target range and wage growth will remain moderate.

A major domestic vulnerability remains the high indebtedness of households. A sharp economic slowdown would weigh on household incomes and could lead to lower consumption expenditure, and to weaker housing demand. On the other hand, were house prices to pick up more sharply, this could lead to a further build-up of imbalances. Another risk is that the United States-Mexico-Canada Agreement is not ratified or that access to the US market becomes less favourable. On the upside, in the event of an increase in oil prices, incomes would be boosted, resulting in higher economic growth.

Chile

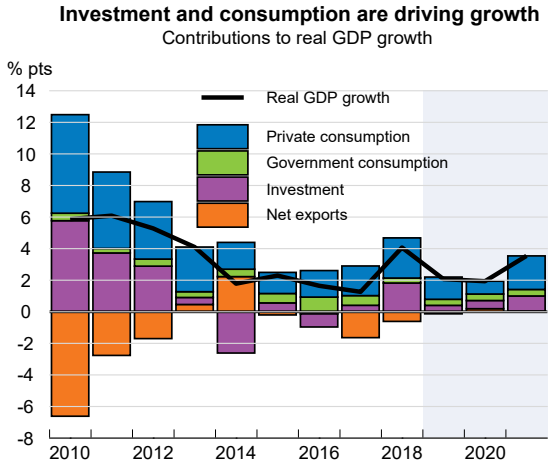
Economic growth is projected to strengthen gradually in the coming years, but remain weaker than previously expected due to the recent social events and persistent external headwinds. Supportive financing conditions and a tax reform in 2020 will sustain investment. Solid private consumption is set to be supported by low real interest rates and rising wages. Stronger growth and sustained immigration will boost employment. The current account deficit will remain stable.

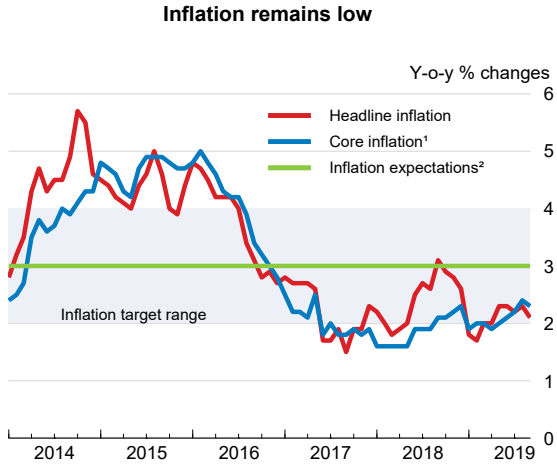
Monetary policy will stay appropriately accommodative and start tightening at a slow pace as inflation approaches the 3% target and the output gap closes. Fiscal policy needs to strike a balance between higher social spending needs and remaining prudent to comply with the fiscal rule. Fostering inclusive growth requires reforms to strengthen social and active labour market policies and boost business dynamism.

Domestic demand is driving growth

Economic activity slowed down in 2019 amid weather-related shocks to mining, weaker manufacturing output and lower export growth. The recent social unrest is weighing on consumption and investment. The labour market remains subdued with conflicting indicators. While administrative data point to healthy formal employment growth, the unemployment rate has not eased, as the labour market has not been flexible enough to accommodate the recent immigration wave. External conditions have worsened, as escalating trade conflicts and trade policy uncertainty have hit world trade. Inflation remains close to 2%, the lower band of the target range, partly reflecting a continuous drop in the prices of services.

Chile





1. Core inflation includes all items without energy and fuels.
2. Inflation expectations at 23 months.
Source: Central Bank of Chile; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045145

Chile: Demand, output and prices

Chile	2016	2017	2018	2019	2020	2021
	Current prices CLP billion	Percentage changes, volume (2013 prices)				
GDP at market prices	169 469.5	1.5	4.0	2.2	2.4	3.5
Private consumption	107 417.2	3.0	4.0	2.2	1.3	3.4
Government consumption	23 361.9	4.4	2.2	2.7	2.9	2.9
Gross fixed capital formation	38 544.7	-2.7	4.6	4.1	3.7	4.4
Final domestic demand	169 323.8	1.9	3.9	2.7	2.1	3.5
Stockbuilding[1]	- 887.1	1.0	0.9	-0.5	-0.3	0.0
Total domestic demand	168 436.7	3.0	4.8	2.3	1.8	3.5
Exports of goods and services	47 722.4	-1.2	5.1	-2.3	1.5	3.0
Imports of goods and services	46 689.6	4.8	7.6	-1.8	0.8	2.8
Net exports[1]	1 032.8	-1.6	-0.6	-0.1	0.2	0.0
Memorandum items						
GDP deflator	_	4.8	2.0	2.6	3.0	2.6
Consumer price index	_	2.2	2.4	2.4	2.5	3.0
Private consumption deflator	_	2.7	2.0	2.3	3.0	3.0
Unemployment rate (% of labour force)	_	6.7	7.0	6.8	6.7	6.2
Central government financial balance (% of GDP)	_	-2.7	-1.7	-1.7	-1.6	-1.4
Current account balance (% of GDP)	_	-2.2	-3.1	-3.6	-3.4	-3.1

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046228

Achieving higher and more inclusive growth hinges on continuing reforms

The central bank has lowered the monetary policy rate from 3% at the beginning of the year to 1.75% at present, in part reflecting weaker-than-expected inflation and activity. Monetary policy is projected to remain accommodative until the 3% inflation target is achieved and the labour market strengthens.

The fiscal stance is broadly appropriate, with the planned gradual consolidation in line with the fiscal rule. The planned fiscal reform, currently being discussed in the legislative assembly, would boost revenues by increasing the personal income tax and the property tax for high-income households. The reform would also spur investment thanks to a simplified tax code for SMEs and accelerating depreciation. Recently announced policy measures to further increase social expenditures, primarily publicly-funded pensions and an increase in the minimum wage for the most vulnerable, have been appropriately accommodated within the fiscal rule and will sustain private consumption.

Stronger and more inclusive growth requires keeping up structural reform momentum. Reducing labour market segmentation between stable and precarious jobs and integrating the recent flow of migrants, streamlining licensing and regulations, and increasing competition in network services remain key. The government has a welcome agenda to boost business investment mainly through administrative changes to help with licensing and procedures for big projects, the extension of bankruptcy law to smaller companies, the legal recognition of access to electronic signatures and the relaxation of requirements for hiring foreign workers. Further expansion of childcare facilities would boost still low female employment in paid jobs and help close the persistently high gender-wage gap. Easing regulations on open-ended labour contracts while extending unemployment insurance would tackle labour-market segmentation and reduce inequalities.

The projected pick-up in growth is surrounded by considerable uncertainty

Solid macroeconomic foundations and sustainable fiscal policy should help support growth despite the negative impact of the social unrest in the last quarter of 2019 and adverse external conditions. Supportive financing conditions, high copper prices, positive business sentiment and the planned tax reform should underpin investment. Low real interest rates and rising wages will continue to support private consumption, but government consumption and exports will remain muted. However, the projections are subject to considerable uncertainty due to the ongoing social unrest. The root causes of the unrest need to be tackled to boost households' well-being and strengthen business confidence. Failure, or delay, to implement the needed ambitious social reforms would lead to weaker growth than currently projected. The subdued external environment, driven by trade tensions and regional instabilities, is also a downside risk. On the upside, full implementation of the ambitious structural reform agenda could raise investment more than anticipated.

China

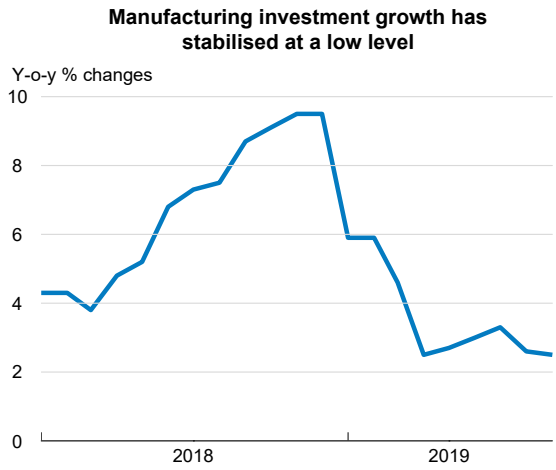
Economic growth is projected to decline to 5.5% in 2021 as the economy continues to rebalance and trade tensions remain high. In 2019, frontloading of exports has helped to support activity, but increased tariffs will constrain growth going forward. Imports will slow further as demand for imported inputs eases, resulting in an increase in the current account surplus. Overall investment growth is no longer slowing thanks to government infrastructure projects and still robust real estate investment, although manufacturing investment growth is weak. Private consumption will grow steadily on the back of relatively strong disposable income gains. Inflation is easing, notwithstanding soaring prices of some consumption goods.

Monetary conditions were tightened by restrictions on shadow banking but are now being eased to support economic activity. Broad-based cuts in minimum reserve requirements have been supplemented with a new pricing mechanism for the loan prime rate and a slight cut in the medium-term lending facility rate aiming at reducing the cost of borrowing. Fiscal policy, with a number of tax cuts, will remain supportive of consumption amid deteriorating consumer confidence. Infrastructure investment will be robust, and project financing is expected to benefit from relaxed own fund requirements.

Growth remains robust

Growth has weakened amid escalating trade tensions and global uncertainties, but frontloading of exports in the second half of 2019 ahead of expected new rounds of tariff increases is supporting industrial production. The rebalancing from investment to consumption has reduced the demand for imported capital goods and raw materials. Greater domestic production of inputs is also contributing to weaker import demand. As a result, the current account surplus has increased. Consumption has remained robust, thanks to steadily rising disposable incomes. Infrastructure investment has bottomed out thanks to the increase of special bond quotas and the easing of rules for enterprise bond issuance. Business investment growth has remained stable, in particular in services, though manufacturing investment growth has slowed significantly. Real estate investment growth has been stable on the back of strong demand for private housing and continuing large-scale reconstruction of shantytowns. New housing starts, however, are moderating, pointing to weaker growth of residential investment in the future. This could potentially reduce vacancy rates but could also inflate the property bubble in cities where demand is robust.

China 1



Note: All data are in nominal terms.
Source: CEIC.

StatLink https://doi.org/10.1787/888934045164

China: Demand, output and prices

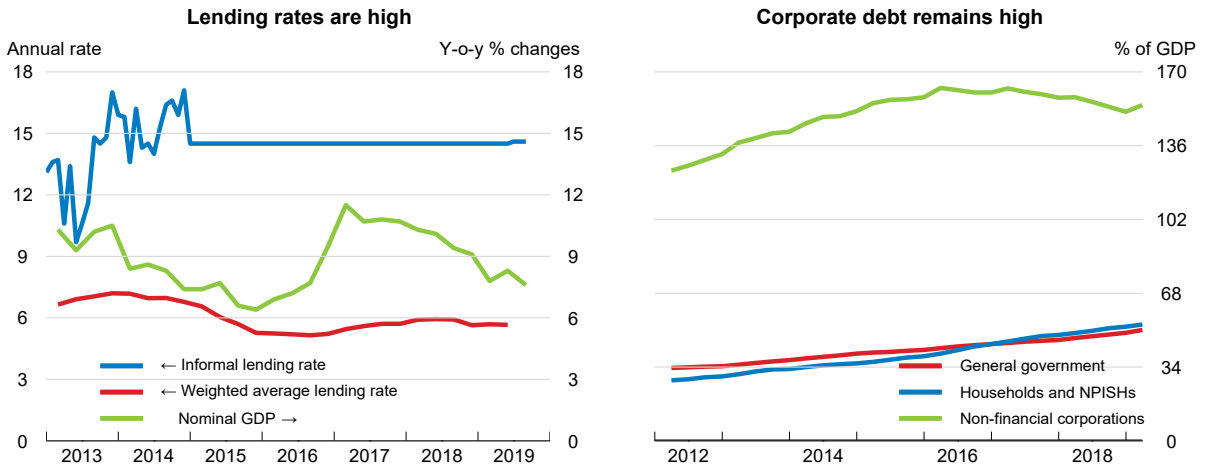
China	2016	2017	2018	2019	2020	2021
	Current prices CNY trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	74.0	6.8	6.6	6.2	5.7	5.5
Total domestic demand	72.3	5.9	7.1	5.2	5.9	5.5
Exports of goods and services	14.6	11.4	3.6	3.7	1.8	2.5
Imports of goods and services	12.9	6.9	5.7	-1.7	2.0	1.7
Net exports[1]	1.7	1.1	-0.3	1.1	0.0	0.2
Memorandum items						
GDP deflator	_	3.8	2.9	1.5	1.5	2.1
Consumer price index	_	1.5	1.9	2.5	2.2	1.9
General government financial balance[2] (% of GDP)	_	-3.0	-3.1	-3.3	-3.6	-3.8
Headline government financial balance[3] (% of GDP)	_	-2.9	-2.6	-2.8	-3.0	-3.0
Current account balance (% of GDP)	_	1.6	0.4	1.4	1.4	1.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Encompasses the balances of all four budget accounts (general account, government managed funds, social security funds and the state-owned capital management account).
3. The headline fiscal balance is the official balance defined as the difference between revenues and outlays. Revenues include: general budget revenue, revenue from the central stabilisation fund and sub-national budget adjustment. Outlays include: general budget spending, replenishment of the central stabilisation fund and repayment of principal on sub-national debt.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046247

China 2



Source: CEIC; and BIS.

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Fiscal stimulus will support growth alongside moderate monetary easing

Fiscal stimulus will continue to hold up growth with the recent acceleration of new project approvals and large-scale projects in the coming years in roads, railways, telecommunications (including rolling out of 5G) and energy, and the continued reconstruction of dilapidated houses. Amid falling investment efficiency, greater attention should be paid to the pricing of risk to reduce the misallocation of capital. Removal of implicit guarantees to state-owned enterprises and other public entities would help. The impact of tax cuts aimed at boosting consumption may be mitigated by adverse confidence effects. Relaxation on car purchases and other measures may provide a short-term lift to consumption (and aggravate pollution problems), but to fully stimulate consumption, structural reforms should be accelerated. In particular, urbanisation and more inclusive public policies are needed. Abolishing the differences in public services that people with different household registrations can access would create more equal opportunities. A minimum level of public services should be ensured through better allocation of resources to provide more equal opportunities to individuals regardless of their place of birth. Central funding for basic public services, such as education and health, is needed to ensure a sufficient level of service provision.

Monetary policy was tightened somewhat over the past couple of years by restrictions put on shadow banking and wealth management activities, which were necessary to maintain financial stability. This heightened risk aversion and affected disproportionately smaller banks and private and smaller firms. Some smaller banks relying on interbank funding defaulted, which required government intervention. As the government did not bail out all creditors, this should sharpen risk perception and goes in the right direction toward phasing out implicit guarantees.

Private and small firms have difficulty in accessing formal lending channels and face continued high interest rates. To drive down borrowing costs, the central bank lowered the one-year medium-term lending facility rate by 5 basis points in early November. It had earlier changed the pricing mechanism for loan prime rates, linking the one-year lending rate on new corporate borrowing to rates set during open market operations (i.e. the PBOC's medium-term lending facility, the MLF), which is determined by broader financial system demand for central bank liquidity. Getting access to loans at rates that better reflect funding conditions will improve the transmission mechanism. In addition, the lowering of the reserve

requirement ratio for the so-called city commercial banks – smaller banks with local government ownership that mostly serve the local economy – in addition to the across-the-board cut should help to alleviate the credit squeeze for micro, small and private enterprises. Corporate debt remains high at 155% of GDP, in particular in the state-owned sector.

Growth is projected to slow

Growth is projected to slow further as the last announced round of tariff increases takes effect and trade tensions continue to weigh on manufacturing output and investment. The additional announcements for tariff increases this year will shave off between 0.3-0.4 percentage points of GDP growth in 2020. This is in addition to the slowing effect of the long-term rebalancing of growth. Cuts in the average import tariff rate by China over the past year (tariff increases on imports from the United States have been more than offset by tariff reductions on other imports), an increased VAT refund on exported products and lowering of export taxes will mitigate the impact of trade tensions. In addition to the measures reducing the costs of doing business, easing producer price inflation will also strengthen competitiveness and exports in 2020-21. Consumer price inflation will nonetheless pick up somewhat due to surging fresh food prices, partly reflecting African swine fever, but these one-off pressures will remain benign. Depreciation of the bilateral US dollar exchange rate may curb overseas tourism somewhat, slightly lifting the current account surplus.

A major upside risk is the alleviation of trade tensions, which would not only lift exports but also manufacturing output and investment. It would also improve consumer confidence, thus leading to stronger growth than projected. Excessive monetary easing would further inflate the property bubble, and thus lift growth, but would imply greater risks down the road. Downside risks stem from financial conditions: greater risk aversion and difficulties at smaller banks may lead to a credit crunch at private and smaller firms. An acceleration in corporate deleveraging would help to restore balance sheets amid high debt service costs, but would slow growth in the short term. A weaker fiscal stimulus, to avoid a further build-up of implicit government liabilities, would adversely affect growth. A fall in house prices would hurt recent buyers through the wealth effect and borrowers through the collateral effect.

Colombia

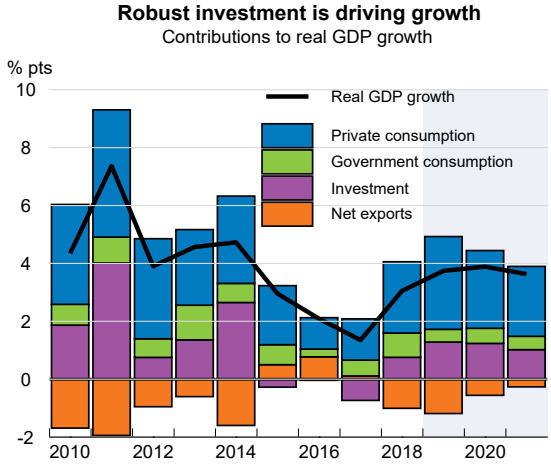
Economic growth is projected to remain robust in the coming two years, despite external headwinds. Investment will be a key driver of growth, aided by tax reforms and ambitious infrastructure projects. Low interest rates will support consumption, while unemployment will start falling. High inequality and informality will remain major policy challenges.

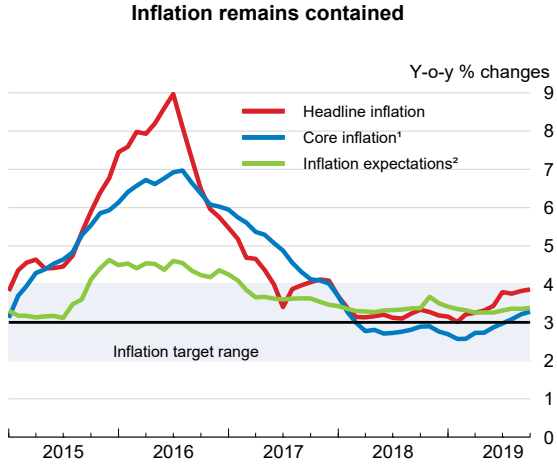
The mildly accommodative monetary policy stance is appropriate, with inflation expectations close to target and still high unemployment. Fiscal policy will need to consolidate to reduce the deficit gradually in line with the fiscal rule. Boosting productivity requires stronger competition and increased openness to trade. A better targeting of social policies and reforms to boost job quality and reduce informality would allow for more widespread sharing of the benefits of growth.

Consumption and investment are driving growth

Economic growth has risen, fostered by strong domestic demand driven by improving credit markets and a positive response from companies to the tax incentives granted in a recent tax reform. The current account deficit has widened, as imports are rising while export performance remains weak. Unemployment has increased despite stronger growth, as employment creation remains too feeble to accommodate the labour force increase due to immigration. Inflation has increased in 2019, driven mainly by increases in food prices and a moderate effect of the peso depreciation, but it remains within the target range.

Colombia





1. Core inflation excludes primary food, utilities and fuel.
2. Inflation expectations are defined as the 12-month ahead inflation expectations.
Source: Banco de la República; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045202

Colombia: Demand, output and prices

Colombia	2016	2017	2018	2019	2020	2021
	Current prices COP trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	863.8	1.4	2.6	3.4	3.5	3.3
Private consumption	596.5	2.1	3.6	4.7	3.9	3.5
Government consumption	125.6	3.8	5.6	2.9	3.5	3.1
Gross fixed capital formation	191.2	1.9	1.5	4.6	5.3	4.5
Final domestic demand	913.3	2.3	3.5	4.4	4.1	3.7
Stockbuilding[1]	9.0	-1.2	0.4	0.3	0.1	0.0
Total domestic demand	922.2	1.2	3.9	4.6	4.2	3.7
Exports of goods and services	127.1	2.5	3.9	4.0	4.0	3.3
Imports of goods and services	185.6	1.2	7.9	8.8	5.5	3.6
Net exports[1]	- 58.5	0.1	-1.0	-1.2	-0.6	-0.3
Memorandum items						
GDP deflator	_	5.1	3.7	4.1	3.5	3.3
Consumer price index	_	4.3	3.2	3.5	3.6	3.0
Core inflation index[2]	_	4.9	2.9	2.9	3.3	3.0
Unemployment rate (% of labour force)	_	9.4	9.7	10.1	9.2	9.0
Current account balance (% of GDP)	_	-3.3	-4.0	-4.2	-4.2	-4.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding primary food, utilities and fuels.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046266

Further structural reforms are needed to boost inclusive growth

Fiscal policy needs to consolidate to reduce the central government's structural deficit to 1% of GDP, in line with the fiscal rule, and to stabilise the public debt-to-GDP ratio. The tax reform going through congress will boost investment. But further measures to raise revenues are likely to be needed in the medium term to meet the fiscal rule and the necessary social and public investment expenditures. It is essential to boost tax revenues in a sustainable manner, while at the same time achieving a tax system more favourable to growth and equity. This could be attained by broadening the bases of personal taxes and VAT, and reducing the corporate income tax rate and eliminating its numerous tax exemptions. To increase revenues, environmental taxes and tax administration efficiency could be boosted.

Stronger and more inclusive growth requires boosting productivity through structural reforms. Raising competition, improving port and customs logistics, and reducing trade and non-trade barriers and regulatory burdens would increase exports, make firms more productive and create quality jobs. The large inflow of migrants can help to boost potential growth, which has fallen in recent years due to lacklustre productivity. However, this requires continuing with the integration policies that help absorb migrants in the formal labour market, as well as investment in training and healthcare systems.

To ensure that the benefits of growth are more widely shared by all, a comprehensive strategy is needed to foster the creation of formal high-quality jobs. This requires reforms in various areas, such as reducing non-wage labour costs, reviewing the minimum wage system to achieve more job-friendly outcomes, improving the quality and relevance of education and training, and adopting measures to integrate more women into the labour market. Reforming the pension system is urgent to reduce old-age poverty and inequality.

Growth is projected to stay robust

Growth is set to remain strong, supported by higher domestic demand. Investment will be a key driver of growth, aided by a lower tax burden and ambitious infrastructure projects. Still low interest rates, inflation within the target of the central bank, and decreasing unemployment will support consumption. The current account deficit will widen in the context of demand-driven growth and weaker export performance. Upside risks include higher oil prices, which could boost investment further. Downside risks include stronger-than-anticipated weakness in the external environment, driven by trade tensions and regional instability, and additional delays in infrastructure projects.

Costa Rica

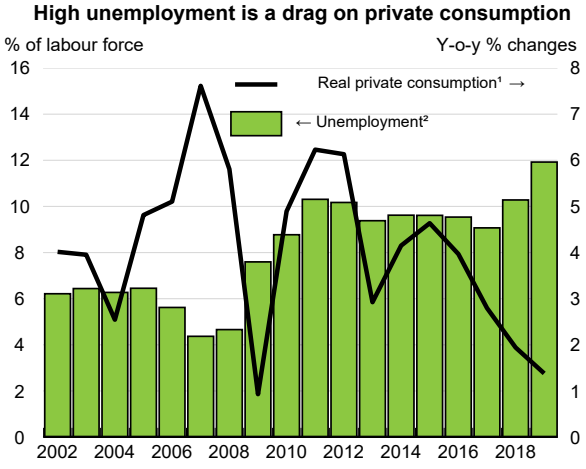
Economic growth is projected to be around 2¼ per cent in 2020-21, underpinned by gradually improving domestic demand, tourism and exports of business services. Declining inflation will gradually support consumption. Investment has been weak, but will benefit from lower interest rates. Informality and inequality remain high, hampering productivity.

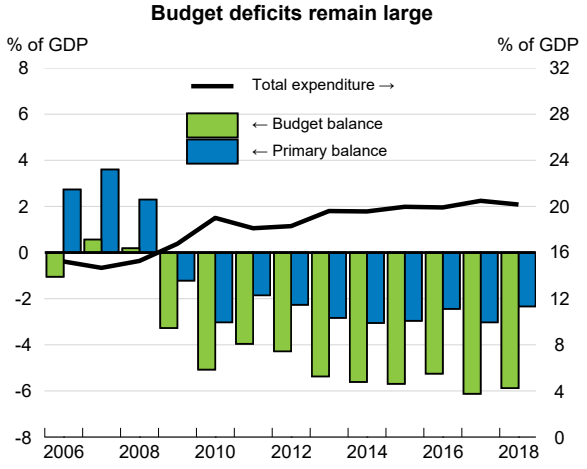
Fiscal policy continues to be characterised by high budget deficits and rising public debt, although recent tax and spending reforms, if fully implemented, will help to restore medium-term sustainability. Monetary policy should remain accommodative, given increasing economic slack. Improving access to, and quality of, early childhood education is key to increased female labour market participation.

Economic activity has slowed down

The global trade slowdown, regional political instability, lower prices of main export goods and adverse weather effects have reduced growth. The very high unemployment rate, at 12%, is eroding consumer confidence. Credit growth and business confidence are also subdued, and investment remains weak. The recently introduced VAT induced a transitory pick-up in inflation.

Costa Rica





1. 2019 is defined as the year-on-year growth of 2019Q2 with respect to 2018Q2.
2. 2019 refers to 2019Q2.
Source: OECD Economic Outlook 106 database; and Ministerio de Hacienda.

StatLink https://doi.org/10.1787/888934045221

Costa Rica: Demand, output and prices

Costa Rica	2016	2017	2018	2019	2020	2021
	Current prices CRC trillion	Percentage changes, volume (2012 prices)				
GDP at market prices	31.2	3.4	2.6	2.0	2.2	2.3
Private consumption	20.0	2.8	1.9	1.9	2.1	2.0
Government consumption	5.4	3.3	0.4	2.9	0.0	0.7
Gross fixed capital formation	5.7	-3.0	3.2	-3.8	2.0	3.7
Final domestic demand	31.0	1.8	1.9	1.1	1.7	2.1
Stockbuilding[1]	0.1	1.1	-0.7	0.3	0.0	0.0
Total domestic demand	31.1	2.8	1.2	1.2	1.6	2.1
Exports of goods and services	10.0	5.0	4.1	3.0	3.1	2.4
Imports of goods and services	9.9	3.2	0.0	0.9	1.3	1.9
Net exports[1]	0.1	0.5	1.4	0.7	0.6	0.2
Memorandum items						
GDP deflator	_	2.6	2.4	2.6	2.2	2.4
Consumer price index	_	1.6	2.2	2.3	2.5	2.4
Core inflation index[2]	_	1.2	2.1	2.5	2.4	2.4
Unemployment rate (% of labour force)	_	9.1	10.3	11.9	12.4	12.3
Current account balance (% of GDP)	_	-2.9	-3.1	-2.4	-2.5	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046285

Full implementation of the fiscal reform is key to rebuild confidence

Government deficits remain large despite the recent approval of a historic tax reform, as well as restraints on non-interest current spending and a temporary tax amnesty that raised additional revenue. Rising public debt and high interest rates imply growing debt-servicing costs for the public budget. The government projects that the deficit will continue to rise to 6.5% and 6.9% of GDP in 2020 and 2021, respectively. Consequently, full implementation of the fiscal reform is necessary to restore fiscal sustainability in the medium term. Reforms to streamline the organisation of the public sector would generate additional savings, improve public services delivery and help decrease inequality. Monetary policy has appropriately become more accommodative, with multiple interest rate cuts. The central bank is expected to continue to provide support to growth, given the limited room for a fiscal stimulus and widening slack.

The financial system is considered by the authorities to be sound, but nonetheless faces a number of vulnerabilities. State-owned banks are heavily exposed to sovereign debt and to state-owned enterprises, which creates risks of adverse feedback loops. Heavy dollarisation also poses challenges linked to currency mismatches. Publishing stress test results for individual banks would boost the effectiveness of the exercise and increase transparency. Continuing to improve corporate governance in the large state-owned enterprise sector and simplifying the current regulatory framework would help boost public sector efficiency, increase competition and reduce prices. Enacting a deposit insurance scheme, covering public and private banks, is key to buttress financial stability, protect all depositors and encourage more competition in the banking sector. Announcing the calendar of monetary policy meetings in advance would further enhance central bank communication and monetary policy effectiveness. Recent reductions in social security contributions for small companies will help curb informality, but further simplification of the still complex minimum wage structure is needed to facilitate compliance and job creation.

Growth is projected to remain modest

Growth is expected to remain subdued but gradually rise in 2020-21. Lower interest rates should stimulate private investment, particularly in export-related sectors. Inflation is set to remain within the official target range as the economy stays weak. Risks to the downside originate from a failure or a delay in fully implementing the fiscal reform, which would curb investor confidence and put pressure on financial stability. Weaker-than-expected global trade is also a downside risk to the export outlook. On the upside, the positive effects of the already implemented structural reforms on investment and growth might turn out to be larger than anticipated.

Czech Republic

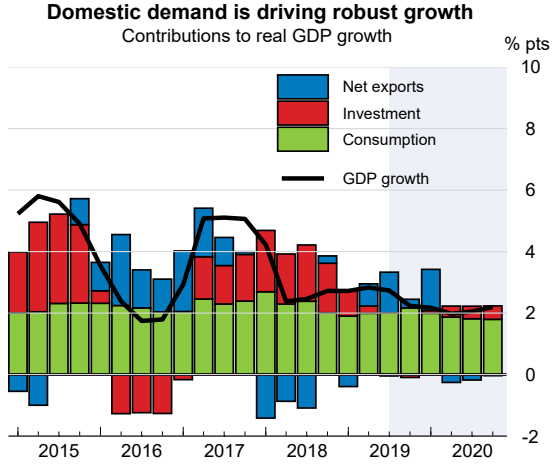
Economic growth is projected to ease to 2–2¼ per cent in 2020-21. Household consumption and government spending will drive growth. Workers will still benefit from high wage growth, while unemployment will remain low. However, the external sector will limit growth as economic activity in the main trading partners is slowing, which will also lead to declining investment growth.

Adjusting monetary policy should continue in 2020 and 2021 as inflation is projected to stay above the 2% target of the central bank. Government spending is increasing, in particular social benefits, thanks to rising revenues. Even so, public debt will continue to decrease. Labour shortages remain the main domestic bottleneck to growth. Accelerating childcare reform to increase women's participation in the labour market and streamlined immigration procedures would help to ease tensions in the labour market.

Robust growth is driven by domestic demand

Government spending and household consumption are driving domestic demand, which is the main engine of growth. The government is increasing spending on social policies while workers are still benefitting from high wage growth fuelled by the very low level of unemployment. The investment rate has fallen sharply this year after the extensive use of EU structural funds last year. It has also declined on the back of the ongoing slowdown in neighbouring countries. Industrial production and new orders have started to decline, indicating the impact of the slowdown in Europe. Exports are declining but less than imports, reflecting a greater diversification of the economy and some upgrading into global value chains.

Czech Republic



1. Inflation target is 2% with a tolerance band of +/- 1% points.
Source: Refinitiv; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045240

Czech Republic: Demand, output and prices

Czech Republic	2016	2017	2018	2019	2020	2021
	Current prices CZK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 765.8	4.5	2.9	2.6	2.1	2.3
Private consumption	2 242.1	4.4	3.3	2.9	2.8	2.8
Government consumption	918.7	1.3	3.9	3.2	2.5	2.1
Gross fixed capital formation	1 188.1	4.0	7.1	0.9	1.3	1.9
Final domestic demand	4 348.9	3.6	4.5	2.4	2.4	2.4
Stockbuilding[1]	49.9	0.1	-0.4	-0.1	-0.3	0.0
Total domestic demand	4 398.8	3.7	4.0	2.3	2.0	2.4
Exports of goods and services	3 789.8	7.1	4.4	1.9	1.7	1.9
Imports of goods and services	3 422.8	6.3	5.9	1.3	1.5	2.0
Net exports[1]	367.0	1.1	-0.8	0.5	0.2	0.1
Memorandum items						
GDP deflator	_	1.4	2.5	3.1	2.3	2.3
Consumer price index	_	2.5	2.1	2.8	2.5	2.3
Core inflation index[2]	_	2.0	2.4	2.5	2.4	2.3
Unemployment rate (% of labour force)	_	2.9	2.2	2.0	2.1	2.2
Household saving ratio, net (% of disposable income)	_	4.4	6.0	6.7	6.6	6.5
General government financial balance (% of GDP)	_	1.6	1.1	0.7	0.5	0.4
General government gross debt (% of GDP)	_	43.8	40.1	38.5	37.2	36.4
General government debt, Maastricht definition (% of GDP)	_	34.6	32.5	30.9	29.6	28.9
Current account balance (% of GDP)	_	1.7	0.3	0.9	0.7	1.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046304

Policies need to address labour shortages

Inflation is stalling above the 2% target of the central bank though it remains within the tolerance band. Food, energy and services prices are driving inflation while import prices are lower than expected. Currency appreciation is also holding down inflation. As relatively high inflationary pressures are projected to persist and high wage growth set to continue, the central bank will need to further adjust monetary policy to economic conditions, while taking into account euro area monetary policy.

The fiscal stance is mildly expansionary. Government spending is increasing at a rapid pace, leading to a sharp reduction in the government surplus. Spending on health, pensions and disability benefits is on the rise. Social transfers to families with children are increasing. In addition, a paternity leave policy has been introduced. However, policies are still needed to address labour shortages, which is the main domestic bottleneck to growth. Moreover, better planning of the use of EU funds for infrastructure would attenuate the volatility of investment and improve the quality of implementation of infrastructure projects.

The labour market is shifting towards higher-skilled employment. The service sector has expanded and manufacturing has become tightly integrated into global value chains, leading to employment shifting from medium-skilled to higher-skilled jobs. Providing workers with the right skill-set and training to adapt to a changing environment would increase their resilience to automation. More developed vocational training and childcare facilities could help reduce the skill mismatch and augment women's labour supply.

Robust growth is projected to continue

Growth is projected to remain above 2% over the projection period, driven by household and government spending. Unemployment will remain low, contributing to persistent high growth of wages. The slowdown in neighbouring countries will weigh on export growth.

Risks to inflation are substantial and slightly tilted to the upside. A weaker-than-assumed koruna exchange rate would result in higher inflation and interest rates. However, an unexpected appreciation would imply decreases in imported prices that should help maintain inflation on track. Given its high participation in global value chains, the Czech economy is highly exposed to trade protectionist measures and uncertainties surrounding Brexit.

Denmark

The economy is projected to grow at a moderate pace of around 1½ per cent in 2020 and 2021. Strong exports will slow and weigh on growth as demand from trading partners weaken. However, robust wage growth, continued job creation and negative interest rates will boost household disposable incomes and bolster private consumption. Inflation is set to rise gradually.

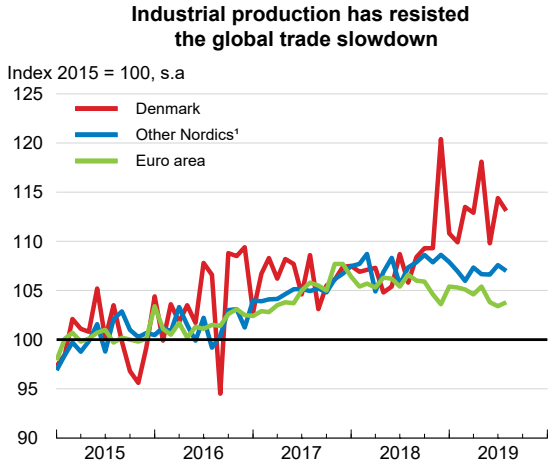
Monetary policy conditions are expected to remain highly accommodative due to the krone's peg to the euro. Strong public spending growth is planned in 2020, while public investment is set to pick up in 2021. A stronger focus on efficiency of public spending and investment would be suitable, not least in the government's ambitious climate policy.

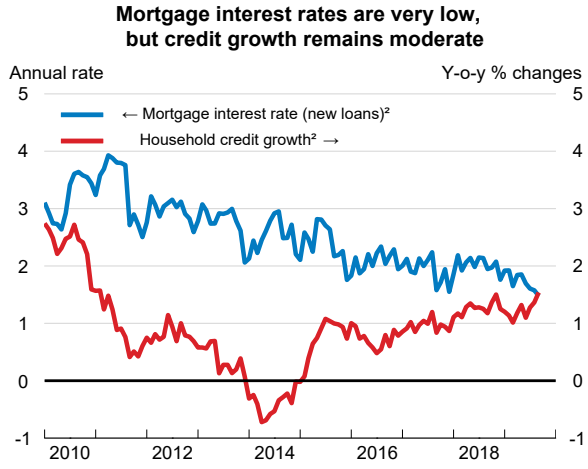
The economy has been resilient

Resilient exports have sustained economic growth in 2019. Pharmaceuticals and machinery, including wind turbines, account for a large part of export growth since the mid-2018. Specialisation in these industries has helped to cushion industrial production from the global trade slowdown. Private consumption continues to grow at a moderate pace, while business and residential investment growth have weakened. Business sentiment indicators have also been declining from a high level.

Employment is still increasing, but job creation and the inflow of foreign workers have slowed. The easing of labour market conditions has stabilised wage growth at around 2.5%. Consumer price inflation has declined and is currently around 0.5%, bringing solid real wage gains for households.

Denmark





1. Other Nordics is a simple average of Finland, Norway and Sweden.
2. Effective mortgage rate of interest including administration rate and capital loss on issue of underlying bonds. Household credit includes all loans from banks and mortgage banks to the household sector.
Source: OECD, Main Economic Indicators database; and Danmarks Nationalbank.

StatLink https://doi.org/10.1787/888934045259

Denmark: Demand, output and prices

Denmark	2016	2017	2018	2019	2020	2021
	Current prices DKK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	2 107.8	2.0	2.4	1.8	1.4	1.4
Private consumption	983.8	1.6	2.6	1.2	2.0	1.8
Government consumption	524.2	1.0	0.4	0.8	1.4	0.6
Gross fixed capital formation	443.2	3.0	5.4	-1.5	3.4	3.0
Final domestic demand	1 951.2	1.8	2.7	0.5	2.2	1.8
Stockbuilding[1]	15.7	-0.1	0.3	-0.2	0.0	0.0
Total domestic demand	1 966.9	1.6	3.1	0.3	2.2	1.8
Exports of goods and services	1 126.1	4.6	2.4	3.8	1.9	2.3
Imports of goods and services	985.2	4.3	3.6	0.4	3.2	3.1
Net exports[1]	140.9	0.5	-0.4	1.9	-0.5	-0.2
Memorandum items						
GDP deflator	_	1.1	0.8	1.4	1.6	1.7
Consumer price index	_	1.1	0.8	0.7	0.9	1.4
Core inflation index[2]	_	0.9	0.6	0.8	1.0	1.4
Unemployment rate (% of labour force)	_	5.8	5.1	5.0	5.0	5.0
Household saving ratio, net (% of disposable income)	_	6.2	6.6	3.9	6.8	6.8
General government financial balance (% of GDP)	_	1.5	0.6	1.8	0.3	-0.2
General government gross debt (% of GDP)	_	48.8	47.5	45.5	45.1	45.4
General government debt, Maastricht definition (% of GDP)	_	35.5	33.8	31.8	31.4	31.7
Current account balance (% of GDP)	_	7.8	7.0	7.7	7.8	7.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046323

Policies should aim at improving cost-efficiency

Ultra loose monetary conditions are expected to last. The central bank reduced its policy interest rate to -0.75% in September 2019 to defend the peg to the euro. Mortgage interest rates have declined throughout 2019, prompting a refinancing boom among homeowners to reduce their debt costs. Household credit growth remains moderate, but could pick up if homeowners decide to raise additional debt. Reducing tax deductibility of interest expenses further would be welcome to remove incentives for excessive household balance sheet expansion. Following money laundering scandals, continued vigilance of the financial sector and updating of regulatory frameworks are also needed.

Fiscal policy was planned to stay close to budget balance during 2019-2021, which is appropriate. However, a sizeable budget surplus is expected in 2019, reflecting large and volatile revenues from recurrent taxation of interest, dividends and capital gains on pension savings. The government now plans to increase spending on public services in 2020, including on health and education, financed by an expected increase in fiscal space and a welcome withdrawal of reduced inheritance taxation for family-owned businesses.

The government is committed to address climate change and reach ambitious greenhouse-gas-reduction targets. This should be pursued by implementing the most cost-efficient reductions first, taking into account implications for global emissions. Continued reform of health, education and active labour market policies should also focus on enhancing efficiency of public spending; for instance, by reducing student grants in tertiary education and relying more on student loans.

Growth is projected to slow down

Economic growth is projected to slow to 1.4% in 2020 and 2021. Domestic demand will underpin growth as exports weaken. A renovation of the largest oil platform in the North Sea during 2019-2021 will give a boost to investment and temporarily increase oil imports. Negative interest rates and nominal wage increases are expected to lift inflation gradually from its low level. Higher-than-expected private consumption could result from a repayment of collected property taxes in 2020 and 2021 along with a pick-up in household credit growth. The main risks to the outlook are nevertheless to the downside, stemming from large uncertainties in the external environment, not least the resolution of Brexit.

Estonia

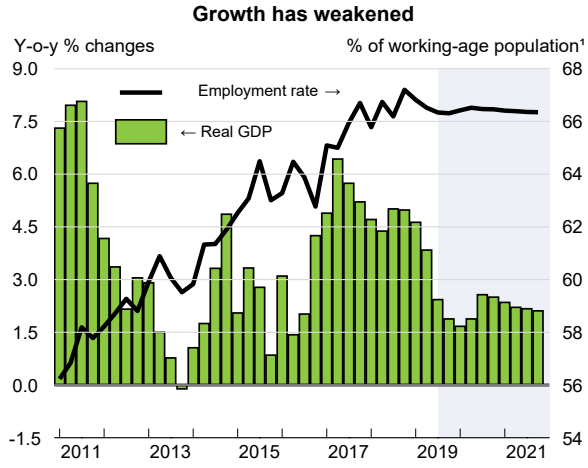
Growth is projected to slow from 3.2% in 2019 to 2.2% in 2020 and 2021, as exports are hit by weak global demand. Consumption is projected to hold up despite slowing real wage growth, as household finances are strong after years of increasing real wages and employment. Buoyant investment, notably in housing, will fall back to moderate levels. Inflation will stabilise somewhat above 2% as the economy cools.

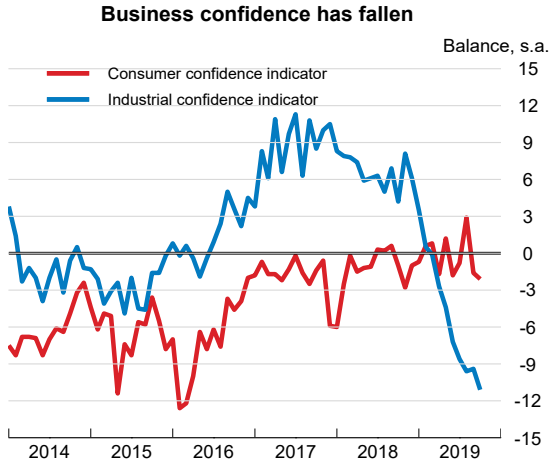
The government is assumed to allow a structural fiscal deficit in 2020-21, in line with its intention to amend the fiscal rule, while the nominal deficit widens. Public debt is very low, and macroprudential tools have been put in place to damp potential financial excesses. A plan to allow people to withdraw second-pillar pension savings risks aggravating the problem of old-age poverty, if implemented fully.

Growth is slowing

Growth has slowed significantly, despite strong investment growth. Relatively solid consumer sentiment contrasts with declining confidence in the business sector. This divergence reflects considerable household resilience after years of rising employment and strong wage growth, whereas the business sector expects a hit from weak global trade. Labour force and employment growth are moderating, as employers are more reluctant to hire. Headline inflation has fallen back to slightly above 2%.

Estonia





1. 15-74 years old.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045278

Estonia: Demand, output and prices

Estonia	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	21.7	5.6	4.8	3.2	2.2	2.2
Private consumption	11.2	2.8	4.4	2.7	3.2	3.1
Government consumption	4.4	1.0	0.8	2.4	1.5	2.0
Gross fixed capital formation	5.1	12.7	0.9	14.1	1.7	2.5
Final domestic demand	20.8	5.0	2.8	5.6	2.4	2.7
Stockbuilding[1]	0.1	-0.5	1.0	-0.5	0.0	0.0
Total domestic demand	20.8	4.3	3.8	4.8	2.4	2.7
Exports of goods and services	16.8	3.8	4.3	4.0	1.1	2.1
Imports of goods and services	16.0	4.2	5.7	3.8	2.2	2.7
Net exports[1]	0.9	-0.1	-0.8	0.2	-0.7	-0.4
Memorandum items						
GDP deflator	_	3.8	4.5	3.4	2.3	2.6
Harmonised index of consumer prices	_	3.7	3.4	2.2	2.3	2.2
Harmonised index of core inflation[2]	_	2.0	1.7	2.3	2.5	2.2
Unemployment rate (% of labour force)	_	5.8	5.4	5.0	5.1	5.2
Household saving ratio, net (% of disposable income)	_	7.9	8.2	9.6	7.7	6.8
General government financial balance (% of GDP)	_	-0.8	-0.6	-0.3	-0.4	-0.8
General government gross debt (% of GDP)	_	13.0	12.7	12.9	12.0	12.0
General government debt, Maastricht definition (% of GDP)	_	9.3	8.4	8.5	7.7	7.6
Current account balance (% of GDP)	_	2.7	2.0	1.4	0.9	0.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046342

The role of fiscal policy is set to increase

Monetary policy in the euro area is expected to remain very accommodative. Somewhat contractionary fiscal policy in 2020 is expected to turn broadly neutral in 2021 following a proposed change to the fiscal policy framework, allowing current deficits without offsetting past surpluses or planned future savings.

Diminishing labour market pressures are set to accentuate the strain on the part of the population negatively affected by ongoing structural shifts towards higher value-added production. Strengthening the social safety net and automatic stabilisers, notably by increasing unemployment and health insurance coverage, and renewed efforts to re-skill and up-skill are important in this respect. These policies are also central to long-term efforts to reduce dependence on high-emitting oil shale extraction and use, a cornerstone industry in the north-east of the country.

The government's plans to allow individuals to opt out and withdraw savings accumulated in the mandatory private individual pension scheme should be reconsidered. A significant share of households, notably those with relatively low incomes and high propensity to consume, are expected to tap into pension savings, supporting consumption from 2021, but this risks feeding macroeconomic volatility in the short term and increasing old-age poverty from already high levels in the long term.

Residential investment growth has been very strong lately, but pressures in the construction sector are easing, house prices are growing in line with incomes, and macroprudential tools have improved resilience. Luminor Group's reorganisation of its Latvian and Lithuanian subsidiaries into branches increases substantially the size of banking assets under Estonian responsibility. Ongoing money laundering investigations implicating several Estonian lenders call for a stronger legal framework with higher fines.

The weak global outlook weighs on exports and investment

The economy is set to slow over the coming two years, driven by weak foreign demand and sapped business confidence and investments. Consumption growth is expected to show some resilience, as households are bolstered by a decade of steadily growing incomes and employment and the proposed pension reform. Employment and labour force growth are projected to level off, while the unemployment rate will start to increase. As the economy slows, and wage pressures abate, inflation will stabilise. Previous gradual losses of price competitiveness have done limited damage so far, but could pose extra challenges to Estonia in the context of a European slowdown and weakening global demand.

Euro area

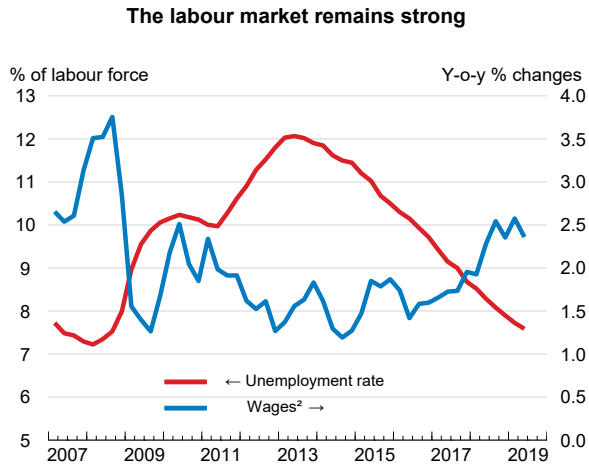
Growth is projected to remain subdued, with little prospects of a recovery over the coming two years. Modest growth in external demand, global trade tensions and policy uncertainty will limit the pick-up in exports and business investment. Household saving is expected to continue to rise, further weakening the prospects for demand growth. Inflation will remain low.

Very accommodative monetary policy is appropriate given the weakness of expected inflation, but a sustainable resumption of growth and a durable return of inflation to target will require further fiscal easing as well. Taking advantage of the enhanced fiscal space afforded by very low interest rates, public investment should increase in countries with low public debt, inter alia to support climate change mitigation and long-term economic growth. A fresh impulse towards stronger European integration, notably by deepening the single market, completing the banking union and developing common fiscal tools, would foster resilience and productivity growth.

The slowdown is becoming entrenched

The euro area economy has slowed further in the course of 2019. Continued deterioration in external demand, persistent global trade tensions and enduring uncertainty surrounding Brexit have severely hampered exports. Investment weakness has also tended to worsen. The labour market has remained robust, with further reductions in unemployment and the continuation of moderate wage dynamism, which has translated into purchasing power gains given subdued inflation. However, growth in private consumption has somewhat declined, reflecting higher household saving, probably related to precautionary saving in a context of rising uncertainties. Manufacturing has been hit hardest by the slowdown, but confidence in services has also shown signs of faltering.

Euro area 1



1. Private service sector firms.
2. Nominal wages per employee.
Source: IHS Markit; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045297

Euro area: Demand, output and prices

Euro area	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	10 781.0	2.7	1.9	1.2	1.1	1.2
Private consumption	5 836.9	1.8	1.4	1.2	1.3	1.2
Government consumption	2 230.9	1.3	1.1	1.5	1.4	1.3
Gross fixed capital formation	2 183.9	3.7	2.4	4.4	0.3	1.8
Final domestic demand	10 251.6	2.1	1.6	2.0	1.1	1.4
Stockbuilding[1]	56.4	0.5	0.1	-0.5	0.1	0.0
Total domestic demand	10 308.1	2.6	1.6	1.4	1.2	1.4
Net exports[1]	472.9	0.5	0.4	-0.3	0.0	-0.1
Memorandum items						
GDP deflator	_	1.0	1.3	1.6	1.3	1.5
Harmonised index of consumer prices	_	1.5	1.8	1.2	1.1	1.4
Harmonised index of core inflation[2]	_	1.0	1.0	1.0	1.1	1.3
Unemployment rate (% of labour force)	_	9.1	8.2	7.6	7.5	7.4
Household saving ratio, net (% of disposable income)	_	6.0	6.3	6.9	7.2	7.2
General government financial balance (% of GDP)	_	-0.9	-0.5	-0.8	-0.9	-1.0
General government gross debt (% of GDP)	_	106.1	102.9	101.8	101.2	100.5
General government debt, Maastricht definition (% of GDP)	_	89.8	87.9	86.7	86.0	85.3
Current account balance (% of GDP)	_	3.7	3.6	3.2	3.1	2.9

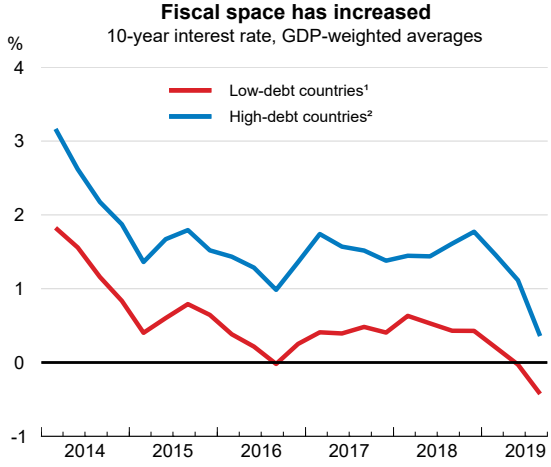
Note: Aggregation based on euro area countries that are members of the OECD, and on seasonally-adjusted and calendar-days-adjusted basis.

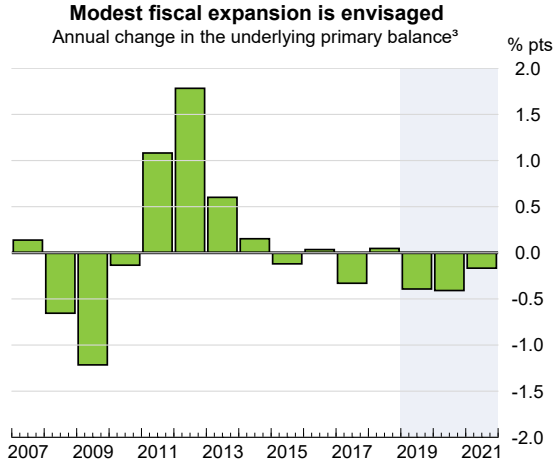
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046361

Euro area 2





1. Low-debt - OECD - euro area countries include: Austria, Finland, Germany, Ireland, Latvia, Lithuania, Luxembourg, the Netherlands, Slovenia and the Slovak Republic. Estonia is excluded due to the limited depth of its sovereign bonds market.
2. High-debt - OECD - euro area countries include: Belgium, France, Greece, Italy, Portugal and Spain.
3. Measured in percent of potential GDP.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045316

Germany and Italy remain the countries most affected by the current slowdown, reflecting in part their strong reliance on manufacturing, compounded in the case of Germany by greater dependence on exports and specific issues in the automobile industry. Countries more reliant on domestic demand, such as France and Spain, have resisted better to the slowdown so far but are now also being impacted through intra-area spillovers.

Fiscal and structural reform efforts need to be stepped up

Monetary accommodation has been further increased. In September, the ECB cut the deposit facility rate by 10 basis points (to -0.5%), vowing to keep policy rates at their present or lower levels until the inflation outlook robustly converges to a level close to 2%. In addition, a two-tier system for reserve remuneration was introduced (exempting part of banks' excess liquidity from the negative deposit rate), and the conditions of targeted longer-term refinancing operations (TLTRO) were made more attractive. Furthermore, monthly net asset purchases of EUR 20 billion restarted in November. Throughout the projection horizon, net purchases are expected to continue at this pace, and policy rates are set to remain unchanged. However, if unaccompanied by other policies, the impact of ECB policy action on aggregate demand will likely be modest.

The euro area aggregate fiscal stance is expected to remain slightly expansionary, with a cumulative impulse of about 0.5 percentage points of GDP over two years (2020-21). This will support activity to some extent. However, the planned fiscal easing is largely uncorrelated with the available fiscal room for manoeuvre, and does not mainly involve stronger public investment, which remains below its 2008 levels. Euro area countries with small or moderate public debt-to-GDP ratios have considerable fiscal space, which low and declining interest rates have boosted further. This space should be used for a sizeable increase in public investment, addressing national needs and generating cross-border spillovers. In this context, high priority should be given to meeting climate targets, requiring at least yearly 1% of GDP of additional investment in areas like energy grids, efficiency of buildings and electric vehicles infrastructure.

Coordinated efforts are also needed on the structural front to improve cyclical stabilisation, help offset negative shocks from rising trade restrictions and increase growth potential. To better reconcile stabilisation with sustainability, European fiscal rules should be simplified and refocussed on expenditure growth anchored to a debt ratio target. The new Budgetary Instrument for Convergence and Competitiveness should be swiftly deployed and subsequently expanded, with a view to creating a common fiscal capacity able to weigh on the area's fiscal stance. Completing the banking union, notably through common deposit insurance and a common fiscal backstop to the Single Resolution Fund remains the highest priority to create a truly European banking system, which would facilitate monetary policy transmission and enhance private risk sharing. Progressing towards capital markets union would diversify funding sources to firms. Renewed efforts to strengthen research and innovation policies and to deepen the single market, by tackling widespread segmentation in services and network industries, would spur trade and investment in Europe, helping to offset the current sources of weakness in activity and paving the way for stronger medium-term growth.

Growth is projected to remain subpar

GDP growth is projected to remain subdued, at just over 1%, over the coming two years, as enduring weak external demand, policy uncertainty and low confidence continue to hamper exports and investment. Support to activity from private consumption and public expenditure is set to be limited by a further increase in the household saving rate and by the modest size of the planned fiscal expansion. The unemployment rate is projected to broadly stabilise, but subpar growth will help keep inflation far below 2%. Although somewhat declining, the euro area current account surplus will remain large and concentrated in a few countries.

Exports and investment would weaken further in the event of an escalation of trade tensions with the United States, a stronger-than-expected slowdown in China or prolonged uncertainty about the content of an eventual trade deal between the European Union and the United Kingdom. The ensuing worsening of the slump in manufacturing activity would heighten risks of contagion to the services sector. Downward pressures on services would be compounded if falling consumer confidence led to further increases in precautionary household saving. On the upside, coordinated efforts to increase public investment and complete the economic and monetary union would reduce policy uncertainty and help boost confidence and productivity.

Finland

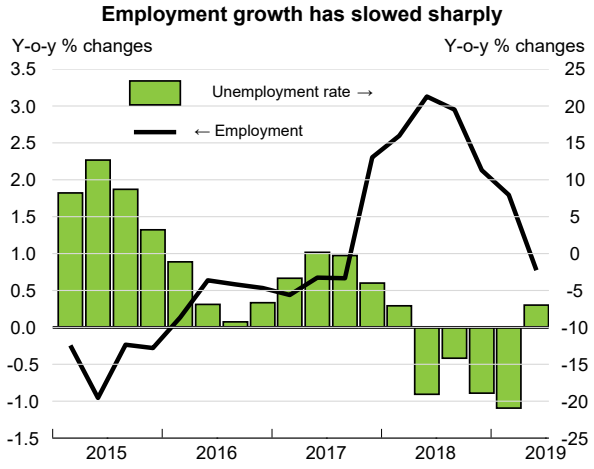
The expansion is projected to continue to lose momentum, with GDP growth edging down to around 1%. Exports are set to weaken, mainly reflecting a deteriorating global environment, and housing investment will slow from recent high rates. Despite a sharp fall in job creation, unemployment should remain unchanged as labour force growth stalls.

Fiscal policy is currently neutral but will appropriately become expansionary in 2020, with the budget deficit widening to 11/2 per cent of GDP in 2020-21. Promoting employment by enhancing work incentives, particularly for older workers and young women, and advancing productivity-reviving reforms are essential to boost growth and improve the fiscal position.

Growth is slowing

Economic growth slowed to 1.2% (year-on-year) by mid-2019, reflecting weakening private consumption and residential and business investment. Both consumer and business confidence have fallen, weighed down by the deteriorating global economic outlook and the downturn in the labour market – the unemployment rate has started rising again after having fallen steadily since 2016. The number of building permits issued has plunged, pointing to further declines in residential investment from near record levels. Export growth was strong early this year owing to temporary large ship deliveries, but is slowing due to the sluggish growth in key export markets. Inflation is rising as a tighter labour market pushes up wages.

Finland



1. Year-on-year percentage changes of 3-month cumulated flows.
Source: OECD Economic Outlook 106 database; and Statistics Finland.

StatLink https://doi.org/10.1787/888934045335

Finland: Demand, output and prices

Finland	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	217.5	3.1	1.7	1.3	1.0	0.9
Private consumption	118.2	1.0	1.9	0.7	1.5	0.8
Government consumption	51.5	0.2	1.5	1.5	3.2	1.7
Gross fixed capital formation	49.4	4.1	3.4	0.6	1.2	0.9
Final domestic demand	219.0	1.5	2.2	0.9	1.8	1.0
Stockbuilding[1,2]	1.2	0.1	0.6	-0.1	0.2	0.0
Total domestic demand	220.3	1.6	2.8	0.8	1.9	1.0
Exports of goods and services	75.7	8.8	2.2	3.3	0.6	1.5
Imports of goods and services	78.5	4.1	5.0	1.9	2.9	1.6
Net exports[1]	- 2.8	1.6	-1.0	0.6	-0.9	-0.1
Memorandum items						
GDP deflator	_	0.7	2.1	2.1	1.7	1.7
Harmonised index of consumer prices	_	0.8	1.2	1.2	1.4	1.7
Harmonised index of core inflation[3]	_	0.6	0.3	0.8	1.3	1.7
Unemployment rate (% of labour force)	_	8.6	7.4	6.6	6.6	6.4
Household saving ratio, net (% of disposable income)	_	-1.1	-1.2	-0.4	0.1	0.4
General government financial balance (% of GDP)	_	-0.7	-0.8	-0.9	-1.4	-1.5
General government gross debt (% of GDP)	_	73.3	72.0	72.0	72.3	75.0
General government debt, Maastricht definition (% of GDP)	_	60.9	59.0	59.2	59.8	60.4
Current account balance (% of GDP)	_	-0.8	-1.4	-0.7	-1.4	-1.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046380

Measures to boost employment and productivity are needed

The underlying primary budget deficit is projected to rise by 0.8% of GDP by 2021, mainly reflecting increases in government consumption expenditure and transfers. The government aims to return to budget balance by 2023, implying a consolidation of 1.2% of GDP between 2020 and 2023. This goal is partly to be achieved by increasing the employment rate from 72.4% currently to 75% by 2023, which would bring it closer to the average for other Nordic countries. The shortfall in Finland's employment rate largely reflects lower labour participation of older workers and young women. Key to boosting the employment rate for older workers is closing early retirement routes, notably extended unemployment benefits ("the unemployment tunnel") and preferential conditions for accessing disability benefits. The participation of young women could be increased by reducing the home-care allowance and enhancing access to quality childcare.

Productivity growth remains subdued and has not recovered as fast as in previous upswings. It could be boosted by reducing barriers to product market competition in some sectors, notably transport and retail distribution, increasing funding for young firms so that their involvement in R&D and innovation can be strengthened, and removing unnecessary obstacles to the growth of start-ups.

Growth is projected to weaken

Growth is projected to slow to less than 1% in 2021, dragged down by declines in the growth of exports and residential investment. Private consumption growth will also moderate, reflecting lower employment growth. The unemployment rate is expected to remain around the current level but inflation is projected to edge up owing to rising labour costs. The main downside risk to the outlook is a greater-than-expected downturn in Germany, Finland's largest export market, depressing exports and business investment. There is also a risk that wage increases are higher than compatible with preserving Finland's cost competitiveness, weighing further on growth. However, a faster-than-expected relaxation of trade tensions and economic recovery in euro area countries could lead to surprises on the upside.

France

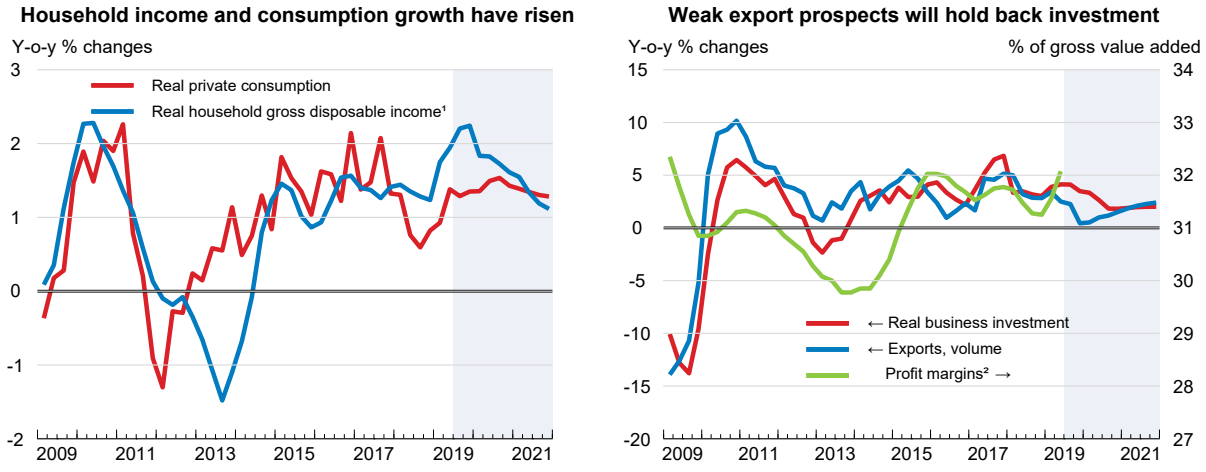
Growth will remain moderate at 1.2% in 2020-21, driven by domestic demand. Resilient job creation, notably for jobs with permanent contracts, tax cuts and the impact of the social emergency measures will raise household disposable income and consumption. Supportive financing conditions and high business profit margins will damp the slowdown in investment, despite weak and uncertain global economic conditions. The unemployment rate will decline slowly towards 8.1% at the end of 2021, while core inflation and wages will strengthen only slightly.

Tax cuts and new social spending will provide some fiscal easing over 2020-21. Even so, the tightening of some social expenditures and decreasing debt-servicing costs are set to reduce the fiscal deficit to 2.1% of GDP in 2021, after the temporary increase due to the tax credit reform in 2019. A reduction in non-priority spending is needed to put the public debt-to-GDP ratio, currently close to 100% (Maastricht definition), on a firmly declining path and sustainably finance ongoing tax cuts for households and businesses. In parallel, the government should continue to pursue structural reforms, including further measures to help low-skilled youth to enter the labour market and improve access to high-quality early education, to generate more inclusive and sustainable growth.

Economic growth has been resilient

Household purchasing power has risen sharply, driven in part by the steady lowering of the housing tax, higher in-work benefits and some cuts in social contributions. This has sustained consumption, but also led to a very high saving rate, at close to 15% of disposable income. Strong employment gains have reduced the unemployment rate and dependence on subsidised jobs and short-term contracts. Wage growth remains dynamic and consumer price inflation has moderated with lower oil prices. Household confidence has progressively recovered and spending on durable consumer goods is increasing.

France 1



1. Four-quarter moving average.
2. Non-financial corporations; four-quarter moving average.
Source: OECD Economic Outlook 106 database; and Insee.

StatLink https://doi.org/10.1787/888934045354

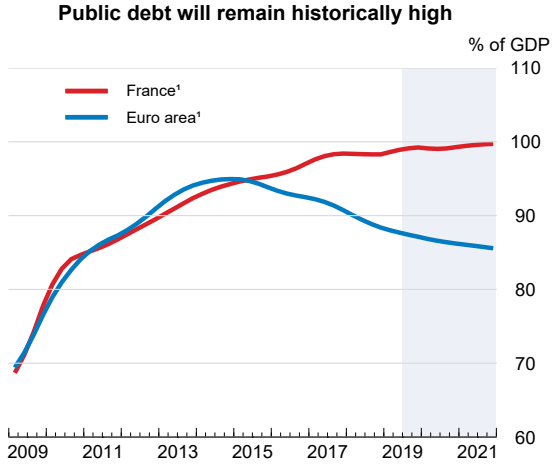
France: Demand, output and prices

France	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2014 prices)				
GDP at market prices	2 232.9	2.4	1.7	1.3	1.2	1.2
Private consumption	1 210.8	1.6	0.9	1.2	1.5	1.3
Government consumption	530.2	1.5	0.8	1.0	1.0	1.0
Gross fixed capital formation	486.8	5.0	2.8	3.3	1.8	1.6
Final domestic demand	2 227.9	2.3	1.3	1.7	1.4	1.3
Stockbuilding[1]	18.5	0.2	-0.3	-0.2	0.0	0.0
Total domestic demand	2 246.3	2.4	1.0	1.5	1.4	1.3
Exports of goods and services	675.6	4.0	3.5	2.1	1.1	2.2
Imports of goods and services	689.1	4.1	1.2	2.7	1.8	2.3
Net exports[1]	- 13.5	-0.1	0.7	-0.2	-0.2	-0.1
Memorandum items						
GDP deflator	_	0.5	0.8	1.5	1.0	1.2
Harmonised index of consumer prices	_	1.2	2.1	1.3	1.2	1.3
Harmonised index of core inflation[2]	_	0.5	0.9	0.6	0.8	1.2
Unemployment rate[3] (% of labour force)	_	9.4	9.1	8.5	8.2	8.1
Household saving ratio, gross (% of disposable income)	_	13.5	13.8	14.7	14.8	14.6
General government financial balance (% of GDP)	_	-2.8	-2.5	-3.1	-2.3	-2.1
General government gross debt (% of GDP)	_	123.2	122.5	123.0	123.7	123.9
General government debt, Maastricht definition (% of GDP)	_	98.4	98.3	98.8	99.5	99.7
Current account balance (% of GDP)	_	-0.7	-0.6	-0.6	-0.8	-0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. National unemployment rate, includes overseas departments.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046399

France 2



1. Maastricht definition; four-quarter moving average.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045373

Business investment, in both services and manufactured goods, has been robust. The reform of a large wage-based tax credit for businesses temporarily increased profit margins in 2019 and financing conditions remain supportive. Yet, manufacturing production and investment expectations have declined. After a strong end of 2018, weak and uncertain global economic conditions, as well as low deliveries in the shipbuilding and aeronautical sectors, have weighed on exports. Public consumption has continued to grow at a moderate pace, and local government investment has rebounded before the municipal elections in 2020. Housing starts have continued to weaken from their 2017 peak, despite a dynamic housing market.

Additional reforms would raise inclusive growth

The fiscal deficit increased in 2019 due to the large one-off business tax reduction, but it is set to decline to 2.1% of GDP by 2021. Measures to reduce the tax burden for households and firms, and higher in-work benefits, will provide some welcome support to economic activity and also enhance employment incentives and boost economic performance. However, public debt will remain historically high. Since a part of the deficit reduction relies on lower debt-servicing costs, which may not be durable, further spending cuts, notably in some social expenditures, will be necessary to reduce the public debt-to-GDP ratio over the medium term.

The ongoing structural reform agenda is improving inclusiveness, skills and job quality. The implementation of the 2017 labour reforms, as well as the unemployment benefit reform, are helping to better align firm-level wage and productivity developments, and encourage hiring on open-ended contracts. The overhaul of vocational training and the increased focus on apprenticeships are also improving skills and ensuring better job matches. Pro-business measures (the PACTE law) are also easing firm entry and growth. Yet, social mobility remains weak and employment rates are low for many disadvantaged groups. Further efforts are needed to ease the labour market entry of low-skilled youth and to improve access to high-quality early education and social mobility. Merging welfare programmes and in-work benefits – taking into account housing benefits and public housing in household resources – would raise work incentives and inclusiveness. Moreover, continuing to increase competition in some service sectors and lowering barriers to firm growth would strengthen employment and productivity growth.

Additional efforts to cut inefficient and non-priority spending will be key to put public debt on a firmly declining path. A rapid implementation of the planned pension reform could improve equity and mobility while providing higher incentives to delay retirement. Higher training opportunities for older workers and measures to limit in-work discrimination would boost its effectiveness. The effective use of targeted expenditure reviews will be particularly important to reduce overlap in sub-central governments' responsibilities and to identify areas where there is room to rationalise public administration. Systematically reviewing tax expenditures and low-revenue taxes, while taking into account their benefits for low-income households, would also promote economic activity and a more redistributive tax structure.

Domestic demand will keep driving growth

Economic growth is projected to remain at 1.2% in 2020-21. Weak trade momentum will weigh on exports and business investment. However, labour market improvements and fiscal measures will raise disposable incomes. A gradual decline in the household saving rate will support private consumption. This will also underpin a slow recovery in housing investment, even though the local electoral cycle will hold back public and household investment in 2020.

Increasing trade tensions and continued uncertainty about an eventual Brexit would reduce further export prospects and investment. The ensuing worsening of the slump in manufacturing activity and euro area activity would heighten risks of contagion to the French services sector, while the historically high level of private debt reduces margins of adjustment for households and firms. On the upside, a fast and efficient implementation of the ongoing public investment plan could lead to higher investment growth.

Germany

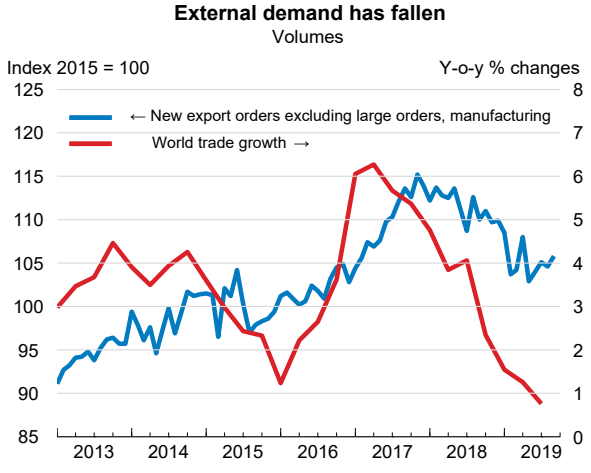
The export-dependent economy has taken a substantial hit from the stagnation of global trade, with declines in export orders and industrial production. After expanding by an estimated 0.6% in 2019, GDP is projected to grow only by 0.4% in 2020 and 0.9% in 2021. Continuing trade disputes and Brexit uncertainty are weighing on business confidence and investment. Private consumption and construction are expected to stay resilient, but weaknesses in manufacturing will spill over to the rest of the economy. However, in light of the shortage of skilled labour and programmes to support flexibility in working hours, large deteriorations in the labour market are not expected.

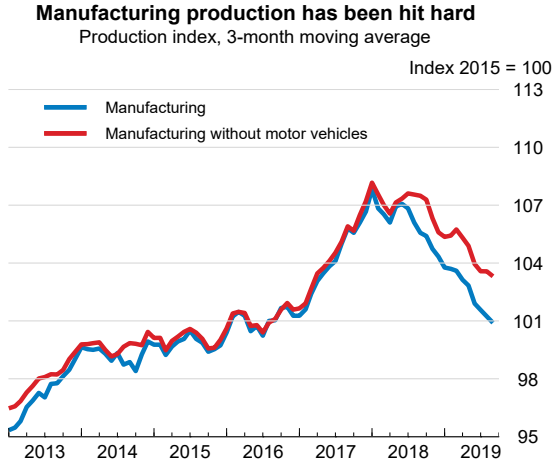
Expansionary monetary and fiscal policy will continue to support growth. As investment is needed across a broad range of infrastructure sectors and the economy is slowing, budgetary margins allowed under the debt brake should be used to strengthen long-term growth and facilitate the transition to a low emissions economy.

Weak external demand is offset by domestic forces

Sustained weak world trade growth has contributed to a further reduction of industrial production and a slowdown of the German economy. The outlook for exports remains poor with new orders stabilising at a low level. Business investment has also declined, as manufacturing business confidence has continued to weaken. While the initial decline in production in late 2018 was partly caused by temporary supply disruptions relating to new emission requirements for motor vehicles, the weakness is now more widespread across all of manufacturing. The motor vehicle manufacturing industry faces a structural challenge from the shift toward low-emission vehicles. Although confidence is still high in the service sector, worsening business expectations suggest some spillover from manufacturing, particularly in closely related business services.

Germany 1





Source: Statistisches Bundesamt; OECD Economic Outlook 106 database and OECD calculations.

StatLink https://doi.org/10.1787/888934045392

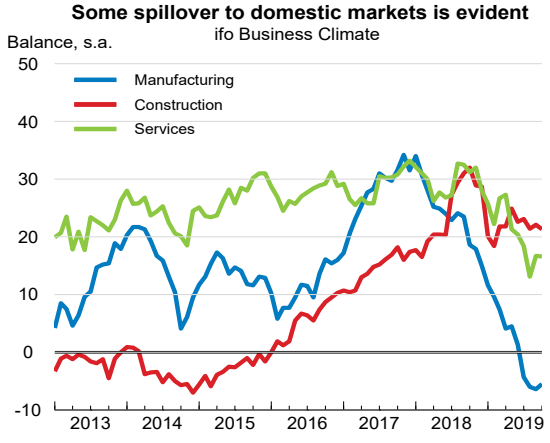
Germany: Demand, output and prices

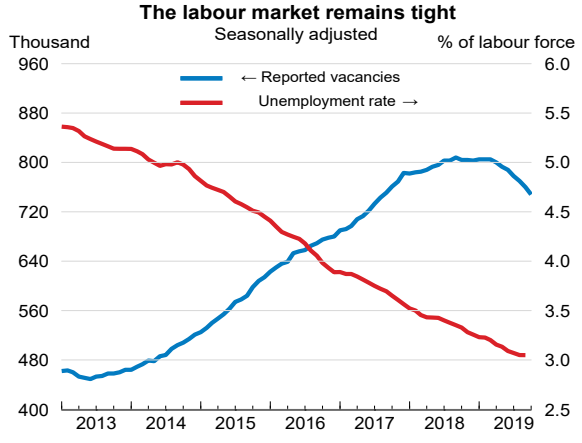
Germany	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	3 128.4	2.8	1.5	0.6	0.4	0.9
Private consumption	1 646.5	1.6	1.2	1.4	1.1	1.2
Government consumption	620.0	2.4	1.4	1.9	1.7	1.8
Gross fixed capital formation	633.7	3.1	3.5	2.7	0.4	1.4
Final domestic demand	2 900.2	2.1	1.8	1.8	1.1	1.4
Stockbuilding[1]	- 0.2	0.4	0.3	-0.5	0.1	0.0
Total domestic demand	2 900.0	2.6	2.1	1.2	1.2	1.4
Exports of goods and services	1 436.3	5.5	2.3	0.8	-0.1	1.3
Imports of goods and services	1 207.9	5.7	3.7	2.3	1.4	2.3
Net exports[1]	228.4	0.4	-0.4	-0.6	-0.6	-0.4
Memorandum items						
GDP without working day adjustments	3134.1	2.5	1.5	0.5	0.8	0.9
GDP deflator	_	1.1	1.5	1.9	1.9	1.9
Harmonised index of consumer prices	_	1.7	1.9	1.3	1.2	1.5
Harmonised index of core inflation[2]	_	1.3	1.3	1.2	1.1	1.5
Unemployment rate (% of labour force)	_	3.8	3.4	3.1	3.2	3.3
Household saving ratio, net (% of disposable income)	_	10.4	11.0	11.0	10.9	10.8
General government financial balance (% of GDP)	_	1.2	1.9	1.0	0.3	-0.2
General government gross debt (% of GDP)	_	74.1	70.3	68.5	67.5	67.0
General government debt, Maastricht definition (% of GDP)	_	65.2	61.8	60.0	59.0	58.5
Current account balance (% of GDP)	_	8.1	7.5	7.3	6.5	6.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046418

Germany 2





Source: Ifo Business Survey; Deutsche Bundesbank; and Statistisches Bundesamt.

StatLink https://doi.org/10.1787/888934045411

Employment growth slowed over the course of 2019 but remains positive, and the unemployment rate continues to be at a record low. However, the number of vacancies has started to decline in recent months, albeit from a very high level. Firms' intentions to use the government's short-time work subsidy scheme have started to pick up. Private consumption is supported by growth in household disposable income due to fiscal measures and wage growth, which exceeded 3% in the second quarter. Headline and core inflation were around 1.5% during the first half of 2019, but fell in the third quarter. Despite an attenuation over the year, consumer confidence is still high. The construction sector has remained robust and business confidence in the sector is strong. Slowing housing investment in the second quarter was largely temporary as relatively mild weather enabled more construction during the winter months and order books are still well stocked.

There is fiscal space to respond to the downturn

With the implementation of various measures from the coalition agreement, such as higher tax allowances, child benefits and pensions, fiscal policy has been expansionary this year. Some of the measures will also stimulate demand in 2020 but to a lesser extent than in 2019. In 2021, a further increase in child benefits and the necessary reform of the solidarity surcharge introduced in the 1990s to finance the costs of reunification will stimulate the economy somewhat.

As the economy is slowing and an investment backlog exists across a broad range of infrastructure sectors, such as broadband internet, roads, schools, housing, energy, waste and water, budgetary margins should be used to strengthen long-term growth, foster regional cohesion and speed up the transition to green, low-emission energy and transport. At the same time, financial and labour constraints on project planning in many municipalities need to be addressed urgently through local training and capacity building. Tight capacity in construction and the labour market also limit the extent to which public investment can be ramped up immediately without raising costs, though this could be alleviated by making use of foreign labour in occupations that restrain output expansion, and it may in any case change if current economic weakness continues. Current spending plans are insufficient to resolve the investment backlog.

Despite the planned law on financial support for mining regions and the climate package, the federal budget is still foreseen to be balanced. Using the available fiscal space, which has expanded with the decline in government borrowing costs, is crucial, as euro area monetary policy is already expansionary with limited scope to do more. Sustained low interest rates amplify financial stability risks from high leverage and accelerating credit growth. The financial supervisor in July 2019 raised the countercyclical buffer to 0.25% to increase the resilience of the banking system.

Enduring weak external demand is a risk to economic growth

As global demand is expected to stay subdued over the projection period, output will grow only modestly in 2020, before picking up gradually in 2021. Unemployment is expected to increase only slightly as the flexible government-supported short-term work programmes absorb some labour market slack as long as the slowdown is temporary. Also, employers will be reluctant to lose skilled employees, as the share of firms seeing a shortage of skilled workers as a risk to business development has risen sharply over the past decade. The strong labour market and modest fiscal measures will support domestic consumption, while housing construction is set to expand to meet unfilled orders as capacity constraints ease. Inflation will remain comfortably below 2%.

Germany's export-dependent economy is particularly exposed to external risks and a further slowing of global trade. Intensifying trade disputes, a sharper slowdown in China or continued uncertainties around Brexit would worsen the outlook and increase the risk of substantial spillovers to the domestic economy and labour market. Structural shifts in the motor vehicle manufacturing industry are another downside risk and could lead to job losses; conversely, a bounce back is likely if temporary factors prove to be a large part of the recent downturn and if trade uncertainty is resolved.

Greece

GDP is projected to expand by about 2% in 2020-21. Employment and real wage gains will support consumption, while improving financing conditions and confidence will boost business investment. Sluggish external demand will moderate export growth. This, and the gradual rise in imports, will mitigate improvements in the current account balance.

In spite of the adoption of expansionary fiscal measures in mid-2019, the primary budget surplus will remain high in 2019 at 3.8% of GDP. The 2020 budget, which includes large tax cuts along with measures to broaden the tax base and, to a lesser extent, rationalise spending, will support growth and lower the primary surplus to 3.5% of GDP. Ambitious reforms need to continue to raise employment durably, especially of women and the young, as well as investment and productivity growth.

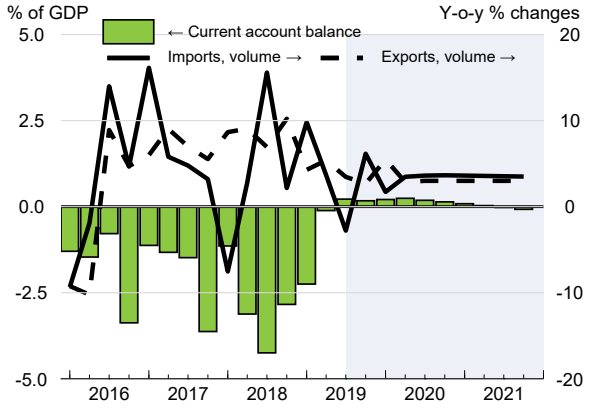
The export-driven economic expansion continues

Exports are driving the recovery, buoyed by tourism receipts. Reform-induced gains in price competitiveness are supporting exports of goods, despite sluggish external demand. Rising business confidence, improving financial conditions and record-low lending rates are supporting business investment. Bank lending to non-financial corporations has been increasing since early 2019 and remaining capital controls were abolished in September 2019. Banks' non-performing loans (NPLs) are gradually declining, though they remain high at 44% of gross loans.

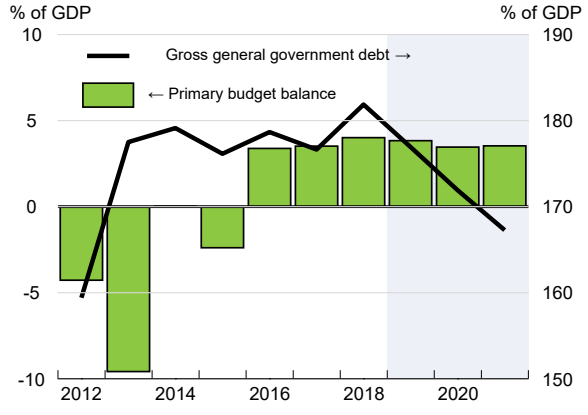
The economy continues to create jobs thanks to past reforms and price competitiveness gains. The employment rate has risen above 57% - the highest level since 2010 - while the unemployment rate has dropped to below 17%. Rising employment is lifting household disposable income, but the rebuilding of private savings and households' deleveraging are constraining private consumption growth. Ample slack in the economy and sluggish productivity growth keep wage increases and consumer price inflation low.

Greece

Exports and imports will continue to grow



The primary surplus will decline but remain sizeable and the debt ratio will decline



Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045430

Greece: Demand, output and prices

Greece	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	176.3	1.4	1.9	1.8	2.1	2.0
Private consumption	122.2	0.9	1.0	0.6	1.8	1.4
Government consumption	35.5	-0.5	-2.5	2.3	1.1	0.7
Gross fixed capital formation	21.2	9.4	-12.0	7.3	10.3	10.0
Final domestic demand	178.9	1.7	-1.2	1.6	2.6	2.3
Stockbuilding[1,2]	- 1.0	0.0	1.8	-0.6	-0.3	0.0
Total domestic demand	178.0	2.0	0.4	0.9	2.3	2.2
Exports of goods and services	52.9	6.9	8.7	3.9	3.6	3.0
Imports of goods and services	54.6	7.4	3.0	4.0	3.1	3.6
Net exports[1]	- 1.6	-0.2	1.9	0.0	0.2	-0.2
Memorandum items						
GDP deflator	_	0.5	0.5	0.8	0.9	0.7
Harmonised index of consumer prices	_	1.1	0.8	0.4	0.4	0.9
Harmonised index of core inflation[3]	_	0.3	0.3	0.8	0.7	0.9
Unemployment rate (% of labour force)	_	21.5	19.3	17.5	16.3	14.8
Household saving ratio, net (% of disposable income)	_	-16.9	-15.1	-12.1	-10.6	-10.0
General government financial balance[4] (% of GDP)	_	0.7	1.0	1.3	1.0	1.1
General government gross debt (% of GDP)	_	191.4	195.8	190.8	185.8	181.2
General government debt, Maastricht definition (% of GDP)	_	176.6	181.9	176.9	171.9	167.3
Current account balance[5] (% of GDP)	_	-1.9	-2.8	-0.5	0.2	0.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. National Accounts basis. Data also include Eurosystem profits on Greek government bonds remitted back to Greece. For 2015-2019, data include the estimated government support to financial institutions and privatisation proceeds.
5. On settlement basis.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046437

Structural reforms and prudent fiscal policies are key to reducing public debt

Tight spending controls, and higher tax revenues, due in part to improved compliance, raised the primary budget surplus to over 4% of GDP in 2017 and 2018, bolstering fiscal credibility. The primary surplus is projected to decline, but remain high at 3.8% of GDP in 2019 and 3.5% in 2020-21. The decline is attributable to the expansionary fiscal measures passed in mid-2019 and the tax cuts planned in the 2020 budget (worth about 0.6% of GDP), partly offset by measures aimed at improving tax compliance (mostly by extending the use of electronic payments) and, to a lesser extent, rationalising spending. The government remains committed to adhere to the fiscal target agreed with EU partners or find an agreement to lower it. Debt servicing costs remain low and will continue to decline, resulting in a headline budget surplus of 1% in 2020-21. Further progress on spending reviews, enhancing tax compliance and broadening the tax base are key to improving the quality of public spending and the equity and efficiency of the tax system. This will allow reductions in the high tax burden while safeguarding fiscal credibility and achieving fiscal targets.

Continuing ambitious structural reforms will raise long-term growth prospects. The approval by the European Commission of the government's plan – involving a public guarantee scheme similar to the one already in use in Italy – to further develop a secondary market for non-performing loans is expected to accelerate banks' disposal of such loans, which is essential to raise bank lending and investment.

Strengthening job-search and training policies and public employment services will raise employment, especially among women and the young, and reduce long-term unemployment. Advancing public sector administration reforms, completing the land registry and opening state-owned companies to private capital would reduce barriers to firms' growth and boost productivity and jobs.

The recovery will firm

GDP is set to grow by around 2% in 2020-21. While goods and tourism exports will grow moderately, imports will continue to recover, supported by rising domestic activity and especially investment. The projected recovery in investment assumes progress in reducing non-performing loans and attracting foreign investment projects.

The planned expansionary fiscal policy could provide a larger growth stimulus than projected. Faster progress in opening up state-owned companies to private investors and reducing red tape would support foreign direct investment. Failing to achieve fiscal targets could undermine fiscal credibility and raise government bond yields, raising banks' funding costs and lending rates. Delays in markedly reducing banks' non-performing loans would restrict bank lending and hold back the investment recovery.

Hungary

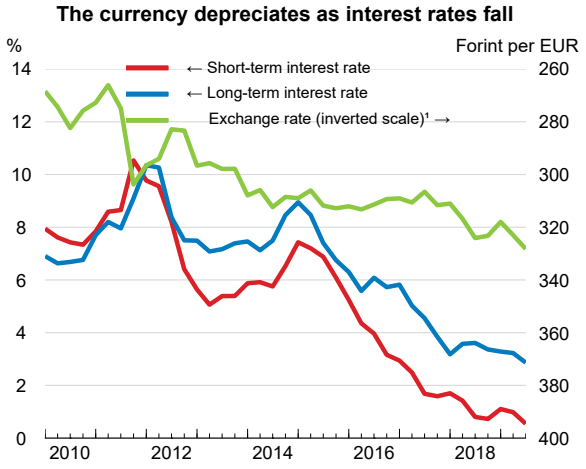
The strong recovery is projected to slow in line with external demand to slightly above 3% in the next two years. Private consumption will continue to drive growth on the back of strong gains in real incomes. Public investment will decelerate along with declining disbursements from EU structural funds. Capacity constraints will bolster business investment and imports. The tightening labour market continues to push up wage and price inflation.

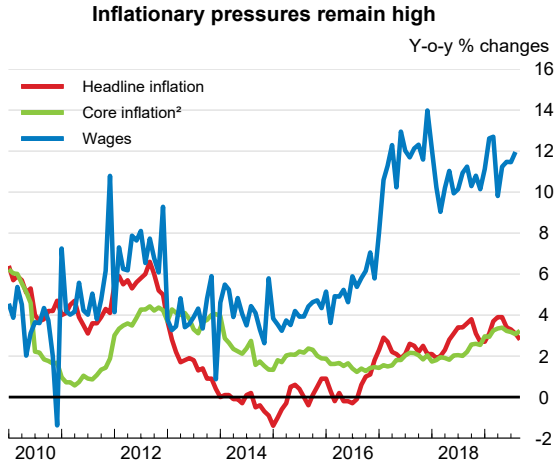
Fiscal policy will remain supportive as social security contributions are further reduced and public spending, including on wages, is increased. The central bank is expected to continue its loose monetary policy stance. However, counter-cyclical policies should address signs of overheating and contain inflation expectations. Policies to bolster geographical labour mobility and labour supply, including expansion of early childhood care, would prolong the recovery.

Domestic demand is the main driver of growth

Household demand remains strong, driven by continued solid gains in employment and real wages, an all-time high consumer confidence, housing investment support schemes and very accommodative monetary policy. Other investments are underpinned by large disbursements of EU structural funds, the demand-driven expansion of production capacity and FDI in the export-oriented automotive sector as well as supportive monetary policy. Exports have slowed in line with foreign demand, while imports continue to expand in response to strong domestic demand.

Hungary





1. Higher values indicate that the currency depreciates, while lower values that it appreciates.
2. Core inflation excludes food products and fuels.
Source: OECD Economic Outlook 106 database; OECD Main Economic Indicators database; and IMF International Financial Statistics database.

StatLink https://doi.org/10.1787/888934045449

Hungary: Demand, output and prices

Hungary	2016	2017	2018	2019	2020	2021
	Current prices HUF billion	Percentage changes, volume (2005 prices)				
GDP at market prices	35 896.3	4.5	5.1	4.8	3.3	3.1
Private consumption	17 876.6	4.7	4.8	4.8	4.1	3.7
Government consumption	7 227.3	2.4	0.9	1.0	1.8	1.0
Gross fixed capital formation	7 058.4	18.7	17.1	16.2	4.0	4.0
Final domestic demand	32 162.3	7.3	6.9	7.1	3.6	3.3
Stockbuilding[1]	593.8	-1.8	0.4	-1.4	0.2	0.0
Total domestic demand	32 756.1	5.2	7.3	5.4	3.8	3.2
Exports of goods and services	31 284.3	6.9	4.3	5.0	3.9	5.0
Imports of goods and services	28 144.1	8.2	6.8	5.5	4.5	5.3
Net exports[1]	3 140.2	-0.5	-1.7	-0.2	-0.4	-0.1
Memorandum items						
GDP deflator	_	3.5	4.5	4.4	3.9	4.2
Consumer price index	_	2.3	2.9	3.3	3.4	4.1
Core inflation index[2]	_	1.8	2.1	3.2	3.5	4.1
Unemployment rate (% of labour force)	_	4.1	3.7	3.4	3.2	3.1
Household saving ratio, net (% of disposable income)	_	6.6	6.9	6.6	6.2	6.0
General government financial balance (% of GDP)	_	-2.4	-2.3	-1.8	-1.7	-1.4
General government gross debt (% of GDP)	_	93.3	87.1	84.2	82.2	80.0
General government debt, Maastricht definition (% of GDP)	_	72.9	70.2	67.2	65.3	63.1
Current account balance (% of GDP)	_	2.3	-0.6	-0.7	-0.9	-1.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046456

The unemployment rate has fallen to an all-time low of less than 3½ per cent, as total employment reached a historical high in late 2019 on the back of strong job creation in the private sector, partly offset by the roll-back of public work schemes. Private firms are reporting widespread labour shortages and the job vacancy rate is among the highest in Europe. The tight labour market and higher minimum wages are underpinning continued double-digit wage growth in the private sector. Further lowering of employer social security contributions partly offset the increase in total wage costs. Nonetheless, core inflation has continued to increase, while headline inflation has eased to below 3% on the back of lower energy prices. A weakening of the forint is adding to inflation pressures.

Reversing macroeconomic policies would sustain the upswing

Lower social security contributions for employers and higher public sector wages and subsidies for house purchases are supporting growth. This effect is reinforced by low monetary policy rates, including a negative overnight deposit rate. Decreasing the stimulus policies gradually would reduce the risk of overheating and contain inflation expectations.

The strong economy presents an opportunity for strengthening fiscal sustainability, reducing old-age poverty, and improving access to healthcare services. This should be combined with measures to improve geographical labour mobility, accelerate the reduction of public work schemes, and expand early childhood care, which would advance work-life balance, in order to bolster the labour supply and prolong the recovery.

Slower growth will not remove inflationary tensions

The economic recovery is projected to slow to a pace of just above 3%, enough to secure continued employment gains. Private consumption will remain the main growth driver, benefitting from solid real income growth. Business investment will be underpinned by the need to expand production capacity. The strong domestic economy and capacity constraints will bolster import growth, while exports slow along with weaker international trade and increasing labour costs. Downside risks are centred on higher-than-projected wage increases, leading to rising inflation expectations. Also, a further weakening of export markets would worsen the growth outlook. On the upside, lower-than-projected import price growth could moderate domestic price developments and sustain the upswing.

Iceland

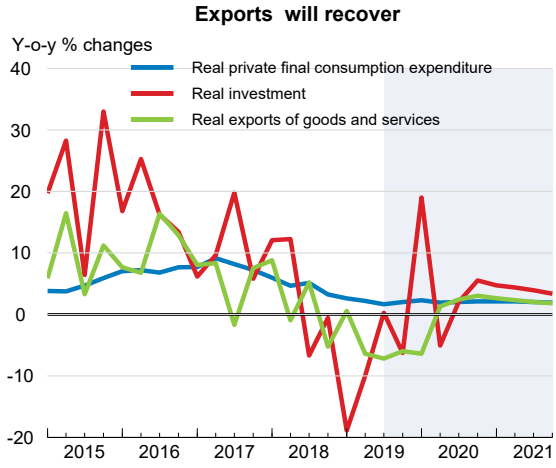
The economy will recover amid a pick-up of foreign tourism and seafood exports. Consumption will remain moderate on the back of contained wage growth and rising social benefits. Business investment will slowly recover as interest rates decline. Unemployment will rise, although in a few high-skill sectors labour shortages will become more apparent. Inflationary pressures will ease as wage drift has weakened and the krona has stabilised.

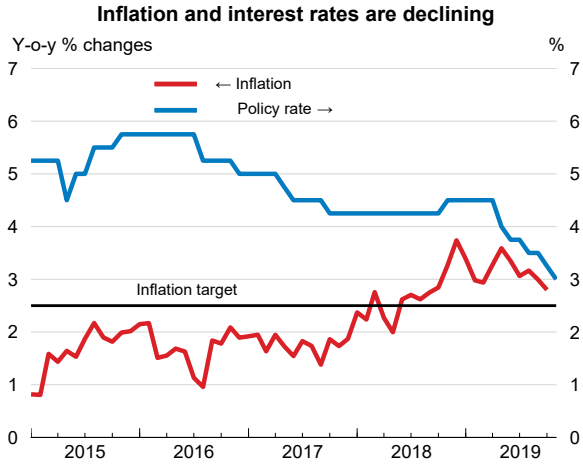
The central bank should continue to adjust interest rates in line with prospects for inflationary developments. Fiscal policy is projected to be broadly neutral following tax cuts and higher spending. Spending increases, especially on disability benefits, need to be restrained to ensure that debt continues to decline. Stringent regulations and restrictions on foreign direct investment, which weaken competition and hold back innovation and productivity, should be adjusted.

Growth is recovering

Growth is recovering gradually, as foreign tourism is stabilising and the capacity constraints in the airline sector are easing. Business investment remains weak after large construction projects have been terminated and because confidence is low. With exports weakening, the current account surplus is declining. Household consumption growth is robust on the back of moderate wage agreements and generous unemployment and social benefits. After declining for several years, the unemployment rate has risen sharply, to more than 4% in autumn 2019. House prices have stabilised following the recent increase in supply, lower immigration and declining demand related to tourism, but they remain high. Both corporate and household debt are hardly growing.

Iceland





Source: OECD Economic Outlook 106 database.

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Iceland: Demand, output and prices

Iceland	2016	2017	2018	2019	2020	2021
	Current prices ISK billion	Percentage changes, volume (2005 prices)				
GDP at market prices	2 490.9	4.4	4.8	0.8	1.6	2.6
Private consumption	1 235.9	8.1	4.7	2.1	2.1	2.0
Government consumption	570.7	3.7	3.5	3.0	2.8	2.5
Gross fixed capital formation	525.9	10.2	4.0	-8.8	4.6	4.1
Final domestic demand	2 332.5	7.4	4.3	-0.3	2.8	2.6
Stockbuilding[1]	2.9	-0.5	0.4	-0.1	0.1	0.0
Total domestic demand	2 335.4	7.0	4.6	-0.6	2.8	2.6
Exports of goods and services	1 186.6	5.4	1.7	-4.8	0.0	2.2
Imports of goods and services	1 031.1	12.3	0.8	-8.8	2.7	2.3
Net exports[1]	155.5	-2.5	0.4	1.6	-1.1	0.0
Memorandum items						
GDP deflator	_	0.5	2.6	4.6	3.2	2.8
Consumer price index	_	1.8	2.7	3.0	2.4	2.1
Core inflation index[2]	_	2.4	2.5	2.9	2.4	2.1
Unemployment rate (% of labour force)	_	2.8	2.7	3.6	4.1	4.1
General government financial balance (% of GDP)	_	0.5	0.8	-0.9	-1.0	-1.3
General government gross debt[3]	_	63.4	62.0	62.6	63.2	64.2
Current account balance (% of GDP)	_	3.8	2.8	4.1	2.5	2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. Includes unfunded liabilities of government employee pension plans.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046475

Policy is neutral

Inflation is declining due to the strong krona and moderate wage increases, again undershooting the central bank's target. With inflation expectations declining, the bank lowered interest rates in five steps from 4.5% in May to 3% in November 2019. The rate is expected to decline further given the outlook for inflation. Interest rates are at a historical low, though they remain significantly higher than in most OECD countries.

Fiscal policy is broadly neutral. Relief on income taxes and social contributions and a rise in social benefits help address impacts from the downturn, while raising the budget deficit. The projection includes discretionary spending increases going forward, as planned by the government, in particular on infrastructure towards the end of the projection period. Public debt will no longer decline. Fiscal policy should be more contractionary, especially by cutting spending on disability, to build up fiscal space.

Product market regulation is stringent and the administrative burden for start-ups is high, holding back investment and innovation. Restrictions on foreign direct investment are among the highest in the OECD area, damping employment and productivity gains through lower international knowledge transfer. The government should set up a comprehensive action plan for regulatory reform, prioritising reforms that foster competition, level the playing field between domestic and foreign firms and attract international investment.

Growth will recover gradually

Growth is projected to recover to 1.6% in 2020 and 2.6% in 2021, as foreign tourism and seafood exports resume. Business investment will slowly recover as interest rates decline, and household consumption growth will ease as income growth slows. Government spending, in particular on infrastructure and social services, will be supportive. Inflation is projected to decline to 2%. The small size of the economy makes it volatile and vulnerable, and a deeper-than-expected global downturn can quickly result in a sharp fall in tourism revenues.

India

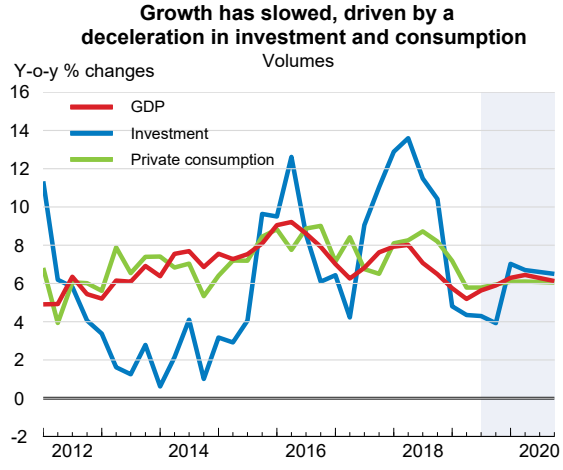
Economic growth is projected to recover to just under 6½ per cent in FY 2021 as election-related uncertainties fade and monetary and fiscal policies have become accommodative. The new income-support scheme for farmers and a good monsoon are supporting private consumption. The cut in corporate income tax will support corporate investment. Inflation and the current account deficit will remain moderate given the relatively large spare capacity in the economy and low oil prices. Job creation remains a challenge.

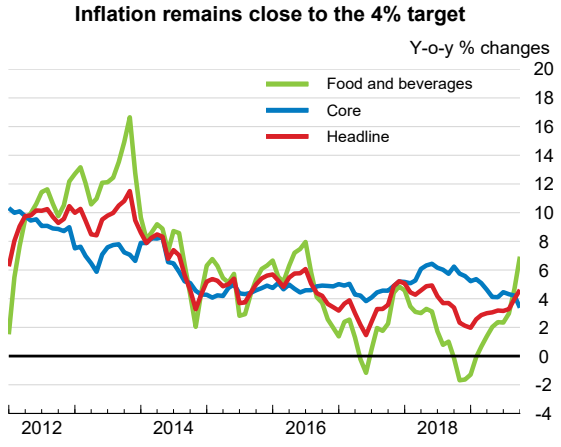
With inflation below target, some room for further accommodation in monetary policy remains. The large cuts in policy rates since the start of 2019 have not yet been fully reflected in lower lending rates, reflecting still high non-performing loans and public sector borrowing needs. Further reforms to improve financial sector soundness and the ease of doing business are needed to revive corporate investment. Re-building fiscal space will be key to finance better infrastructure and public services. Tax reforms are needed to broaden the property and personal income tax base. Borrowings from public enterprises and banks also need to be restrained.

The economy is bottoming out

Growth has slowed from a rapid pace. Stress in non-banking financial companies, coupled with changes in insurance regulations, has affected car sales, while volatility in fuel prices has weighed on consumer confidence. Construction has been hurt, as non-banking financial companies contribute a large share to its financing, weighing on job creation, income and consumption. Industrial production and related imports have weakened. Exports have suffered from the slowdown in foreign demand. However, they have benefitted from improvements in the Goods and Services Tax (GST) administration, enabling exporters to get faster tax refunds, while efforts to improve trade infrastructure, logistics and processes are starting to pay off. Overall, India has succeeded in seizing some of the market shares lost by other countries and exports have proved relatively resilient.

India 1





Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045487

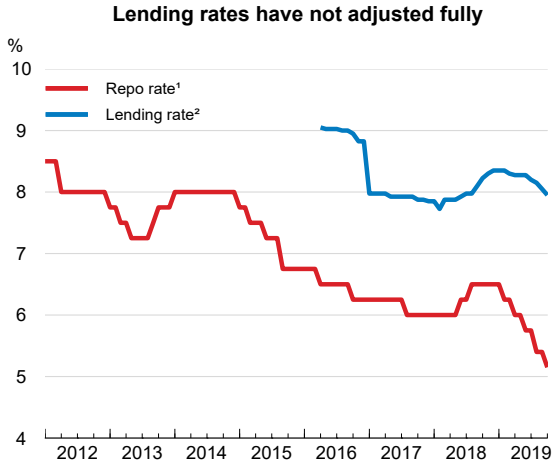
India: Demand, output and prices

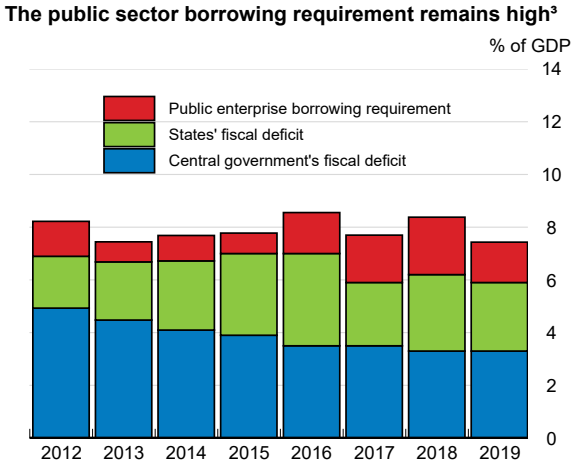
India	2016	2017	2018	2019	2020	2021
	Current prices INR trillion	Percentage changes, volume (2011/2012 prices)				
GDP at market prices	153.6	7.2	6.8	5.8	6.2	6.4
Private consumption	91.2	7.4	8.1	5.9	6.0	6.5
Government consumption	15.8	15.0	9.2	7.1	6.0	6.5
Gross fixed capital formation	43.4	9.3	10.0	4.9	6.6	6.8
Final domestic demand	150.3	8.8	8.8	5.7	6.2	6.6
Stockbuilding[1,2]	6.0	0.2	0.1	0.0	0.0	0.0
Total domestic demand	156.3	9.9	7.7	5.0	6.1	6.5
Exports of goods and services	29.5	4.7	12.5	5.0	4.4	4.9
Imports of goods and services	32.2	17.6	15.4	2.2	4.4	5.6
Net exports[1]	- 2.7	-2.8	-1.1	0.5	-0.2	-0.4
Memorandum items						
GDP deflator	_	3.8	4.1	3.1	3.7	3.8
Consumer price index	_	3.6	3.4	3.5	3.9	4.2
Wholesale price index[3]	_	2.9	4.3	1.5	3.0	3.7
General government financial balance[4] (% of GDP)	_	-5.8	-6.2	-6.2	-6.3	-6.1
Current account balance (% of GDP)	_	-1.9	-2.1	-1.7	-1.8	-2.0

Note: Data refer to fiscal years starting in April.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Actual amount in first column includes statistical discrepancies and valuables.
3. WPI, all commodities index.
4. Gross fiscal balance for central and state governments.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046494

India 2





1. The repo rate is the rate at which the Reserve Bank of India lends money to commercial banks.
2. The lending rate refers to the marginal cost of funds based lending rate (MCLR), the minimum interest rate below which a bank cannot lend.
3. Data for FY 2019-20 are budget estimates.
Source: OECD Economic Outlook 106 database; Reserve Bank of India; and Union Budget Expenditure Profile (Resources of Public Enterprises).

StatLink https://doi.org/10.1787/888934045506

Headline consumer price inflation has remained close to the 4% target and core inflation is adjusting down. Spare capacity, a good monsoon, the steady rupee, relatively low oil prices and modest increases in minimum support prices for summer crops are all contributing to keep price pressures low.

The current account deficit has declined. Moderate oil prices have helped, together with hefty remittances from abroad. Foreign exchange reserves stand at a healthy 8 months of imports of goods and services and almost four times short-term external debt. Overall, India's external vulnerability remains limited, with a low level of external debt compared to many emerging-market economies and predominantly long-term maturities.

Fiscal and monetary policies are accommodative

The Reserve Bank of India has cut policy rates by 135 basis points since early 2019 and maintains an accommodative stance. Lending rates have adjusted only partially and with a lag, as still large non-performing loans are weighing on banks' profitability, and high public sector borrowing has put pressures on lending rates. The August 2019 decision to link lending rates for new loans to an external benchmark should help speed up monetary policy transmission. Reducing the spread between administered rates on small savings – used to finance government debt – and market rates should also be considered. Given sticky inflation expectations and uncertainty around food price developments because of local floods, further cuts in policy rates should remain prudent.

Several structural reforms have been introduced, with a large fiscal cost. On the revenue side, the government has reduced corporate income tax rates from 30% to 22% (plus surcharges) and streamlined exemptions. The reduced 15% rate (plus surcharges) for new manufacturing companies created before 2023 is improving India's competitiveness and could attract companies considering relocating production. The estimated revenue loss is high (0.7% of GDP) while revenue from the Goods and Services Tax has disappointed.

On the spending side, the government has extended an income-support scheme for land-owning farmers (145 million beneficiaries), with a cost equivalent to 0.4% of GDP. This scheme could support rural consumption and help finance investment in the agricultural sector. Its impact on productivity in the agricultural sector remains uncertain given land fragmentation. It may not help much to reduce poverty for tenant farmers and daily labourers. The government is stepping up public infrastructure projects, which will contribute to improve wellbeing and competitiveness (including water and electricity provision, rural roads and ports).

A record transfer from the Reserve Bank of India will help contain the general government deficit for FY 2019-20. At the same time, the increasing reliance on off-budget transactions, often through public enterprises, weighs on the overall public sector borrowing requirement and the debt-to-GDP ratio remains relatively high. Raising more revenue from property and personal income taxes and improving the financial situation of public banks and enterprises will be key to finance better public education and health services. To boost job creation and reduce informality, efforts to modernise labour regulations should continue.

Growth is projected to rebound

Economic growth is set to climb to just under 6½ per cent by FY2021. Private investment will bounce back as capacity utilisation rises and the cost of borrowing for the corporate sector declines. The ongoing resolution of distressed assets of non-financial corporates under the Insolvency and Bankruptcy Code is expected to unlock resources for new investment projects. Recent reforms to improve the ease of doing business – including measures to liberalise FDI, lower corporate income tax rates and efforts to improve judicial services and contract enforcement – will also help. Rural consumption will pick up, thanks to the good monsoon, the full implementation of the new income support scheme for farmers and measures to reduce liquidity stress in non-banking financial companies.

The increased ability to pass and implement reforms, as illustrated with the recent liberalisation of FDI and disinvestment plans, represents a positive risk to the outlook. On the other hand, renewed stress in the banking or non-banking financial sector would create a credit crunch and affect growth. Higher oil prices would put pressure on inflation, the current account and public finances and would reduce households' purchasing power. An aggravation of trade tensions would further affect business sentiment and investment. The impact could be limited by the fact that India has specialised more in services than in merchandise trade.

Indonesia

Steady growth has lifted GDP per capita by around 4% annually for several years. During 2020-21, domestic demand is projected to continue supporting growth despite external headwinds. Rising household incomes and low inflation will underpin household spending. Investment growth will edge up again, partly reflecting infrastructure projects. Weaker trade growth globally is weighing on exports in the near term.

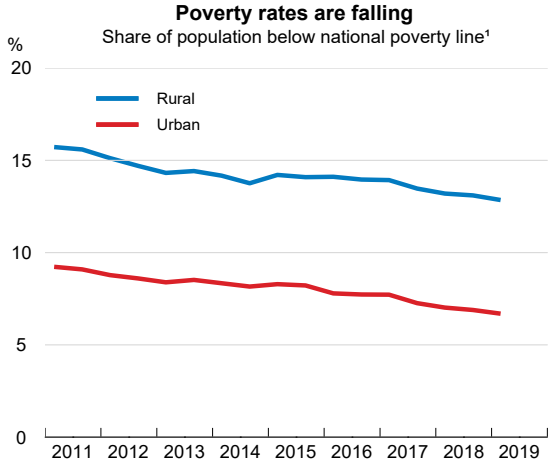
Bank Indonesia has begun easing monetary policy to boost growth and has some scope to lower interest rates further. It has also deployed macroprudential instruments to make policy more accommodative. Fiscal policy is expected to be broadly neutral, with the budget deficit well inside the 3%-of-GDP limit. An ambitious regulatory reform programme could help boost business confidence, investment and formal employment. Winding back fossil fuel subsidies, matched by more targeted social benefits, would improve environmental and social outcomes.

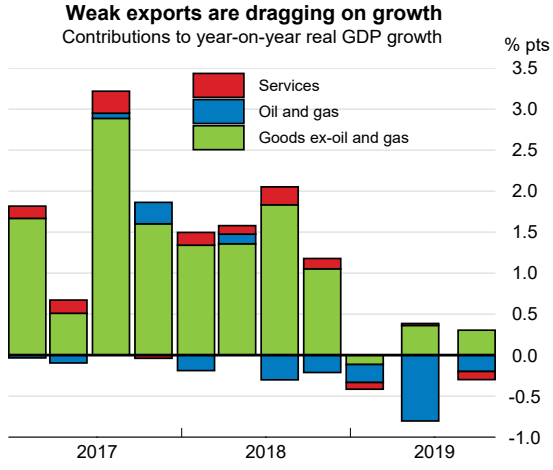
Growth remains resilient

Declining poverty rates, low inflation, healthy employment growth, and social assistance programmes are all supporting incomes and consumption. Consumer confidence has ebbed but remains high. Inflation is low. Commitments to freeze fuel and electricity prices in 2018-19 have contained administered prices. Investment growth has eased from its fast pace, partly because some government projects were postponed to reduce imports. However, bank loans for investment are growing strongly.

Export growth has slowed. Government policies to reduce fuel imports by diverting exports to domestic use have dramatically reduced exports and imports. Growth in other exports is also soft. Lower prices for key commodities are weighing on export income and the terms of trade. Overall, the current account deficit has been contained at 2.9% of GDP over the past year.

Indonesia 1





1. The poverty line is based on the minimum expenditure for food equivalent to 2 100 kilocalories per day, and basic housing, clothing, education and health needs.
Source: CEIC database.

StatLink https://doi.org/10.1787/888934045525

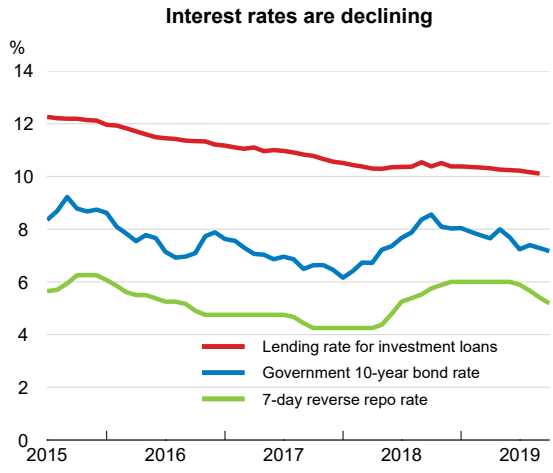
Indonesia: Demand, output and prices

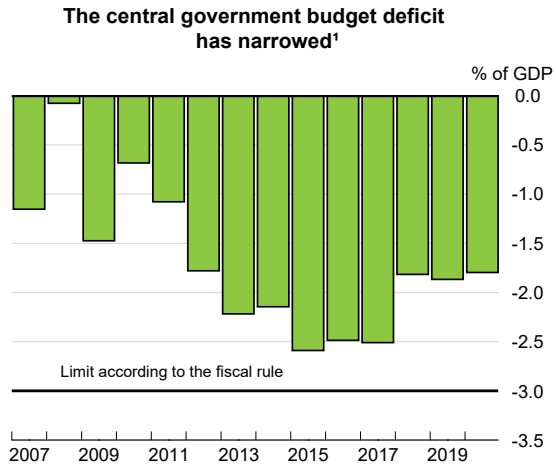
Indonesia	2016	2017	2018	2019	2020	2021
	Current prices IDR trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	12 401.7	5.1	5.2	5.0	5.0	5.1
Private consumption	7 171.5	5.0	5.1	5.2	5.2	5.5
Government consumption	1 181.6	2.1	4.8	4.8	3.3	4.5
Gross fixed capital formation	4 040.2	6.2	6.7	4.7	5.2	5.6
Final domestic demand	12 393.3	5.1	5.6	5.0	5.0	5.4
Stockbuilding[1]	- 85.4	-0.2	0.8	-1.0	0.2	0.0
Total domestic demand	12 307.9	4.8	6.3	3.8	5.2	5.3
Exports of goods and services	2 367.4	8.9	6.5	-0.1	2.5	3.6
Imports of goods and services	2 273.5	8.1	12.0	-6.2	3.0	4.9
Net exports[1]	93.8	0.3	-1.0	1.3	0.0	-0.2
Memorandum items						
GDP deflator	_	4.3	3.8	1.7	2.7	3.6
Consumer price index	_	3.8	3.2	3.2	3.5	3.4
Private consumption deflator	_	3.4	3.2	3.3	3.5	3.2
General government financial balance (% of GDP)	_	-1.9	-2.2	-1.9	-1.7	-1.7
Current account balance (% of GDP)	_	-1.6	-3.0	-2.8	-2.8	-2.8

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046513

Indonesia 2





1. Data for 2019 and 2020 are budgeted figures.
Source: CEIC database; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045544

Policy continues to balance stability and growth

Monetary policy now focusses more on economic growth than a year ago when stability concerns gained primacy amid capital outflows. Policy easing by major central banks has created space for Bank Indonesia to lower interest rates without sacrificing stability. From July to October, it lowered policy rates by 100 basis points. Bank lending rates and long-term government bond yields have declined substantially, implying easier financial conditions. The inflation target will be lowered to 3% +/-1% in 2020 and inflation is expected to be in that range, implying scope to lower interest rates further.

Bank Indonesia has actively used macroprudential tools to make its overall policy stance more accommodative overall. Through various measures it has sought to lower interest rates and promote credit growth. For example, maximum loan-to-valuation ratios have been removed for the first loan on a property when banks meet certain criteria. While the raft of measures to encourage lending can stimulate growth, they do come with risks. Accordingly, banks' lending standards should be monitored carefully for signs that credit quality has deteriorated. Continuing efforts to deepen financial markets will add to the overall resilience of the financial system.

Fiscal policy is expected to be broadly neutral, with the government focussed on containing the overall deficit and using the composition of revenue and expenditure to enhance growth. The central government budget deficit is on course to narrow to less than 2% of GDP in 2020. There is ample space to react if the growth outlook deteriorates. Infrastructure spending is to be revived through guarantees and other instruments to promote public-private partnerships. Given the associated fiscal risks, alternatives such as concessioning and foreign direct investment should also be promoted. Social assistance could be better targeted by gradually replacing direct and indirect fossil fuel subsidies with transfers.

Raising revenues remains a major challenge to realise spending plans. Lower commodity prices and trade are weighing on revenues, as will new tax incentives to stimulate investment. Non-tax-related factors that are likely to be more important in firms' investment location decisions should be tackled. Raising tax compliance remains critical, through administrative simplification to improve voluntary compliance and making better use of available data to strengthen enforcement.

Renewed reforms are needed to spur private investment and job creation, and to raise productivity. Streamlining and simplifying business regulations should remain a priority. Improvements to the online single submission system are ongoing and should continue based on user feedback. Reducing stringent labour market regulations, accompanied by measures to support workers, would make it easier to hire workers formally. More sectors should be opened to foreign investment, as discussed. Sustaining the fight against corruption is also crucial. Policy uncertainty in the mining sector should be addressed too. At the same time, some regulations need better enforcement, as evidenced by the widespread forest fires associated with illegal clearing of peatland despite stronger *de jure* regulations.

The domestic economy will remain solid notwithstanding external headwinds

GDP growth is projected to remain around 5% during 2020-21. Ongoing employment growth, the expansion of social assistance and lower interest rates will support robust consumption growth. Investment is expected to pick up thanks to the lifting of election-related uncertainty and more supportive financial conditions. Postponed infrastructure projects are set to resume in 2020. Slowing growth in China will hold back exports but rising demand in other key trading partners will partly offset this. Inflation is projected to remain within Bank Indonesia's target range.

A key risk to growth in 2020-21 is that trade tensions worsen, hurting commodity prices and exports. If global risk aversion rose, renewed capital outflows could necessitate higher interest rates, weighing on domestic demand, particularly investment. Conversely, if the level of domestic or global uncertainty eased and confidence rose, investment would be stronger than expected. Faster completion of large infrastructure projects would boost growth.

Ireland

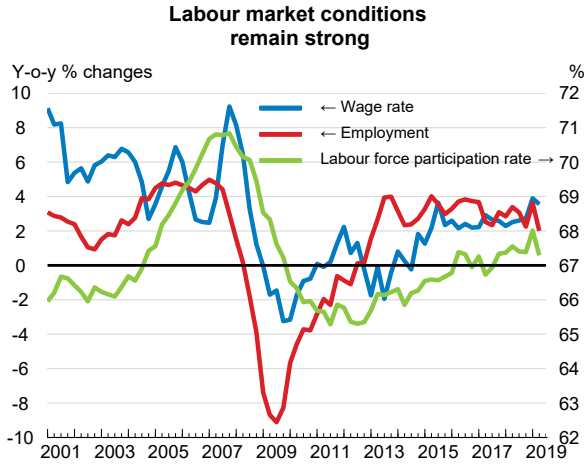
On the assumption of a "smooth" Brexit, GDP growth in Ireland is projected to remain robust, though moderating. Abstracting from multinationals' volatile activities, underlying domestic demand will remain resilient, supported by strong construction investment and despite the toll taken by slower trade partner growth and high external uncertainty on business sentiment. The labour market will tighten, and the associated wage pressures will push up inflation.

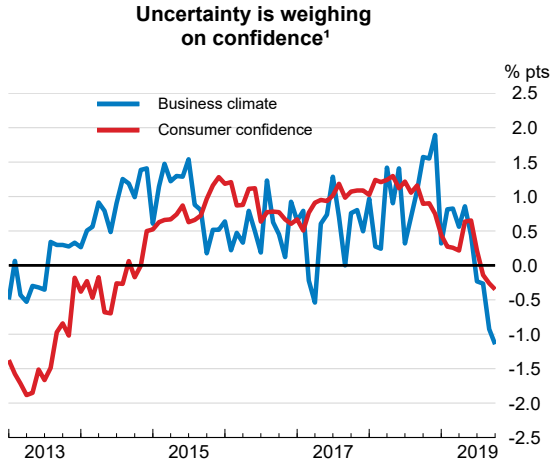
Fiscal restraint has been needed to avoid overheating and to build buffers in the face of risks, including those related to the Brexit negotiation. The government plans to deploy a significant fiscal package in the event of shocks related to Brexit, while letting the automatic stabilisers fully operate.

Underlying growth momentum has slowed but remains solid

Total domestic demand, adjusted for volatile activities of multinational enterprises, continued to grow at a solid pace of around 3% in mid-2019, following very strong expansion over the preceding years. Business sentiment has declined since early 2019, on the back of the higher risk of a 'disorderly' Brexit. Equipment investment has stalled over recent months, but construction activity has kept its momentum and industrial production remains resilient. The unemployment rate has reached historically low levels, and wage growth has gained further momentum recently. In contrast, inflation remains moderate, pulled down by lower import costs. Consumption is robust, underpinned by strong gains in employment and income as well as improved net worth, notwithstanding weakened consumer confidence over the past few months.

Ireland





1. The series are normalised using their long-term average and standard deviation.
Source: OECD Economic Outlook 106 database; and European Commission, Economic Sentiment Indicator.

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Ireland: Demand, output and prices

Ireland	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2017 prices)				
GDP at market prices	271.4	8.1	8.3	5.6	3.3	3.0
Private consumption	91.8	3.3	3.4	2.6	2.4	2.3
Government consumption	33.5	3.5	4.4	4.0	4.3	4.1
Gross fixed capital formation	96.6	-7.1	-20.6	39.2	-26.9	4.5
Final domestic demand	221.8	-1.2	-5.2	17.5	-8.5	3.3
Stockbuilding[1]	6.6	1.3	-2.4	2.1	0.3	0.0
Total domestic demand	228.5	11.4	-6.4	22.2	-7.9	3.2
Exports of goods and services[2]	328.0	9.1	10.4	10.0	4.8	4.4
Imports of goods and services	285.1	0.9	-2.9	20.6	-4.7	5.1
Net exports[1]	42.9	10.0	15.5	-6.1	10.8	0.9
Memorandum items						
GVA[3], excluding sectors dominated by foreign-owned multinational enterprises	_	8.1	8.3	3.9	3.8	3.3
GDP deflator	_	1.1	0.8	0.9	2.0	2.5
Harmonised index of consumer prices	_	0.3	0.7	0.9	1.7	2.2
Harmonised index of core inflation[4]	_	0.2	0.3	0.9	1.7	2.2
Unemployment rate (% of labour force)	_	6.7	5.7	5.3	4.8	4.6
Household saving ratio, net (% of disposable income)	_	6.0	5.8	5.8	5.6	5.2
General government financial balance[5] (% of GDP)	_	-0.3	0.1	0.3	0.5	0.7
General government gross debt (% of GDP)	_	77.4	76.0	71.4	66.6	65.4
General government debt, Maastricht definition (% of GDP)	_	67.8	63.6	59.0	54.2	53.0
Current account balance (% of GDP)	_	0.5	10.6	1.4	9.6	9.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. So called "contract manufacturing" (exports of goods produced abroad under contract from an Irish-based entity) by multinational enterprises is assumed to remain at the 2019 level in 2020 and 2021.
3. Gross value added. Data for 2017-2021 are OECD 's estimates.
4. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
5. Includes the one-off impact of recapitalisations in the banking sector.

Source: OECD Economic Outlook 106 database.

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Fostering resilience is key

The recent improvement in public finances largely reflects strong cyclical conditions, while public debt as a share of measured underlying economic activity remains high, calling for continued fiscal prudence. The government has been ramping up public investment as part of Project Ireland 2040, which has supported construction activity over the past year. The plan should be implemented conditional on pursuing the target of further reducing public debt, with the focus exclusively on projects with the highest social returns, while avoiding fuelling the risk of overheating. At the same time, the government should contain expenditure overruns, which have been significant in some sectors, notably in health.

While labour market conditions have tightened, labour force participation remains low by historical standards, despite government tax and benefit reforms aimed at boosting it. The authorities should enhance up-skilling and re-skilling programmes to help the inactive population return to work. In particular, an emphasis on training in digital skills is important, given the shortages of such skills in some sectors.

Growth prospects hinge on the outcome of the Brexit negotiations

Output will expand at a more moderate pace over the next two years due to increasing capacity constraints and weaker external conditions, including the slowdown in Europe. The unemployment rate will continue to fall to historically very low levels, albeit more slowly, with wage pressures becoming intense. As firms pass higher wages partially to prices, competitiveness and profitability will deteriorate, given weak productivity growth.

Uncertainty related to the Brexit negotiation remains high, including the content of an eventual trade deal, while the risk of a ‘disorderly’ Brexit is not completely eliminated. Similarly, further protectionist trade policies adopted elsewhere could have a substantial and abrupt effect on the Irish economy, given its openness to global trade. Such shocks could also worsen global financial conditions and push down domestic property prices, as some domestic asset classes, such as commercial real estate and non-performing loans, are particularly reliant on foreign investors. In contrast, if uncertainties associated with Brexit were to fade faster than anticipated, confidence would be boosted, strengthening economic activity more than currently projected.

Israel[1]

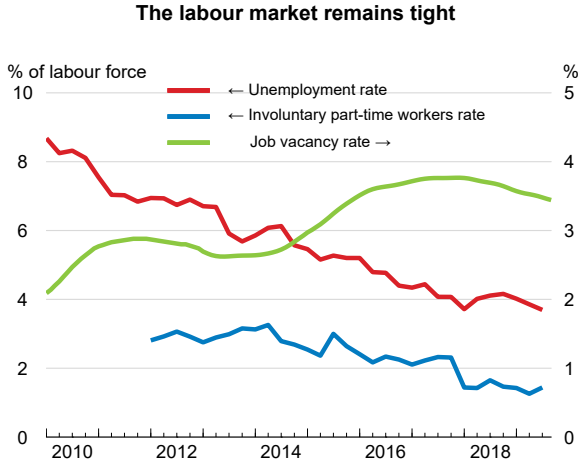
Economic growth is projected to ease slightly, but will remain close to 3% in 2020 and 2021. The global slowdown is weakening exports, and private consumption growth will moderate as the labour market cools slightly, but low interest rates and the start of gas exports will support activity. Inflation will rise slowly towards the lower half of the Bank of Israel's 1-3% target range.

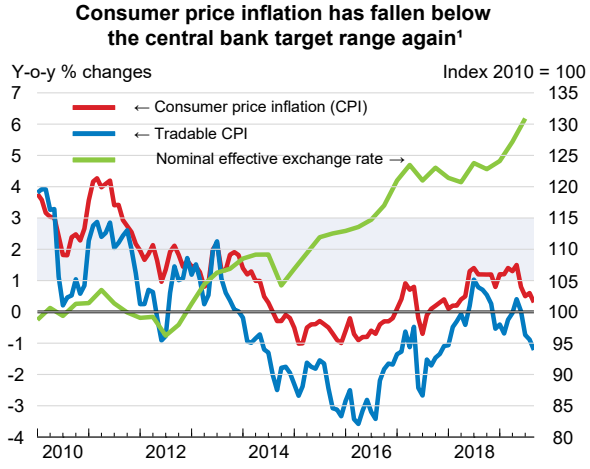
Fiscal policy tightening is needed to bring debt back on a downward trajectory and ensure room for manoeuvre should downside risks materialise. The accommodative monetary stance is appropriate and the authorities should wait until inflation is entrenched in its target range before gradually raising interest rates. Intensifying structural reforms, especially to improve skills of the Ultra-Orthodox and Israeli-Arabs and align them with labour market needs, is crucial to lower the large social disparities and boost productivity.

Growth remains robust

Growth remains robust and close to the potential rate. Industrial production remains resilient and consumer credit card purchases continue to expand at a healthy rate. Business and consumer confidence remain solid despite prolonged political uncertainty. Exports have been holding up well despite the rising shekel and global trade slowdown due to strong performance in tourism and high-tech services.

Israel





1. Shaded area is the Bank of Israel's inflation target range.
Source: OECD Economic Outlook 106 database; Bank of Israel; and CBS Israel.

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[1] The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Israel: Demand, output and prices

Israel	2016	2017	2018	2019	2020	2021
	Current prices NIS billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 225.0	3.6	3.5	3.1	2.9	2.9
Private consumption	670.9	3.3	3.6	3.4	3.2	3.0
Government consumption	274.7	3.4	4.1	2.9	3.7	2.5
Gross fixed capital formation	253.7	4.2	5.0	2.1	1.0	1.8
Final domestic demand	1 199.2	3.5	4.0	3.0	2.8	2.7
Stockbuilding[1]	6.3	0.3	-0.4	-0.8	-0.2	0.0
Total domestic demand	1 205.6	3.8	3.6	2.2	2.6	2.7
Exports of goods and services	363.7	4.0	5.7	4.6	3.0	3.5
Imports of goods and services	344.4	4.9	6.3	3.0	2.9	2.7
Net exports[1]	19.4	-0.2	-0.1	0.5	0.1	0.3
Memorandum items						
GDP deflator	_	0.2	1.1	2.1	1.2	1.7
Consumer price index	_	0.2	0.8	0.9	1.1	1.7
Core inflation index[2]	_	0.0	0.6	0.8	1.2	1.7
Unemployment rate (% of labour force)	_	4.2	4.0	3.9	4.1	4.3
General government financial balance (% of GDP)	_	-1.1	-3.6	-4.1	-3.8	-3.6
General government gross debt (% of GDP)	_	60.5	60.9	62.1	63.6	64.5
Current account balance (% of GDP)	_	2.3	2.6	3.8	3.9	4.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

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The labour market remains tight with the unemployment rate near its historical low, although the job vacancy rate has been declining moderately from high levels. Despite strong wage growth, inflation has fallen back below the lower bound of the target band. This is mainly due to volatile food and vegetable prices and a sharp decline in tradable goods inflation owing to lower energy prices and strong shekel appreciation.

Fiscal prudence is needed

The Bank of Israel has kept its policy rate at 0.25% since November 2018. Amid low inflation, shekel appreciation, heightened uncertainty about the global outlook and monetary easing in the United States and the euro area, the authorities have signalled that they will leave the policy rate at the current level for an extended period or reduce it until inflation is sustainably back in the target range. With the expected moderate rise in inflation, a gradual increase in the policy interest rate is included in the projection from the first quarter of 2021.

The general government budget deficit increased markedly from 1.1% of GDP in 2017 to a projected 4.1% of GDP in 2019, as strong increases in expenditures coincided with the lowering of some tax rates. With the economy at full employment, the new government should focus on preserving fiscal margins while allowing for spending to enhance social cohesion and productivity. This will require higher tax revenues, preferably by cutting inefficient tax exemptions and increasing environmental taxes, including by introducing congestion charges. Savings on the expenditure side can be generated for example by increasing the retirement age of women to that of men. Policy action in these areas would bring the budget deficit to more sustainable levels. Fiscal prudence should be accompanied by stepping up structural

reforms to improve infrastructure, particularly in public transport, boost competition in sheltered sectors and enhance training and education, especially in Israeli-Arab and Ultra-Orthodox communities.

Growth will ease slightly

Growth is projected to ease slightly in 2020 and 2021. Domestic demand growth will slow as the labour market cools, fiscal stimulus fades, and uncertainty from trade tensions weigh on investment. The assumed moderate recovery in export markets over the coming two years and the start of gas exports to Egypt will improve the trade balance and support the economy. Growth could be stronger if a faster-than-assumed development of the gas fields further reduces energy imports or boosts exports. In contrast, continued shekel appreciation and heightened geopolitical tensions would hurt growth. Domestic demand could slow more quickly if the new government takes necessary consolidation measures, which are not factored into the baseline projection.

Italy

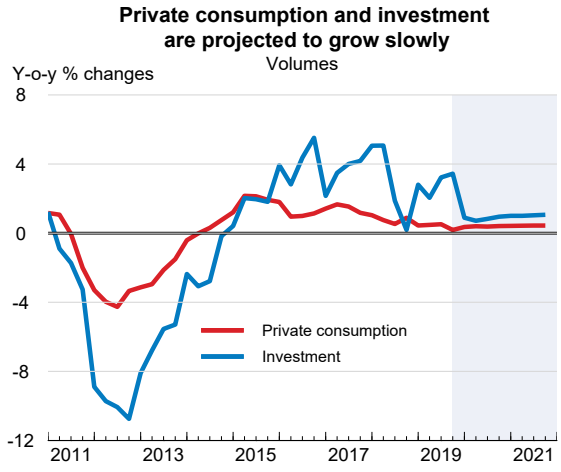
GDP growth is projected to resume very gradually. Global trade uncertainty and softer external demand will continue to weigh on export growth and business investment. Consumption will gradually pick up, as households' disposable incomes keep rising and as confidence stabilises. Fiscal policy is projected to support activity through reduced tax burdens and social security charges, as well as higher public investment and tax incentives for business investment.

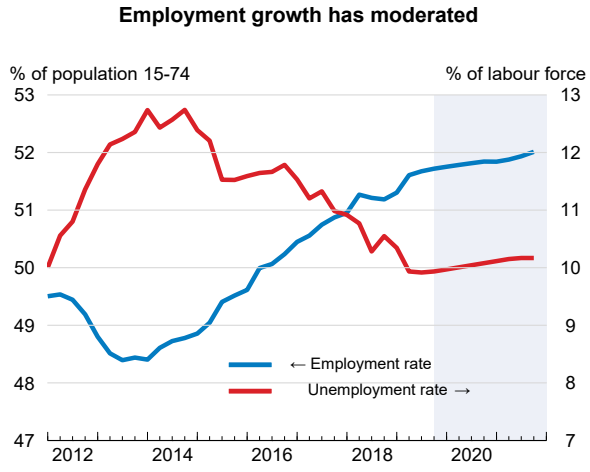
The primary budget surplus is expected to continue falling modestly in 2020, and then to stabilise in 2021. This will allow the high public debt-to-GDP ratio to start falling from 2021. A comprehensive fiscal reform is key to improving spending effectiveness, enhancing the equity and efficiency of the tax system and reducing the debt burden. Improving public services, reducing the regulatory burden, and enhancing job-search and training programmes would buttress investment and employment and reduce income and regional disparities.

The economy has remained weak

GDP growth remains feeble amid low confidence. Firms have drawn down inventories as major trading partners' growth slows and trade restrictions generate uncertainty about future demand. Industrial production has weakened whereas services activity has been more robust and construction has picked up after a deep recession. Employment has continued to expand, though at a slowing pace, with a larger share of new positions filled by permanent contracts. Flat productivity growth continues to constrain private sector wage increases. Consumer confidence has weakened, hindering private consumption growth through rising household saving rates.

Italy 1





Source: OECD Economic Outlook 106 database.

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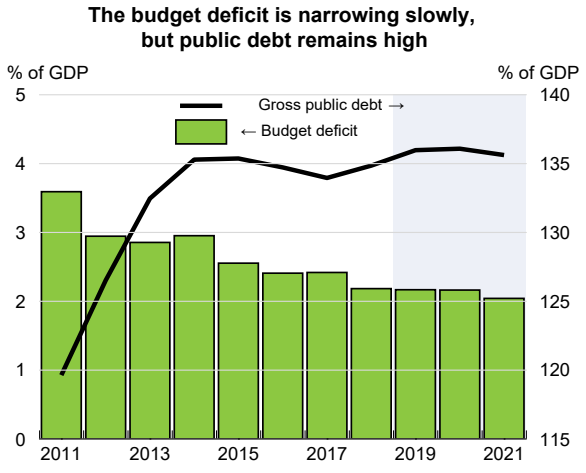
Italy: Demand, output and prices

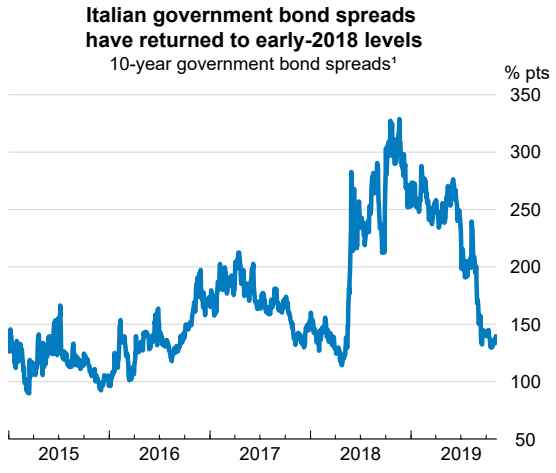
Italy	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 696.3	1.8	0.7	0.2	0.4	0.5
Private consumption	1 019.5	1.5	0.8	0.4	0.4	0.4
Government consumption	322.6	-0.2	0.4	0.4	0.3	-0.1
Gross fixed capital formation	291.3	3.5	3.0	2.9	0.8	1.0
Final domestic demand	1 633.4	1.5	1.1	0.9	0.5	0.4
Stockbuilding[1]	7.8	0.2	-0.2	-1.3	0.0	0.0
Total domestic demand	1 641.2	1.6	1.0	-0.5	0.4	0.4
Exports of goods and services	496.7	6.6	1.3	2.7	1.3	1.8
Imports of goods and services	441.6	6.7	2.4	0.8	1.5	1.9
Net exports[1]	55.1	0.2	-0.3	0.6	0.0	0.0
Memorandum items						
GDP deflator	_	0.7	0.9	0.6	0.7	1.1
Harmonised index of consumer prices	_	1.3	1.2	0.6	0.6	1.2
Harmonised index of core inflation[2]	_	0.8	0.6	0.5	0.8	1.2
Unemployment rate (% of labour force)	_	11.3	10.6	10.0	10.0	10.2
Household saving ratio, net (% of disposable income)	_	2.5	2.5	4.3	5.2	5.3
General government financial balance (% of GDP)	_	-2.4	-2.2	-2.2	-2.2	-2.0
General government gross debt (% of GDP)	_	153.3	148.5	149.5	150.1	149.9
General government debt, Maastricht definition (% of GDP)	_	134.0	134.9	136.0	136.1	135.6
Current account balance (% of GDP)	_	2.6	2.5	2.7	2.7	2.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046570

Italy 2





1. 10-year Italian government bond yield less 10-year German government bond yield.
Source: OECD Economic Outlook 106 database and Refinitiv.

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Lending to firms has been contracting since early 2019 as banks tightened credit standards modestly. The ECB's loosening of monetary policy, falling spreads on government bonds and rising bank deposits have reduced funding costs for banks. This has started to pass into lower lending rates for borrowers. Bad loans to non-financial corporations have fallen 1 percentage point since January 2019 to 8.9% of outstanding loans. Demand for loans for business investment and housing has picked up, and businesses plan to expand investment.

A comprehensive reform plan is key

Fiscal policy is supporting activity in the face of weaker external growth. The primary budget surplus is estimated to fall from 1.3% of GDP in 2018 and 2019 to 1.0% of GDP in 2020 and 2021. The government plans new policy measures for 2020 and 2021, including lower social contributions, renewing fiscal incentives linked to the "Industry 4.0" programme to encourage private investment, and higher public investment especially in lagging regions. The government plans to finance these measures through higher revenues, including new environmental and sugar taxes, raising VAT compliance, lower interest costs and spending cuts. Overall, the fiscal measures and slower growth will make the public debt ratio rise in 2019 to 136% of GDP before it starts falling from 2021. The government is committed to support activity while complying with the EU Growth and Stability Pact.

Putting public debt on to a sustained downward path, while supporting growth, especially in lagging areas, will require implementing a credible medium-term fiscal plan alongside ambitious structural reforms. Applying spending reviews to rationalise spending, reversing the changes in early retirement rules introduced in 2019 and preserving the link between retirement ages and life expectancy would free resources for more effective programmes and public investment and improve inter-generational equity. Reducing tax expenditures, especially environmentally harmful subsidies, and combatting tax evasion will support revenues and broaden the tax base, allowing the government to raise environmental quality and enhance the fairness of the tax system.

Lasting and inclusive gains in income and living standards require raising Italy's lagging productivity and employment. Reducing administrative barriers to investing and enhancing competition in markets that are still protected, such as professional services, would support productivity and investment. Improving public sector performance, especially in lagging regions, is pivotal to raising productivity, activity and inclusiveness. Strengthening the public employment services is central to the Citizen's Income social protection and work activation programmes. Implementing the government's plans to expand access to childcare and increase education and care support for families will improve inclusiveness and reduce barriers to work for women.

Growth will slowly resume

GDP growth is projected to be around ½ per cent in 2020 and 2021. Weak external demand and persistent uncertainties relating to global trade policies will limit export growth, weighing on investment, employment and incomes. On the other hand, household consumption will rise moderately, supported by stabilising consumer confidence and cuts to the tax wedge for many dependent workers. Reduced domestic policy uncertainty, easier financing conditions and tax incentives are expected to support investment.

A deeper or prolonged slowdown in global trade or trading partner growth would significantly harm the outlook, due to Italy's openness. High public debt ratios mean that Italy's borrowing costs and banks' lending remain sensitive to a renewed deterioration in market conditions and sovereign risk perceptions. On the other hand, quicker improvements in the effectiveness of public services, in the execution of public investment projects, or in reducing administrative and regulatory burdens would boost domestic investment, employment and consumer confidence. Greater progress in rationalising tax expenditures and improving the effectiveness of public spending would raise the primary surplus, boosting confidence and reducing public debt faster than projected.

Japan

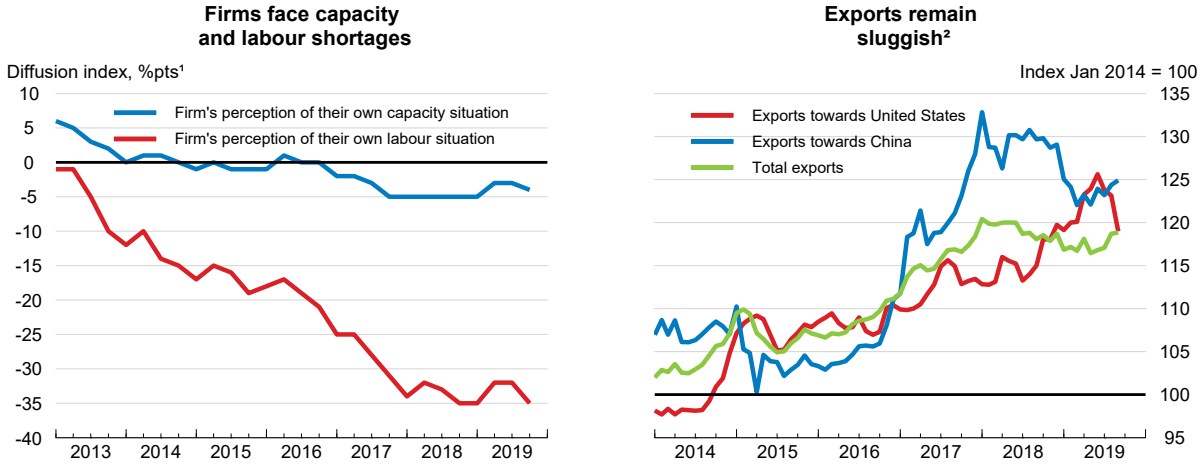
The economy is estimated to have expanded by 1% in 2019, but growth is projected to ease somewhat in 2020-21. The temporary effect of the consumption tax increase on GDP growth will be mitigated by fiscal measures and the 2020 Olympic Games in Tokyo. With wage and investment growth sustained by labour and capacity shortages, GDP growth is set to remain close to potential following the rollback of the temporary fiscal measures in 2021. Headline inflation is projected to edge up to 1½ per cent by 2021, sustained by continued wage and economic growth.

Record high gross government debt, at 224% of GDP, poses serious risks and calls for a detailed consolidation programme in the medium to long term with further gradual increases in the consumption tax rate and measures to control spending in the face of rapid population ageing. Structural reforms to boost employment and productivity are also key, both to put the public finances back on a sustainable trajectory and to improve well-being. The Bank of Japan should maintain its expansionary monetary policy until the 2% inflation target is achieved.

Domestic demand is supporting growth

Despite sluggish exports reflecting weaker world trade growth, economic growth in the first three quarters of 2019 picked up to 1¼ per cent, sustained by a moderate recovery of private consumption and robust business investment. While export volumes have remained flat since mid-2018, wage income in real terms has been growing at 1.3% per annum since autumn 2018 and firms plan to increase business investment by 2.4% in FY 2019. Domestic demand was also supported by the FY 2018 second supplementary budget and the FY 2019 budget, including via extra public investment.

Japan 1



1. The diffusion indices show the number of firms responding they had an excess number of workers minus those reporting a shortage and the number of responding that they had excess capacity minus those with a capacity shortage. A negative number thus indicates an overall shortage of labour and capacity. The numbers for 2019Q4 are based on forecasts by firms.
2. Seasonally-adjusted data (three-month moving average).
Source: Bank of Japan.

StatLink https://doi.org/10.1787/888934045639

Japan: Demand, output and prices

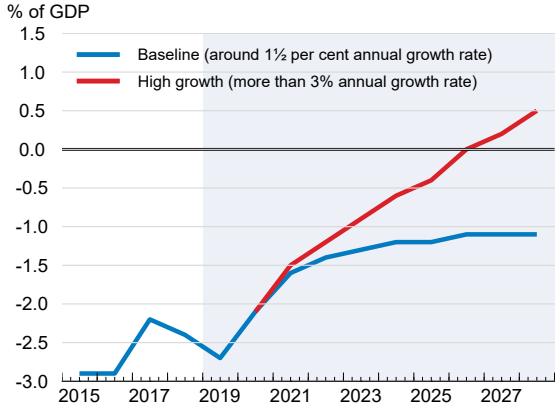
Japan	2016	2017	2018	2019	2020	2021
	Current prices YEN trillion	Percentage changes, volume (2011 prices)				
GDP at market prices	536.0	1.9	0.8	1.0	0.6	0.7
Private consumption	298.6	1.1	0.4	0.7	0.2	0.6
Government consumption	106.6	0.3	0.8	2.0	1.3	0.9
Gross fixed capital formation	125.0	3.0	1.1	2.1	1.2	0.1
Final domestic demand	530.2	1.4	0.6	1.3	0.7	0.5
Stockbuilding[1]	0.5	0.0	0.2	0.0	-0.2	0.0
Total domestic demand	530.7	1.4	0.8	1.3	0.5	0.5
Exports of goods and services	87.1	6.8	3.4	-1.9	1.5	3.2
Imports of goods and services	81.8	3.4	3.4	-0.3	1.2	2.0
Net exports[1]	5.3	0.6	0.0	-0.3	0.1	0.2
Memorandum items						
GDP deflator	_	-0.2	-0.1	0.6	0.9	1.0
Consumer price index[2]	_	0.5	1.0	0.6	1.1	1.2
Core consumer price index[3]	_	-0.1	0.2	0.5	1.1	1.2
Unemployment rate (% of labour force)	_	2.8	2.4	2.4	2.4	2.3
Household saving ratio, net (% of disposable income)	_	2.5	4.3	4.5	5.0	4.8
General government financial balance (% of GDP)	_	-3.0	-2.4	-2.6	-2.4	-1.9
General government gross debt (% of GDP)	_	222.5	224.1	224.7	225.2	225.0
Current account balance (% of GDP)	_	4.2	3.5	3.5	3.4	3.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Calculated as the sum of the seasonally adjusted quarterly indices for each year.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

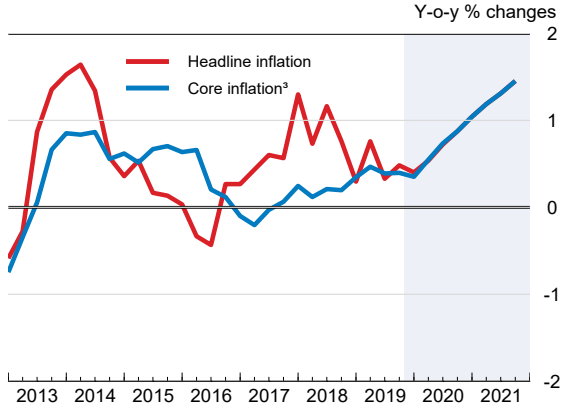
StatLink https://doi.org/10.1787/888934046589

Japan 2

The primary budget deficit is projected to continue through FY 2025 under current policies[1]



Consumer price inflation remains below the 2% target[2]



1. Government projections in July 2019. Both scenarios incorporate the increase in the consumption tax rate from 8% to 10% in October 2019. The primary balance is central and local governments, as a percentage of GDP on a fiscal year basis.
2. Excluding the effects of the April 2014 consumption tax increase, which added 2 percentage points to inflation in FY 2014 according to a government estimate. It also excludes the impact of the October 2019 consumption tax increase, which adds 1.0 percentage point to inflation in the fourth quarter of 2019, and the impact of free childcare for children aged three to five, which would reduce it by 0.5 percentage points, according to an OECD estimate.
3. OECD measure, which excludes food and energy.
Source: Cabinet Office; OECD Economic Outlook 106 database; and Bank of Japan.

StatLink https://doi.org/10.1787/888934045658

Labour shortages have been exacerbated by the rapidly declining working-age population and are sustaining wage growth and business investment. The unemployment rate has stayed at around 2¼ per cent and the ratio of job openings-to-applicants around 1.6, its highest level since 1974. Repeated minimum wage increases and a tax incentive to raise wages have contributed to overall wage gains. While headline inflation remains well below the Bank of Japan's 2% target, underlying inflation has gradually risen to close to ½ per cent, as increases in unit labour costs have fed into prices of goods and services.

Meeting the intertwined challenges of population ageing and government debt

To cushion the short-term economic impact of the October 2019 increases in the consumption tax rate, the government introduced several temporary spending and tax measures, alongside some new durable spending programmes funded by half of the 1% of GDP additional revenue. The primary deficit is projected to stay around 2½ per cent of GDP over 2019-20 but to decline to 1.9% in 2021, with temporary fiscal measures to be withdrawn starting in FY 2021 in line with the government's fiscal consolidation plan to achieve a primary surplus by FY 2025. Restoring fiscal sustainability requires a detailed and concrete consolidation programme beyond the FY 2025 primary surplus target. Revenue measures should rely primarily on less-distortive taxes, notably the consumption tax, which should be gradually raised further, and environmentally-related taxes. On the spending side, containing social spending, notably by making better use of healthcare resources, is a priority.

Under its "yield curve control" policy, and with its large holdings and continued purchases of government bonds, the central bank is currently keeping the yield on 10-year government bonds at around zero. It is committed to continuing monetary base expansion until CPI inflation (excluding fresh food) exceeds the 2% target and stays above it in a stable manner, and expects interest rates to remain at their present or lower levels as long as it is necessary to maintain the momentum toward achieving the target. The projection assumes an unchanged degree of monetary accommodation through 2021.

Despite the relatively high employment rate of older persons, Japan's shrinking and ageing population makes it important to remove obstacles to employing them, particularly beyond age 65. Boosting elderly employment could include abolishing the right of firms to set mandatory retirement ages, which are most typically at age 60. This would also help reduce the importance of seniority in wage setting. Breaking down labour market dualism, including by reducing employment protection for regular workers, would promote female employment and reduce Japan's large gender wage gap. The government launched a plan to accept up to 345 150 foreign workers over 2019-24 in sectors facing severe labour shortages, such as construction, accommodation and food services and long-term care. With the Action Plan of the Growth Strategy launched in June 2019, the government plans a range of measures to realise "Society 5.0", including rulemaking on transactions in the digital market, regulatory reforms to promote new services such as Fintech, and further corporate governance reforms. Further efforts to boost productivity growth are needed, including to promote trade openness through multilateral arrangements.

Growth is projected to remain just above potential

Growth will be supported in 2020 by the fiscal measures mitigating the impact of the consumption tax increase, and by the Olympic Games, which are expected to buoy private consumption and service exports. Labour and capacity shortages will tend to push up wages and investment. As a result, growth is projected to remain just above its estimated potential through 2021, notwithstanding the unwinding of temporary fiscal stimulus. This should help headline inflation move up to 1½ per cent towards the end of the period.

Japan, particularly the manufacturing sector, is vulnerable to a further slowdown in China's import demand. Protectionism also remains a risk, though no new trade restrictions on Japanese exports are expected in view of the September 2019 Japan-US Joint Statement. Fiscal policy could counteract those downside risks, including through additional temporary stimulus measures to be included in the FY 2019 supplementary budget and the FY 2020 budget. Nevertheless, Japan's unprecedentedly high level of public debt is a key risk: a loss of confidence in Japan's fiscal sustainability could destabilise the financial sector and the real economy, with large negative spillovers to the world economy.

Korea

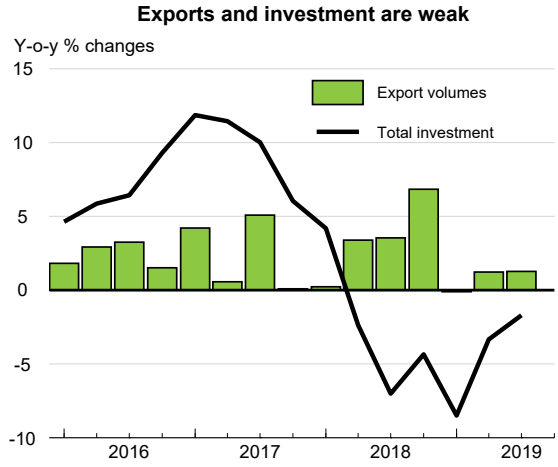
Economic growth will remain subdued, as the global slowdown and trade tensions hold back exports, while high uncertainty weighs on investment. Job creation in the public sector will mitigate the impacts of sluggish output growth on employment. A gradual recovery in global demand for semi-conductors and expansionary fiscal policy will support the economy.

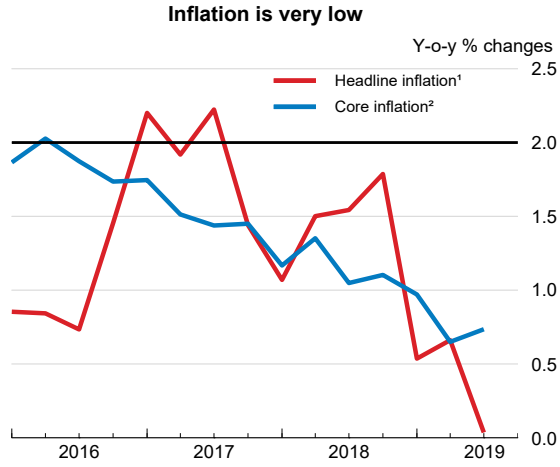
Further monetary policy easing is expected in 2020, as headline inflation will remain below the 2% inflation target. The fiscal expansion of over one percentage point of GDP in 2020 provides a welcome stimulus, but sustaining long-term growth in the face of rapid population ageing will require structural reforms to boost productivity and create better jobs.

Weak exports and investment are pulling down growth

Shrinking export markets, heightened global uncertainty and falling prices for semi-conductors are holding back exports and driving down business investment. Residential investment is falling sharply, reflecting strong cyclicality in housing supply and tightened mortgage lending regulations. The creation of public sector jobs, notably in health care and welfare services, is bringing the unemployment rate down, despite the negative impact of the weak economy and the 29% increase in the minimum wage in 2018-19 on business employment and economic growth. Real household income growth supports private consumption, even though weak consumer confidence, reflecting uncertainty and subdued private job creation, restrains sales of durable goods. Although very low headline inflation is partly due to falls in food prices, core inflation is also well below the 2% inflation target.

Korea





1. The central bank's 2% target is for CPI inflation.
2. Excludes food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045677

Korea: Demand, output and prices

Korea	2016	2017	2018	2019	2020	2021
	Current prices KRW trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 740.8	3.2	2.7	2.0	2.3	2.3
Private consumption	834.8	2.8	2.8	1.8	1.9	2.4
Government consumption	265.3	3.9	5.6	6.8	7.0	4.7
Gross fixed capital formation	517.3	9.8	-2.4	-4.1	0.0	1.2
Final domestic demand	1 617.4	5.2	1.5	0.7	2.3	2.5
Stockbuilding[1]	7.4	0.4	0.2	0.4	-0.2	0.0
Total domestic demand	1 624.8	5.6	1.7	1.1	2.0	2.5
Exports of goods and services	698.6	2.5	3.5	1.5	3.7	1.7
Imports of goods and services	582.7	8.9	0.8	-0.5	3.1	2.0
Net exports[1]	116.0	-2.0	1.1	0.8	0.3	0.0
Memorandum items						
GDP deflator	_	2.2	0.5	-0.6	1.1	1.3
Consumer price index	_	1.9	1.5	0.3	1.1	1.4
Core inflation index[2]	_	1.5	1.2	0.8	1.1	1.4
Unemployment rate (% of labour force)	_	3.7	3.9	3.7	3.5	3.5
Household saving ratio, net (% of disposable income)	_	7.5	8.0	9.2	9.2	8.4
General government financial balance (% of GDP)	_	2.7	2.8	1.3	-0.1	-0.4
General government gross debt (% of GDP)	_	40.8	39.4	38.7	40.4	42.4
Current account balance (% of GDP)	_	4.6	4.4	3.5	3.9	4.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046608

Macroeconomic policy support needs to be complemented by structural reforms

The government took strong measures to counter the headwinds of waning global growth and mounting uncertainty. A supplementary budget of 0.3% of GDP was voted in August 2019 and fiscal stimulus of about 1.2% of GDP is planned for 2020. This is welcome, given the government's sound budget position, low debt level and the need to expand social welfare. Caution is nevertheless warranted to avoid unfunded spending becoming permanent, especially as rapid population ageing and rising demand for social services will push up public spending over the next decades. Reinforcing the fiscal framework would ensure that active fiscal policy remains consistent with long-term fiscal sustainability.

The Bank of Korea cut its policy rate by 25 basis points twice, in July and October 2019, to 1.25% and is expected to lower it further next year, as inflation will remain below the 2% target and economic activity will stay lacklustre. The wide range of macroprudential measures put in place in recent years should help contain increases in high household debt, and could be tightened further if necessary.

To foster inclusive long-term growth, Korea needs to implement structural reforms. As the population is ageing very rapidly, labour resources should be better mobilised and productivity, which is only about half of that in the top half of OECD countries, needs to rise. Easing labour market regulations and investing further in skills, especially digital, would help lift female and youth employment, enhance the quality of older workers' jobs, and reduce labour market duality. Regulatory reform to increase competition and greater policy focus on innovation and business dynamism in small and medium-sized enterprises would raise productivity, especially in services, where it is lagging.

Growth is vulnerable to the global environment

Growth will be supported by expansionary fiscal policy and accommodative monetary policy, along with a gradual recovery in demand for semi-conductors. Investment will stabilise, albeit at a low level. Public sector hiring will continue to support employment growth and the much smaller increase in the minimum wage in 2020 than in previous years will have a limited impact on private job creation. Weak export demand will remain a brake on growth and global trade tensions generate downside risks and uncertainties, which could discourage investment.

Latvia

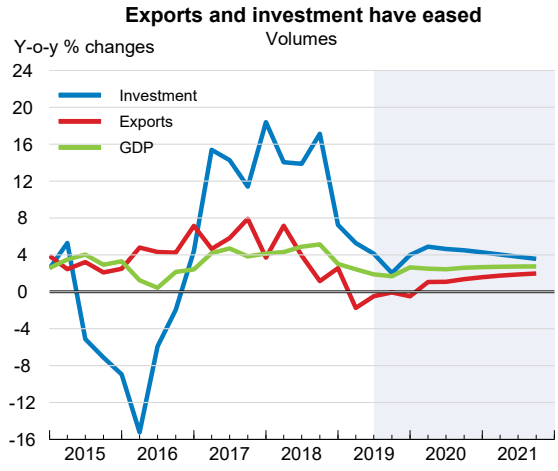
Economic growth slowed in the first half of 2019 and is projected to remain moderate. Weak world trade will be a drag on growth, while investment growth will ease to a more sustainable pace following an exceptional surge in the disbursement of EU funds. Private consumption will continue to play a key role in maintaining growth, supported by the strong labour market. Inflation will gradually decrease towards 2%.

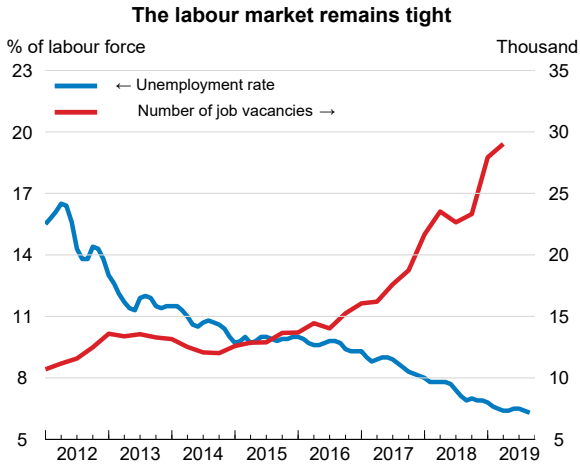
The strong fiscal position, alongside already low interest rates, leaves room for the government to take a bigger role in supporting growth if the effects of the trade downturn are more serious than projected and flow through to the labour market. Higher investment in skills and research would drive further improvements in efficiency and the quality of living. Continuing to reduce informality would help to finance these investments.

Strong growth is set to moderate

GDP growth slowed to about 2.5% in the first half of 2019, with a sharp fall in export and investment growth. Domestic demand continues to be robust, as the employment rate and wages increase. The unemployment rate has fallen further, to 6.4%. Vacancies continue to grow and nominal wages keep rising at a pace of about 8% per year, fuelled by productivity advances and rising skill shortages. Wage growth has contributed to the continuing strength of private consumption and to rising labour costs, with effects on competitiveness tempered by similar increases in Estonia and Lithuania. Despite rapid wage growth, inflation is stable at around 3%.

Latvia





Source: Central Statistical Bureau of Latvia; Eurostat; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045696

Latvia: Demand, output and prices

Latvia	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	25.1	3.8	4.6	2.3	2.5	2.7
Private consumption	15.1	3.1	4.2	3.1	3.7	3.3
Government consumption	4.5	3.2	4.0	2.6	2.8	2.8
Gross fixed capital formation	4.9	11.3	15.8	4.6	4.5	3.9
Final domestic demand	24.5	4.8	6.6	3.3	3.7	3.3
Stockbuilding[1]	0.3	0.5	-0.1	1.1	0.4	0.0
Total domestic demand	24.8	5.0	6.2	4.2	4.1	3.3
Exports of goods and services	15.1	6.4	4.0	0.0	0.8	1.8
Imports of goods and services	14.9	8.4	6.4	3.1	3.3	2.7
Net exports[1]	0.2	-1.1	-1.5	-1.9	-1.6	-0.6
Memorandum items						
GDP deflator	_	3.0	4.0	2.7	2.0	2.5
Harmonised index of consumer prices	_	2.9	2.6	2.9	2.3	2.3
Harmonised index of core inflation[2]	_	1.7	1.9	2.4	2.3	2.4
Unemployment rate (% of labour force)	_	8.7	7.4	6.4	6.4	6.6
Household saving ratio, net (% of disposable income)	_	-5.1	-2.6	-0.2	1.4	2.9
General government financial balance (% of GDP)	_	-0.5	-0.7	0.5	0.5	0.6
General government gross debt (% of GDP)	_	45.9	44.2	43.2	42.2	41.2
General government debt, Maastricht definition (% of GDP)	_	38.6	36.4	35.3	34.4	33.3
Current account balance (% of GDP)	_	1.0	-0.7	-0.6	-1.9	-2.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046627

Strengthening productivity growth is essential as the population declines

The fiscal position remains strong: government debt is decreasing and currently is at the relatively low level of about 35% of GDP according to the Maastricht definition. The primary budget balance is projected to remain in surplus, in spite of slowing growth. The fiscal stance will remain broadly neutral. This leaves room for tax cuts or higher government spending if the trade downturn leads to a rise in unemployment. Accommodative ECB monetary policy is supporting growth through low borrowing costs.

Stronger productivity growth is necessary to continue the convergence to GDP per capita levels in Western Europe despite demographic headwinds stemming from ageing and emigration. This will require higher investment in skills and research, as well as greater competition, particularly in sectors where state-owned or municipal enterprises have wide influence. Aligning vocational and tertiary education more closely with labour market needs, and developing a rental housing market would help address skill mismatches. Supporting access to long-term finance and helping municipalities to build more affordable rental apartments would help to develop the rental market. Additionally, the government should continue to implement measures to decrease high poverty among elderly people.

The global slowdown will further hurt growth

Economic growth will further slow in 2020, before recovering gradually in 2021. Export growth will stay low as global trade remains weak. EU structural funds will continue to support investment, but should return to a more sustainable pace. Wage growth will stay high as skill shortages persist and productivity is increasing. However, it will slow as weaker investment decreases employment demand and no minimum wage increase hike is expected. Wage growth will support robust private consumption. Even so, the projected slowdown of wages and output growth will gradually decrease private consumption growth, as well as inflation.

Latvia faces risks from global trade uncertainty, particularly where it affects key trading partners, notably Germany and the United Kingdom. Trade risks will be intensified if rapid wage increases are not matched by productivity growth, threatening the competitiveness of domestic firms. On the other hand, rising incomes could strengthen consumption more than expected, leading to a more sustained pick-up in domestic business confidence and investment.

Lithuania

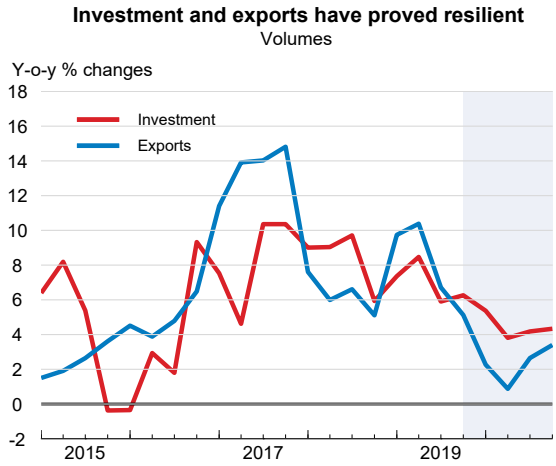
Economic growth is projected to ease amid weak export market conditions and capacity constraints. A slower increase in EU fund disbursements will also bear on investment. Strong wage growth will support consumption and reduce income inequalities, but put pressure on service prices and potentially on competitiveness.

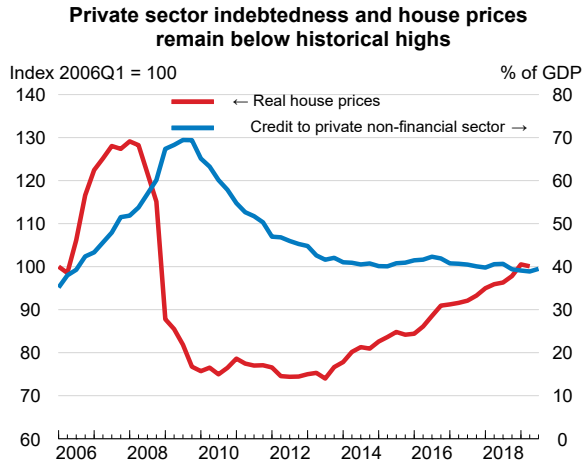
The government budget will remain in a small surplus in 2020-21. A healthy fiscal position is vital to support the implementation of further structural reforms to address social needs and improve skills. Measures should aim to reduce large skill mismatches through improvements in educational outcomes and effective re-skilling programmes. Promoting business dynamism by lowering administrative burdens is also essential for higher productivity growth.

Growth has been resilient

Economic activity has remained robust. Private consumption has continued to be supported by rapidly rising wages and higher social transfers, as well as intensified immigration flows and concomitant employment gains. Investment has strengthened, benefiting from a surge in construction and a faster implementation of EU-funded projects. High capacity utilisation has spurred business expenditure. Exports grew solidly in the first half of the year, driven by buoyant grain and service exports, but have subsequently lost momentum. Business confidence and export expectations have weakened, pointing to a softening in activity. Headline inflation remains subdued, due to lower oil prices, but rapid wage increases in excess of productivity growth continue to exert pressures on service prices.

Lithuania





Source: OECD Economic Outlook 106 database; and European Central Bank.

StatLink https://doi.org/10.1787/888934045715

Lithuania: Demand, output and prices

Lithuania	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	38.9	4.2	3.6	3.6	2.5	2.5
Private consumption	24.5	3.5	3.7	3.7	3.8	3.4
Government consumption	6.6	-0.3	0.5	1.3	0.7	0.6
Gross fixed capital formation	7.7	8.2	8.4	7.0	4.4	4.0
Final domestic demand	38.9	3.7	4.1	3.9	3.4	3.0
Stockbuilding[1]	- 0.3	-1.0	-0.8	-1.8	0.2	0.0
Total domestic demand	38.6	2.8	3.4	2.0	3.8	3.1
Exports of goods and services	26.3	13.6	6.3	7.9	2.3	3.7
Imports of goods and services	26.0	11.5	6.0	5.9	3.1	4.5
Net exports[1]	0.3	1.5	0.4	1.6	-0.5	-0.5
Memorandum items						
GDP deflator	_	4.3	3.3	2.4	2.3	2.2
Harmonised index of consumer prices	_	3.7	2.5	2.3	2.2	2.2
Harmonised index of core inflation[2]	_	2.6	1.9	2.2	2.2	2.2
Unemployment rate (% of labour force)	_	7.1	6.1	6.0	5.9	5.9
Household saving ratio, net (% of disposable income)	_	-3.6	-5.1	-4.9	-4.7	-4.6
General government financial balance (% of GDP)	_	0.5	0.6	0.1	0.1	0.1
General government gross debt (% of GDP)	_	47.3	41.1	40.3	39.6	39.0
General government debt, Maastricht definition (% of GDP)	_	39.3	34.1	33.2	32.5	31.9
Current account balance (% of GDP)	_	0.5	0.3	1.9	0.7	0.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046646

Strengthening skills remains a key priority

Monetary conditions in the euro area remain very accommodative. The relatively low cost of borrowing and fast rising incomes keep housing market activity at record highs and growth of house prices strong, though developments differ significantly across regions. Housing loans increased by around 9% in the first half of the year. As the private credit-to-GDP ratio and real house prices are still low by historical standards, risks to financial stability seem contained. The authorities need to continue using prudential measures pro-actively to prevent imbalances from emerging.

The 2020 budget entails further increases in social spending, notably child benefits, and pay rises for public sector employees in areas such as education and health. The increased expenditures of these poverty-reducing initiatives are partially compensated by an improvement in tax administration, including through the development of a continuous taxpayer control system to prevent tax fraud, and increases in some taxes, such as excise duties on fuel, strong alcohol and tobacco products. After easing in 2019, the fiscal stance is assumed to become broadly neutral in 2020-21. A healthy fiscal position is vital to address social needs and support further structural reforms in key areas, such as education and innovation, and for safeguarding low debt levels.

Strengthening skills and reducing skill mismatches are key to higher productivity and inclusiveness. Many workers are over-qualified for the jobs they do. Measures that improve teaching quality and make the education system more responsive to labour market needs are vital. Moreover, vocational education should be strengthened through more work-based training and made more attractive for young people. Fostering strong and relevant skills also hinges upon effective up-skilling and re-skilling programmes that promote life-long learning and enhance employment opportunities and labour market inclusiveness.

Growth will slow

GDP growth is projected to ease to 2½ per cent in 2020-21 as the global slowdown takes its toll on exports and business confidence. A weaker increase in EU fund disbursements, as flows return to normal levels, will also be a drag on investment. Domestic demand will be further influenced by the declining population, restraining consumption growth. The unemployment rate will remain at around 6% over the projection period. A positive migration balance has helped to alleviate labour shortages, but supply constraints will continue to bite, reinforced by a large skills mismatch. Fast wage increases will keep prices in the service sector elevated. Weaker-than-expected growth in Lithuania's main EU trading partners could curb exports and investment, while larger-than-anticipated labour market imbalances could lead to faster wage increases, harming competitiveness. On the upside, implementation of structural reforms could foster stronger productivity and output growth.

Luxembourg

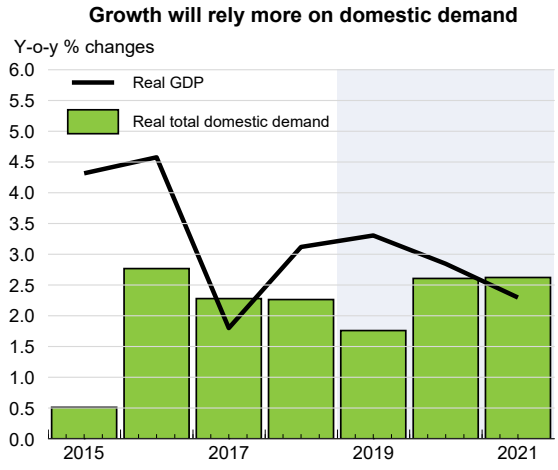
Growth is projected to ease to 2.8% in 2020 and to 2.3% in 2021, amid subdued investment and persistent weakness in the euro area, which will hamper further export dynamism. Solid private consumption growth will underpin domestic demand. The buoyant labour market will keep creating jobs, though at a decelerating pace and benefitting primarily cross-border workers. Consequently, the unemployment rate is projected to decline only slightly.

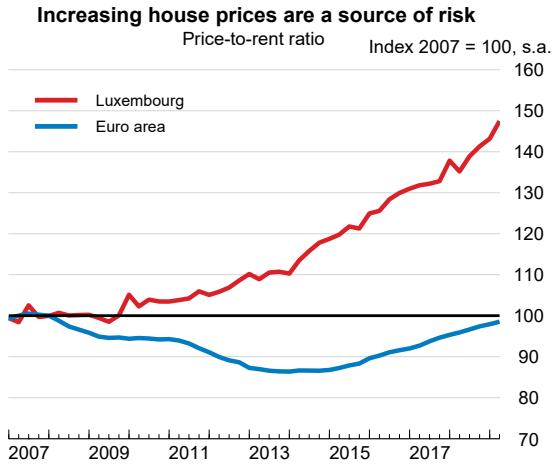
The fiscal position is sound and fiscal space is ample. Fiscal policy should be eased if the current slowdown worsens and reduces growth significantly below potential. Increasing the supply of social and private rental housing is key for making the access to housing more equitable and slowing house price growth. Rising household indebtedness creates vulnerabilities for some families and banks, calling for the introduction of borrower-targeted macroprudential tools.

Growth is relying more on domestic demand

GDP growth was strong in the first half of 2019, mainly due to surging exports. This largely reflected a significant rebound of financial and insurance activities, in part as compensation for a very weak end of 2018. Consumer confidence and retail sales are still strong. Construction maintains an upward trend. However, business surveys are beginning to show a deteriorating outlook, reflecting the slowdown in activity in the euro area. The unemployment rate has declined and there is growing evidence of skill mismatches and shortages, signalling potential capacity constraints.

Luxembourg





Source: OECD Economic Outlook 106 database; and OECD Analytical House Price database.

StatLink https://doi.org/10.1787/888934045734

Luxembourg: Demand, output and prices

Luxembourg	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	54.9	1.8	3.1	3.3	2.8	2.3
Private consumption	16.3	2.2	3.3	2.5	2.8	2.7
Government consumption	8.7	5.2	3.9	4.4	3.8	3.7
Gross fixed capital formation	10.0	5.6	-6.1	2.0	1.3	1.3
Final domestic demand	35.0	3.9	0.8	2.9	2.7	2.6
Stockbuilding[1]	0.5	-1.0	0.9	-0.7	-0.1	0.0
Total domestic demand	35.4	2.3	2.3	1.8	2.6	2.6
Exports of goods and services	116.8	0.7	0.5	1.7	2.9	2.6
Imports of goods and services	97.4	0.7	-0.3	1.0	2.8	2.8
Net exports[1]	19.4	0.4	1.6	1.8	1.3	0.7
Memorandum items						
GDP deflator	_	1.7	2.5	2.9	1.9	1.7
Harmonised index of consumer prices	_	2.1	2.0	1.7	1.7	1.8
Harmonised index of core inflation[2]	_	1.4	0.9	1.8	1.7	1.8
Unemployment rate (% of labour force)	_	5.9	5.5	5.3	5.3	5.2
Household saving ratio, net (% of disposable income)	_	16.0	16.0	14.5	13.6	13.2
General government financial balance (% of GDP)	_	1.4	2.7	2.8	2.9	2.9
General government gross debt (% of GDP)	_	29.9	29.0	29.0	28.3	27.2
General government debt, Maastricht definition (% of GDP)	_	22.4	21.0	21.0	20.3	19.2
Current account balance (% of GDP)	_	4.9	4.8	5.0	4.6	4.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046665

Policies are needed to promote green growth and increase productivity

The fiscal position is strong, with the fiscal surplus projected to remain close to 3% of GDP and the gross public debt ratio among the lowest in the OECD area. After some corporate income tax cuts and reduced VAT rates for certain products introduced in 2019, the fiscal stance is projected to remain broadly neutral over the coming two years. Fiscal measures can improve green growth through higher taxes on transport fuel, the introduction of congestion charges in Luxembourg City, an increase in car taxation and investment in electric vehicles infrastructure.

Productivity growth has been subdued in recent years. Skill shortages, regulatory constraints in some professional services and lack of innovation, even among the top productive firms, are among the drivers of the productivity slowdown. Labour market policies should aim to undertake regular exercises for the assessment of future professional needs and ensure their outcomes feed into enhanced training offers. The modernisation of bankruptcy law should aim to ease restraints on early restructuring and promoting second-chance opportunities, as well as facilitating the exit of non-viable firms. Policies should also ensure a level playing field between FinTech and traditional financial intermediaries, promoting a risk-based approach in regulating financial innovations.

House prices have been growing strongly, driven by population growth, a high rate of household formation, sustained demand pressure from cross-border workers and limited use of land available for construction. As a consequence, housing affordability has been deteriorating, in particular for low-income households. A mix of policies addressing supply-side restrictions, together with measures to increase housing tenure neutrality and better targeted fiscal support will be needed to make the housing market more efficient and inclusive.

Growth will ease but remain robust

Growth is projected to weaken but to remain comfortably above 2% in 2020 and 2021. Investment growth is set to decline and exports to slow from their strong performance in early 2019, making their contribution to GDP growth ebb to modest levels by historical standards. Robust private consumption, in the context of a strong labour market, will help sustain economic activity.

Risks to the outlook are tilted to the downside and include weaker-than-expected euro area and global growth and uncertainty about Brexit, even if in the medium-run Luxembourg could benefit from the relocation of some UK-based financial services activities. The financial sector is poised to remain profitable, but increased volatility in global financial markets may accelerate the pullback in global equity markets and the corresponding decline in net assets under management by investment funds.

Mexico

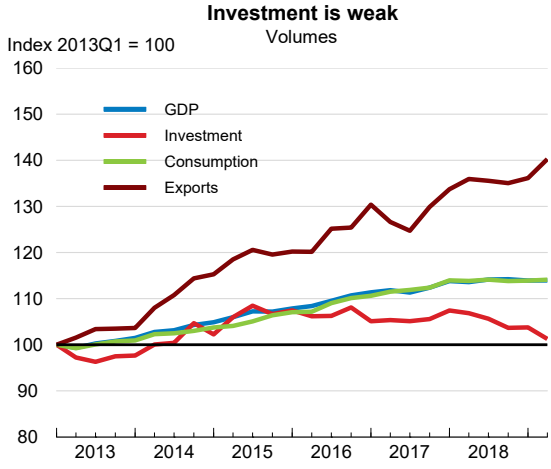
Growth will pick up gradually, as robust remittances, increases in minimum wages and declining inflation will boost consumption. Investment has been weak but will gradually strengthen on the back of lower interest rates. Export growth will decline owing to less favourable global conditions, especially in the United States. Informality remains widespread and inequalities across regions are high.

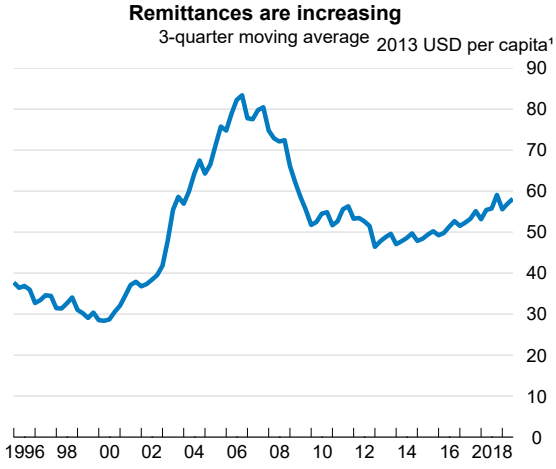
Monetary policy will appropriately become more accommodative, given declining inflation and the prevailing slack in the economy. Fiscal policy will need to remain prudent to stabilise public debt. Boosting productivity requires more competition and continuing efforts to strengthen the rule of law and to reduce crime. Increasing low female labour market participation by expanding access to early childhood education would boost growth and inclusion.

Economic activity has weakened

Trade tensions and policy uncertainty have reduced business confidence and held back investment. The industry and agriculture sectors are weak while services remain more resilient. Due to lower fuel prices, inflation is falling, boosting purchasing power and private consumption. Government consumption is subdued, as federal government spending remains restrained. Job creation in the formal sector has fallen and unemployment has edged up. The current account deficit has declined in line with slowing domestic demand.

Mexico





1. Population figures projected from 2019Q1 onward.
Source: OECD Economic Outlook 106 database; OECD Population Statistics; and Bank of Mexico.

StatLink https://doi.org/10.1787/888934045753

Mexico: Demand, output and prices

Mexico	2016	2017	2018	2019	2020	2021
	Current prices MXN billion	Percentage changes, volume (2013 prices)				
GDP at market prices	20 118.1	2.1	2.0	0.2	1.2	1.6
Private consumption	13 188.7	3.2	2.2	0.6	2.1	2.5
Government consumption	2 417.6	0.5	1.4	-0.8	0.9	0.8
Gross fixed capital formation	4 612.4	-1.6	0.6	-3.5	1.4	2.1
Final domestic demand	20 218.7	1.8	1.7	-0.5	1.8	2.2
Stockbuilding[1]	296.6	0.0	0.1	-0.1	-0.1	0.0
Total domestic demand	20 515.3	1.7	1.8	-0.7	1.7	2.2
Exports of goods and services	7 456.4	4.2	5.7	3.7	3.7	3.0
Imports of goods and services	7 853.6	6.4	6.2	0.3	4.6	4.5
Net exports[1]	- 397.2	-0.7	-0.2	1.2	-0.3	-0.5
Memorandum items						
GDP deflator	_	6.6	5.3	3.5	2.7	2.7
Consumer price index	_	6.0	4.9	3.5	2.7	2.7
Core inflation index[2]	_	4.7	3.8	3.6	2.9	2.7
Unemployment rate[3] (% of labour force)	_	3.4	3.3	3.5	3.4	3.3
Current account balance (% of GDP)	_	-1.7	-1.8	-0.7	-1.1	-1.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding volatile items: agricultural, energy and tariffs approved by various levels of government.
3. Based on National Employment Survey.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046684

Reforms are required to promote more inclusive growth

Monetary policy will appropriately become more accommodative, as inflation is below the 3% target and economic slack widens. Fiscal policy will continue to be prudent, targeting a primary budget surplus of 1.0% this year and 0.7% in 2020. This strikes an appropriate balance between the need to stabilise debt and to safeguard social spending. Boosting tax collection, by strengthening tax administration and eliminating regressive exemptions, would create more space for infrastructure investment and social outlays. Establishing an independent fiscal council would reinforce the fiscal framework and improve transparency and accountability.

Stronger and more inclusive growth requires boosting productivity through reforms. Pursuing the fight against corruption, for example by reinforcing whistle-blower protection, would contribute to higher investment and public sector efficiency. Accelerating reform implementation in key policy areas, such as judicial reforms, is crucial to improve the business environment and achieve higher investment and growth. Granting competition authorities and sector regulators adequate resources to carry out their mandates would help to boost productivity and reduce prices, particularly benefiting low-income households.

Informality has fallen slightly but it still affects 60% of employment. This calls for additional and coordinated efforts, such as reducing social security contributions for low-wage workers or simplifying procedures for the registration of companies. Expanding early childhood education, and raising its quality, would improve school outcomes and allow more women to take up paid work. Continuing to reduce the duplication of social programmes would create space to expand their coverage.

Growth is projected to increase modestly

The economy is expected to strengthen gradually in 2020 and grow by 1.6% in 2021. Consumption will be a key driver of growth, aided by higher wages and strong remittances. Declining interest rates will support a gradual increase in investment. Upside risks include a better-than-expected performance in the oil sector, as production focuses on exploiting high yield opportunities. The construction sector also holds potential for upside surprises, following the recent removal of some restrictions on construction sites in Mexico City. Downside risks include further trade tensions with the United States and renewed episodes of financial volatility in emerging-market economies, which could increase debt-financing costs.

Netherlands

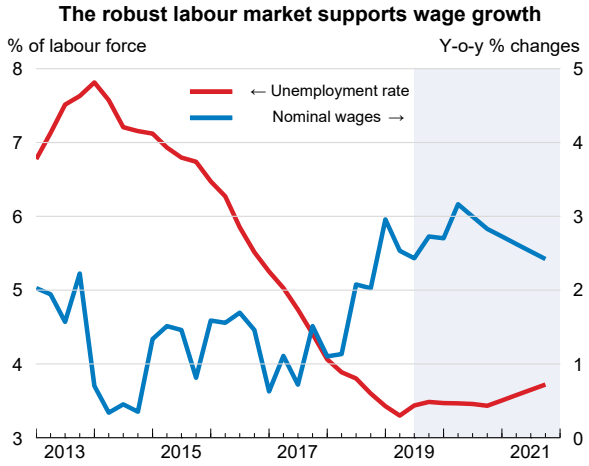
After declining in 2019 due to the slowing of world trade, economic growth in 2020 is projected to be boosted by a significant fiscal stimulus package. The labour market will remain strong, with a low unemployment rate and solid wage growth.

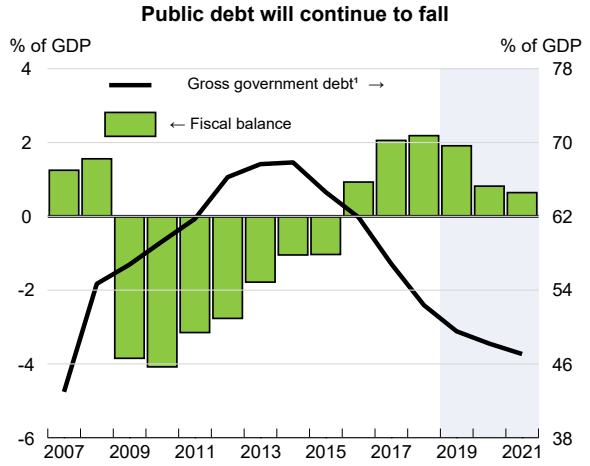
The planned fiscal impulse will slow the decline in public debt as per cent of GDP. There remains fiscal space to intervene should the international environment deteriorate further, particularly in the event of a disruptive Brexit outcome. Reducing the tax wedge between regular employees and self-employment would improve inclusiveness.

Weak external demand is weighing on growth

Weak external demand, especially from Germany, is weighing on export growth and has reduced the current account surplus slightly. By contrast, growth of business investment has picked up. Private consumption has been robust, largely reflecting low unemployment and strong wage growth. Consumer and business confidence, on the other hand, remain subdued. Headline inflation has fallen, as the effects of the past VAT increase have dropped out. A tight housing market has pushed up house prices, and housing construction has slowed.

Netherlands





1. Maastricht definition.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045772

Netherlands: Demand, output and prices

Netherlands	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	708.3	3.0	2.5	1.7	1.8	1.6
Private consumption	316.1	2.2	2.3	1.4	1.8	1.5
Government consumption	174.9	0.9	1.6	1.3	2.5	2.0
Gross fixed capital formation	141.8	4.3	3.2	5.0	1.7	1.6
Final domestic demand	632.8	2.3	2.3	2.2	2.0	1.7
Stockbuilding[1]	3.4	0.1	-0.2	0.0	0.0	0.0
Total domestic demand	636.2	2.4	2.1	2.3	2.0	1.6
Exports of goods and services	562.8	6.7	3.7	2.4	2.7	2.1
Imports of goods and services	490.7	6.4	3.2	3.2	3.1	2.3
Net exports[1]	72.1	0.9	0.7	-0.3	0.0	0.1
Memorandum items						
GDP deflator	_	1.2	2.2	2.8	1.4	1.3
Harmonised index of consumer prices	_	1.3	1.6	2.7	1.8	1.5
Harmonised index of core inflation[2]	_	0.8	1.0	1.9	1.8	1.5
Unemployment rate (% of labour force)	_	4.9	3.8	3.4	3.5	3.6
Household saving ratio, net[3] (% of disposable income)	_	8.8	8.4	7.8	8.0	8.1
General government financial balance (% of GDP)	_	1.3	1.5	1.3	0.4	0.3
General government gross debt (% of GDP)	_	70.8	65.6	62.8	61.4	60.3
General government debt, Maastricht definition (% of GDP)	_	56.9	52.4	49.5	48.2	47.1
Current account balance (% of GDP)	_	10.8	10.9	8.8	8.8	8.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Including savings in life insurance and pension schemes.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046703

Fiscal policy will support the economy

Fiscal policy has become supportive. The budget for 2020 includes a reduction in income taxes and an increase in employment tax credits. Additional government spending will be directed to stimulate affordable housing and welfare. The fiscal package is about 1% of GDP and is estimated to increase growth in 2020 by 0.6 percentage point. The fiscal policy stance is appropriate given the economic slowdown, the sound fiscal position, the favourable debt trajectory, and the low cost of government financing. An active fiscal policy will support demand and narrow the current account surplus. Policy should consider additional action in the event of a disruptive Brexit outcome.

With government financing costs near historical lows, an investment fund, as proposed by the government, could help to strengthen the economy's potential to cope with the forthcoming challenges of digitalisation, climate change and population ageing. Despite recent progress in reducing labour market duality, further reforms, in particular to the tax system and social security contributions, need to put self-employed and regular employees on the same footing.

Weaker trade and Brexit are risks for growth

GDP growth is projected to increase slightly, to 1.8%, in 2020 and then slow to 1.6% in 2021. Demand in 2020 will be mainly supported by private consumption and the strong fiscal stimulus. A sharper-than-expected deceleration in key export markets, including Germany, is a downside risk. The Netherlands remains vulnerable to continued uncertainty around Brexit. Furthermore, high levels of house prices and household debt pose a risk for financial stability. Despite recent measures to reduce household debt, particularly the reduction of the mortgage interest payment tax deductibility, efforts should be continued and financial risks monitored. An upside risk is a stronger-than-anticipated rise in business confidence.

New Zealand

Economic growth is projected to remain around 2½ per cent in 2020-21. Exports are set to decelerate and consumption will lose momentum, reflecting diminishing net migration inflows and lower housing wealth gains. On the other hand, business investment is expected to strengthen in response to rising labour costs and a falling cost of capital, thereby easing tight capacity constraints.

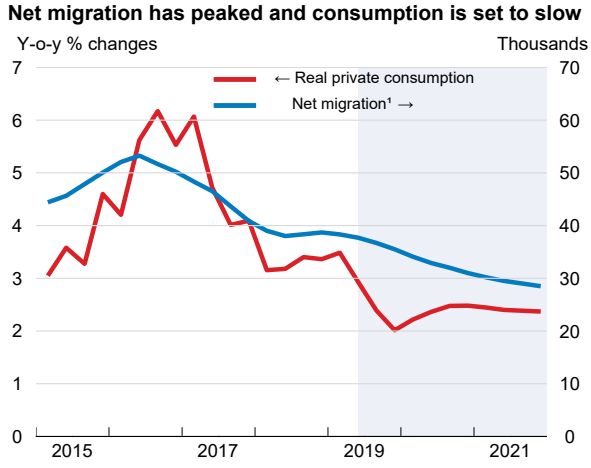
Fiscal policy is currently expansionary, turning close to neutral in 2020 and contractionary in 2021. The central bank has recently cut the policy rate by 50 basis points to 1% and is expected to make two further 25-basis-point cuts by mid-2020, which are needed to increase inflation towards the mid-point of the target band. It is also planning to raise bank capital requirements substantially, which would reduce risks but increase credit costs.

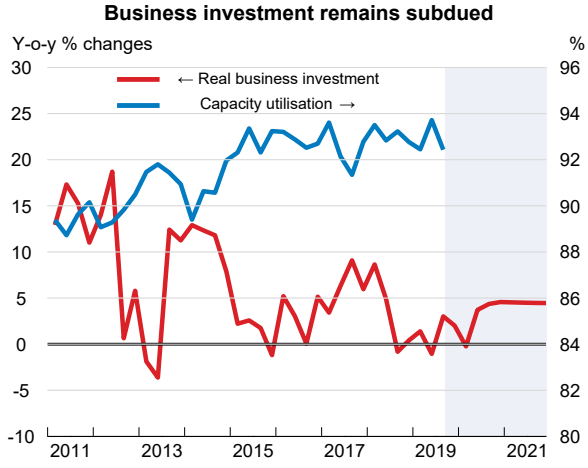
Economic growth is stable

Economic growth has eased to around 2½ per cent. Household consumption has moderated on the back of slower net migration and smaller housing wealth gains. Despite historically high capacity utilisation and the low cost of capital, business investment remains subdued, as business confidence has been depressed by heightened uncertainty over global economic conditions, concerns about government policy, the costs and availability of labour and tight profit margins. However, residential investment has strengthened considerably, helping to ease housing shortages. Prices for New Zealand's commodity exports remain high by historical comparison, supporting income and economic activity.

The labour market is tight, with the unemployment rate below the estimated structural rate and wage growth edging up, partly reflecting scheduled increases in the minimum wage rate, which is set to rise to NZD 20 per hour by 2021, one of the highest levels relative to the median wage in the OECD. Inflation remains slightly below the mid-point of the Reserve Bank's target band.

New Zealand





1. RBNZ projections. Net migration data refer to working-age (15 and over) migrants.
Source: Reserve Bank of New Zealand (2019), Monetary Policy Statement, August; New Zealand Institute of Economic Research (2019), Capacity Utilisation, Business Opinion; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045791

New Zealand: Demand, output and prices

New Zealand	2016	2017	2018	2019	2020	2021
	Current prices NZD billion	Percentage changes, volume (2009/2010 prices)				
GDP at market prices	265.9	2.7	2.8	2.7	2.5	2.4
Private consumption	153.0	4.7	3.3	2.7	2.4	2.4
Government consumption	48.1	2.8	2.2	2.9	3.5	2.2
Gross fixed capital formation	61.1	3.5	3.6	3.0	3.0	3.5
Final domestic demand	262.2	4.1	3.2	2.8	2.7	2.6
Stockbuilding[1]	0.8	-0.1	0.5	-0.7	0.3	0.0
Total domestic demand	263.1	3.9	3.7	2.1	3.0	2.6
Exports of goods and services	71.1	2.3	2.6	2.8	1.6	2.3
Imports of goods and services	68.2	6.9	5.8	1.0	3.3	3.1
Net exports[1]	2.9	-1.2	-0.8	0.5	-0.5	-0.2
Memorandum items						
GDP deflator	_	3.5	1.1	2.1	2.2	2.0
Consumer price index	_	1.9	1.6	1.5	1.9	1.9
Core inflation index[2]	_	1.4	1.2	1.8	1.9	1.9
Unemployment rate (% of labour force)	_	4.7	4.3	4.1	4.2	4.3
Household saving ratio, net (% of disposable income)	_	-1.4	-1.0	-0.7	-0.6	-0.4
General government financial balance (% of GDP)	_	1.1	0.9	0.4	0.3	0.8
General government gross debt (% of GDP)	_	36.0	34.5	32.7	32.5	31.8
Current account balance (% of GDP)	_	-2.7	-3.9	-3.2	-3.3	-3.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046722

Monetary policy is expansionary but fiscal policy will become contractionary

Fiscal policy will be slightly expansionary in 2020, reflecting the lagged effects of the estimated decline (by ½ per cent of GDP) in the underlying general government primary surplus in 2019, and is projected to be contractionary in 2021, when the underlying primary surplus rises by ½ per cent of GDP. Some planned spending increases in FY 2019-20 (fiscal years end on 30 June) may be delayed due to capacity constraints, notably in infrastructure, pushing back the stimulus. Fiscal tightening in 2021 will result from higher tax revenue. Monetary policy is set to become more expansionary, with two more 25-basis-point rate cuts expected by mid-2020, from the current, historically low, 1% rate. However, the planned increase in banks' Tier 1 capital requirements risks tightening access to credit.

Should further stimulus be needed, New Zealand is well placed to deliver it through fiscal policy as the general government budget is in a surplus and debt is low. The well-being approach to budgeting, first adopted in the FY 2019-20 budget, has the potential to enhance the effectiveness of additional spending or tax cuts in raising well-being. Well-being and aggregate demand could be boosted by reforms to reduce barriers to new housing supply, notably those arising from unnecessarily restrictive and complex land-use regulation, and financial disincentives for local governments to supply housing-related infrastructure.

Economic growth will remain steady

GDP growth is projected to remain around 2½ per cent in 2020-21. While net migration inflows and exports are set to slow and fiscal policy to turn mildly contractionary, business investment should expand in response to rising wage costs and further declines in the cost of capital. The unemployment rate is projected to remain around the current low level. Rising labour costs will gradually push up inflation. A key downside risk is that global economic conditions deteriorate more than expected, resulting in lower growth in exports and business investment. In such a scenario, prices for New Zealand's commodity exports could also decline, pushing down incomes and output growth. An upside risk is that net inward migration falls less than assumed, supporting higher growth.

Norway

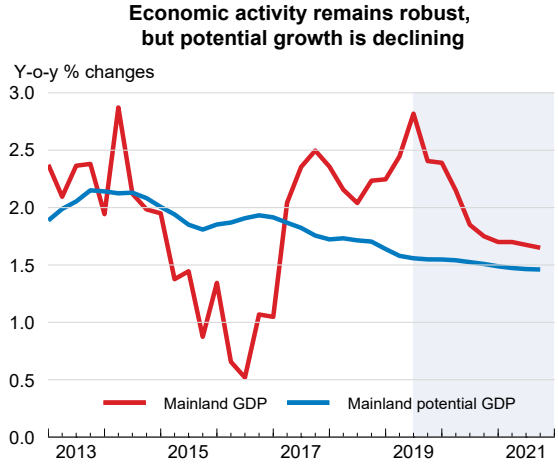
Mainland GDP growth has been robust, but will slow as capacity constraints bind further and export and investment growth diminish. Price pressures will be muted and employment growth will begin to ease.

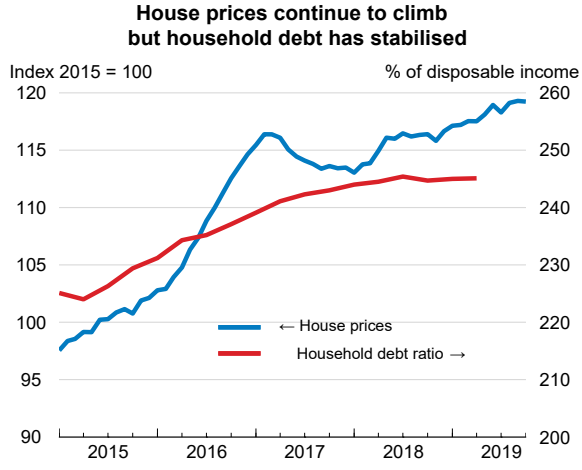
Given slowing growth, Norges Bank's signalling that the policy interest rate will most likely remain on hold after recent increases is appropriate. The neutral stance of fiscal policy is also appropriate given that growth is set to remain above potential. However, the authorities must remain vigilant to the risks around oil prices, the weakening global outlook and, domestically, the housing market and mortgage borrowing. Structural policy should focus on improving long-term growth prospects, including through increasing employment among some groups and improvements in public-sector spending efficiency.

Economic growth remains robust

Mainland output growth (i.e. abstracting from oil and gas production) has been robust in recent quarters, remaining above potential. A continuing rebound in oil-sector investment and a return to growth in housing investment have supported output growth. Meanwhile, non-oil exports have slowed recently. Household consumption growth has declined somewhat, partly reflecting slowing income growth. Wage growth continues to pick up, but employment growth has slowed slightly according to labour force surveys. Unemployment continues to fall. Headline inflation has headed down towards the 2% target as the effects of exchange-rate depreciation have worn off.

Norway





Source: OECD Economic Outlook 106 database; Statistics Norway; and Real Estate Norway (Eiendom Norge).

StatLink https://doi.org/10.1787/888934045810

Norway: Demand, output and prices

Norway	2016	2017	2018	2019	2020	2021
	Current prices NOK billion	Percentage changes, volume (2017 prices)				
Mainland GDP at market prices[1]	2 691.6	2.0	2.2	2.5	2.0	1.7
Total GDP at market prices	3 098.1	2.3	1.3	1.1	2.4	2.3
Private consumption	1 411.4	2.2	1.9	1.8	1.9	1.9
Government consumption	754.7	1.9	1.4	2.2	1.9	1.8
Gross fixed capital formation	780.8	2.6	2.8	4.3	3.3	2.1
Final domestic demand	2 946.9	2.3	2.0	2.6	2.3	1.9
Stockbuilding[2]	89.9	0.2	0.1	0.0	-0.1	0.0
Total domestic demand	3 036.8	2.4	2.1	2.4	2.1	1.9
Exports of goods and services	1 098.6	1.7	-0.2	1.6	2.6	3.1
Imports of goods and services	1 037.3	1.9	1.9	5.4	1.9	2.0
Net exports[2]	61.3	0.0	-0.7	-1.2	0.3	0.5
Memorandum items						
GDP deflator	_	4.0	5.8	-0.6	1.5	2.2
Consumer price index	_	1.9	2.7	2.3	2.0	2.2
Core inflation index[3]	_	1.7	1.2	2.5	2.0	2.2
Unemployment rate (% of labour force)	_	4.2	3.8	3.4	3.2	3.2
Household saving ratio, net (% of disposable income)	_	6.7	6.5	6.7	6.8	7.0
General government financial balance (% of GDP)	_	5.0	8.1	8.8	9.1	9.0
General government gross debt (% of GDP)	_	44.9	45.7	38.2	..	..
Current account balance (% of GDP)	_	4.7	7.2	4.2	4.3	4.8

1. GDP excluding oil and shipping.
2. Contributions to changes in real GDP, actual amount in the first column.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046741

House prices continue to climb following the downward correction in 2017, but still at a moderate pace. Stocks of unsold houses remain high and properties are taking longer to sell, which may foreshadow another correction. The debt-to-income ratio among households remains elevated but stable.

A broadly neutral stance of fiscal policy is appropriate

The 2020 Budget proposal essentially retains the broadly neutral fiscal stance adopted in budgets since 2017, envisaging a small fiscal contraction between 2019 and 2020. This stance aligns well with continuing above-potential output growth. Deficits will remain below the reference target value (the “3% path”). As such, the fiscal stance also represents a welcome prudent interpretation of the fiscal rule - that the structural deficit over time should equal 3% of the value of the oil fund (the Government Pension Fund Global). Norges Bank is expected to keep rates on hold following the four increases implemented since September 2018.

Structural policy needs to help reverse the decline in potential output growth, while also ensuring the economy is on target to meet climate change goals and retaining a high priority on inclusiveness. Labour supply and skills issues, including the elevated numbers of sick-leave and disability-benefit claimants, are being addressed by a government-appointed commission. Tackling these issues is important for economic

inclusiveness, as well as labour supply. Under current policies, programmed measures for reducing domestic non-European Trading System (ETS) emissions will need to be combined with non-ETS reductions purchased from EU countries for goals to be met. Structural policy also needs to help budgets stay on target; this should principally be achieved through greater attention to public-spending efficiency.

Mainland output growth will slow and risks remain elevated

Mainland output growth is projected to slow to 1.7% by 2021, principally due to an end to the rebound in oil investment, and slowing growth of exports and household consumption. Nevertheless, capacity utilisation will remain high with a low rate of unemployment. Consumer-price inflation will rise gradually.

Risks are tilted to the downside. Weakening economic prospects globally, and particularly in Europe, may accelerate the slowdown in non-oil export growth. Also, substantial adjustment of the housing market and the potential for a negative fall-out from the large amount of household credit remain sizeable risks, particularly for household consumption. Uncertainty surrounding oil prices remains elevated, and is a source of both upside and downside risks. The petroleum sector's substantial cost reductions have increased resilience.

Poland

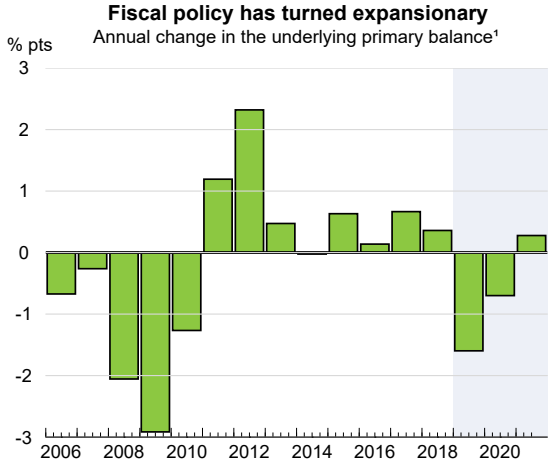
Economic growth will remain robust, although decreasing to 3.8% in 2020 and 3% in 2021. Both private and public investment will decelerate, and low world trade growth will limit exports. Private consumption growth will decline gradually as the impact of new social transfers and tax cuts fade. Decreasing employment gains and the steady decline of the labour force will lead to a progressive reduction in the unemployment rate.

The fiscal stance is pro-cyclical, remaining expansionary in 2020. This will help to offset the impact of weak global conditions in 2020, but the composition of the fiscal easing package could provide more support to address long-term issues. The central bank is expected to keep its policy interest rate unchanged, focusing on declining growth prospects rather than on the medium-term inflation outlook. Structural policies will need to support seniors' and female employment, better integrate immigrants in the labour market, and ensure environmentally sustainable development.

Domestic demand is driving growth

GDP growth hasslowed in 2019, down from a post-crisis peak of 5.1% in 2018. Domestic demand has remained strong, supported by both private consumption and investment. Private consumption is firm due to a booming labour market, and investment has benefitted from fast disbursements of EU funds and still accommodative financial conditions. However, the slowdown in the euro area has already dented export growth. Employment gains and a shrinking labour force have led to a historically low unemployment rate and rising labour shortages. As a result, increasing labour costs continue to drive up inflation.

Poland



1. Measured in per cent of potential GDP.
2. Four-quarter moving average.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045829

Poland: Demand, output and prices

Poland	2016	2017	2018	2019	2020	2021
	Current prices PLN billion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 861.1	4.9	5.1	4.3	3.8	3.0
Private consumption	1 088.4	4.5	4.2	4.2	4.7	3.8
Government consumption	333.1	2.9	3.6	3.9	4.4	3.4
Gross fixed capital formation	335.0	4.0	8.9	8.6	4.6	3.3
Final domestic demand	1 756.5	4.1	5.0	5.0	4.6	3.6
Stockbuilding[1]	29.5	0.8	0.4	-0.5	0.1	0.0
Total domestic demand	1 786.0	4.9	5.3	4.4	4.6	3.6
Exports of goods and services	971.4	9.5	7.0	4.5	3.0	3.2
Imports of goods and services	896.3	9.8	7.6	4.7	4.2	4.3
Net exports[1]	75.1	0.3	0.0	0.1	-0.5	-0.5
Memorandum items						
GDP deflator	_	1.9	1.1	3.0	3.0	2.9
Consumer price index	_	2.1	1.8	2.3	2.9	2.8
Core inflation index[2]	_	0.7	0.8	1.9	2.5	2.8
Unemployment rate (% of labour force)	_	4.9	3.9	3.4	3.1	2.8
Household saving ratio, net (% of disposable income)	_	0.4	0.3	1.4	1.9	1.5
General government financial balance (% of GDP)	_	-1.5	-0.2	-1.2	-0.6	-1.4
General government debt, Maastricht definition (% of GDP)	_	50.6	48.9	47.4	45.6	45.0
Current account balance (% of GDP)	_	0.0	-1.0	-0.1	-0.6	-0.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046760

Structural reforms would help to raise long-term growth

Despite robust growth, a strongly expansionary fiscal policy in 2019 and 2020 will push up the budget deficit from 0.2% of GDP in 2018 to 1.4% of GDP in 2021. In 2020, the extension of the family support scheme, pension increases and public wage increase will boost public expenditures and domestic demand. Yet, temporary revenues, notably from another change to the pension system, worth around 0.7% of GDP in 2020 and 2021, will help limit the deficit. A tighter fiscal stance would be appropriate to sustain rising ageing-related spending pressures over the medium term.

Monetary policy has been appropriately accommodative given subdued inflationary pressures. Yet, wage growth is projected to remain robust, reflecting increasing capacity constraints, steady minimum-wage increases and public-sector pay rises. Increasing labour costs, and energy price and tobacco tax increases, will push prices up in 2020-21. Though the central bank is expected to keep its interest rate constant in the coming two years, initiating an earlier tightening of interest rates would help to contain inflationary pressures.

Structural reforms would boost medium-term growth by addressing the decline in the working-age population and low productivity. Increasing access to high-quality early childcare would facilitate combining work with family life and improve opportunities for women's labour force participation and under-privileged children. Strong immigration from neighbouring countries in Eastern Europe is alleviating labour shortages, but putting in place comprehensive monitoring and integration policies would help attract and retain skilled

migrants. Demographic challenges could be further addressed by encouraging longer working lives and aligning male and female retirement ages. Finally, predictable and long-term climate change policies and adequate tax incentives are necessary to improve environmental and health outcomes.

Growth will gradually ease

Output growth is projected to moderate. Investment growth will decline on the back of lower absorption of EU funds and weaker export prospects. Private consumption growth will temporarily hold up due to rising social transfers and wages. Import growth is projected to outpace increases in exports, and the current account deficit will widen. Escalations of trade tensions and continued uncertainty about an eventual Brexit risk further lowering the growth of exports and private investment. A possible decline in the inflow of foreign workers could spur labour shortages and be a drag on growth. On the other hand, faster-than-projected wage growth and higher household confidence could boost private consumption.

Portugal

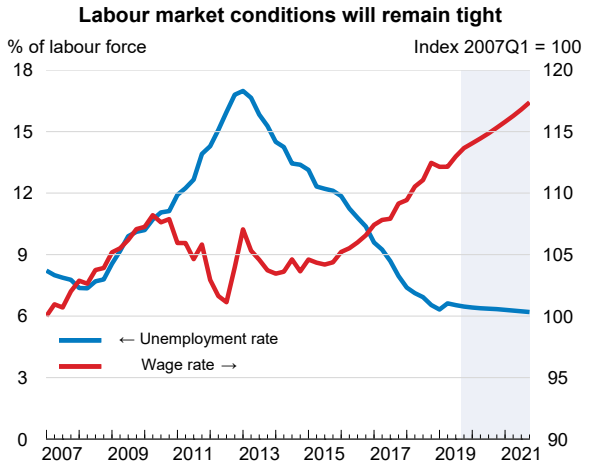
Economic growth is projected to edge down to 1.7% by 2021. Consumption growth will soften due to lower wage growth. Export growth will be sustained by competitiveness gains despite challenging external conditions. The absorption of EU structural funds will sustain investment. Inflation is expected to remain low. Unemployment is projected to decline slightly.

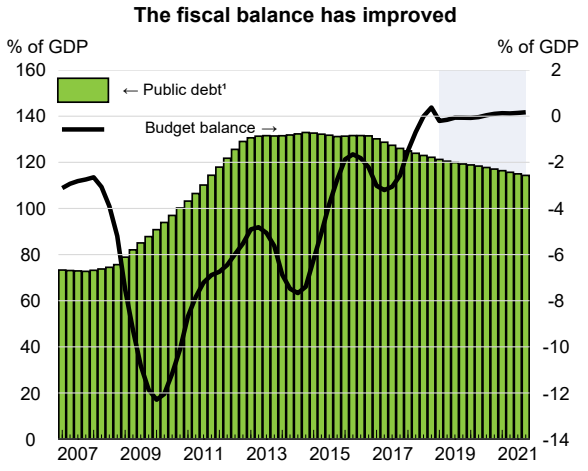
The fiscal stance is expected to be broadly neutral in 2020-21, which is appropriate given the absence of economic slack, and the public debt-to-GDP ratio will continue to decrease. Structural policies could help boost productivity growth further. A more streamlined regulatory environment, stronger product market competition – especially in professional services and network industries – and improved skills are key in that respect.

Domestic demand is the main driver of economic growth

Economic activity remained dynamic in the first half of the year. Private consumption has benefitted from tight labour markets modestly pushing up wage growth, and from weak inflation. Domestic demand has also been boosted by strong business investment. Export growth has softened slightly and industrial confidence has deteriorated in the second half of the year, reflecting rising uncertainty about external conditions and trade tensions. However, confidence indicators for services, consumers and construction have stabilised, indicating some resilience to negative external developments.

Portugal





1. Maastricht definition.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045848

Portugal: Demand, output and prices

Portugal	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2016 prices)				
GDP at market prices	186.5	3.5	2.4	1.9	1.8	1.7
Private consumption	122.0	2.1	3.1	2.1	2.2	1.7
Government consumption	32.8	0.2	0.9	0.5	0.6	0.6
Gross fixed capital formation	28.9	11.5	5.8	6.9	1.2	4.3
Final domestic demand	183.7	3.2	3.2	2.7	1.7	2.0
Stockbuilding[1]	0.6	0.1	0.1	0.2	0.2	0.0
Total domestic demand	184.3	3.4	3.3	2.9	1.9	1.9
Exports of goods and services	75.0	8.4	3.8	2.7	1.1	2.2
Imports of goods and services	72.8	8.1	5.8	4.9	1.4	2.6
Net exports[1]	2.1	0.2	-0.8	-0.9	-0.2	-0.2
Memorandum items						
GDP deflator	_	1.5	1.6	1.1	0.5	1.0
Harmonised index of consumer prices	_	1.6	1.2	0.3	0.5	1.0
Harmonised index of core inflation[2]	_	1.2	0.8	0.5	0.6	1.0
Unemployment rate (% of labour force)	_	8.9	7.0	6.5	6.4	6.3
Household saving ratio, net (% of disposable income)	_	-2.2	-2.4	-2.7	-2.7	-2.7
General government financial balance[3] (% of GDP)	_	-3.0	-0.4	-0.1	0.0	0.1
General government gross debt (% of GDP)	_	145.9	139.2	136.3	134.1	131.3
General government debt, Maastricht definition (% of GDP)	_	126.0	122.2	119.3	117.1	114.3
Current account balance (% of GDP)	_	0.4	-0.6	-1.2	-1.0	-1.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Based on national accounts definition.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046779

Fiscal consolidation will reduce public debt

Fiscal policy is expected to remain prudent with a nearly balanced budget in 2019-21, which equates to a broadly neutral fiscal stance. The public debt-to-GDP ratio is set to keep declining. Increasing public spending efficiency will support the build-up of fiscal buffers to address unanticipated shocks and the fiscal impact of an ageing population.

Financial conditions are expected to remain accommodative. On the supply side, banks have made significant progress in strengthening their balance sheets and reducing the stock of non-performing loans, supporting credit growth and consumption. On the demand side, after a period of corporate deleveraging and improved profitability, businesses are undertaking investments on the back of low interest rates and high capacity utilisation.

Improving judicial efficiency and reducing judicial backlog, as well as reducing regulatory barriers in network industries and professional services remain crucial to stimulate productive investment. Portugal also needs to continue increasing skill levels. Educational attainment continues to improve, but the share of low-skilled workers is still high. Raising the quality of education and training in vocational schools would help align skills with business needs and achieve inclusive growth.

Economic growth is projected to edge down

GDP growth is projected to ease to 1.7% by 2021. Despite low inflation and supportive financial conditions, household spending growth is set to soften due to some moderation in employment growth and stabilisation of wage growth. Despite weak foreign demand, exports are set to keep growing due to competitiveness gains on the back of subdued unit labour cost growth. Investment growth will increase in 2021, supported by increased absorption of EU structural funds, and push up imports.

Downside risks stem from a further deterioration of growth prospects in the European Union. Continued uncertainty stemming from the Brexit may affect trade and tourism. The banking sector is still vulnerable to financial shocks due to high levels of non-performing loans. Upside risks stem from improved labour market performance and competitiveness of Portuguese exports as a result of ongoing structural reforms.

Romania

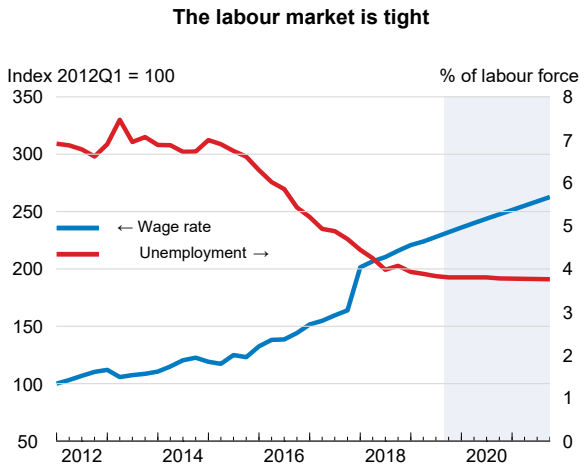
After the strong expansion in recent years, growth is projected to slow to 3.2% in 2020 and then increase to 3.7% in 2021. While wages will return to single-digit growth, private consumption is expected to remain robust, sustained by significant increases in public pensions. The trade deficit will increase further due to weak foreign demand and lower price competitiveness. Investment growth will remain at a moderate pace, supported by higher absorption of EU funds.

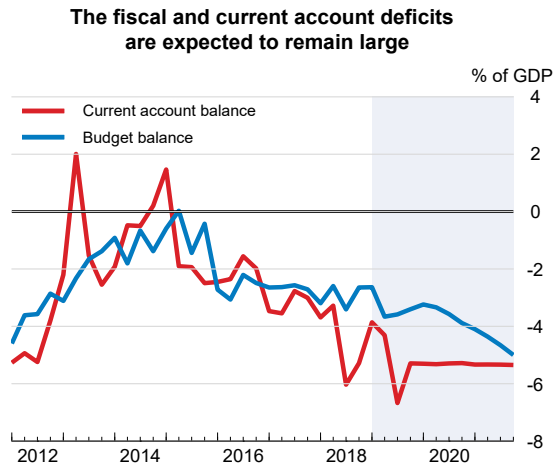
Despite relatively high inflation, monetary policy is projected to remain on hold as risks of overheating subside. While public debt is still moderate, fiscal space is limited as the volatile external environment could limit debt-financing capacity. Prudent fiscal policy requires consolidation efforts. This should be done by revising the public spending mix and improving efficiency of tax collection.

Economic growth has been strong

GDP growth has been strong in 2019, sustained by robust consumption and buoyant investment in the construction sector. Increases in both public sector and minimum wages have supported household purchasing power. Unemployment has reached a record low level and labour shortages have intensified. Rising labour costs have undermined the price competitiveness of domestic producers, contributing to the widening of the current account deficit. Furthermore, slowing global trade has damped growth in industrial production and exports. Business confidence is deteriorating and capacity utilisation is falling.

Romania





Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045867

Romania: Demand, output and prices

Romania	2016	2017	2018	2019	2020	2021
	Current prices RON billion	Percentage changes, volume (2010 prices)				
GDP at market prices	765.1	7.1	4.0	4.0	3.2	3.7
Private consumption	478.2	10.0	5.2	4.6	3.9	4.3
Government consumption	115.4	4.2	1.5	3.2	3.0	2.0
Gross fixed capital formation	175.0	3.6	-3.3	13.5	5.7	5.1
Final domestic demand	768.7	7.7	2.7	6.2	4.1	4.1
Stockbuilding[1]	3.5	0.8	2.8	-0.9	-0.3	0.0
Total domestic demand	772.2	8.4	5.5	5.3	3.8	4.1
Exports of goods and services	315.1	7.6	5.4	3.2	1.6	2.9
Imports of goods and services	322.2	10.8	9.1	6.3	3.3	3.9
Net exports[1]	- 7.1	-1.4	-1.7	-1.5	-0.8	-0.6
Memorandum items						
GDP deflator	_	4.7	5.9	4.8	3.4	3.5
Consumer price index	_	1.3	4.6	3.9	3.4	3.2
Core consumer price index[2]	_	1.5	2.8	3.2	3.3	3.2
Unemployment rate (% of labour force)	_	4.9	4.2	3.9	3.8	3.8
Household saving ratio, net (% of disposable income)	_	-15.4	-8.9	-8.1	-7.9	-7.7
General government financial balance (% of GDP)	_	-2.6	-3.0	-3.3	-3.5	-4.5
General government gross debt (% of GDP)	_	45.1	43.8	45.5	47.7	50.6
General government debt, Maastricht definition (% of GDP)	_	35.1	35.0	36.7	38.9	41.8
Current account balance (% of GDP)	_	-3.2	-4.6	-5.0	-5.3	-5.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046798

Fiscal space is limited

Past expansionary and pro-cyclical fiscal policy has reduced available fiscal space. The fiscal deficit is set to widen further over the coming two years, putting public debt on a fast upward trajectory. A recent pension reform will increase public spending by more than 2 percentage points of GDP by 2021. Expected improvements in tax collection and public efficiency are not likely to materialise soon enough to compensate for increases in public spending. As a result, the fiscal stance is expected to be broadly neutral in 2020 and strongly expansionary in 2021.

The deterioration of the budget balance creates some risks by putting further pressure on the current account deficit, with a potential loss of foreign investor confidence in case of a negative macroeconomic shock. Fiscal buffers need to be rebuilt to address these risks and to preserve sustainability of public finances. To reduce the fiscal deficit, the government should reconsider the scope and/or the timetable of the pension reform. Otherwise, the consolidation effort may have to rely on spending cuts in priority areas, including education, health and infrastructure. Increasing taxes that are the least distortive to growth, such as environmental and property taxes, could also be considered.

Financing conditions will remain favourable as monetary policy is projected to remain accommodative despite inflation exceeding the 2.5% (+/- 1%) target in 2019. Interest rates are projected to remain unchanged going forward, as inflationary pressures are expected to ease slowly and return to the central bank's target band in 2020.

The labour market will remain tight as the labour force continues to decline due to ageing and emigration. Activation measures that increase labour market participation from its current low level can help reduce shortages and wage pressures. Growth in public sector pay and in minimum wages will moderate. As a result, wage inflation will ease, but still exceed productivity gains.

GDP growth is projected to slow

After growing at 4% in 2019, GDP is projected to decelerate to 3.2% in 2020 before increasing to 3.7% in 2021. Falling inflation and fiscal stimulus will sustain increases in household purchasing power. Business investment growth will remain relatively low due to the weak external environment, but higher absorption of EU structural funds will sustain public investment. Competitiveness of domestic producers will be affected by rising labour costs. The current account deficit is set to exceed 5% of GDP.

The main downside risks include a further deterioration of trade prospects in the European Union and heightened global financial volatility leading to capital outflows. Excessive fiscal relaxation, especially sharp increases in wages in the public sector and pensions, would entail stronger competitiveness losses. Steep rises in sovereign spreads could strongly affect the banking sector due to its large sovereign debt exposure. By contrast, activation policies could have a more pronounced positive impact on labour force participation and contribute to easing labour market tensions. Improved policy predictability after the elections in 2020 could strengthen business confidence and investment.

Slovak Republic

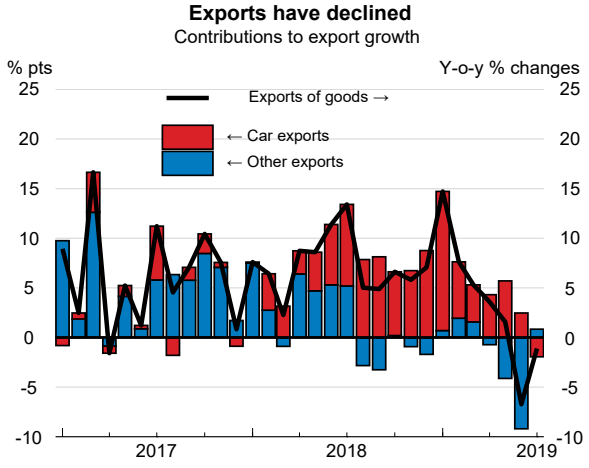
Economic growth is projected to slow to around 2½ per cent in 2020-21, as weaker external demand will weigh on export growth. Domestic demand will remain relatively strong, notably due to private consumption, which will be held up by a resilient labour market with historically low unemployment. Inflation will remain above 2% as the economy operates above its normal capacity.

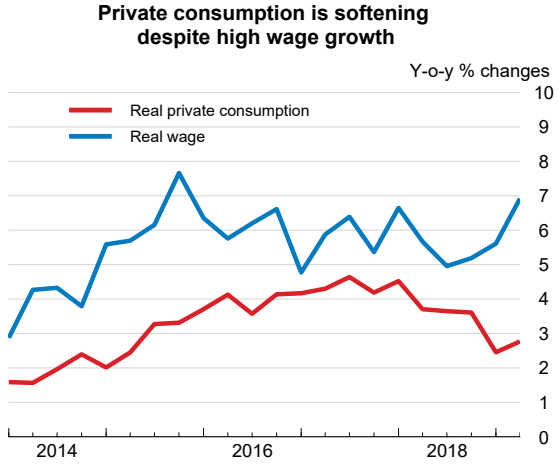
The fiscal stance will be neutral in 2020-21. Nevertheless, containing public spending pressures will be important, given the absence of spare capacity and medium-term challenges posed by population ageing. A thorough reform of the public sector could increase efficiency and finance inclusiveness-friendly reforms in the area of Roma integration and education.

The economy has slowed

Led by weakening exports, the economy has slowed markedly. The softening of foreign demand weighs on demand for goods in which the Slovak Republic specialises. Persisting uncertainty has been holding back investment. The labour market has remained strong, with a historically low unemployment rate and expanding wages supported by public wage increases. However, its effects on household consumption has been moderated by a significant increase in saving. The inflation rate has increased to 2.6% mainly due to higher food price inflation and continuous pressures on resources.

Slovak Republic





Source: OECD Economic Outlook 106 database; OECD National Accounts database; National Bank of Slovakia; and Statistical office of the Slovak Republic.

StatLink https://doi.org/10.1787/888934045886

Slovak Republic: Demand, output and prices

Slovak Republic	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	81.0	3.0	4.0	2.5	2.2	2.6
Private consumption	44.6	4.3	3.9	2.5	2.7	2.9
Government consumption	15.3	1.0	0.2	2.9	2.7	2.3
Gross fixed capital formation	17.0	3.9	3.7	2.5	2.5	3.0
Final domestic demand	77.0	3.6	3.1	2.5	2.7	2.8
Stockbuilding[1]	1.7	-0.2	0.5	0.2	0.0	0.0
Total domestic demand	78.6	3.3	3.6	2.7	2.6	2.7
Exports of goods and services	76.0	3.5	5.4	1.5	1.8	3.6
Imports of goods and services	73.6	3.9	5.0	1.7	2.3	3.7
Net exports[1]	2.4	-0.2	0.5	-0.1	-0.4	-0.1
Memorandum items						
GDP deflator	_	1.2	2.0	2.6	2.8	2.6
Harmonised index of consumer prices	_	1.4	2.5	2.8	2.6	2.5
Harmonised index of core inflation[2]	_	1.4	2.0	2.1	2.6	2.5
Unemployment rate (% of labour force)	_	8.1	6.5	5.8	5.7	5.7
Household saving ratio, net (% of disposable income)	_	2.5	2.6	4.0	4.4	4.4
General government financial balance (% of GDP)	_	-1.0	-1.1	-1.0	-1.2	-1.2
General government gross debt (% of GDP)	_	65.7	63.6	62.5	61.7	61.0
General government debt, Maastricht definition (% of GDP)	_	51.3	49.4	48.4	47.6	46.8
Current account balance (% of GDP)	_	-1.9	-2.6	-1.7	-2.2	-2.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046817

The fiscal stance is set to be neutral

The budget deficit is assumed to remain broadly constant in the coming two years. However, containing public spending pressures will be important, given the absence of spare capacity and medium-term challenges posed by population ageing. Ageing-related costs will increase significantly, as the Slovak Republic has one of the fastest ageing populations in the OECD area and the new constitutional law has introduced a cap on the statutory pension at the age of 64. Nevertheless, if downside risks materialise and growth were to slow significantly, fiscal policy should stand ready to cushion the downturn.

Implementing the recommendations of broad-based spending reviews would help achieve budget efficiency and help to finance much needed structural reforms. Efficient public investment, particularly in education, training and innovation, should foster productivity and more inclusive growth. The decline in educational performance must be reversed, and more needs be done to improve the chances of children from poorer backgrounds, particularly the Roma. Better-trained and better–paid teachers are necessary to address these issues. Stepping up efforts to develop further high-quality childcare and pre-school facilities would also help increase the participation of women with young children in the labour market.

Growth will slow in 2020

Growth will slow to 2¼ per cent in 2020 before recovering to around 2½ per cent in 2021. Private consumption will continue to grow at a robust pace due to the tight labour market and rising social transfers. Weak external demand and global uncertainty will continue to hold back exports and investment. Inflation is projected to remain slightly above 2% in the coming two years. Policy uncertainty regarding trade and a further slowdown in export markets, notably in Germany, remain the main negative risks to the outlook, as they would dent exports and investment even further. On the other hand, faster growth in private consumption is an upside risk, as wages could accelerate more than projected and the high saving rate could decline.

Slovenia

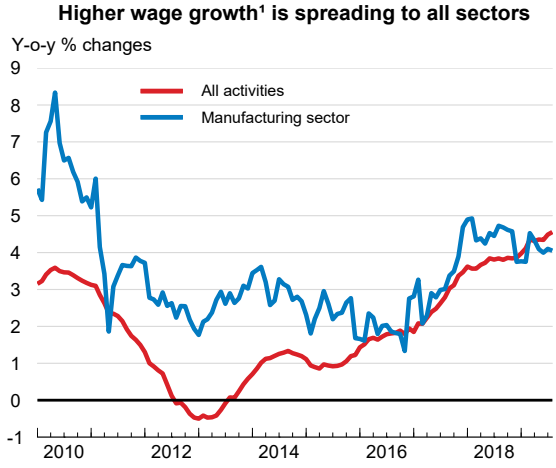
Economic growth is projected to remain at around 3% until 2021. Private consumption will continue to be the main driver of growth, sustained by higher wages and solid employment gains. Uncertainty about the external environment will slow the pace of new business investment. Improvements in export performance will slow with rising labour unit costs. The import content of exports is rising, as foreign demand for goods with higher domestic value added weakens. Domestic demand is increasingly satisfied through imports, owing to tightening capacity constraints.

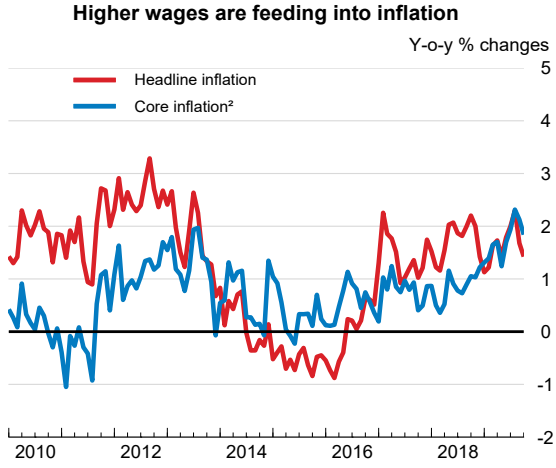
Fiscal policy will remain supportive of growth in the coming two years, driven by higher public sector wages and social transfers. As favourable borrowing conditions persist, growing domestic inflationary pressures call for a moderation in the fiscal stimulus. Measures to restrict pathways to early retirement would mobilise older workers, while accelerating privatisations and decentralising wage bargaining, would contribute to improve labour allocation, and alleviate labour shortages and wage pressures.

Domestic inflationary pressures are building up

Growth has moderated despite strong private consumption. Weaker foreign demand for components from the car, electrical machinery and metal products industries has been reflected in lower export growth. Growing uncertainty about future export orders contributed to lower growth in business investment. At the same time, domestic demand is increasingly satisfied through imports as capacity constraints tighten. The structure of exports is also changing towards manufactured goods with higher import content.

Slovenia





1. Hourly earnings. Year on year percentage change, three-month moving average.
2. Core inflation excludes energy and food.
Source: OECD Main Economic Indicators database.

StatLink https://doi.org/10.1787/888934045905

Slovenia: Demand, output and prices

Slovenia	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	40.4	4.8	4.1	3.1	3.0	3.1
Private consumption	21.8	2.3	3.4	3.6	3.6	3.7
Government consumption	7.7	0.3	3.2	2.4	2.5	2.6
Gross fixed capital formation	7.0	10.4	9.4	6.8	6.2	6.4
Final domestic demand	36.5	3.4	4.6	4.0	4.0	4.1
Stockbuilding[1]	0.4	0.7	0.2	-0.2	0.2	0.0
Total domestic demand	36.9	4.2	4.7	3.7	4.1	4.0
Exports of goods and services	31.5	10.8	6.6	7.8	4.6	5.4
Imports of goods and services	28.0	10.7	7.7	9.1	6.0	6.5
Net exports[1]	3.5	1.0	-0.2	-0.3	-0.8	-0.6
Memorandum items						
GDP deflator	_	1.6	2.2	2.7	2.9	2.6
Harmonised index of consumer prices	_	1.6	1.9	1.8	2.4	2.3
Harmonised index of core inflation[2]	_	0.7	1.0	2.0	2.3	2.3
Unemployment rate (% of labour force)	_	6.6	5.1	4.5	4.1	3.4
Household saving ratio, net (% of disposable income)	_	4.6	5.0	6.0	5.7	5.2
General government financial balance (% of GDP)	_	0.0	0.8	0.7	0.4	0.3
General government gross debt (% of GDP)	_	89.4	84.1	82.1	80.5	79.1
General government debt, Maastricht definition (% of GDP)	_	74.1	70.4	68.7	67.5	66.8
Current account balance (% of GDP)	_	6.1	5.7	5.0	4.2	3.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046836

Employment creation remains strong, mostly benefiting foreign workers, and the unemployment rate has fallen to its lowest level in a decade. Wages have accelerated, particularly in the public sector, reflecting recent wage agreements with trade unions, promotions for civil servants and a higher minimum wage. Headline inflation has risen to almost 2%, mostly driven by higher services prices. Wage pressures are feeding into higher unit labour costs and deteriorating cost competitiveness.

Reducing the fiscal stimulus is required to prevent overheating

Fiscal policy continues to be supportive, with higher public wages, social transfers and pension outlays. Higher social spending helps to preserve an equal society. However, a moderation of the stimulus is needed to contain wage and other cost pressures and to improve fiscal sustainability. The quality of bank assets continues to improve and the banking system appears to be resilient. Favourable bank lending conditions are set to continue and the volume of consumer loans has increased significantly despite tighter macroprudential measures.

Closing pathways to early retirement and better-targeted activation policies to mobilise the older, long-term and low-skilled unemployed, and shifting taxation away from labour to remove disincentives to work, would bolster labour supply, prolong the recovery and help to address labour market and fiscal challenges associated with population ageing. A more decentralised wage bargaining system would improve labour allocation.

Downside risks stem from prolonged tensions in international trade

Economic growth is projected to remain broadly stable in 2020-21. A deterioration in cost competitiveness, owing to higher labour costs and weak productivity gains, will hold back export growth. Investment will continue to slow somewhat, despite higher construction activity, as spending on machinery and equipment weakens. A slow recovery of exports and business investment is expected towards the end of 2021 as international trade expands more rapidly. The main upside risk stems from a faster recovery of business sentiment and business investment growth. On the downside, prolonged tensions in the international environment could lead to lower-than-anticipated export market growth. Stronger wage growth, and even lower productivity gains, would also hamper the recovery of exports.

South Africa

Economic growth remains weak and is projected to pick up to only 1¼ per cent in 2020-21. Confidence is low on the back of continuing policy uncertainty, which hampers investment. Unemployment will remain high, weighing on private consumption. Trade is currently held down by global trade tensions, but export growth should pick up in line with the recovery of world trade. Inflation will increase moderately in 2020 due to rising electricity, food and fuel prices.

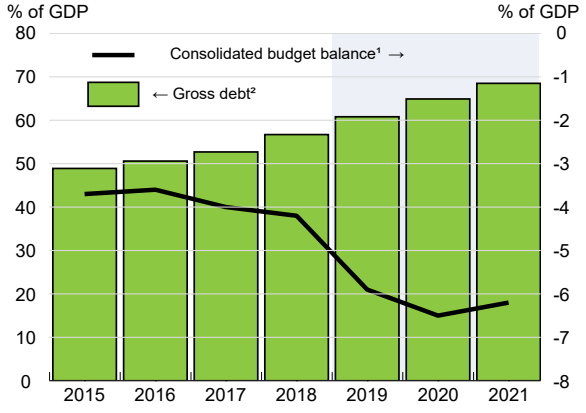
The fiscal deficit has increased, driven by a rising government wage bill, increasing interest payments and bailouts of state-owned enterprises. Government debt exposure to under-performing state-owned enterprises (15% of GDP) is high, posing a risk to debt sustainability. Implementing an effective governance framework for state-owned enterprises and reducing the wage bill are needed to create fiscal space. The slowdown in inflation and the anchoring of inflation expectations could provide room to ease monetary policy.

Falling exports and low domestic demand are weakening growth

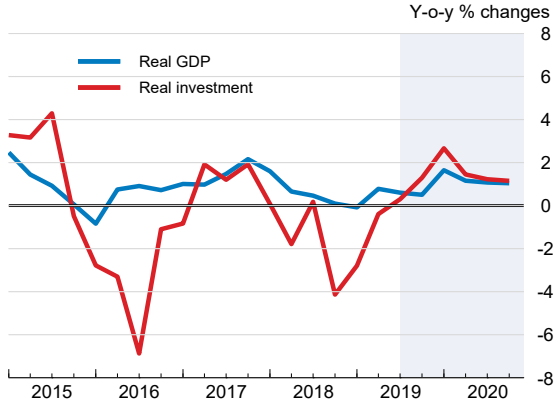
Growth has been volatile and low in 2019 due to weak domestic demand. Replacement and maintenance of machinery and equipment will boost investment somewhat, as confidence is not expected to improve strongly. Mining and manufacturing production are slowing. Though improving in the second half of the year, net exports will not contribute to growth.

South Africa

The public finances are deteriorating



The projected pick-up in GDP growth is dependent on stronger investment



1. National and provincial government, social security funds and public entities. Fiscal year beginning on the 1st of April.
2. Debt of the central government, excluding extra-budgetary institutions and social security funds. Fiscal year beginning on the 1st of April.
Source: National Treasury, Budget Review 2019, Medium Term Budget Policy Statement 2019; and OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045924

South Africa: Demand, output and prices

South Africa	2016	2017	2018	2019	2020	2021
	Current prices ZAR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 348.8	1.4	0.7	0.5	1.2	1.3
Private consumption	2 584.4	2.1	1.8	1.3	1.4	1.5
Government consumption	906.3	0.2	1.9	1.6	1.2	1.1
Gross fixed capital formation	846.6	1.0	-1.4	-0.4	1.6	1.7
Final domestic demand	4 337.3	1.5	1.2	1.1	1.4	1.5
Stockbuilding[1]	- 11.3	0.4	-0.3	0.6	0.3	0.0
Total domestic demand	4 325.9	1.9	0.9	1.7	1.7	1.5
Exports of goods and services	1 333.0	-0.7	2.6	-2.6	1.8	2.3
Imports of goods and services	1 310.2	1.0	3.3	1.7	3.3	2.7
Net exports[1]	22.8	-0.5	-0.2	-1.3	-0.5	-0.2
Memorandum items						
GDP deflator	_	5.7	3.4	4.3	4.8	4.3
Consumer price index	_	5.3	4.6	4.2	4.6	4.5
Core inflation index[2]	_	4.6	4.2	4.2	4.4	4.5
General government financial balance (% of GDP)	_	-3.8	-3.4	-5.9	-6.6	-6.3
Current account balance (% of GDP)	_	-2.5	-3.6	-3.6	-3.6	-3.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046855

Reforms are needed to stimulate the economy

Inflation has receded markedly in 2019, but it will pick up moderately in 2020 and 2021 to slightly above the Reserve Bank's target of 4.5%, driven by increases in electricity, food and fuel prices. Inflation expectations should continue to moderate progressively toward the inflation target. Risks to inflation are balanced. Demand side pressures are low, as food prices and wages are expected to grow modestly. Given ample spare capacity and the anchoring of inflation expectations, there could be room for easing monetary policy, particularly in 2021.

Rising compensation of government employees and increased bailouts of state-owned enterprises are putting pressure on public finances. Wage negotiations have systematically granted above-inflation increases. The government has announced an early-retirement plan to reduce employment levels, but early-retirement schemes are costly in the short run, with limited benefits. The government could consider indexing public sector wages below inflation for three years. Slow reform of state-owned enterprises is weighing on the economic climate and confidence. The underperformance of these enterprises is widespread due to mismanagement, corruption, overstaffing and an uncontrolled wage bill. An effective governance framework for state-owned enterprises needs to be established, setting clear company-specific goals in terms of profitability, capital structure and non-financial objectives.

Developing tourism and boosting transport infrastructure investments would contribute to growth in the short run and to job creation. Regulatory restrictions are still relatively high. This includes a high level of government involvement in the economy, barriers to domestic and foreign entry, complex rules for licences and permits, and protection of existing businesses from competition. Giving more independence to regulators in the energy, transport and telecom industries and accelerating the adoption and implementation of the Transport Regulation Bill are necessary.

Persistent low growth is set to continue

Growth is projected to pick up modestly in 2020 and 2021. Investment will be the main driver of growth aided by government spending. Stronger exports should also contribute to growth. Household consumption growth will remain low. Domestic near-term risks to GDP growth include load-shedding (rolling blackouts) by power utilities and higher-than-expected electricity prices. Moreover, the level of investor confidence in the economy remains fragile and vulnerable to policy developments. A stronger-than-anticipated slowdown of growth in China – South Africa's largest trading partner – would negatively affect the price and demand for South Africa's export commodities.

Spain

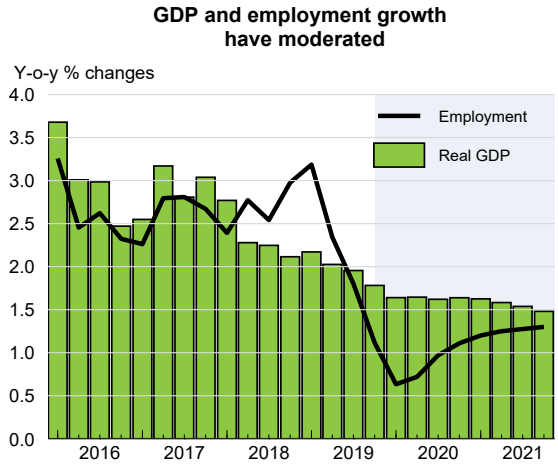
The moderation in economic growth in 2019 is projected to continue in 2020 and 2021. Domestic demand will remain the main driver of growth, albeit at a slower pace than in recent years, with moderating employment growth weighing on consumption and heightened uncertainty hindering investment. Lower export market growth will be a drag on exports. Inflation will remain subdued, with continued slack in the economy.

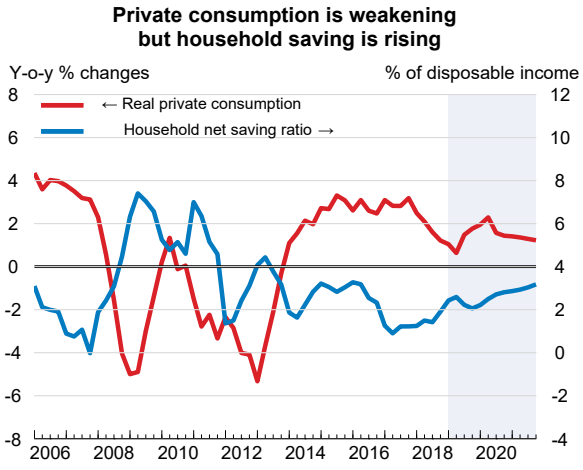
The recent improvements in the public finances largely relied on favourable macroeconomic conditions. Further improving the structural fiscal balance to allow for a durable reduction in the high public debt-to-GDP ratio is key. To boost potential growth and reduce inequalities, the skills and labour market outcomes of vulnerable groups should be improved. Boosting productivity growth requires firms to be more exposed to competition and innovation.

Growth has moderated

Domestic demand has been less dynamic than in recent years, in the context of heightened uncertainty. Continued job creation, wage increases and low inflation have supported household real disposable income and the recent rise in household saving. A fall in confidence and weak external growth have adversely affected the manufacturing sector, but services continue to perform well. Employment growth moderated recently, but remains around 2%. Trends in housing sales and new loans for house purchases point to a continued slowdown in residential investment.

Spain





Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934045943

Spain: Demand, output and prices

Spain	2016	2017	2018	2019	2020	2021
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 113.8	2.9	2.4	2.0	1.6	1.6
Private consumption	648.3	3.0	1.8	1.2	1.8	1.3
Government consumption	212.3	1.0	1.9	2.3	1.6	1.1
Gross fixed capital formation	200.0	5.9	5.3	2.8	3.6	3.0
Final domestic demand	1 060.6	3.1	2.5	1.7	2.1	1.6
Stockbuilding[1]	8.8	0.0	0.2	0.0	0.1	0.0
Total domestic demand	1 069.4	3.1	2.7	1.8	2.2	1.6
Exports of goods and services	377.4	5.6	2.2	1.6	1.3	2.2
Imports of goods and services	333.0	6.6	3.3	1.0	3.0	2.5
Net exports[1]	44.4	-0.1	-0.3	0.3	-0.5	0.0
Memorandum items						
GDP deflator	_	1.4	1.1	1.6	1.1	1.3
Harmonised index of consumer prices	_	2.0	1.7	0.8	1.1	1.3
Harmonised index of core inflation[2]	_	1.2	1.0	1.1	1.3	1.3
Unemployment rate (% of labour force)	_	17.2	15.3	14.2	14.1	13.6
Household saving ratio, net (% of disposable income)	_	1.2	1.5	2.3	2.6	3.0
General government financial balance (% of GDP)	_	-3.0	-2.5	-2.2	-1.8	-1.4
General government gross debt (% of GDP)	_	115.8	114.8	114.3	114.0	113.2
General government debt, Maastricht definition (% of GDP)	_	98.6	97.6	96.6	96.4	96.2
Current account balance (% of GDP)	_	2.7	1.9	1.6	1.3	1.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046874

Boosting productivity growth is key

Monetary policy in the euro area will remain accommodative, fostering investment and consumption via lower lending rates. Political uncertainty creates ambiguity over the future fiscal stance, which is assumed to be broadly neutral in the coming two years. As the public debt-to-GDP ratio remains high at 96%, further improvements in the structural balance are needed to ensure a durable reduction of public debt.

Higher potential growth can also help to improve fiscal sustainability and increase resilience to shocks. Productivity growth would be supported by boosting skills, competition and innovation. Targeted active labour market policies could help low-skilled workers to improve their labour market prospects, lowering inequalities. Introducing a single point of contact for employment and social services to provide integrated support for jobseekers would improve coordination. Training in digital skills should be targeted to less-educated and low-income individuals, whose jobs might be more at the risk of automation. Further increasing the coordination and evaluation of regional and national innovation policies would raise the quality of innovation. Ensuring the effective implementation of prior structural reforms addressing the internal fragmentation of product markets is key to creating economies of scale.

Growth is set to slow

Growth is projected to moderate to 1.6% in 2020 and 2021. Domestic demand will remain the main driver of growth. As the effect of pent-up demand subsides and household saving continues to increase, private consumption will moderate. Employment growth is projected to slow, but the unemployment rate is set to decline further to 13.6% in 2021. Business investment will be less dynamic than in the past, but will be supported by high capacity utilisation and favourable financing conditions. The contribution of net exports to growth will be negative in 2020, in the context of weaker export market growth, and neutral in 2021.

A key downside risk is lower-than-projected growth in Europe, Spain's main export destination, which would lower exports. Brexit could adversely affect the tourism sector. Consumption growth might turn out weaker than expected, if the slowdown in employment growth is stronger or if uncertainty persists. Alternatively, given strong fundamentals, investment could be higher if uncertainty decreases, boosting business confidence.

Sweden

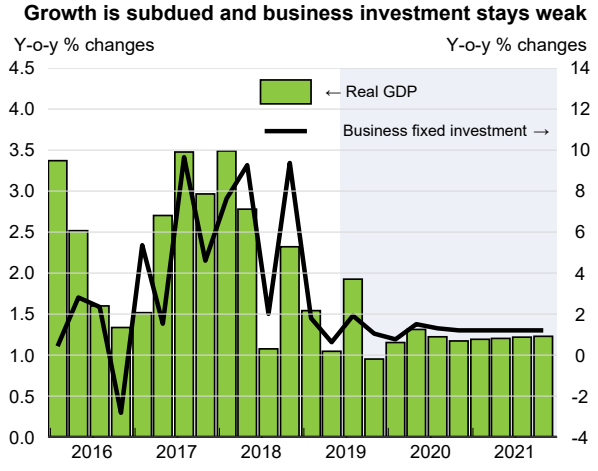
The long expansion is losing momentum. Export growth will decline sharply, reflecting the global slowdown. Heightened uncertainty will continue to weigh on business investment, while residential investment will bottom out. Households will continue to spend with caution, as unemployment is rising and wage gains remain moderate. Inflation will continue to undershoot the 2% target.

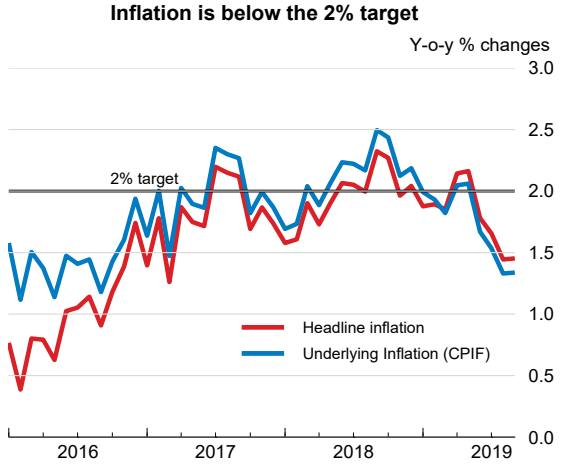
Monetary policy will likely remain accommodative until the economy shows clear signs of recovery and inflation moves clearly towards the target. Automatic stabilisers and discretionary fiscal measures will support the economy, but space for additional stimulus is available, should economic conditions deteriorate more than projected. Support for entry-level jobs and skills development, along with labour market reform, will be critical to contain the rise in unemployment.

Growth is slowing markedly and unemployment is rising

Weak exports and business investment, resulting from the global slowdown and higher uncertainty, are dragging down economic growth. Low consumer confidence and subdued wage growth are holding back private consumption. Residential investment continues to contract, but from a high level and at a slowing pace. Unemployment is rising, though most probably not as steeply as suggested by recent data. Sluggish activity, slower energy price increases and fading effects from the depreciation of the krona have pulled down inflation to below the 2% target.

Sweden





Source: OECD Economic Outlook 106 database; and Statistics Sweden.

StatLink https://doi.org/10.1787/888934045962

Sweden: Demand, output and prices

Sweden	2016	2017	2018	2019	2020	2021
	Current prices SEK trillion	Percentage changes, volume (2018 prices)				
GDP at market prices	4 407.0	2.7	2.4	1.4	1.2	1.2
Private consumption	1 997.4	2.2	1.6	1.0	1.9	1.4
Government consumption	1 163.4	0.5	0.7	0.8	0.8	0.8
Gross fixed capital formation	1 063.5	6.0	4.6	-0.8	1.0	1.2
Final domestic demand	4 224.4	2.7	2.1	0.5	1.4	1.2
Stockbuilding[1]	21.2	0.1	0.5	0.0	0.1	0.0
Total domestic demand	4 245.6	2.7	2.7	0.5	1.4	1.2
Exports of goods and services	1 901.4	4.7	3.3	3.9	0.9	1.2
Imports of goods and services	1 740.0	5.1	3.8	1.7	1.2	1.2
Net exports[1]	161.4	0.0	-0.1	1.1	-0.1	0.0
Memorandum items						
GDP deflator	_	2.1	2.2	2.8	1.8	1.9
Consumer price index[2]	_	1.8	2.0	1.8	1.8	1.8
Core inflation index[3]	_	2.0	2.1	1.7	1.8	1.8
Unemployment rate[4] (% of labour force)	_	6.7	6.3	6.8	7.0	7.0
Household saving ratio, net (% of disposable income)	_	13.3	15.4	17.1	17.3	17.6
General government financial balance (% of GDP)	_	1.4	0.8	0.4	0.2	0.1
General government debt, Maastricht definition (% of GDP)	_	40.7	38.7	35.7	33.3	33.1
Current account balance (% of GDP)	_	2.8	1.7	4.5	4.5	4.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. The consumer price index includes mortgage interest costs.
3. Consumer price index with fixed interest rates.
4. Historical data and projections are based on the definition of unemployment which covers 15 to 74 year olds and classifies job-seeking full-time students as unemployed.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046893

Policies are cushioning the downturn and fiscal space is available

Monetary policy continues to support the economy, despite the expected December policy rate increase from -0.25% to 0%. Subdued growth, high uncertainty and below-target inflation are likely to delay any additional increase in the policy rate over the coming two years, as the benefits of expansionary policy outweigh potential adverse side effects on household debt and resource allocation. Scope for further monetary stimulus, should growth and inflation disappoint, is limited.

In addition to powerful automatic stabilisers, discretionary measures in the 2020 budget bill, amounting to 0.5% of GDP, will bolster activity. They include tax cuts for higher-income households and pensioners, and increased support for green investments, health care, schools and employment, as well as public investment, notably in road and rail maintenance. With a budget surplus and gross government debt close to 35% of GDP, there is room for additional fiscal stimulus if the economic situation deteriorates further.

Containing the rise in unemployment as the economy slows will be challenging. In particular, the tight labour market over recent years has facilitated the employment of low-skilled workers and newly-arrived immigrants, who are likely to face tougher prospects going forward. The government intends to introduce new measures, including entry agreements negotiated with the social partners, to help newly-arrived immigrants and long-term unemployed find jobs. A skills development programme will help workers adapt

to evolving job requirements and the public employment service will be reformed, with increased involvement of private providers.

Growth will remain sluggish with downside risks

Weak global demand, notably for the intermediate and capital goods in which Sweden specialises, and global uncertainty will continue to weigh on exports and business investment. Residential investment will bottom out as inventories of unsold dwellings decline. However, even though house prices have stabilised and a general shortage of dwellings persists, no rapid rebound in construction is expected. Huge uncertainty surrounds the reaction of employment to the economic slowdown and the ability of the new labour market policies to counter the rise in unemployment. With the uncertainties surrounding the labour market and modest wage growth, households will remain cautious in spending, despite benefiting from tax cuts. Risks related to the global environment are tilted to the downside and lower global growth and intensified trade tensions could reduce Swedish exports and investment further. However, the strong fiscal position would allow more expansionary fiscal policy to damp the downturn.

Switzerland

After decelerating during 2019, economic growth is projected to pick up in 2020-21. Private consumption will remain resilient, supported by low unemployment. A gloomy global environment will weigh on investment and trade, but the current account surplus will remain large. International sporting events will boost service exports and thus growth in 2020. Inflation will be subdued following the recent currency appreciation but inch up in 2021.

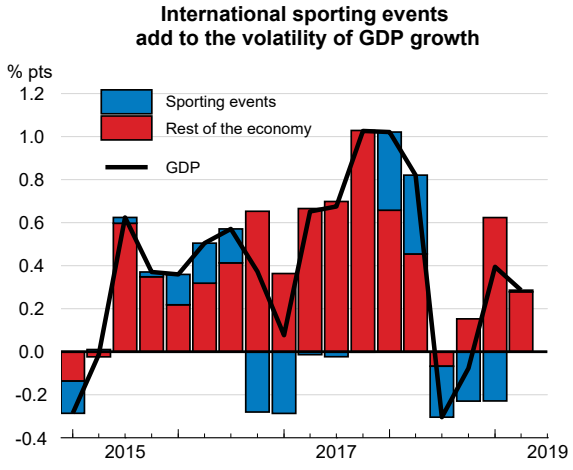
Monetary policy will remain very accommodative, with the policy rate set to stay at -0.75% in the coming two years. Fiscal policy will be expansionary in 2020. Reforms are necessary to cope with population ageing and sustain high well-being. Increasing the statutory retirement age would reduce future public expenditure, limit the expected fall in the labour force and help maintain retirees' living standards.

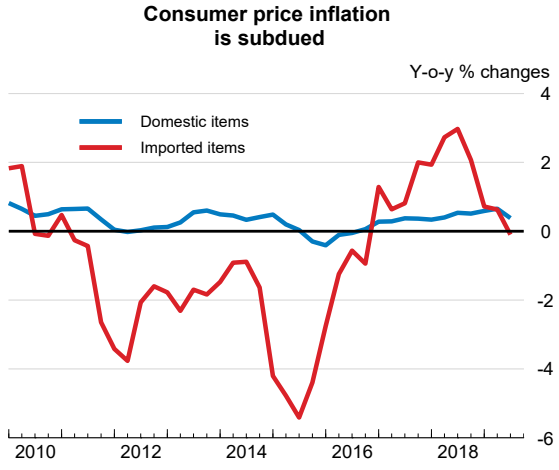
Growth has slowed

Headline GDP growth has declined sharply in 2019, partly because of the effects of biannual international sporting events that impart a sizeable boost every even year. This is due to the related licences, patents and rights being recorded as service exports in Switzerland because it hosts the respective international bodies. However, weak investment and the gloomy global environment are also dragging down growth, with business and consumer confidence below their long-term averages.

The unemployment rate remains low and wage growth is picking up. Inflation is subdued because of falling domestic and imported inflation. Recent currency appreciation is hurting competitiveness outside of less price-sensitive sectors like pharmaceuticals, but the current account surplus remains sizeable.

Switzerland





Source: State Secretariat for Economic Affairs; and Federal Statistical Office.

StatLink https://doi.org/10.1787/888934045981

Switzerland: Demand, output and prices

Switzerland	2016	2017	2018	2019	2020	2021
	Current prices CHF billion	Percentage changes, volume (2010 prices)				
GDP at market prices	661.6	1.9	2.8	0.8	1.4	1.0
Private consumption	353.2	1.3	1.0	1.1	1.4	1.5
Government consumption	79.4	1.2	0.3	1.1	1.1	1.2
Gross fixed capital formation	158.2	3.5	1.1	0.4	1.5	1.5
Final domestic demand	590.7	1.8	0.9	0.9	1.4	1.5
Stockbuilding[1]	- 5.7	0.0	-0.1	-0.1	0.1	0.0
Total domestic demand	585.0	1.7	0.8	0.9	1.5	1.5
Exports of goods and services	435.0	0.0	2.9	-0.4	2.7	1.9
Imports of goods and services	358.4	-0.5	-0.3	-0.6	3.3	2.8
Net exports[1]	76.6	0.3	2.0	0.1	0.0	-0.3
Memorandum items						
GDP deflator	_	-0.6	0.3	0.7	0.7	1.1
Consumer price index	_	0.5	0.9	0.4	0.4	1.0
Core inflation index[2]	_	0.3	0.5	0.5	0.4	1.0
Unemployment rate (% of labour force)	_	4.8	4.7	4.5	4.5	4.5
Household saving ratio, net (% of disposable income)	_	17.3	17.3	17.6	17.6	17.3
General government financial balance (% of GDP)	_	1.2	1.4	1.2	1.0	0.8
General government gross debt (% of GDP)	_	42.9	41.8	40.7	40.0	39.5
Current account balance (% of GDP)	_	6.5	10.5	10.4	10.1	9.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046912

Macroeconomic policy is set to become more expansionary

Monetary policy has been expansionary since the global financial crisis, and the reference rate has been negative since 2015, at around -0.75%. Low interest rates affect bank net interest margins as well as the returns of pension funds and life insurers. Part of banks' sight deposits at the central bank are exempted from negative rates, reducing the burden on the banking sector; the threshold was raised in November. Lower returns lead to rising real estate exposures of financial institutions. House prices continue to outpace rents and income, and mortgage lending has picked up. Despite the recent tightening of bank self-regulation on maximum loan-to-value ratios, a formal framework setting lending limits is needed, with enforcement on a comply-or-explain basis.

Fiscal expansion in 2020 will lower the budget surplus, as a corporate tax reform reduces tax revenues. Low public debt provides fiscal space to stimulate the economy if needed. However, population ageing will exert pressure on pension and health spending in the medium term. Equalising the statutory retirement age for both sexes at 65, and then gradually increasing it to 67 and linking it to life expectancy would support the pension system as well as growth and incomes. Shifting the tax mix towards value-added taxes and away from personal income taxes would reduce the exposure of government revenues to ageing. The planned cut in second earners' income tax will lower work disincentives.

Skill shortages are growing, notably in IT-related fields, hampering firms' expansion and the absorption of new technologies. Easing procedures for non-EU immigration would attenuate skill shortages. Promoting scientific and technical courses, particularly among women, would also add to supply in the medium term. Re-skilling and upgrading skills can reduce shortages and avoid workers being left behind in the digital transformation.

External factors will exert a drag on growth

Growth is projected to remain modest in underlying terms as the gloomy global environment weighs on trade and investment. However, the influence of international sporting events will boost headline growth in 2020 and depress it in 2021. Private consumption will gain strength, supported by low unemployment and renewed wage growth. Switzerland's economy could cope with low global trade growth better than projected thanks to its growing specialisation in pharmaceuticals, although more labour-intensive export sectors could lose ground. An escalation of global trade tensions with further repercussions for Europe could have significant spillovers to Switzerland's export-oriented sectors. Uncertainty regarding negotiations over an institutional framework agreement with the European Union could damage business confidence and investment.

Turkey

Growth has continued to pick up over recent months. Substantial government stimulus is lifting domestic demand more vigorously than previously anticipated and currency depreciation is supporting exports. Yet, weak external trade demand, geopolitical uncertainties and impaired private balance sheets are projected to keep GDP growth at around 3%, well below potential growth which itself has weakened and which may decline further due to increased policy-related distortions in the economy. Investor confidence remains fragile and investment has declined sharply.

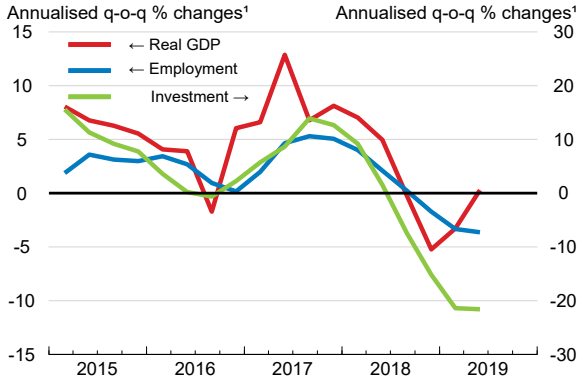
To rebuild domestic and international confidence, the macroeconomic policy framework should be simplified and made more transparent. Enhancing the transparency of the general government fiscal position, including the expanding quasi-fiscal channels, and ensuring the credibility of central bank independence would strengthen confidence. Further measures to enhance labour market flexibility and product market competition in the formal sector are needed to reverse the weakening of medium to long-term investment intensity and growth potential.

Recovery is underway, but uncertainties remain very high

On the back of the substantial minimum wage increase at the beginning of 2019, temporary indirect tax cuts, and credit expansion by public banks, private consumption has continued to recover. In contrast, business investment continued to decline in the first half of the year and high-frequency indicators herald no sizeable upturn. Non-financial firms continue to de-leverage their previously strongly increased foreign and domestic currency debts. The reported increase in bankruptcy protection applications suggests that financing constraints continue to undercut investment capacity.

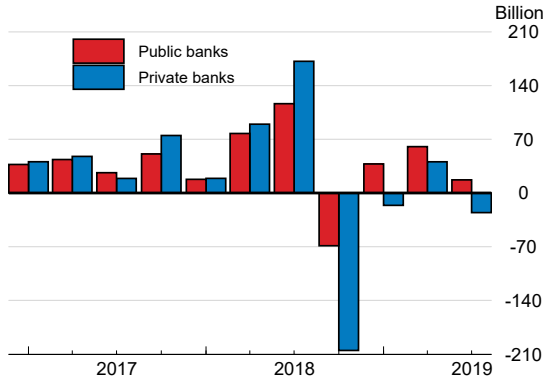
Turkey

A recovery has started but investment has remained very weak



Public banks are mobilised to support domestic demand

Flows of credits in Turkish lira²



1. Three-quarter moving average.
2. Includes consumer and commercial credits.
Source: OECD Economic Outlook 106 database; and Banking Regulation and Supervision Agency.

StatLink https://doi.org/10.1787/888934046000

Turkey: Demand, output and prices

Turkey	2016	2017	2018	2019	2020	2021
	Current prices TRY billion	Percentage changes, volume (2009 prices)				
GDP at market prices	2 608.5	7.5	2.8	0.3	3.0	3.2
Private consumption	1 560.5	6.2	0.1	-0.6	4.0	3.8
Government consumption	387.0	4.6	7.1	4.8	1.8	2.1
Gross fixed capital formation	764.7	8.2	-0.6	-15.9	4.0	6.5
Final domestic demand	2 712.2	6.6	0.9	-4.4	3.6	4.3
Stockbuilding[1]	- 28.4	0.7	-2.3	-0.5	0.2	0.0
Total domestic demand	2 683.8	7.4	-1.6	-4.9	3.8	4.3
Exports of goods and services	573.0	12.0	7.8	5.2	3.7	2.0
Imports of goods and services	648.2	10.3	-7.7	-12.4	6.6	5.8
Net exports[1]	- 75.3	0.1	4.2	5.3	-0.7	-1.0
Memorandum items						
GDP deflator	_	11.0	16.4	16.0	13.0	10.9
Potential GDP, volume	_	5.5	5.2	4.4	4.0	3.9
Consumer price index[2]	_	11.1	16.3	15.8	13.2	10.0
Core inflation index[3]	_	10.1	16.5	14.3	12.9	9.9
Unemployment rate (% of labour force)	_	10.9	11.0	13.5	13.2	13.0
Current account balance (% of GDP)	_	-5.6	-3.0	0.3	-0.7	-1.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Based on yearly averages.
3. Consumer price index excluding food and energy.

Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046931

Export market shares have risen due to the competitiveness gains delivered by the sharp exchange rate depreciation. Tourism exports benefited most, soaring by more than 15% in real terms in the first seven months of the year. Manufacturing export orders from the European market have contracted, but aggregate exports have remained positive. In contrast, employment has declined through 2019, despite considerable additional job creation in public and social services. Despite a strong pro-cyclical decline in labour force participation, the rate of unemployment excluding agriculture increased to 15% in the May-July period and the rate of youth unemployment to 25%.

Macroeconomic policy draws excessively on opaque instruments

Public banks have strongly supported private consumption by rescheduling households' credit card and other debt, extending additional consumer loans, and offering subsidised housing and car credits. Consumer loans grew more rapidly than commercial credits, reaching the very high annualised rate of 25% in early October. At the same time, the exchange rate, which had depreciated by 33% against the US dollar after the August 2018 shock, and the country risk premium, which had risen severely, regained some ground. The lira exchange rate and the country risk premium nevertheless remain exposed to bouts of volatility arising from political and geopolitical uncertainties, which have risen recently. Against this backdrop, the high degree of dollarisation of domestic savings and credits further increases volatility risks for the Turkish Lira.

A new economic programme introduced in September intends to lift GDP growth sharply in 2020 and 2021. As private consumption is hindered by high unemployment and low household confidence, and as private banks (which face higher loan delinquencies and are undergoing large-scale loan restructurings) remain prudent, public banks and other government financial institutions are being solicited on an ever-larger

scale. Public banks are also reported to be undertaking foreign exchange operations to help stabilise the exchange rate, within the scope provided by regulations. Together with additional subsidies and incentives to selected businesses and projects, capital formation is being stimulated largely through policy leverage. This shift may raise important risks for the quality and sustainability of capital formation in the business sector, including in activities exposed to large capital misallocation risks such as energy and real estate development. This may compound the observed past decline in productivity growth and the potential growth rate, with short-term stimulus gains risk being more than offset by durable losses in trend growth. The expansion of government-controlled and subsidised funding is also not included in formal fiscal reports or in official fiscal plans, nor are most other off-budget liabilities such as expanding government guarantees to public-private partnerships. Even though detailed data are lacking, it is clear that public contingent liabilities have increased massively over the past year.

Monetary policy has benefitted from the very benign global monetary conditions by sharply cutting the policy interest rate from 24% in July to 14% in October. At 8.6% in October, the annual inflation rate remains, however, well above the 5% target and is subject to upward risks in the period ahead as a result of sharp administrative price increases. A tight monetary stance should be maintained to ensure the continuation of the disinflation process. Ensuring the independence of the central bank is key for future credibility.

The recovery will be gradual and is vulnerable to substantial risks

GDP growth is expected to remain steady at around 3% in 2020 and 2021. Private consumption is projected to recover but investments should improve only very gradually. Weak export demand and impaired private balance sheets will continue to weigh on the recovery. Additional risks arise from geopolitical uncertainties, which, if not appeased, may erode confidence and increase volatility. In contrast, credible policy improvements in fiscal, financial and monetary policy areas may accelerate the recovery by upholding domestic and international investor commitment.

United Kingdom

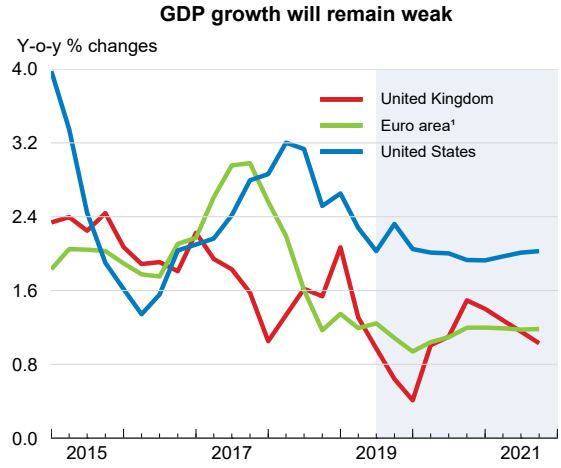
The economic outlook is unusually uncertain given the risks around exit from the European Union. Assuming there is a smooth transition ending after 2021, activity is expected to grow at around 1% in the next two years. Brexit-related uncertainty will keep holding back investment until there is clarity about future trading arrangements. Weak global economic prospects will slow the recovery in exports. Inflation is projected to slow to below 2%.

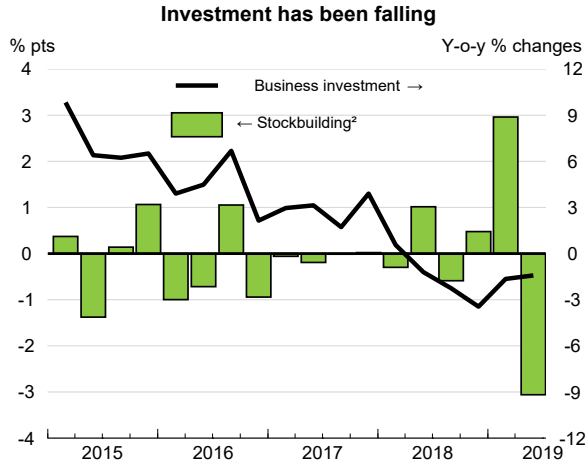
Monetary policy should continue to support activity and keep inflation close to target, but cannot fully address all shocks. The government should stand ready to intervene to address any Brexit-related disruption or a weakening of economic growth. The United Kingdom should strive to find an agreement that ensures the closest possible trading relationship with the European Union and high access for financial services to overseas markets.

Economic uncertainty has held back investment

Shifting expectations about the potential timing and nature of Brexit and a deteriorating international environment have weighed on trade and business investment. Persistent weakness in investment is starting to erode long-term prospects, and surveys point to weak investment intentions going forward. The accumulation of stocks in the first quarter of the year has been partially unwound, with little effect on growth as it essentially related to imported goods. Consumption growth has remained resilient, supported by continued growth in real household incomes. There are signs that the labour market is starting to cool. The unemployment rate has ticked upward and the number of vacancies has started falling. Net migration from the European Union has decelerated markedly since 2017 and has been only partly compensated for by more migrants from non-EU countries. Inflation has recently fallen below target.

United Kingdom 1





1. Covers 17 countries that are both euro area and OECD members.
2. Contribution to changes in real GDP.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046019

United Kingdom: Demand, output and prices

United Kingdom	2016	2017	2018	2019	2020	2021
	Current prices GBP billion	Percentage changes, volume (2016 prices)				
GDP at market prices	1 995.5	1.9	1.4	1.2	1.0	1.2
Private consumption	1 299.1	2.2	1.6	1.2	1.0	0.7
Government consumption	381.5	0.3	0.6	3.3	3.1	2.1
Gross fixed capital formation	343.7	1.6	-0.1	0.0	0.0	1.3
Final domestic demand	2 024.3	1.7	1.1	1.4	1.2	1.1
Stockbuilding[1]	3.5	-0.6	0.3	0.3	-1.5	0.0
Total domestic demand	2 027.8	1.2	1.4	1.6	-0.3	1.1
Exports of goods and services	567.5	6.1	-0.9	0.2	1.2	1.6
Imports of goods and services	599.8	3.5	0.7	2.5	-2.8	1.2
Net exports[1]	- 32.3	0.7	-0.5	-0.7	1.3	0.1
Memorandum items						
GDP deflator	_	1.9	1.9	2.1	1.7	1.6
Harmonised index of consumer prices	_	2.7	2.5	1.9	2.0	1.8
Harmonised index of core inflation[2]	_	2.3	2.1	1.7	1.8	1.8
Unemployment rate (% of labour force)	_	4.4	4.1	3.8	4.0	4.1
Household saving ratio, gross (% of disposable income)	_	5.3	6.1	6.4	6.5	6.6
General government financial balance (% of GDP)	_	-2.4	-2.2	-2.6	-3.2	-3.2
General government gross debt (% of GDP)	_	115.1	111.8	111.8	112.9	113.9
General government debt, Maastricht definition (% of GDP)	_	86.2	85.9	85.2	85.4	85.6
Current account balance (% of GDP)	_	-3.5	-4.3	-4.5	-3.7	-3.6

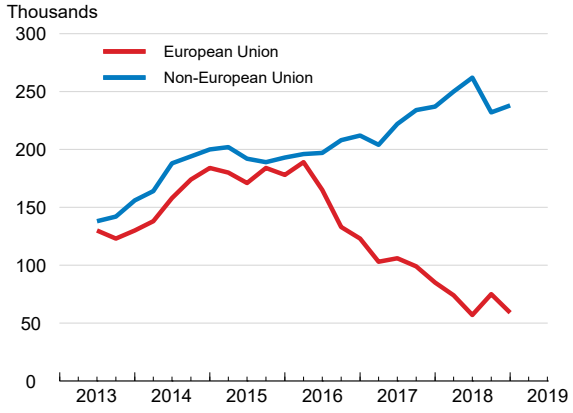
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 106 database.

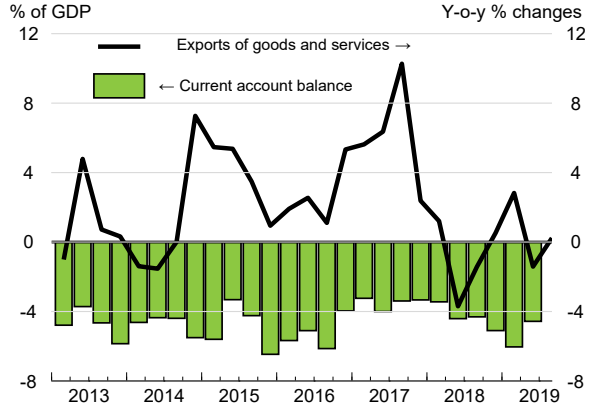
StatLink https://doi.org/10.1787/888934046950

United Kingdom 2

Net migration of EU citizens is decelerating
Net migration to the United Kingdom



The current account deficit is large



Source: Office for National Statistics.

StatLink https://doi.org/10.1787/888934046038

Policy action will be needed to smooth the exit from the European Union

The projections assume a smooth exit from the European Union, with a transition period ending after 2021. The UK authorities should clarify their position as soon as possible in terms of the nature of the relationship with the European Union to lower uncertainties, whose persistence is detrimental to long-term prospects. The government should strive to forge an agreement that will ensure the closest possible trading relationship with the European Union and high access for financial services to overseas markets. Given the high degree of trade integration with the European Union and its extensive trading relationships with third countries, exit will increase barriers to trade and damp UK exports.

The monetary policy stance has appropriately remained accommodative in the context of high uncertainty. If there were to be a disruptive exit, the Bank of England should stimulate the economy by cutting interest rates and buying bonds, although this would be insufficient to fully offset the sizeable output loss in such an event. The Financial Policy Committee should be prepared to reduce the counter-cyclical capital buffer rate to preserve banks' capacity to lend to households and firms in case of financial turbulence.

The government has announced a significant increase in spending for the fiscal year 2020-21 in the Spending Round, which is set to add around 0.2 percentage point to growth. The government has also signalled future tax cuts and additional spending increases, which have not been included in the projections. Future fiscal policy is particularly uncertain in view of the general election in December. In case of exit from the European Union without an ageed trade deal or if the international environment deteriorates further, a temporary fiscal package would be warranted to manage the disruption. In addition to letting the fiscal automatic stabilisers operate fully, this could include increasing active labour market spending on training and services to displaced and low-skilled workers. Government policies should seek to support workers, not particular sectors or jobs, should trade and production shift as a result of Brexit. Temporary emergency measures, such as accelerating depreciation allowances, could also be envisaged.

Growth is projected to remain weak

Activity is expected to grow below trend, at just above 1% on average in the coming two years. Investment growth will recover as uncertainty regarding the nature of Brexit is assumed to diminish gradually, but it will remain low. With the continued weakness in world trade, exports are set to grow only very modestly. Inflation will slow to below 2% by 2021, in line with currency developments. The unemployment rate is anticipated to edge up slightly in the context of continued economic fragility. With the already announced increase in spending, the public deficit, corrected for the business cycle, is expected to increase to around 2.5% of GDP in the next two years, and the public debt-to-GDP ratio is set to increase moderately even before any additional stimulus measures. The current account deficit will remain large.

Exit from the European Union without an agreed deal would significantly damage the economy, especially if it triggers turbulence in financial markets. The UK economy is also exposed to global financial risks, a further slowdown in the world economy and rising protectionism. Leaving the European Union may exacerbate these vulnerabilities. By contrast, investment prospects could recover faster should the United Kingdom and the European Union agree on a future close economic relationship. Following the general election, fiscal policy might be eased more than assumed in the projections, which would strengthen growth in the short term.

United States

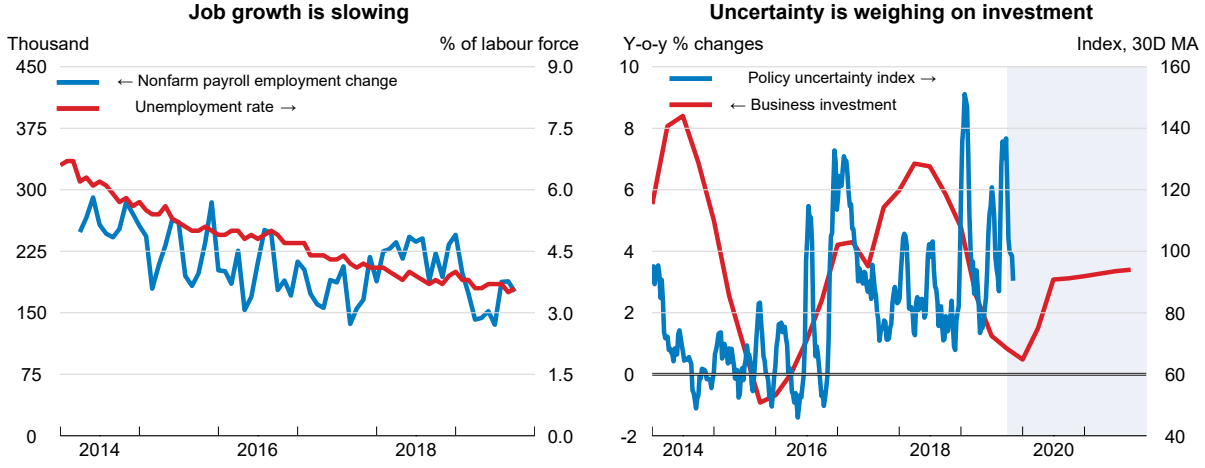
The current economic expansion has become the longest on record but economic growth is now slowing, partly due to increased tariffs on imported goods and high trade tensions. The labour market has created many new jobs and unemployment has fallen to historically very low rates. Rising real wages and high asset prices are supporting average household income and consumption growth. On the other hand, in addition to intense trade tensions and uncertainty, the combined effects of a waning fiscal impulse, weaker growth in trading partners, and demographic pressures are weighing on confidence and activity.

The Federal Reserve has acted to meet its dual employment and inflation mandate. With inflation returning to target only slowly and inflation expectations slipping, no changes to interest rates are projected, which may help meet the inflation target symmetrically. With large budget deficits and unsustainable long-run fiscal trends, the federal government has limited space to support the economy. Reducing barriers to finding jobs would help boost labour supply and productivity.

The economy is slowing

Investment and trade are slowing due to heightened uncertainty and weak demand from foreign markets, denting growth prospects. New trade measures implemented in September and those scheduled to be introduced in December 2019 on USD 300 billion imports from China have increased uncertainty, which is weighing on confidence, business investment and industrial production. The effect of new trade measures will also depress consumption growth and temporarily boost inflation. These effects are compounded by weak demand from trading partners.

United States 1



Source: OECD Economic Outlook 106 database; US Bureau of Labor Statistics; and Refinitiv.

StatLink https://doi.org/10.1787/888934046057

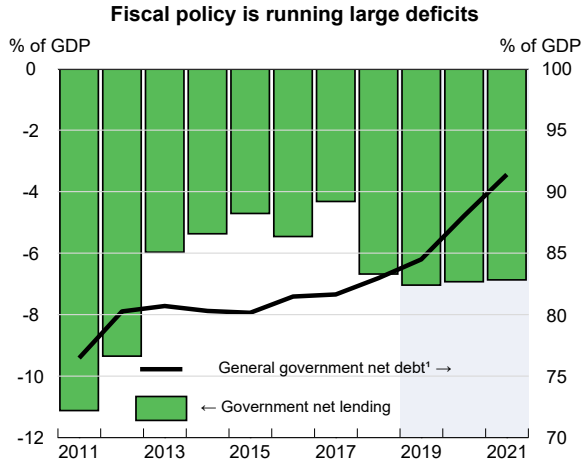
United States: Demand, output and prices

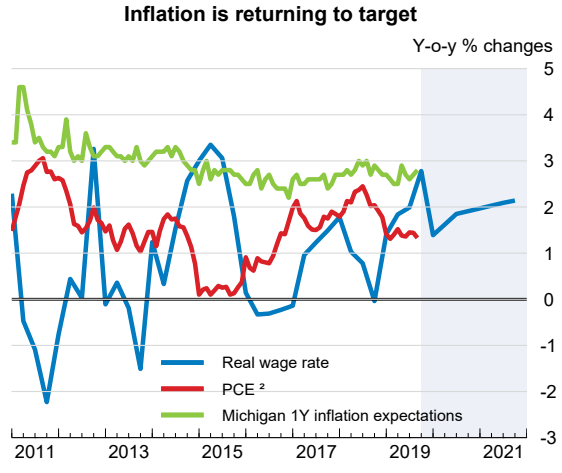
United States	2016	2017	2018	2019	2020	2021
	Current prices USD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	18 715.0	2.4	2.9	2.3	2.0	2.0
Private consumption	12 748.5	2.6	3.0	2.6	2.3	2.0
Government consumption	2 671.4	0.6	1.7	1.9	2.1	1.6
Gross fixed capital formation	3 786.9	3.7	4.1	1.9	2.1	3.1
Final domestic demand	19 206.8	2.5	3.0	2.4	2.2	2.1
Stockbuilding[1]	27.1	0.0	0.1	0.2	-0.1	0.0
Total domestic demand	19 233.8	2.6	3.1	2.5	2.2	2.1
Exports of goods and services	2 220.6	3.5	3.0	-0.1	0.7	1.9
Imports of goods and services	2 739.4	4.7	4.4	1.6	2.1	3.0
Net exports[1]	- 518.8	-0.3	-0.3	-0.3	-0.2	-0.2
Memorandum items						
GDP deflator	_	1.9	2.4	1.8	2.2	2.2
Personal consumption expenditures deflator	_	1.8	2.1	1.5	2.1	2.1
Core personal consumption expenditures deflator[2]	_	1.6	2.0	1.7	2.2	2.1
Unemployment rate (% of labour force)	_	4.4	3.9	3.7	3.5	3.7
Household saving ratio, net (% of disposable income)	_	7.0	7.7	8.1	7.9	8.0
General government financial balance (% of GDP)	_	-4.3	-6.7	-7.0	-6.9	-6.9
General government gross debt (% of GDP)	_	105.9	106.9	108.4	111.9	115.3
Current account balance (% of GDP)	_	-2.3	-2.4	-2.5	-2.5	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Deflator for private consumption excluding food and energy.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046969

United States 2





1. General government shows the consolidated (i.e. with intra-government amounts netted out) accounts for all levels of government (central plus state/local) based on OECD national accounts. This measure differs from the federal debt held by the public, which was 77.8% of GDP for the 2018 fiscal year.
2. Personal Consumption Expenditures price index.
Source: OECD Economic Outlook 106 database.

StatLink https://doi.org/10.1787/888934046076

Strong job growth has helped drive down unemployment to rates that have not been seen since the 1960s. Wage growth has picked up, although somewhat hesitantly, which coupled with strong asset prices has helped support average household income and consumption growth. However, more recently job growth has been slowing towards rates that are more consistent with underlying labour force growth.

Policies to address weakening growth are needed

Heightened policy uncertainty about international trade is weighing on activity and investment decisions. Exporters have been hit by retaliatory measures and consumers are facing higher prices due to the tariff increases. Measures to reduce trade tensions and accompanying uncertainty, such as reaching agreement with China, would help bring forward investment from firms currently waiting before committing. The projections assume that trade measures remain unchanged after the introduction of the new tariff measures already announced for December. On that basis, increased US tariffs and associated retaliation may reduce US GDP by ½ percentage point by 2021.

Monetary policy has faced communication challenges as uncertainty about the outlook has increased and criticism of monetary policy has become more voluble. Given low inflation expectations monetary policy needs to ensure that the inflation target is met symmetrically. The Federal Reserve has undertaken three interest rate cuts as the international outlook deteriorated and as uncertainty has risen. If growth falters significantly, monetary policy may need to augment interest rate cuts with extended forward guidance and additional balance sheet operations. On the other hand, if economic conditions prove to be stronger than anticipated, a resumption of monetary policy normalisation would be appropriate.

The government is running substantial budget deficits, which are projected to rise to nearly 7% of GDP in 2021. To the extent possible, federal, state and local governments should reorient spending to areas such as infrastructure that would support productivity in the longer run. However, fiscal policy is unsustainable if sizeable deficits continue and long-term fiscal spending pressures mount. This leaves limited room for the federal government to react in the event of a sizeable downturn. Rebuilding fiscal buffers and preparing contingency plans would help prepare for possible shocks.

Part of the projected slowdown is structural, driven by demographic pressures leading to lower labour force growth. Some evidence is showing that strong job growth has drawn in workers who have tended to remain on the margins of the labour market. In addition, efforts to reduce opioid addiction appear to be bearing fruit, which will likely reduce death rates and support higher labour force participation. Continuing to help individuals back to the labour market and into jobs would help offset some of the employment slowdown while at the same time boosting productivity. Easing occupational licensing requirement and zoning restrictions would help workers find more productive jobs. These effects would help boost household incomes and help many low-income families.

Risks abound around projected slowing economic growth

Against a background of slowing economic growth due to demographic pressures, increased trade restrictions and policy uncertainty are further depressing activity. Investment growth remains modest as uncertainty remains high and trade growth fails to recover. Partly in reaction to the weaker outlook, monetary policy remains accommodative over the projections, and with new tariff rates coming into play inflation is projected to pick up to slightly above the Federal Reserve's target.

There are substantial downside risks to the projection if trade tensions continue to escalate, especially if disputes spread to the automobile sector, intensifying uncertainty even more, further depressing investment and holding back a recovery of world trade. Domestic risks are also mounting, notably borrowing by the non-financial corporate sector. Limited space for fiscal and monetary policies to react to a sharp slowdown makes building up buffers and avoiding further disruption important. For monetary policy to remain effective, political interference should be avoided as it blurs communication, in particular concerning forward guidance. Working with trading partners in multilateral institutions would help relax tensions and give greater certainty to companies. On the other hand, a stronger international outlook, reduced trade tensions, building on the recent agreement with China to reach a wider-ranging deal, and stronger productivity growth could boost growth and inflation.

Statistical Annex

The Statistical Annex is available on-line only at http://www.oecd.org/economy/outlook/statistical-annex.

OECD Economic Outlook

The *OECD Economic Outlook* is the OECD's twice-yearly analysis of the major economic trends and prospects for the next two years. The Outlook puts forward a consistent set of projections for output, employment, prices, fiscal and current account balances.

Coverage is provided for all OECD member countries as well as for selected non-member countries. This issue includes a general assessment, a series of focus notes on selected macroeconomic and structural issues, and a chapter summarising developments and providing projections for each individual country.

Consult this publication on line at ***https://doi.org/10.1787/9b89401b-en***.

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