ECONOMIC OUTLOOK
No. 92

Press Conference
Paris, 27 November 2012
11h (Paris time)

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For a video link to the press conference and related material:
www.oecd.org/OECDEconomicOutlook

Summary of projections

	2012	2013	2014	2012		2013				2014				2012	2013	2014
				Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q4 / Q4		
								Per cent								
Real GDP growth																
United States	2.2	2.0	2.8	3.0	1.2	2.1	2.0	2.3	2.6	2.9	3.0	3.3	3.5	1.8	2.2	3.2
Euro area	-0.4	-0.1	1.3	-0.1	-1.3	-0.2	0.4	0.8	1.2	1.3	1.6	1.7	1.9	-0.5	0.6	1.6
Japan	1.6	0.7	0.8	-3.5	-0.4	1.5	1.9	1.9	2.7	2.8	-5.0	1.0	1.0	0.3	2.0	-0.1
Total OECD	1.4	1.4	2.3	1.1	0.5	1.5	1.8	2.1	2.3	2.5	1.9	2.7	2.8	1.0	1.9	2.5
Inflation[1]								year-on-year								
United States	1.8	1.8	2.0	1.5	1.8	1.5	1.8	1.9	1.8	2.0	2.0	2.0	2.0			
Euro area	2.4	1.6	1.2	2.5	2.1	1.8	1.7	1.6	1.4	1.4	1.3	1.2	1.2			
Japan	0.0	-0.5	1.3	-0.3	-0.2	-0.9	-0.7	-0.3	-0.3	-0.3	1.8	1.8	1.8			
Total OECD	2.1	1.7	1.9	2.0	2.0	1.7	1.8	1.8	1.7	1.8	2.0	2.0	2.0			
Unemployment rate[2]																
United States	8.1	7.8	7.5	8.1	7.9	7.9	7.8	7.8	7.7	7.7	7.6	7.5	7.4			
Euro area	11.1	11.9	12.0	11.3	11.5	11.7	11.9	12.0	12.1	12.1	12.0	12.0	11.9			
Japan	4.4	4.4	4.3	4.2	4.4	4.4	4.4	4.3	4.3	4.3	4.3	4.3	4.3			
Total OECD	8.0	8.2	8.0	8.0	8.1	8.1	8.2	8.2	8.1	8.1	8.0	8.0	7.9			
World trade growth	2.8	4.7	6.8	1.5	3.6	5.0	5.7	6.3	6.6	6.9	7.2	7.3	7.3	3.2	5.9	7.2
Current account balance[3]																
United States	-3.0	-3.0	-3.2													
Euro area	1.4	1.9	2.2													
Japan	1.1	1.2	1.5													
Total OECD	-0.6	-0.6	-0.6													
Fiscal balance[3]																
United States	-8.5	-6.8	-5.2													
Euro area	-3.3	-2.8	-2.6													
Japan	-9.9	-10.1	-7.9													
Total OECD	-5.5	-4.6	-3.6													
Short-term interest rate																
United States	0.4	0.4	0.5	0.4	0.4	0.4	0.3	0.4	0.5	0.5	0.5	0.5	0.5			
Euro area	0.6	0.2	0.1	0.4	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1			
Japan	0.2	0.3	0.2	0.1	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2			

Note: Real GDP growth and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day adjusted annualised rates. Inflation is measured by the increase in the consumer price index or private consumption deflator for the United States and total OECD. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate.

The cut-off date for information used in the compilation of the projections is 15 November 2012.

1. USA; price index for personal consumption expenditure, Japan; consumer price index and the euro area; harmonised index of consumer prices.
2. Per cent of the labour force.
3. Per cent of GDP.

Source: OECD Economic Outlook 92 database.

Country projections

Annual real GDP growth, in per cent

	2011	2012	2013	2014
Australia	2.3	3.7	3.0	3.2
Austria	2.7	0.6	0.8	1.8
Belgium	1.8	-0.1	0.5	1.6
Canada	2.6	2.0	1.8	2.4
Chile	5.9	5.2	4.6	5.4
Czech Republic	1.9	-0.9	0.8	2.4
Denmark	1.1	0.2	1.4	1.7
Estonia	8.3	3.1	3.7	3.4
Finland	2.7	0.7	1.1	2.2
France	1.7	0.2	0.3	1.3
Germany	3.1	0.9	0.6	1.9
Greece	-7.1	-6.3	-4.5	-1.3
Hungary	1.6	-1.6	-0.1	1.2
Ireland	1.4	0.5	1.3	2.2
Iceland	2.6	2.5	2.7	2.7
Israel	4.6	3.1	2.9	3.9
Italy	0.6	-2.2	-1.0	0.6
Japan	-0.7	1.6	0.7	0.8
Korea	3.6	2.2	3.1	4.4
Luxembourg	1.7	0.6	1.2	2.0
Mexico	3.9	3.8	3.3	3.6
Netherlands	1.1	-0.9	0.2	1.5
Norway	1.4	3.3	2.5	2.0
New Zealand	0.5	1.6	2.4	2.9
Poland	4.3	2.5	1.6	2.5
Portugal	-1.7	-3.1	-1.8	0.9
Slovak Republic	3.2	2.6	2.0	3.4
Slovenia	0.6	-2.4	-2.1	1.1
Spain	0.4	-1.3	-1.4	0.5
Sweden	3.9	1.2	1.9	3.0
Switzerland	1.9	0.8	1.1	2.3
Turkey	8.5	2.9	4.1	5.2
United Kingdom	0.9	-0.1	0.9	1.6
United States	1.8	2.2	2.0	2.8
Brazil	2.7	1.5	4.0	4.1
China	9.3	7.5	8.5	8.9
India	7.8	4.5	5.9	7.0
Indonesia	6.5	6.2	6.3	6.5
Russian Federation	4.3	3.4	3.8	4.1
South Africa	3.1	2.6	3.3	4.0

Source: OECD Economic Outlook 92 database.

EDITORIAL

The policy challenges: now and in the long term

After five years of crisis, the global economy is weakening again. In this we are not facing a new pattern. Over the recent past, signs of emergence from the crisis have more than once given way to a renewed slowdown or even a double-dip recession in some countries. The risk of a new major contraction cannot be ruled out. A recession is ongoing in the euro area. The US economy is growing but performance remains below what was expected earlier this year. A slowdown has surfaced in many emerging market economies, partly reflecting the impact of the recession in Europe.

The weaker outlook has several causes. A significant drop in confidence is a key driver. This takes place against a background of deleveraging, simultaneous fiscal consolidation across countries and a large multiplier, and weakening global trade. High and, in some countries, rising unemployment is further depressing confidence and spending.

Lack of confidence largely reflects insufficient or ineffective policy responses, both in terms of too little short-term action and a lack of credible long-term strategies. This, in turn, seems to be determined not so much by a lack of understanding of the policy requirements, but rather by failure to reach consensus on the policy response. The fiscal cliff and the debt ceiling in the United States, and the management of the euro area crisis are two cases in point. Policy challenges, both macroeconomic and structural, are present in emerging market economies as well, reflecting a range of country-specific conditions.

Failure to take sufficient action now could have significant consequences on the global outlook. If the fiscal cliff is not avoided, a large negative shock could bring the US and the global economy into recession. In the euro area, where the greatest threats to the world economy remain, progress in adjustment and in strengthening institutions has been significant over the recent past. However, challenging fiscal sustainability conditions in some countries risk sparking a chain of events that could considerably harm activity in the monetary union and push the global economy into recession, as described in a downside scenario in this Economic Outlook.

The crisis in the euro area is being sustained by three negative feedback loops that amplify shocks and interact. Solvency fears for banks and their sovereigns are feeding on each other due to government guarantees for banks and bank holdings of government bonds. The possibility of exit from monetary union pushes up yields, which in turn reinforces breakup fears. Worries about government debt are also driving up yields, which further weigh on debt dynamics. Against such a fragile background, it is not difficult to imagine a situation in which something goes wrong, for example a programme country is unable to deliver or the new EU rescue mechanisms cannot be deployed in time with sufficient impact. This would precipitate a deterioration in market risk assessments, inverting the positive trend which has emerged over recent months. In addition, rising unemployment could trigger reform fatigue and social resistance. The euro area, which is witnessing significant fragmentation pressures, could be in danger.

A positive policy response, avoiding the downside scenario and securing more sustainable growth, is possible. It should be based on the full use of available policy tools: monetary, fiscal, and structural.

The monetary policy stance should be further eased in many economies. Current policies in the United States are appropriate as the employment outlook is improving only slowly and inflation expectations are well anchored. Additional easing is required in the euro area, Japan and some emerging market economies, including China and India. In a longer-term perspective, however, it should be kept in mind that unconventional monetary stimulus, while necessary in the current situation, involves negative risks. Keeping long-term rates very low for a long period could delay necessary deleveraging and prompt excessive risk-taking and resource misallocation.

Excessive near-term fiscal consolidation should be avoided, given high fiscal multipliers at present. In the United States, budgetary tightening should proceed at a more measured pace than currently legislated, in the context of a detailed medium-term consolidation plan. This framework needs to be established. In the euro area, structural budgetary tightening should be limited to that embedded in current fiscal commitments, with the automatic stabilisers operating freely. To enhance credibility, this policy should be set out and communicated in a coordinated fashion. In the large majority of euro area countries, underlying budget positions by the end of the projection period will be consistent with declining debt-to-GDP ratios with a further positive impact on confidence.

In Japan, given the extraordinarily high sovereign debt ratio, a more detailed and credible medium-term fiscal consolidation programme needs to be established. High indebtedness limits the room for manoeuvre, in the event of a negative shock, to allow automatic stabilisers to work.

If serious downside risks were to materialise, further policy support would be essential. Lower interest rates, where possible, and much stronger additional quantitative easing would be warranted in major OECD economies. Temporary fiscal stimulus should be provided by countries with robust fiscal positions (including Germany and China). Most other economies should either slow planned budgetary consolidation or, in the case of those with very high debt levels or under intense market pressure, allow the automatic stabilisers to operate fully.

Structural policies have already been activated in many countries. These reforms should be fully implemented. They could begin delivering fruit sooner than expected in terms of higher growth, better employment performance, and sustainable current account rebalancing, especially in the euro area where ongoing rebalancing reflects cyclical weakness more than underlying structural adjustment. Ambitious reforms are needed in all countries to boost growth potential and make the adjustment more symmetric.

Strong institutions, such as independent fiscal councils or credible fiscal rules, can provide additional support. Indeed, the ongoing sovereign debt crisis suggests that countries with strong institutions can enjoy market confidence beyond what would be warranted by their fiscal policy performance alone.

Institution building is very relevant in the euro area, where the progress has been remarkable over the past two years. The establishment of a crisis management mechanism based on the OMT/ESM buys time, but also shows the resolve to address major weaknesses in the structure of monetary union. Markets have reacted positively to its establishment. Its effectiveness, however, will ultimately depend on the progress in reform implementation in countries that require assistance, as well as the willingness of creditor countries to agree on the use of common resources.

Progress towards a fully fledged banking union is essential to complete the architecture of the euro area and to facilitate disentangling sovereign and banking sector fragilities. This will involve supervision at euro area level, effective cross-border crisis resolution procedures, a common deposit guarantee mechanism, and a euro area fiscal backstop. Delays in putting the banking union in place could have negative consequences on the sustainability of the euro area. Furthermore, it remains essential to address in the coming years the capital shortage of euro area banks.

At the global level, stronger confidence and more sustained growth will require taking international spillovers more into account. This concern is at the heart of the G20 agenda, a key policy institution on issues such as global imbalances and the impact of monetary policies on capital flows and exchange rates. Indeed, the global nature of the current slowdown reminds us, once again, of the need to take interdependence and channels of transmission into serious consideration and shape the policy response accordingly.

Decisive policy action to deal with the immediate challenges is a necessary condition to lengthen the horizon for policy. Looking beyond the forecast interval presented in this Economic Outlook, the policy challenge is to guide the global economy forward towards a new long-term path. This requires a departure from the pre-crisis business as usual. In addition to repairing the financial system, policy will need to find ways to ensure environmental sustainability and to tackle rising inequality. New sources of growth, such as green growth and innovation in intangible assets, will have to play an increasingly important role.

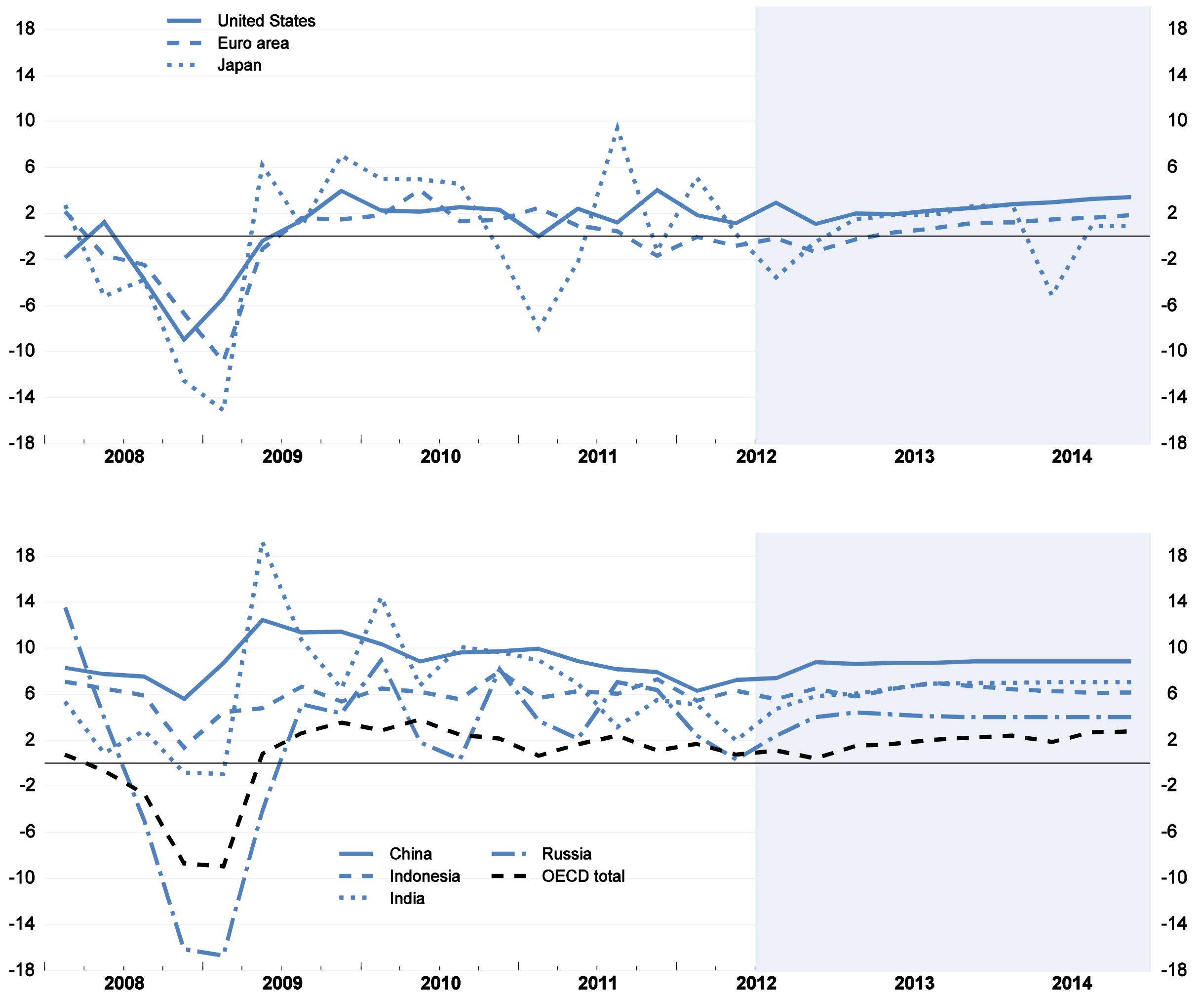
Potential trade-offs between growth and equity, growth and sustainability, growth and environmental sustainability will have to be addressed. For example, as this Economic Outlook shows, the impact on inequality of fiscal consolidation can be significantly different according to the specific consolidation strategies that are put in place. Well-designed structural reform packages, together with credible fiscal consolidation, are key both in dealing with such trade-offs and in addressing imbalances that may be associated with long-term growth. Even as policy deals with the immediate challenges, there is no need to wait any longer for such long-term strategies that can and should be activated now.

27 November 2012

Pier Carlo Padoan
Deputy Secretary-General and Chief Economist

Growth projections

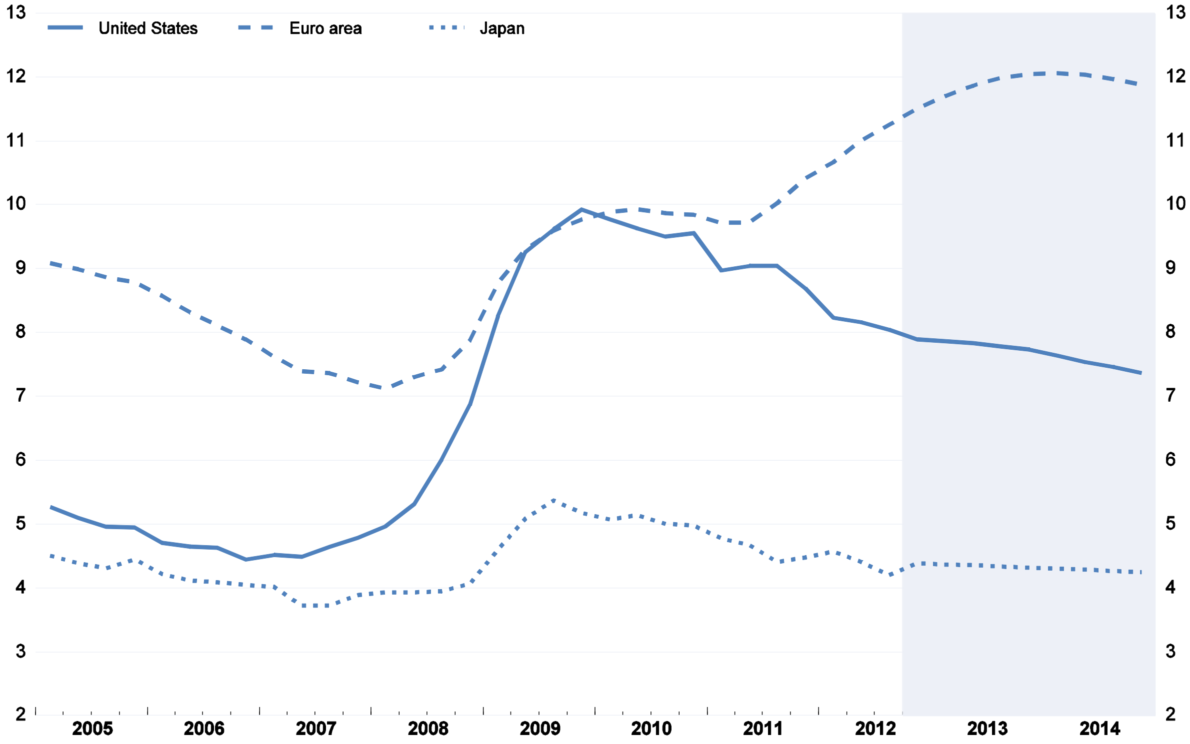
Annualised quarter-on-quarter real GDP growth, in per cent



Source: OECD Economic Outlook 92 database.

Unemployment in the three main regions

Unemployment rate, percentage of labour force



Source: OECD Economic Outlook 92 database.

Risks to the outlook

Downside Risks:

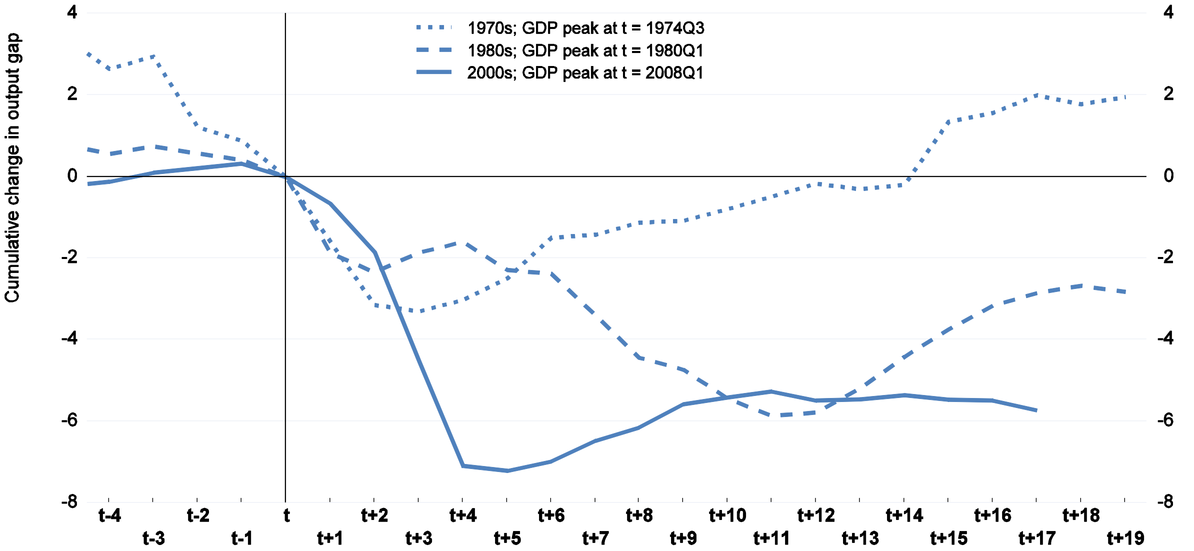
- **Euro area crisis is the largest downside risk:**
  - Policy measures (OMT, ESM) have dampened market pressures but risks of further flare ups remain.
  - Negative financial feed-back loops still operational.
  - Underlying rebalancing still in progress.
- **Excessive budgetary tightening in the United States (the “fiscal cliff”).**
- **Geopolitical risks to oil prices.**
- **High unemployment undermining confidence.**
- **Emerging market economies (EMEs) transition to domestic sources of growth.**

Upside Risks:

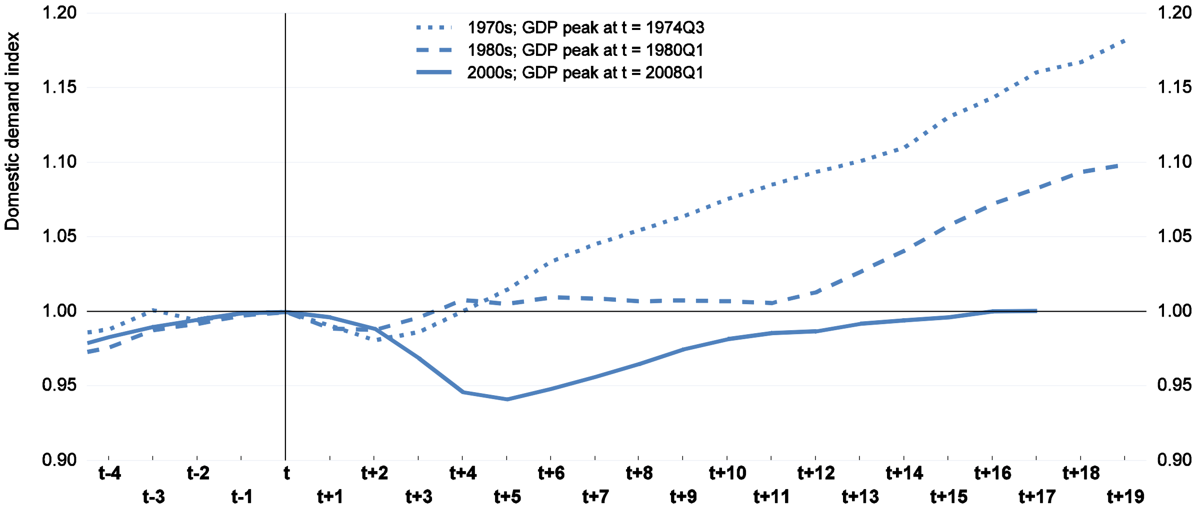
- **Comprehensive resolution of the euro area crisis.**
- **Medium-term fiscal framework agreed for United States, and releasing pent up demand.**
- **Structural reform benefits flowing through earlier than assumed.**

OECD recoveries compared

OECD-wide output gap before and after recessions, cumulative change since quarter t



OECD domestic demand before and after recessions, index = 1 at quarter t



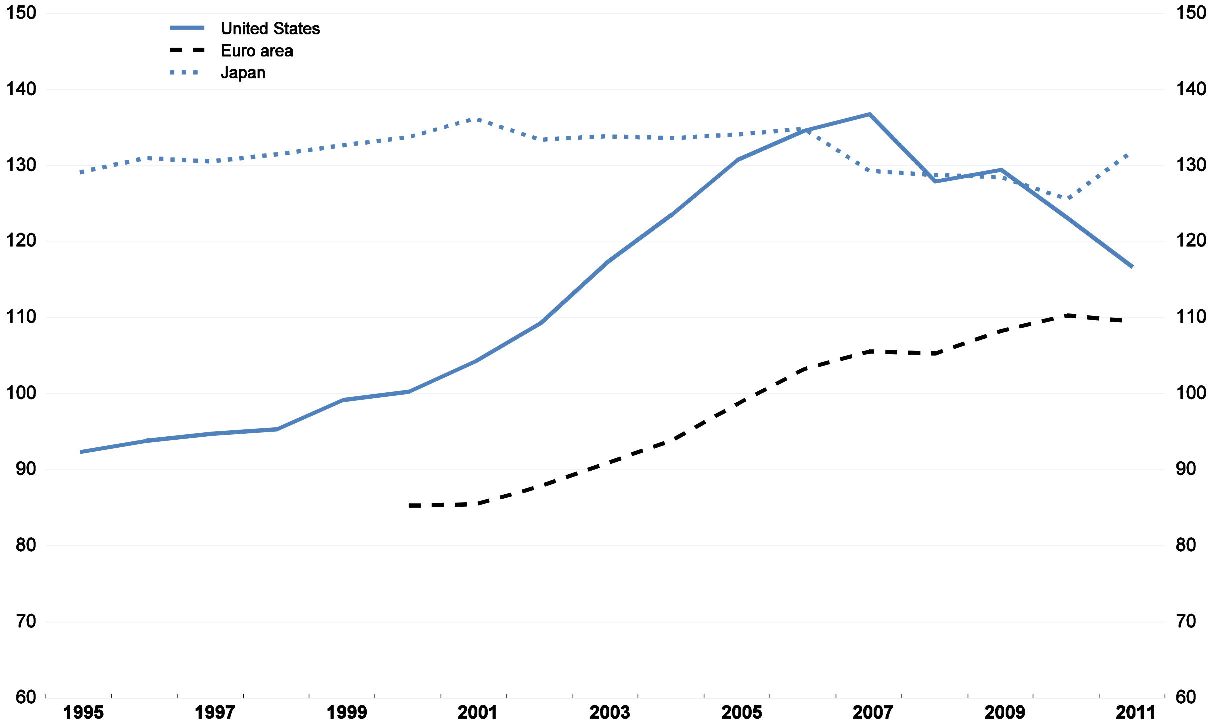
Source: OECD Economic Outlook 92 database.

Reasons for the slow recovery

- **Private sector deleveraging:**
  - More advanced in the United States, less in the euro area but mixed.
- **Fiscal consolidation:**
  - Fiscal consolidation, while necessary, has affected growth.
- **Euro area crisis:**
  - Crisis has dragged on longer than necessary due to insufficient and delayed policy action.
- **EMEs slowdown:**
  - Domestic factors and only partly induced by euro area crisis.

Deleveraging by the household sector

Household gross debt, in per cent of net disposable income

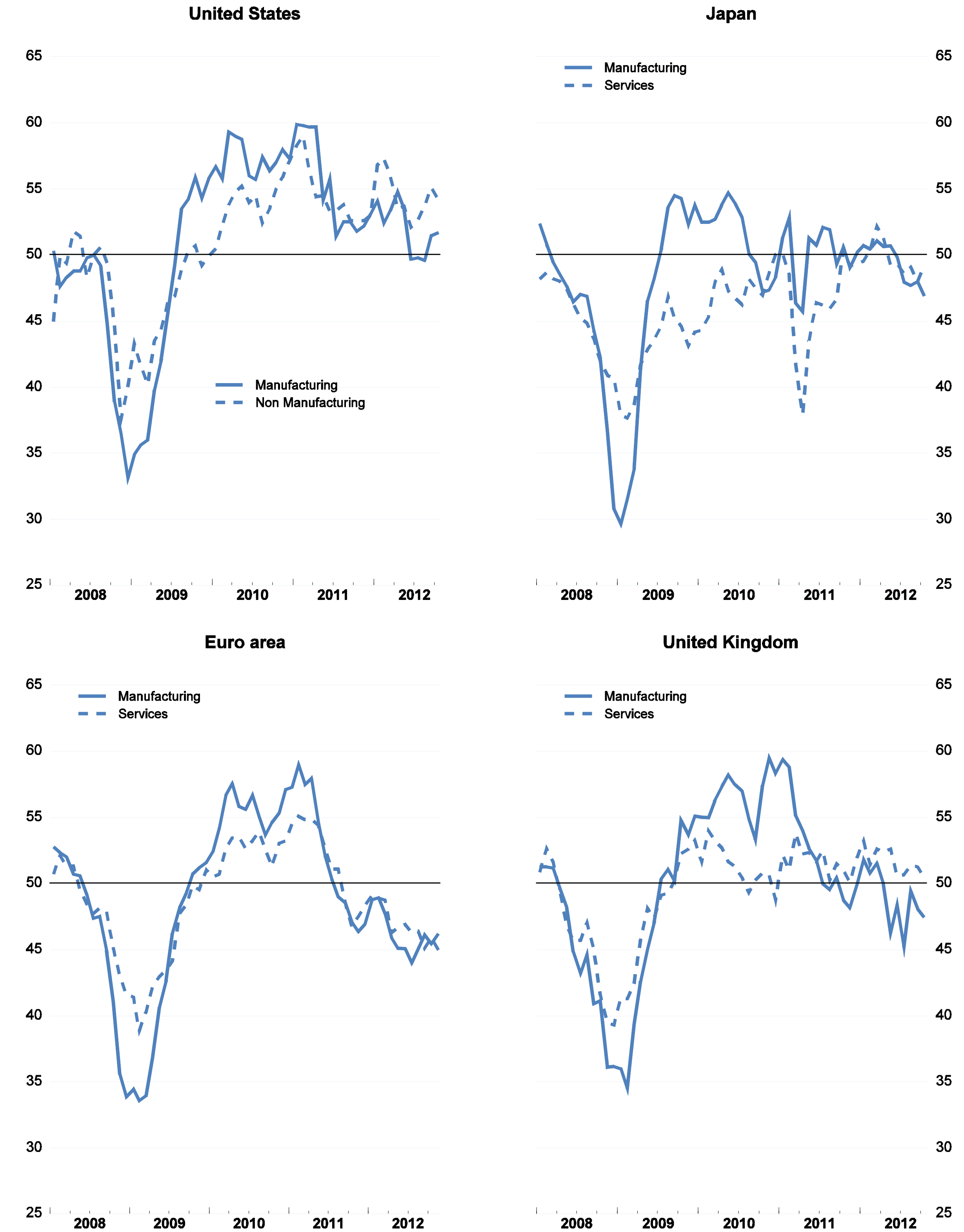


Note: Data for USA and Japan are not consolidated. For Japan, net disposable income for the year 2011 is an estimate from the OECD Economic Outlook 92 database.

Source: OECD Annual National Accounts, and OECD Economic Outlook 92 database.

Business sentiment - Advanced economies

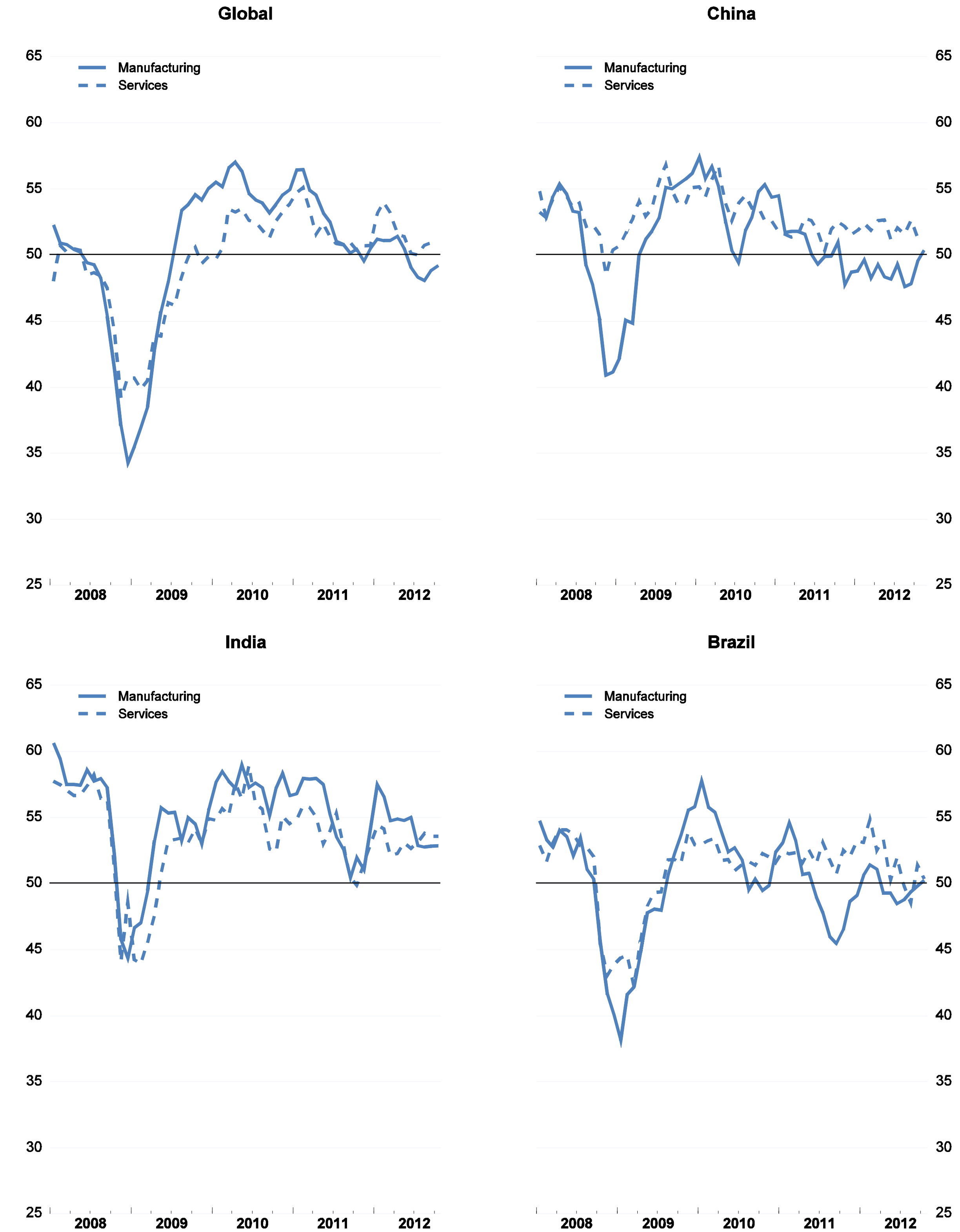
Purchasing Managers Index (PMI)



Source: Markit.

Business sentiment - Global and emerging market economies

Purchasing Managers Index (PMI)



Source: Markit.

Consumer confidence

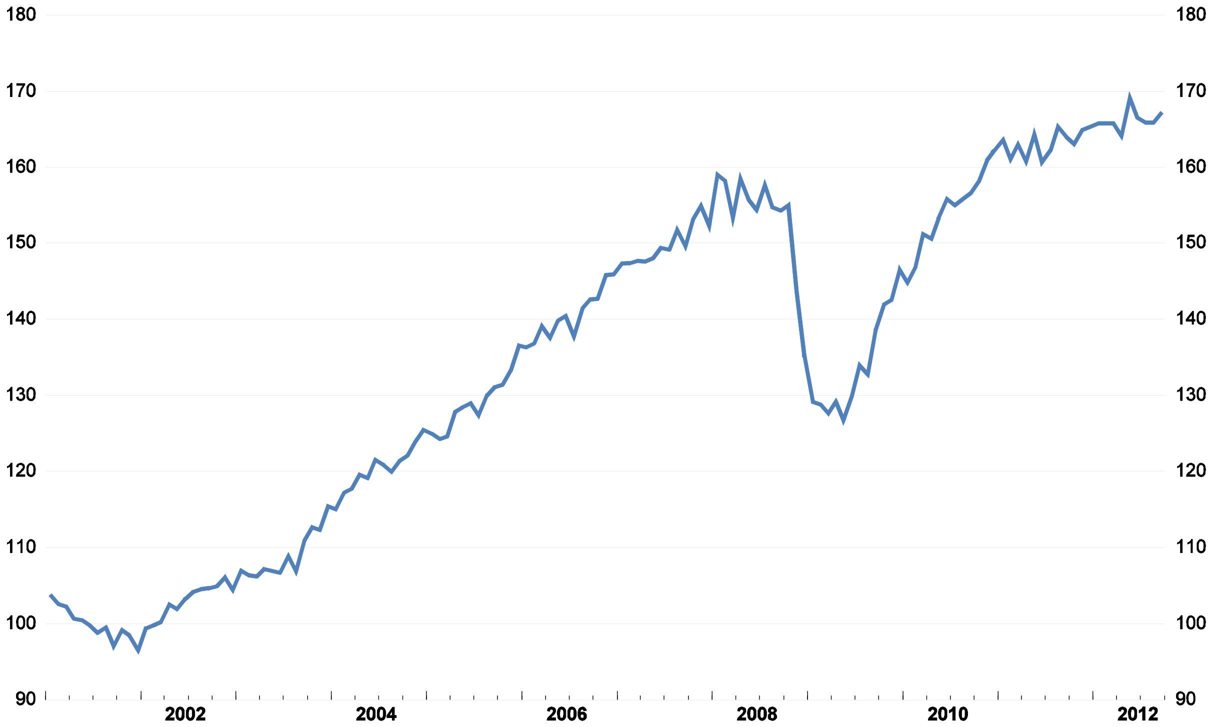
Consumer confidence survey indicators, standard deviations

Note: Normalised at 1999M1 to 2012M10 period average and presented in units of standard deviation. Values above zero signify levels of consumer confidence above the period average. Data for United States provided by the Conference Board.

Source: Datastream, and European Commission.

World merchandise trade

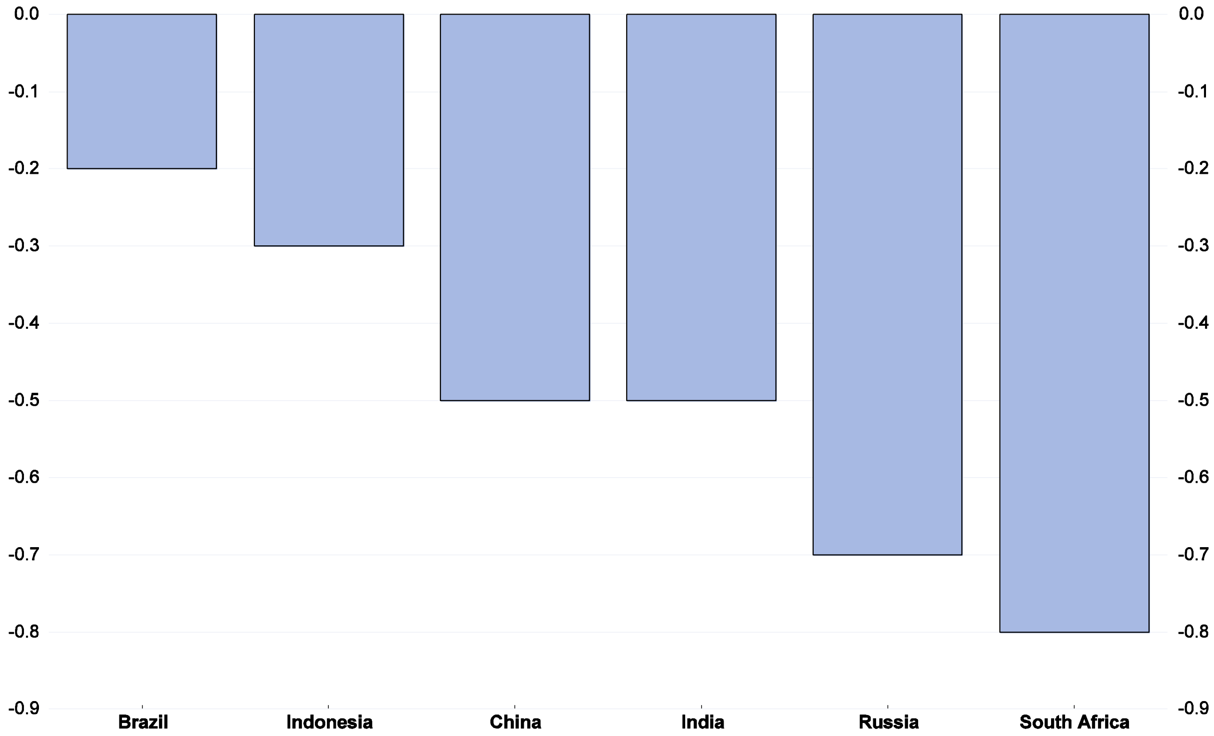
CPB indicator of world merchandise trade, 2001 = 100



Source: CPB.

Euro area trade spillovers on emerging economies

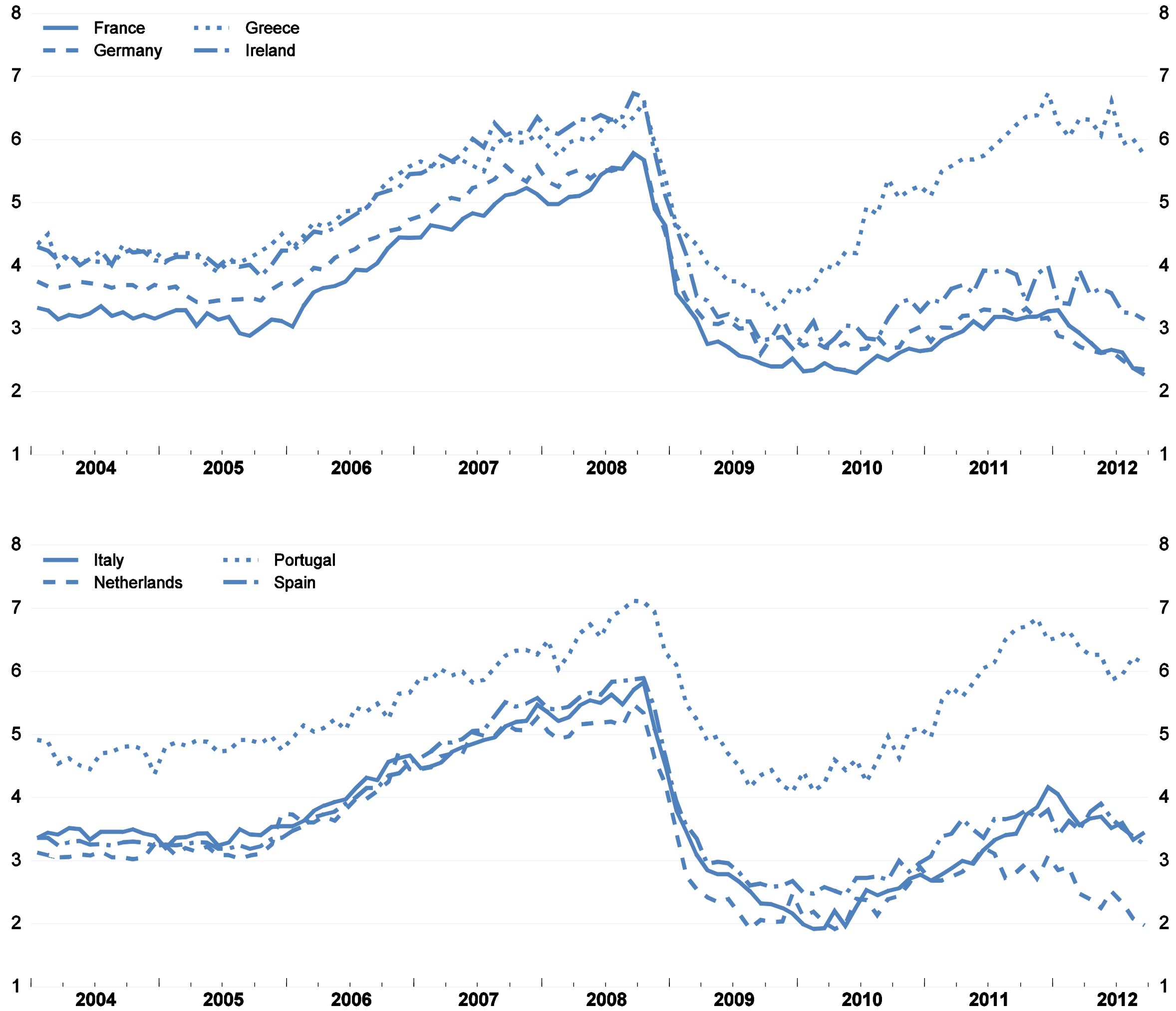
Change in GDP growth contribution due to direct effects of changes in export growth to euro area, first half of 2012 relative to first half of 2011, percentage points



Source: OECD Economic Outlook 92, and OECD calculations.

Cost of credit among euro area countries

Bank interest rates for lending to business, percent

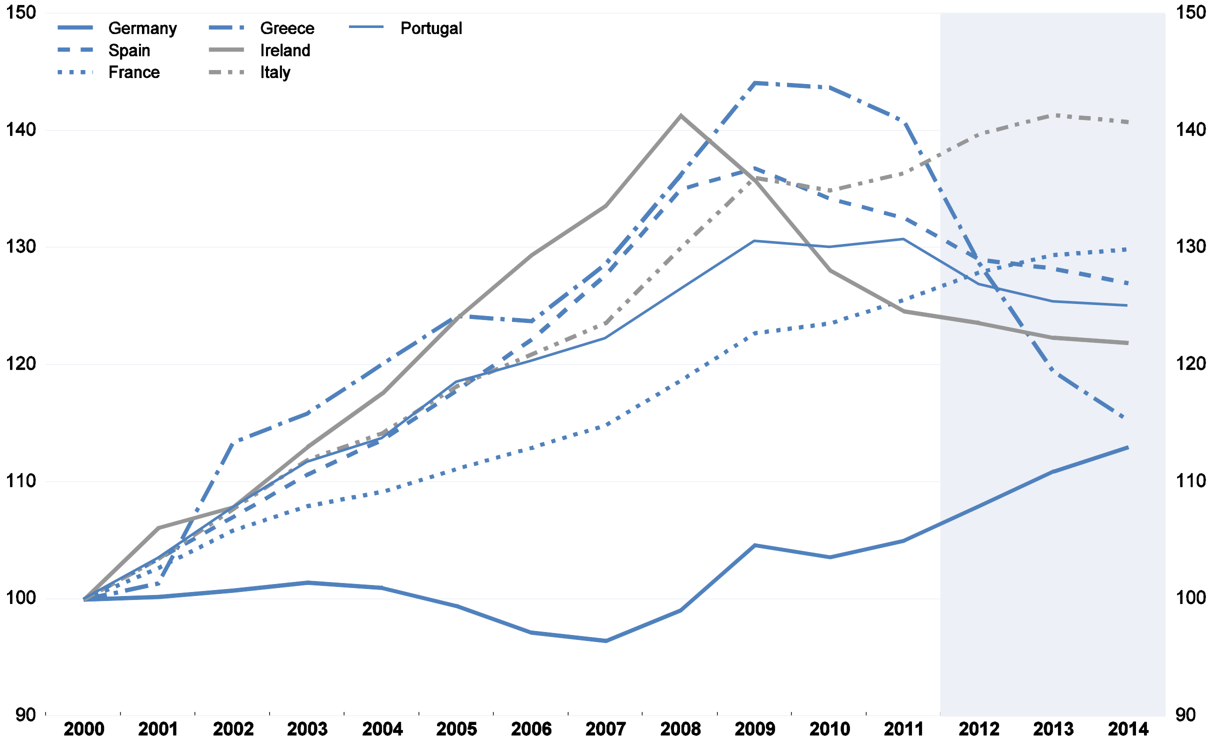


Note: Cost of credit is defined as interest rates on new loans to non-financial corporations (all maturities), with the exception of Greece where it refers to new loans with maturity of up to one year. Last observation is September 2012.

Source: European Central Bank.

Unit labour costs

Index 2000 = 100

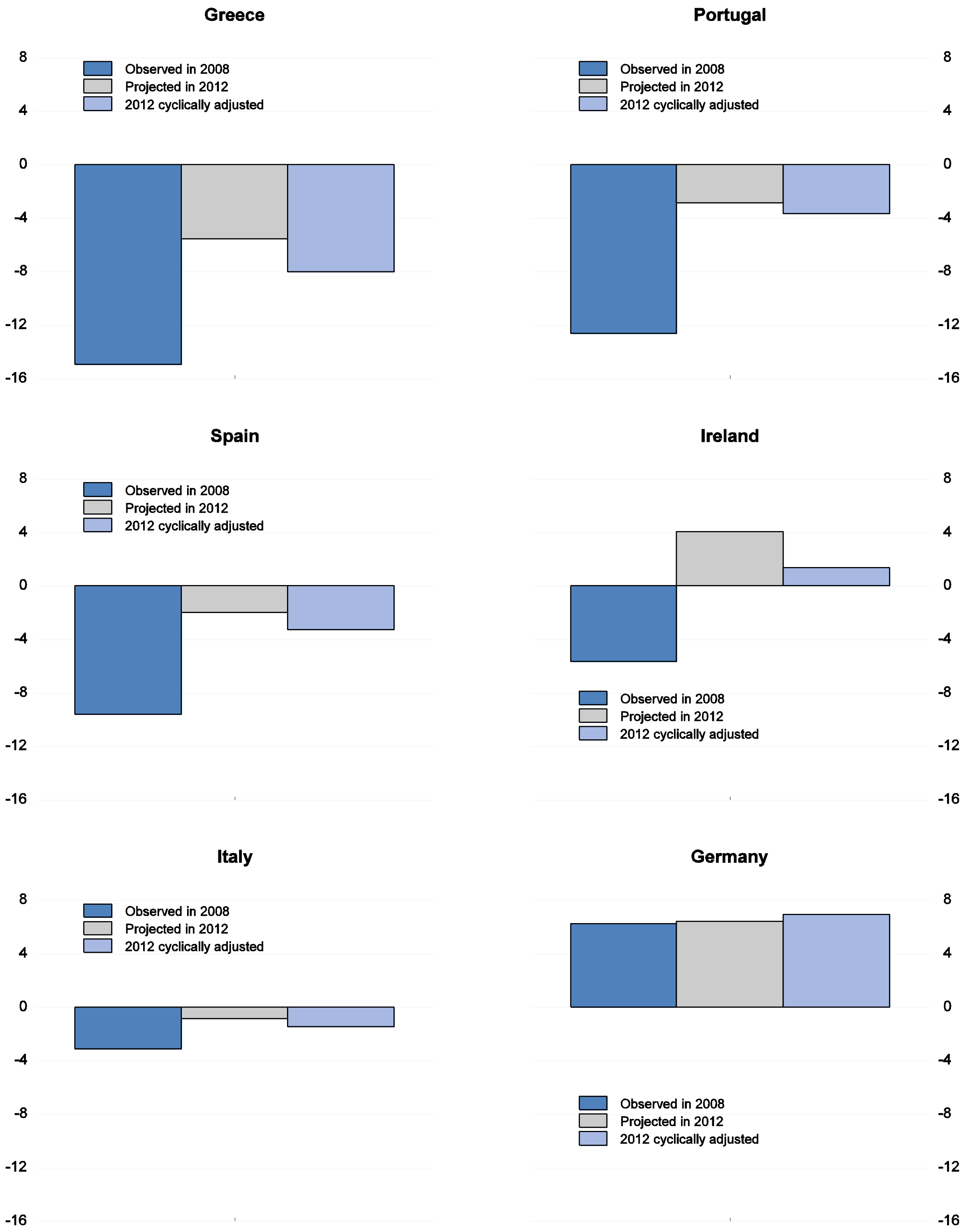


Note: The figures shown are for whole economy unit labour costs. If wage developments in the public sector diverge from those in the rest of the economy, changes in private sector costs may differ from those shown. This may mean that economy-wide labour costs are falling more sharply than private sector costs in the EU/IMF programme countries.

Source: OECD Economic Outlook 92 database.

Current account balances in euro area countries

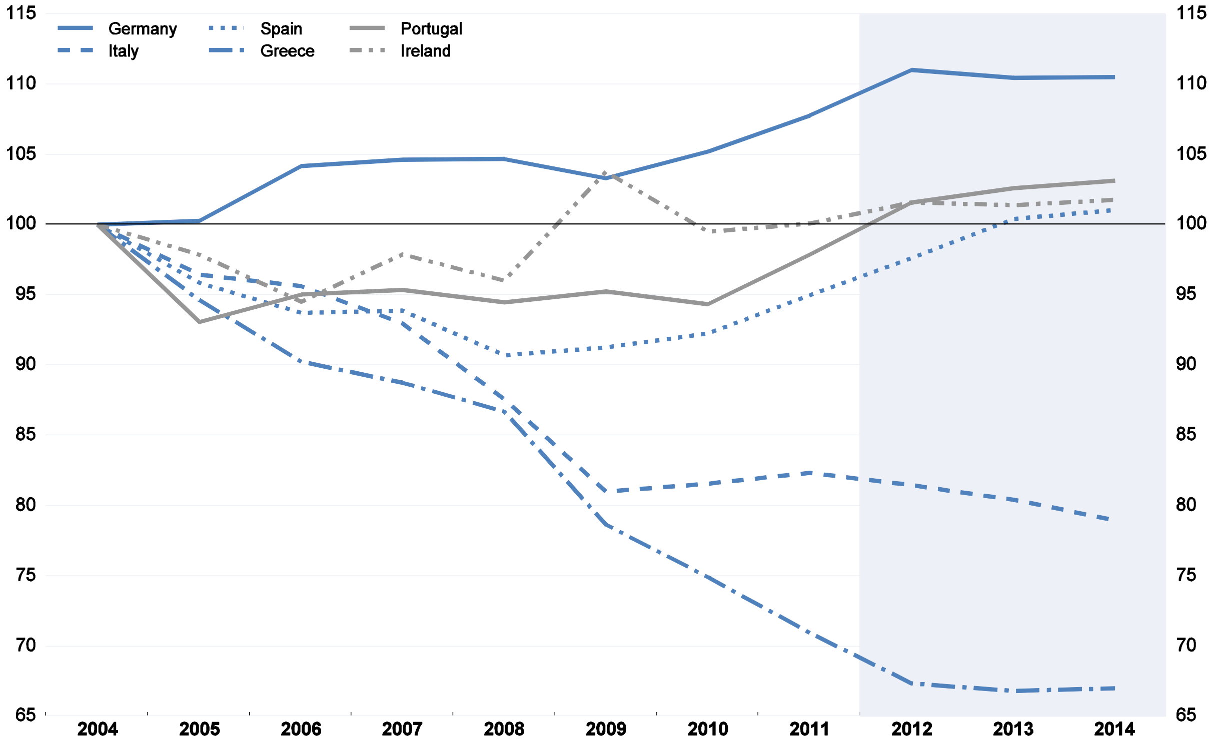
In per cent of GDP



Note: Cyclical adjustment assumes that the economy's cyclical position is the same as that of its (trade weighted) trading partners. *Source*: OECD Economic Outlook 92 database, and OECD calculations.

Export market performance of selected euro area countries

Index 2004 = 100

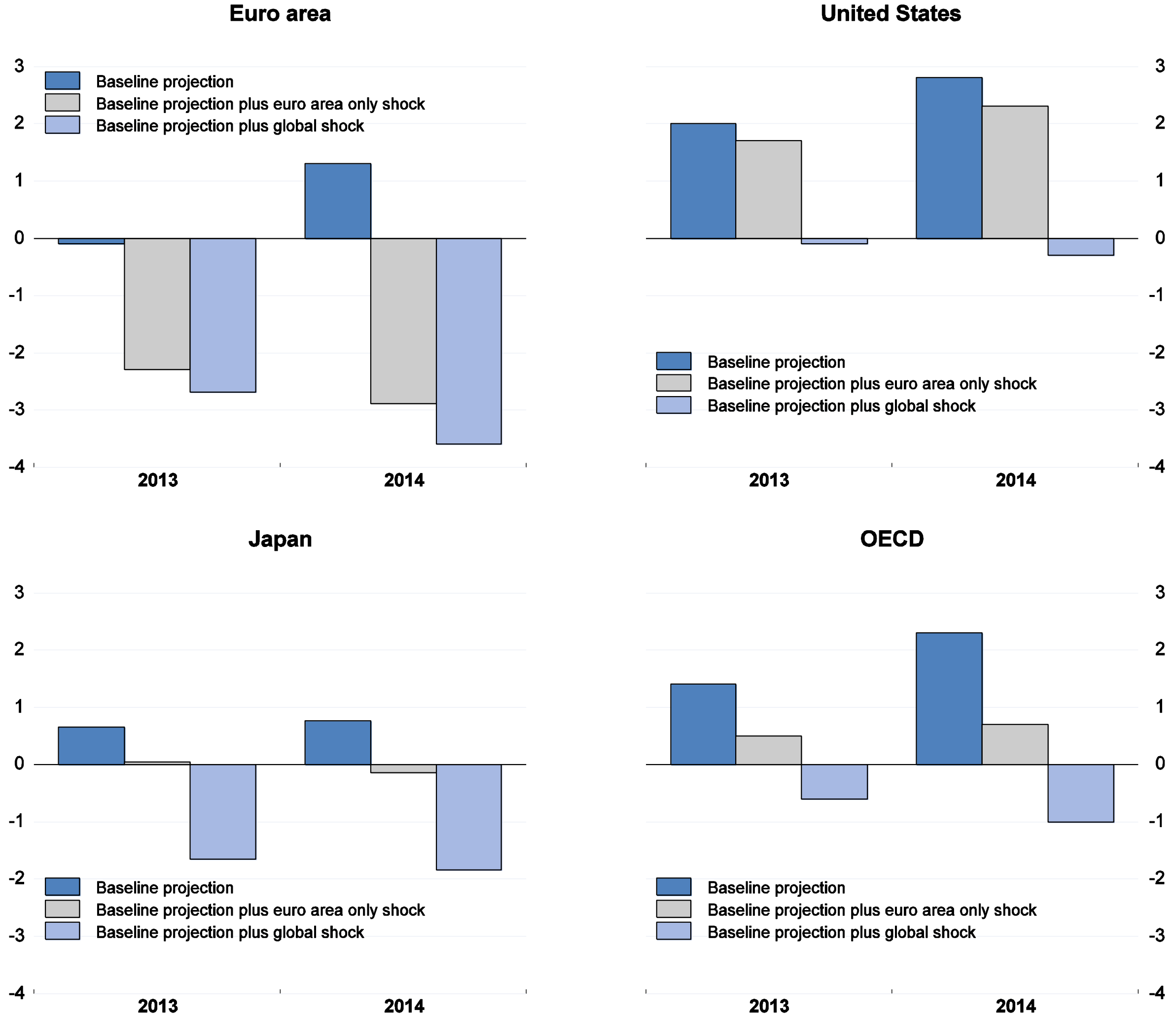


Note: Export performance refers to the ratio of the growth in country's export volumes relative to growth in that country's export markets.

Source: OECD Economic Outlook 92 database.

GDP growth in the baseline and a downside scenario

Per cent



Source: OECD calculations.

Policies for the euro area

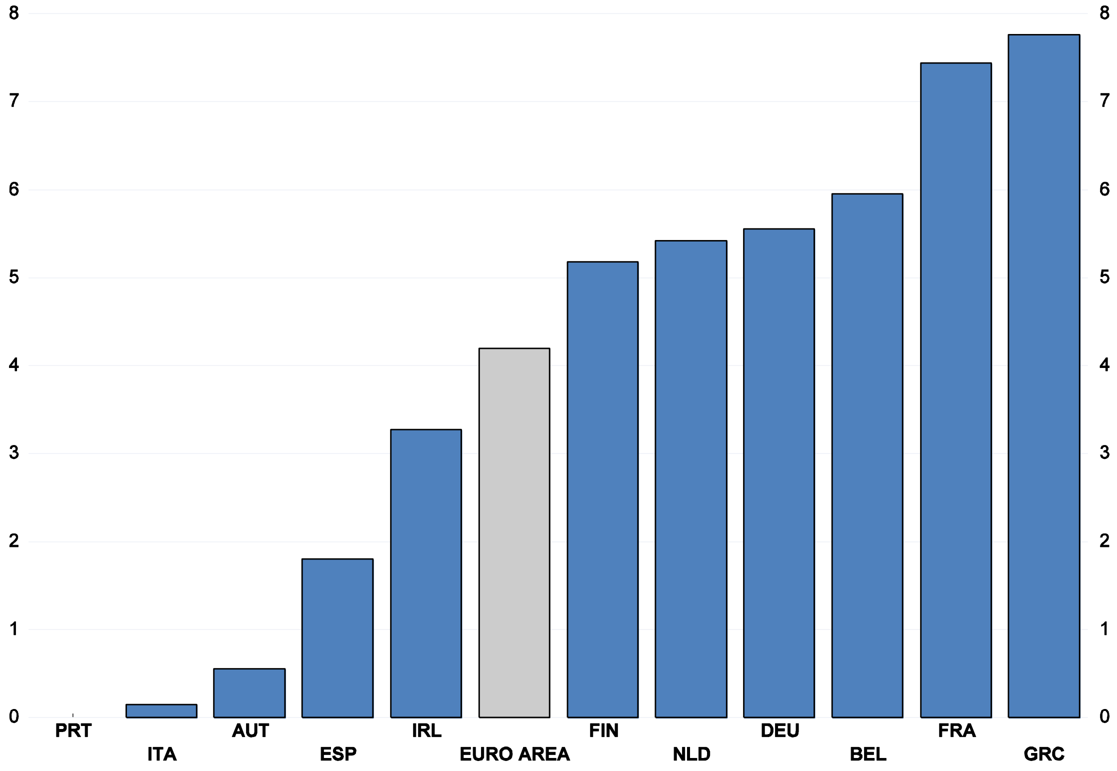
- **Break feedback loop between banks and governments:**
  - Strengthen capital position of banks.
  - Banking union (single supervisor, bank resolution, common deposit insurance, common fiscal backstop).
- **Break feedback loop between exit risk, bond yields and debt sustainability:**
  - Commitment to reforms and ESM/OMT.
  - Fiscal Compact.
  - Deal with legacy debt.
- **Boost growth:**
  - Structural reforms and Single Market.

Upside for the euro area

- **Fiscal consolidation is progressing:**
  - Immediately beyond the forecast period, debt-to-GDP ratios falling in most euro area countries, boosting confidence.
- **Structural reforms may have larger than expected positive short-run effects.**
- **Progress with institution building may proceed more rapidly than expected and have strong confidence effects.**

Capital positions of euro area banks need strengthening

Required increases in capital of large banks to reach a 5% leverage ratio, in percent of GDP



Note: Based on almost 200 euro area banks. The number of banks in the sample for each country displayed and the corresponding number of banks with less than 5% leverage ratio (in brackets) are as follows: Austria 19 (8), Belgium 9 (4), Finland 5 (3), France 8 (8), Germany 60 (30), Greece 9 (4), Ireland 10 (2), Italy 33 (8), Netherlands 9 (5), Portugal 8 (0) and Spain 27 (8).

Source: Company Reports, and OECD.

Monetary policy

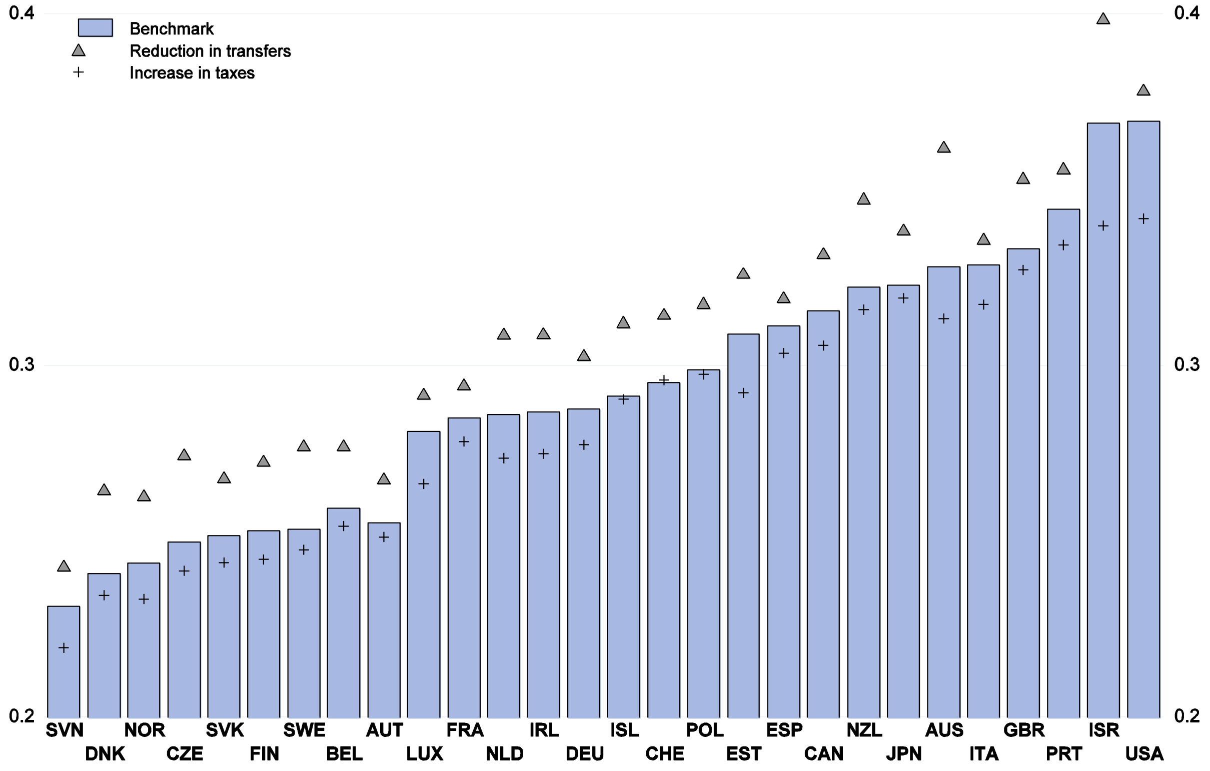
- **Further easing required in Japan, euro area and some EMEs. United States should keep current stance.**
- **If downside risks materialise, a stronger response would be warranted:**
  - Including further quantitative easing, and forward guidance.
- **Caveats:**
  - Creating conditions for high leverage and bubbles.
  - Misallocation of credit as costs of forbearance and ever-greening fall.

Fiscal policy

- **Multipliers are likely to be high at the current juncture:**
  - Significant weight on expenditure cuts.
  - Limited room for monetary easing and impaired financial system.
  - Simultaneous consolidations across countries.
- **General recommendations:**
  - Choose an appropriate pace of consolidation.
  - Let automatic stabilisers play around structural consolidation path.
  - For those with space, be prepared to ease if the downside scenario materialises.
- **United States: Link fiscal cliff to medium term:**
  - Fiscal consolidation should include tax increases and spending reforms. Major tax expenditures should be scaled back - including mortgage interest deduction and the health-care insurance exclusion – and the Bush tax cuts for high income earners allowed to expire. On the spending side, the retirement age should be increased faster and the promised savings under health-care reform need to be made.
- **Euro area: Enhance effectiveness by coordinated action.**
- **Japan: A detailed and credible fiscal consolidation plan is essential.**

Impact of 3-per cent consolidation on income inequality

Gini coefficient



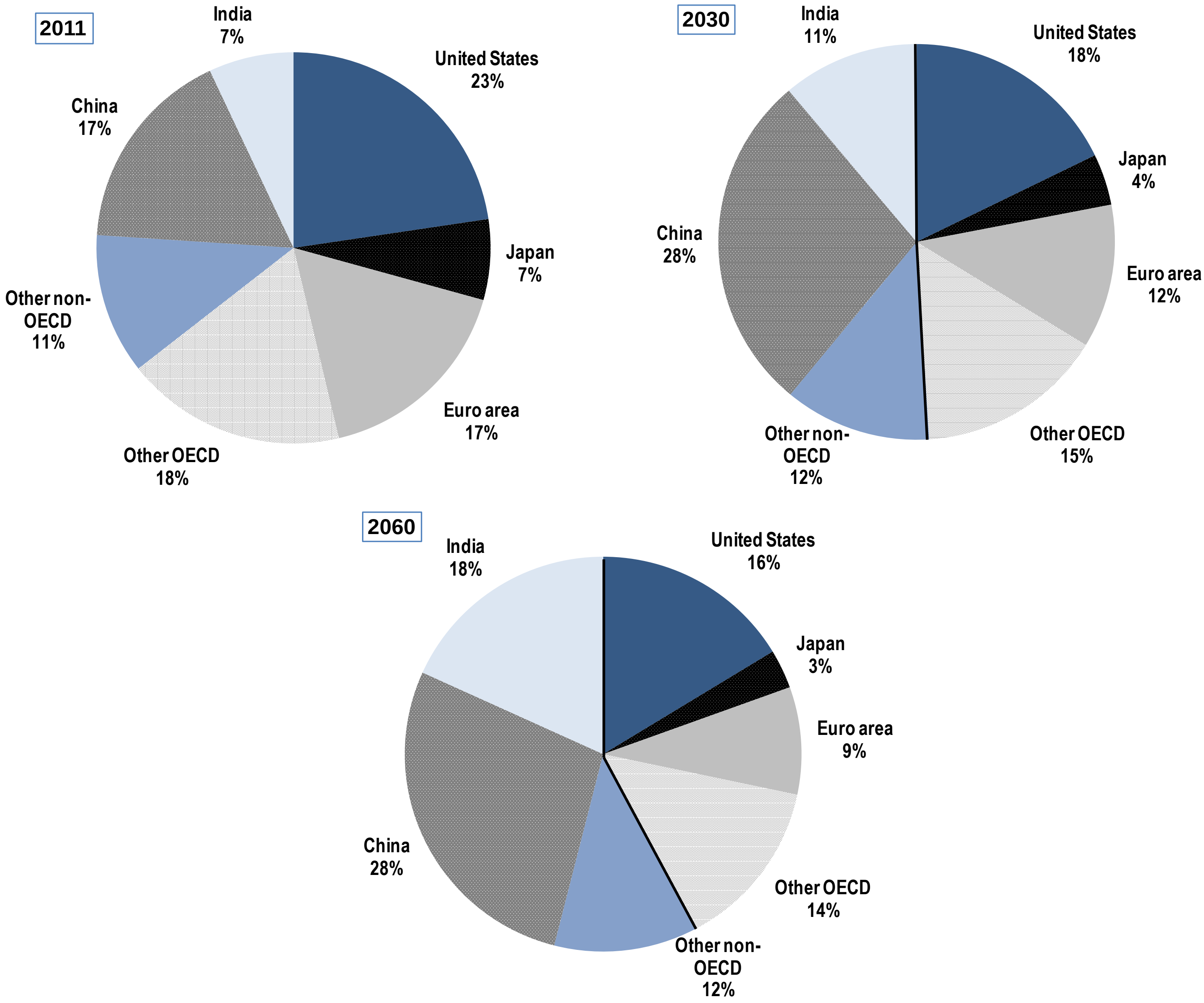
Source: OECD calculation based on OECD Income and Poverty Distribution Database, and Joumard et. al. (2012), “Less Income Inequality and More Growth – Are They Compatible? Part 3. Income Redistribution via Taxes and Transfers Across OECD Countries”, OECD Economics Department Working Papers, No. 926, OECD Publishing.

Fiscal policy considerations

- **Consolidation needs to balance:**
  - Short-term demand impact.
  - Social impact.
  - Long-term growth impact.
- **Mix of consolidation instruments can improve tradeoffs.**
- **Preferred instruments:**
  - Reduce tax breaks to wealthy and cut unwarranted tax expenditures.
  - Increase taxes on real estate and energy in some countries.
  - Shift taxes from labour to consumption.
  - Tackle public spending inefficiencies.
- **Consolidation and inequality:**
  - Transfers versus taxes.

Long term shift in the composition of global GDP

Percentage of global trend GDP, 2005 PPPs



Note: Global GDP is taken as sum of GDP for 34 OECD and 8 non-OECD G20 countries

Source: Johansson, Å., et al. (2012), "Looking to 2060: Long-Term Global Growth Prospects: A Going for Growth Report", OECD Economic Policy Papers, No. 3, OECD Publishing.

Long-term developments and policy implications

- **Long-term global developments:**
  - Growth will be sustained by emerging economies but at a declining rate.
  - Relative sizes of economies will shift dramatically.
  - GDP per capita gaps will narrow, but differences will persist.
  - Saving will decline in line with demographics.
  - Current account imbalances may build up.
- **Role of policy:**
  - Product market reforms will speed income convergence.
  - Labour market and retirement reforms and rising education levels will lift long-run GDP.
  - Ambitious fiscal consolidation and structural reforms would reduce imbalances and boost growth.