

28 November 2017

The Policy Challenge:
Catalyse the private sector
for stronger and more inclusive growth

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OECD Economic Outlook – November 2017

Summary of OECD projections for G20 countries

Real GDP growth

Year-on-year % increase

	2016	2017	2018	2019
World	3.1	3.6	3.7	3.6
Argentina	-2.2	2.9	3.2	3.2
Australia	2.5	2.5	2.8	2.7
Brazil	-3.6	0.7	1.9	2.3
Canada	1.5	3.0	2.1	1.9
China	6.7	6.8	6.6	6.4
Euro area¹	1.8	2.4	2.1	1.9
France	1.1	1.8	1.8	1.7
Germany	1.9	2.5	2.3	1.9
India²	7.1	6.7	7.0	7.4
Indonesia	5.0	5.0	5.2	5.4
Italy	1.1	1.6	1.5	1.3
Japan	1.0	1.5	1.2	1.0
Korea	2.8	3.2	3.0	3.0
Mexico	2.7	2.4	2.2	2.3
Russia	-0.2	1.9	1.9	1.5
South Africa	0.3	0.7	1.0	1.5
Spain	3.3	3.1	2.3	2.1
Turkey	3.3	6.1	4.9	4.7
United Kingdom	1.8	1.5	1.2	1.1
United States	1.5	2.2	2.5	2.1
OECD¹	1.8	2.4	2.4	2.1
Non-OECD	4.1	4.6	4.9	4.8
World real trade growth	2.6	4.8	4.1	4.0

1. With growth in Ireland in 2015 computed using gross value added at constant prices excluding foreign-owned multinational enterprise dominated sectors.

2. Fiscal years starting in April.

Key Messages

Global growth is strengthening but longer-term challenges remain

- Growth has picked up and is synchronised globally
- Policy stimulus is supporting the upturn, but the private investment recovery is modest
- Inflation and wage growth remain subdued

Financial vulnerabilities and high debt could undermine medium-term growth

- Low interest rates and low market volatility have encouraged risk-taking
- Corporate indebtedness is high and rising, creating vulnerabilities
- High debt makes households in many countries vulnerable to shocks

Policy action will be key to ensure robust, inclusive and resilient growth

- Focus structural and fiscal action on long-term potential as monetary policy support is reduced
- Implement reform packages to promote productivity, higher wages and inclusive growth
- Pursue an integrated approach to balance growth and risks in the financial sector

Editorial

Global economic growth is strengthening, with incoming data surprising on the upside. We project global GDP growth to be between 3½ and 3¾ per cent through the projection horizon, closer to long-run averages. Will this synchronised momentum finally propel the global economy to gather enough speed to raise productivity, real wages, and living standards for all?

More robust and higher quality private sector investment, including in intangibles and skills, is key for long-term productivity and real wage growth. There are positive signs: surveys indicate that businesses intend to invest, particularly in technology-embodied capital; and the now synchronous global upturn signals demand for investment, particularly given the erosion of the capital stock. But, projected investment rates remain too low to sustain the acceleration of activity. As a result, our projection for global GDP for 2019 shows a tempering of growth rather than continued strengthening.

A myriad of obstacles (different across countries) stand in the way of the more robust investment crucial for productivity growth to meet the public's expectations for higher living standards, and to fulfil the longer-term commitments of governments to provide solid career paths for the young and adequate pensions for the old. For example, services restrictions create hurdles to invest, particularly for smaller firms; judicial delays hinder the clean-up of balance sheets and capture resources in poorly performing firms; housing policies can make it difficult to hire workers with the right skills, undermining investment by both workers and firms.

Some people think that the per capita income growth enjoyed in previous decades is out of reach, and that those expectations are unrealistic or even inappropriate, given demographic and environmental considerations. On the former, OECD research shows that changes in pension policies to promote longer working careers and increased participation of women can offset much of the demographic drag on potential output. On the latter, the OECD report “Investing in Climate, Investing in Growth” shows a path to better well-being consistent with climate change commitments. More robust productivity growth is needed to raise wage prospects in advanced economies and higher investment – in social, public, human, and physical capital (with different combinations for different countries) – is needed for emerging economies to sustain catch-up in living standards.

Financial markets provide additional signals that real investment has yet to fully fire, and that incentives are misaligned. When firms invest in financial assets rather than in real capital, asset prices rise relative to long-term growth prospects. Evidence continues to build that financial asset prices are inconsistent with expectations for future growth and the policy stance, exacerbating the risks of financial corrections and growth downdrafts. Vulnerabilities appear through a number of channels: volatility measures are low even as the probability of sharp corrections is high, equity prices are high relative to expected growth rates and discount rates, credit spreads are narrow relative to risks, bond yields are low relative to probable outcomes of fiscal and monetary policies, and historically-high duration exposes bond holders to interest rate normalisation. Current global growth rates, and fiscal and monetary space are too limited to weather a financial downdraft. This puts an even greater premium on structural policy efforts.

Policymakers need to trigger deeper changes to their policies to catalyse investment, productivity, and real wage growth and make growth more inclusive. The OECD's Going for Growth exercise documents that many countries have focussed and made progress on policies that enhance labour market fluidity and participation by redesigning benefits and “making work pay”, and by improving childcare so as to enhance labour force inclusion of women. These reforms have paid off with higher employment rates, particularly among groups that typically have been more weakly

attached to the labour market. However, for these reforms to be reflected in high productivity and real wage growth, opportunities for right-skilling need to improve and productivity gains need to diffuse from the frontier to all firms. Further, competition in markets enhances competition for workers, making for better skill matching and higher real wages. Policymakers' efforts on product market reforms have been less ambitious, in particular on anti-trust/competition policy action and on trade and investment policies; indeed, threats to roll back openness permeate the policy landscape. Although progress has been made on financial market repair, zombie firms still capture too much labour and capital, taking a toll on business dynamism, productivity and real wage growth.

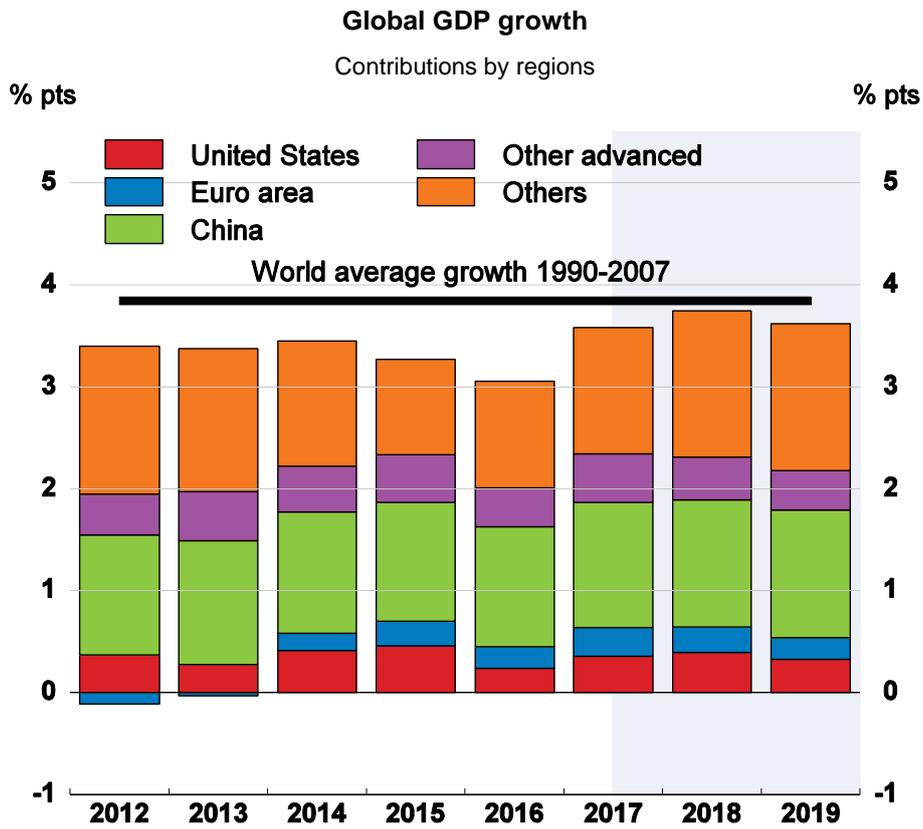
The financial crisis prompted structural reform and new regulation of parts of the financial system, but private sector debt remains high. The past decade has seen a growing reliance by firms on bond financing at attractive rates, with deteriorating credit quality and use of international issuance, as set out in Chapter 2 of this Economic Outlook on “Resilience in a Time of High Debt”. While credit is needed to support economic activity and innovation, it can increase risks, lower growth and raise inequality. An integrated policy approach is needed to enhance the financial resilience of economies to shocks and to minimise the risks of sub-par growth in the medium term. Financial regulation should not focus only on risk, but also on growth.

Policy fatigue and sluggish growth in the past decade have curbed reform ambitions. And some might suggest that the global upturn means that no more policy effort is needed. In fact, the rapid pace of technological change – digitalisation, robotics, artificial intelligence, cloud computing – demands deeper and more extensive reforms, not complacency. Attention to the local challenges of global and technological changes has to ensure that opportunities will be shared. Those countries that step up policy efforts will create a better environment for their firms and public. With the global upturn putting wind under the wings of policy, now is the time to redouble the effort.

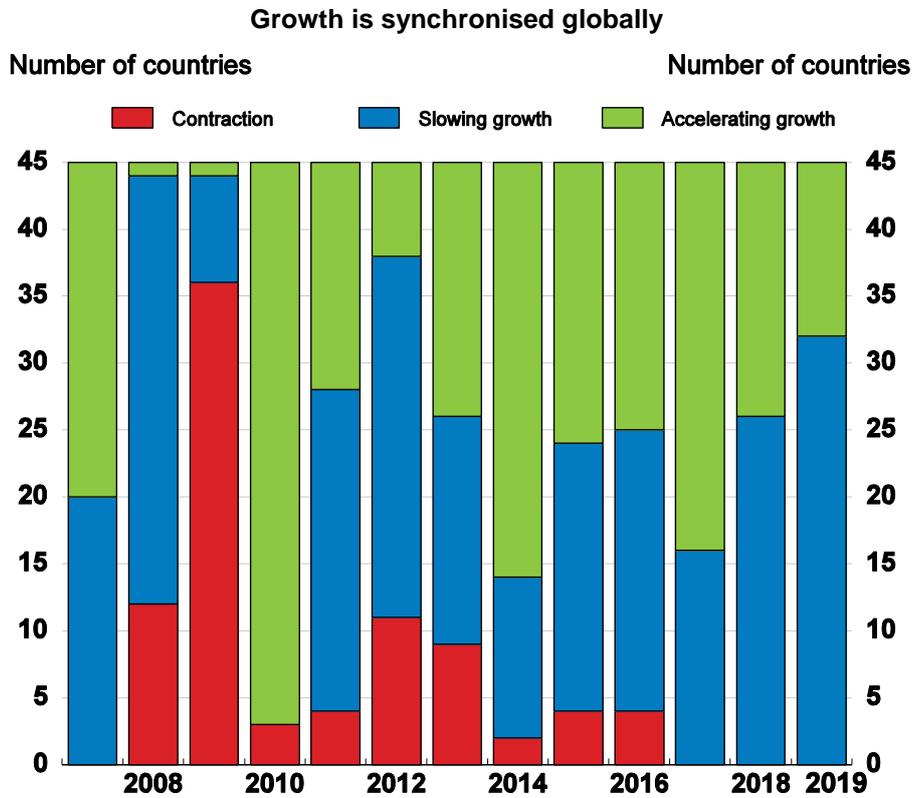
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Catherine L. Mann
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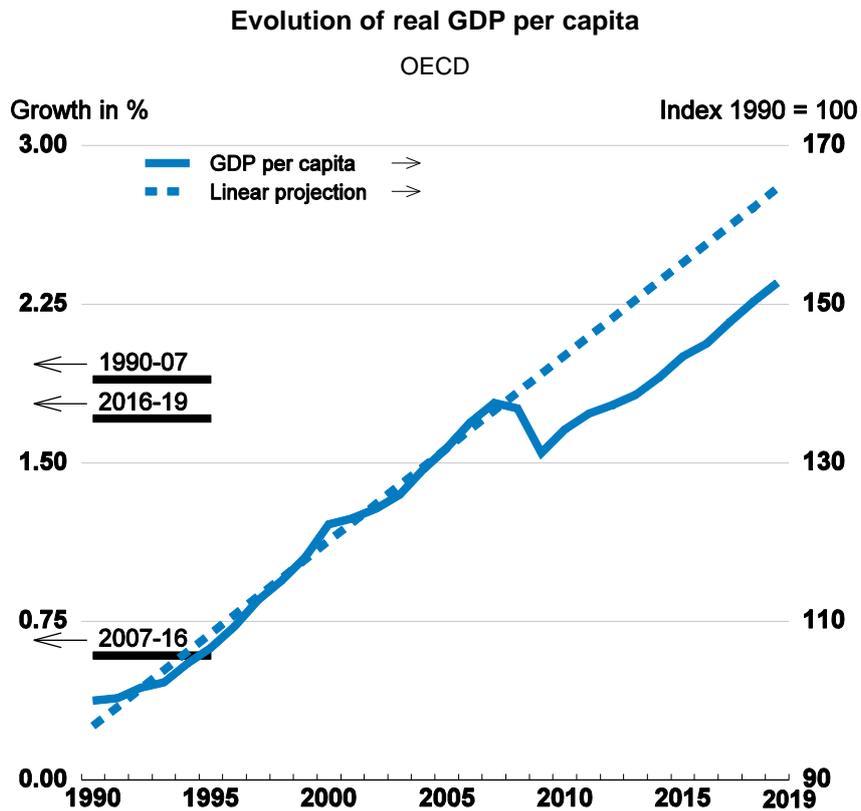


Source: OECD Economic Outlook database.



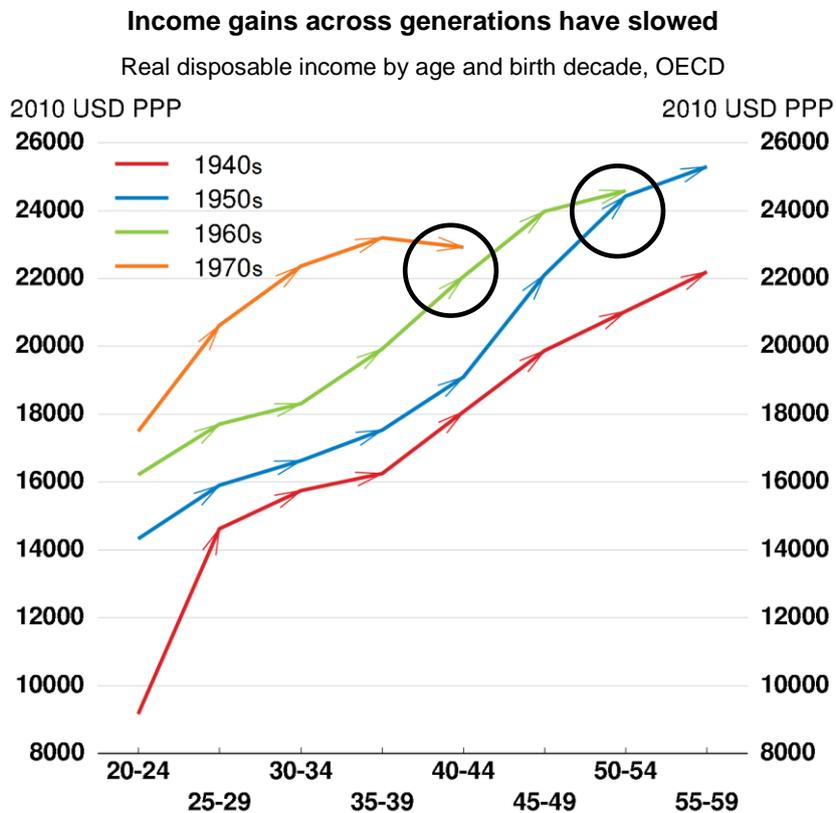
Note: The panel shows 45 countries accounting for more than 80% of global GDP. Accelerating/slowing growth refers to a comparison with the previous year.

Source: OECD Economic Outlook database.



Note: Series calculated with GDP PPP weights. Horizontal lines show average annual real GDP per capita growth for each period. The dotted line indicates a linear projection based on the 1990-2007 period.

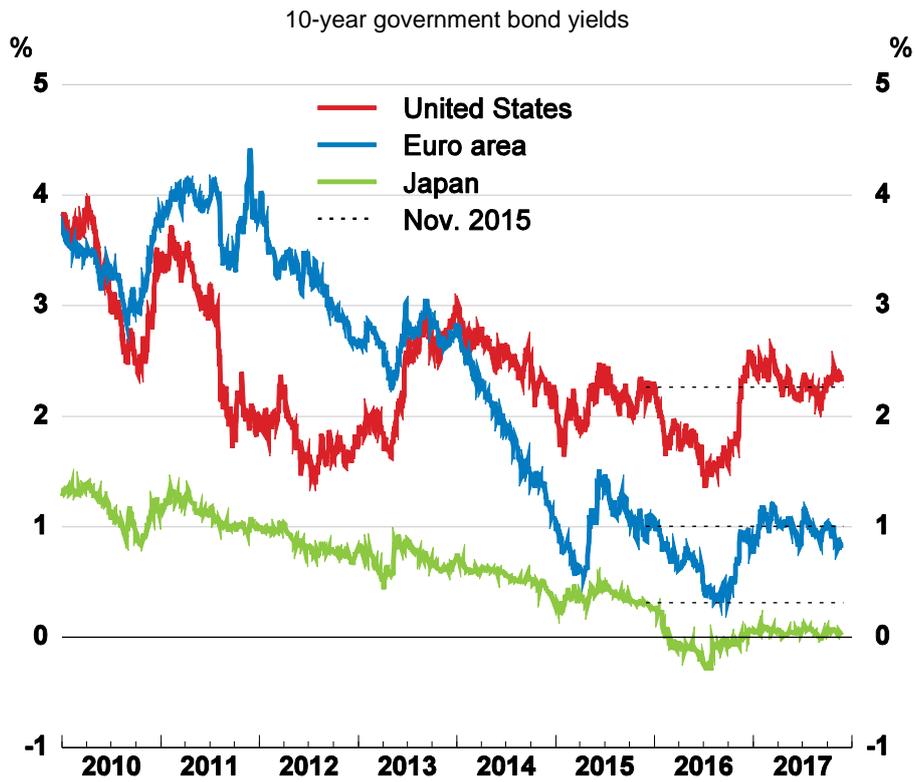
Source: OECD Economic Outlook database.



Note: Data cover 24 OECD countries. The series shown are derived for each cohort from a specification controlling for country and age fixed effects.

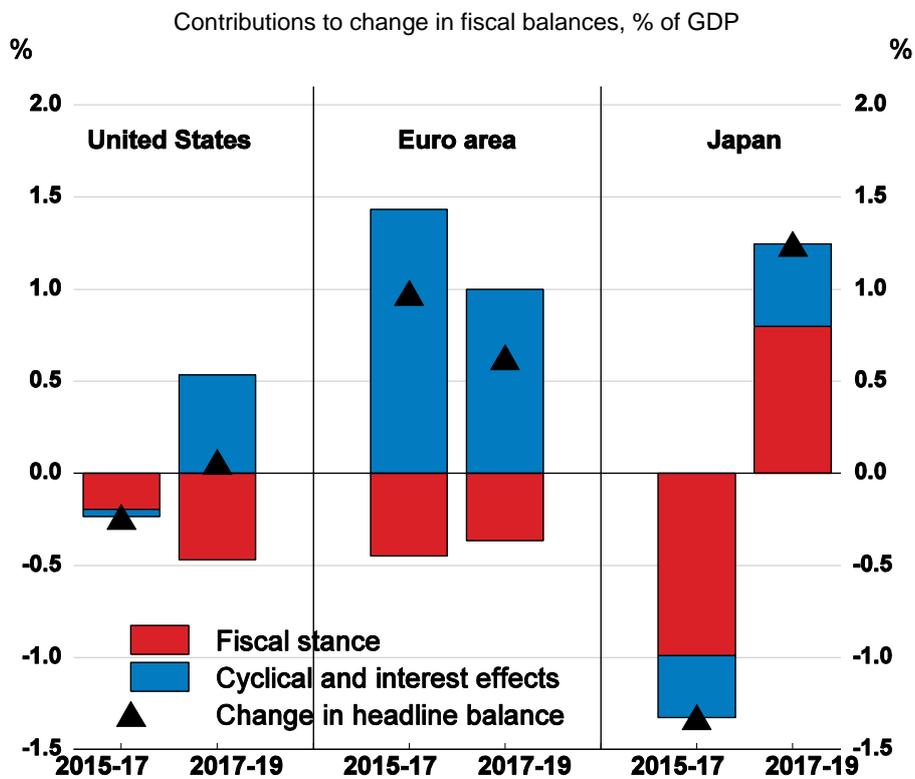
Source: OECD calculations from the Luxembourg Income Study data.

Long-term yields remain low



Source: Thomson Reuters.

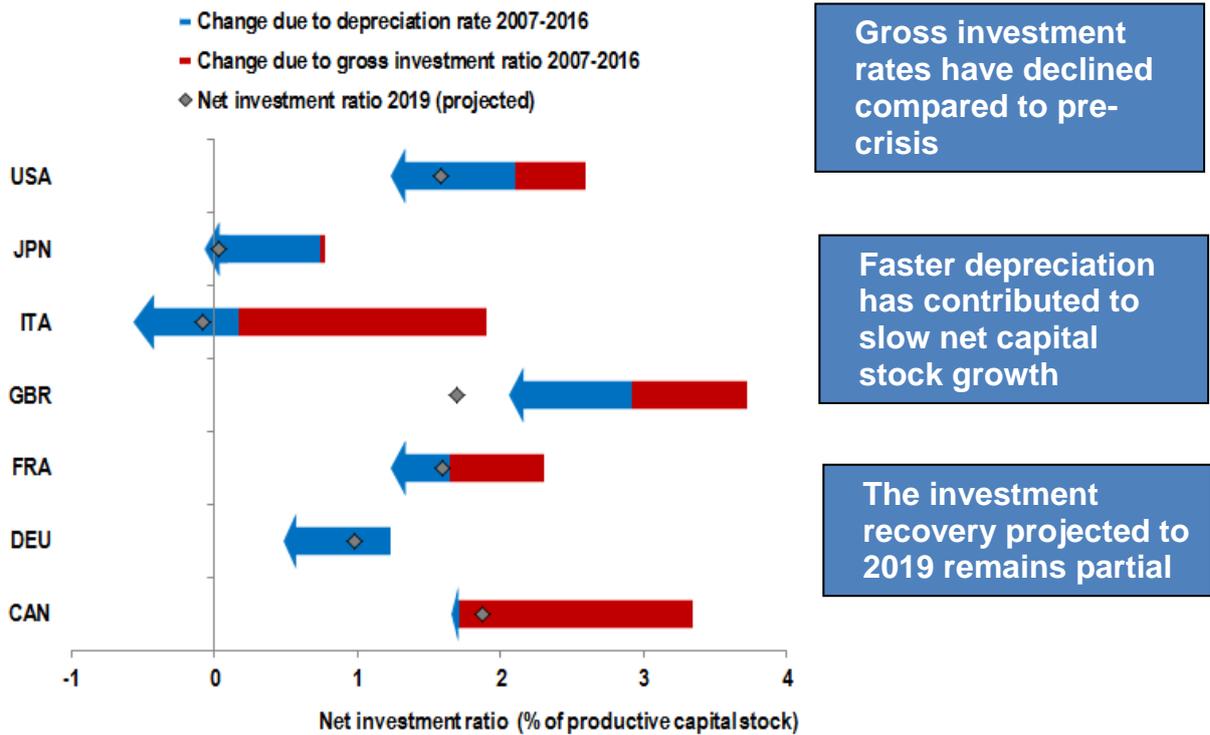
Fiscal stance has eased in OECD countries



Note: The fiscal stance is shown as the change in the underlying primary balance.

Source: OECD Economic Outlook database; and OECD calculations.

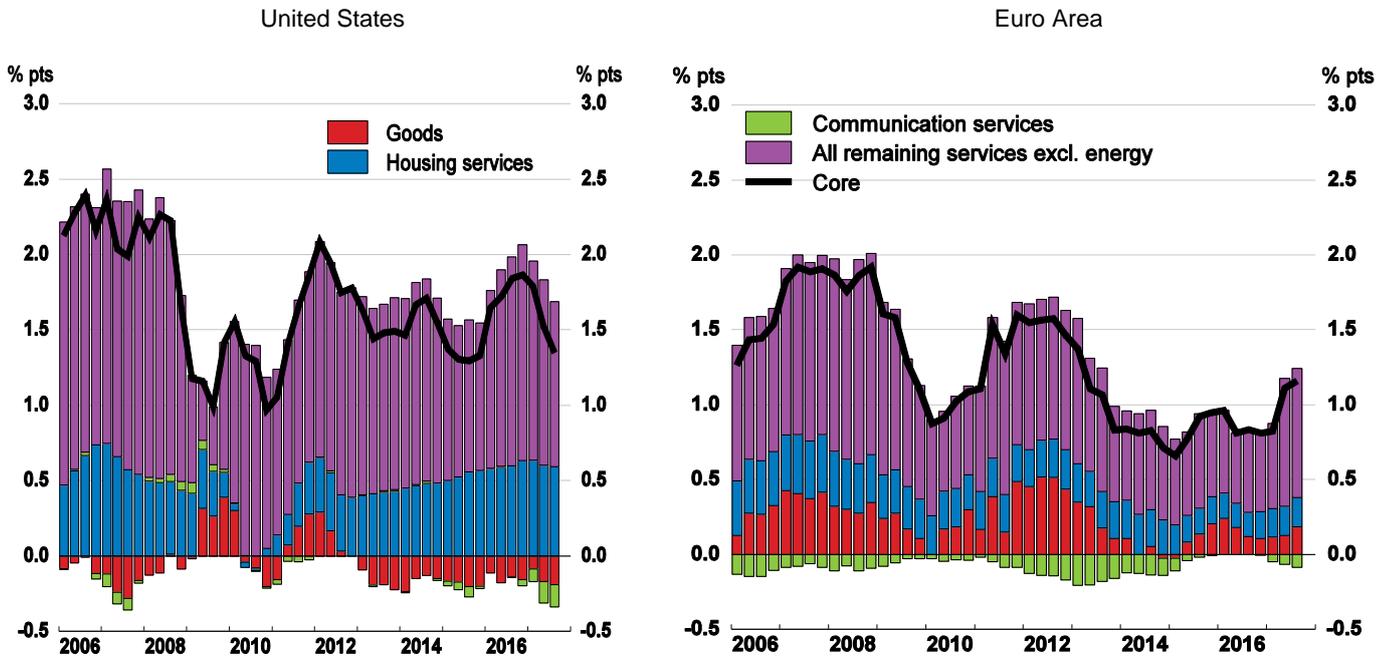
Dynamics of the net investment ratio



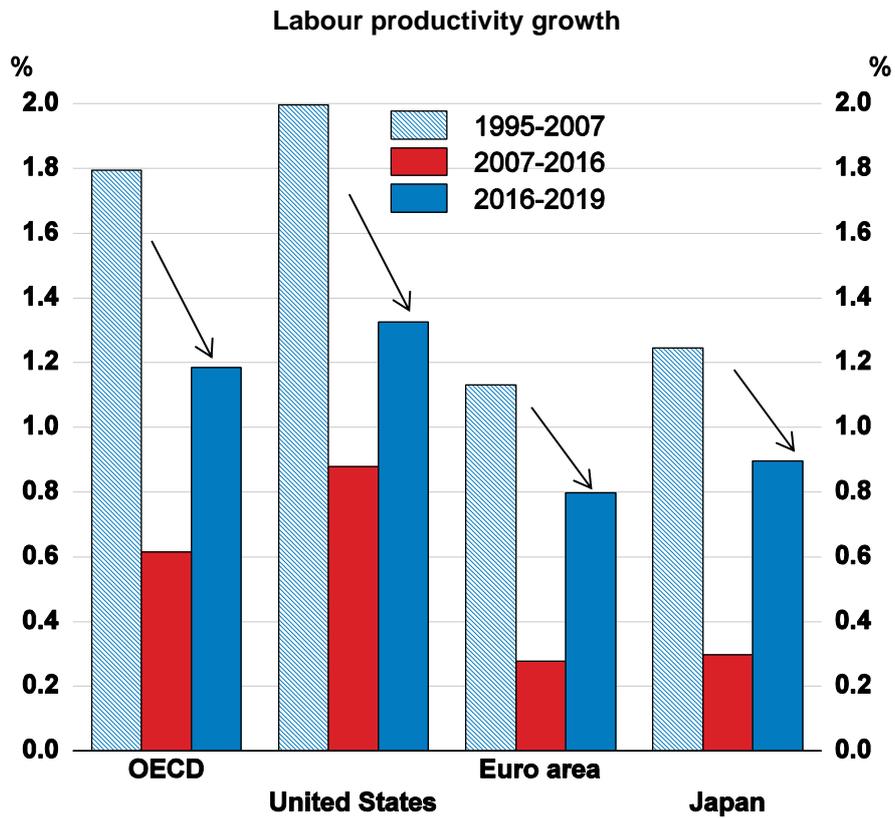
Note: The net investment ratio is defined as the gross investment ratio minus the depreciation rate in % of the productive capital stock. It includes business plus government investment.

Source: OECD Economic Outlook database; and OECD calculations.

Contributions to core inflation for major economies

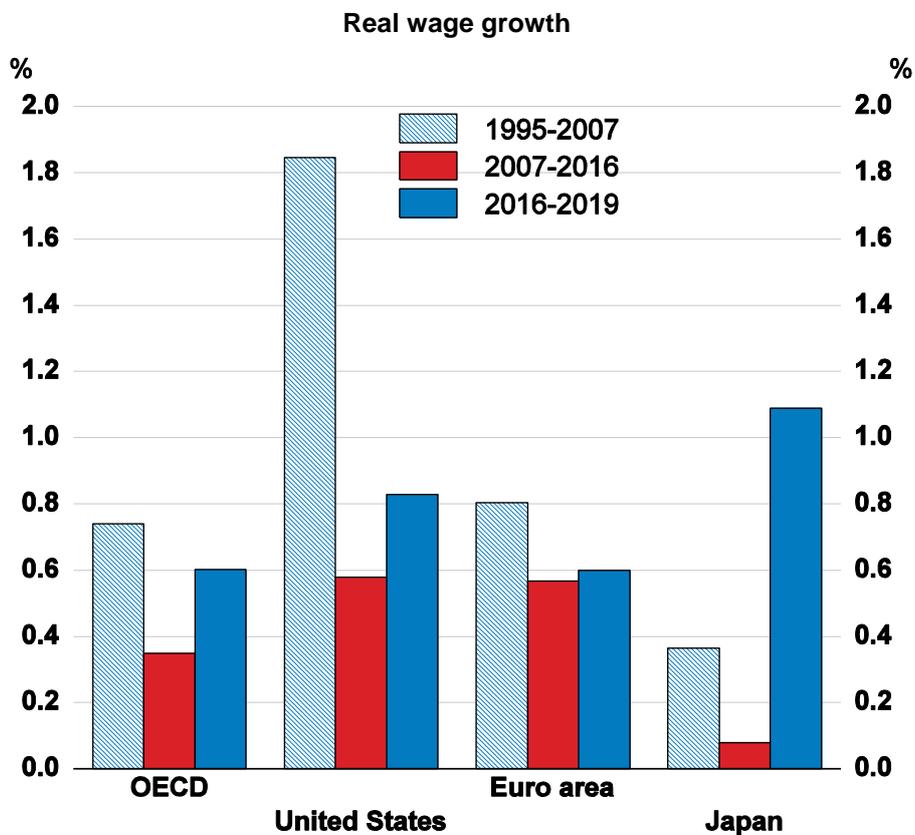


Source: Bureau of Economic Analysis; Eurostat; and OECD calculations.



Note: Labour productivity growth is the average annual growth rate of output per person employed. 2017-2019 are projections.

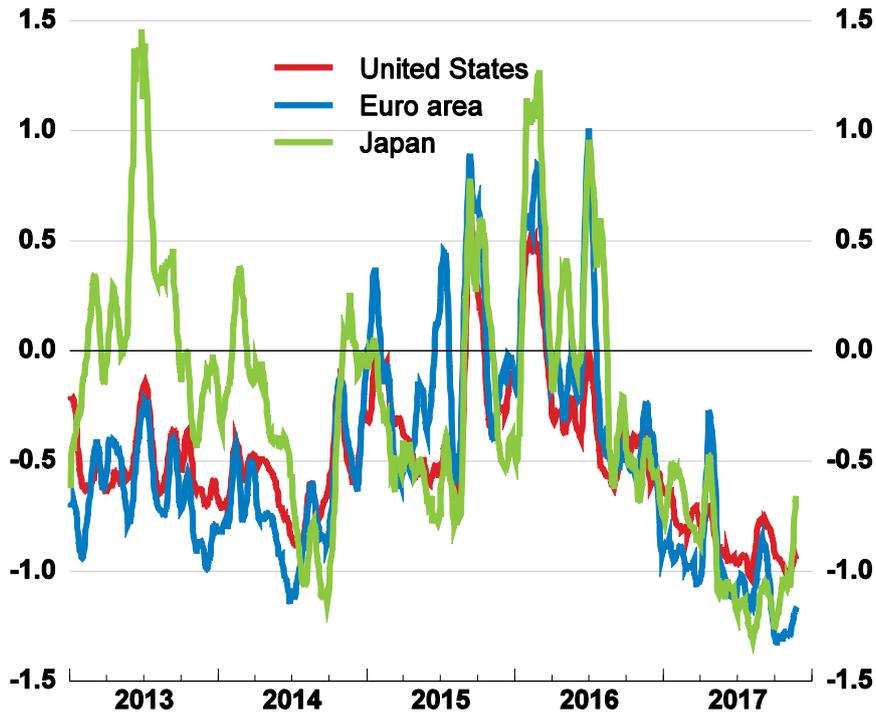
Source: OECD Economic Outlook database.



Note: Real wage growth is calculated from nominal wage growth and the GDP deflator. 2017-2019 are projections.

Source: OECD Economic Outlook database.

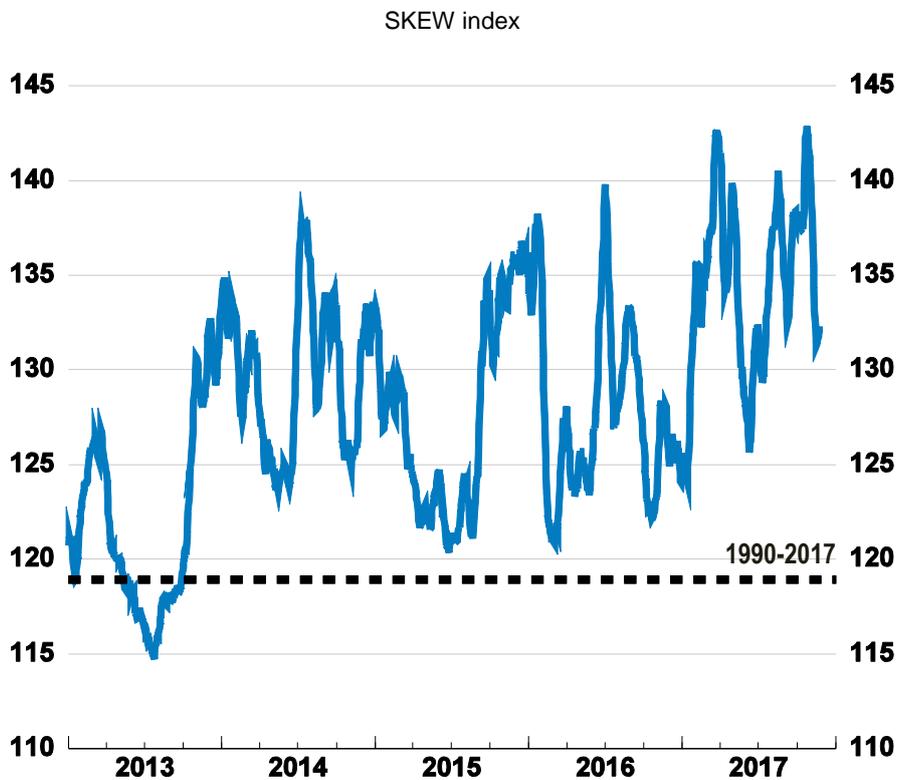
Low volatility in equity prices



Note: 15-day moving average of normalised values, in standard deviations. The equity market volatility indices measure an expected symmetric range of movements in the main equity indices over next 30 days.

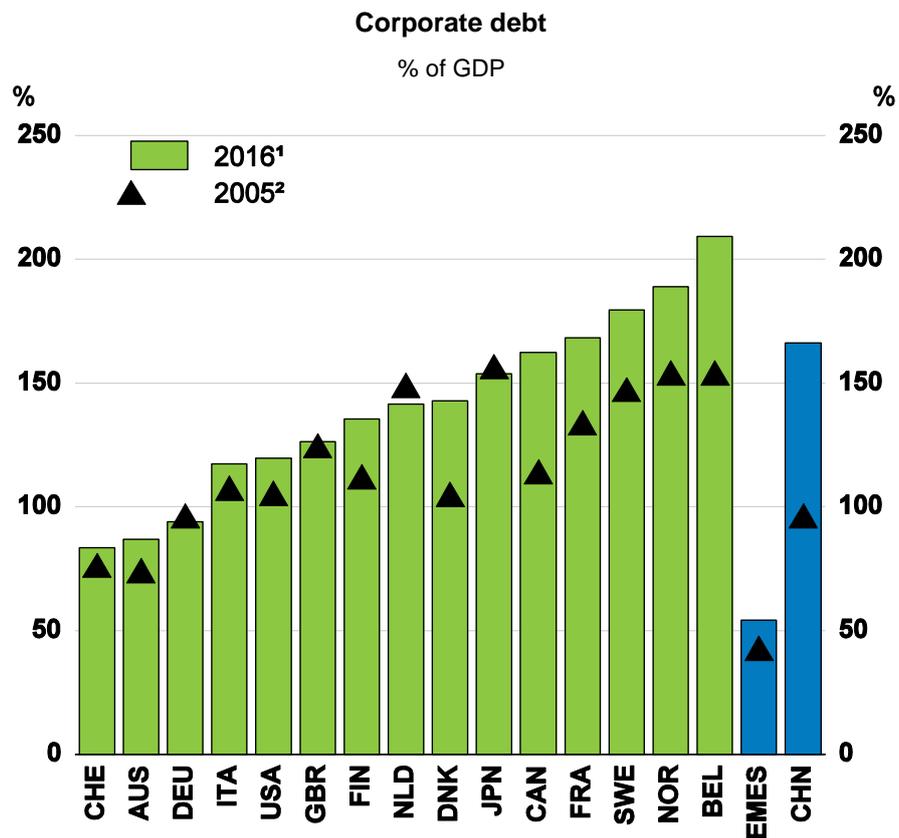
Source: Thomson Reuters; and OECD calculations.

Rising tail risk in equity markets



Note: 15-day moving average. The dashed line indicates the long-term average (1990-2017) of the SKEW index.

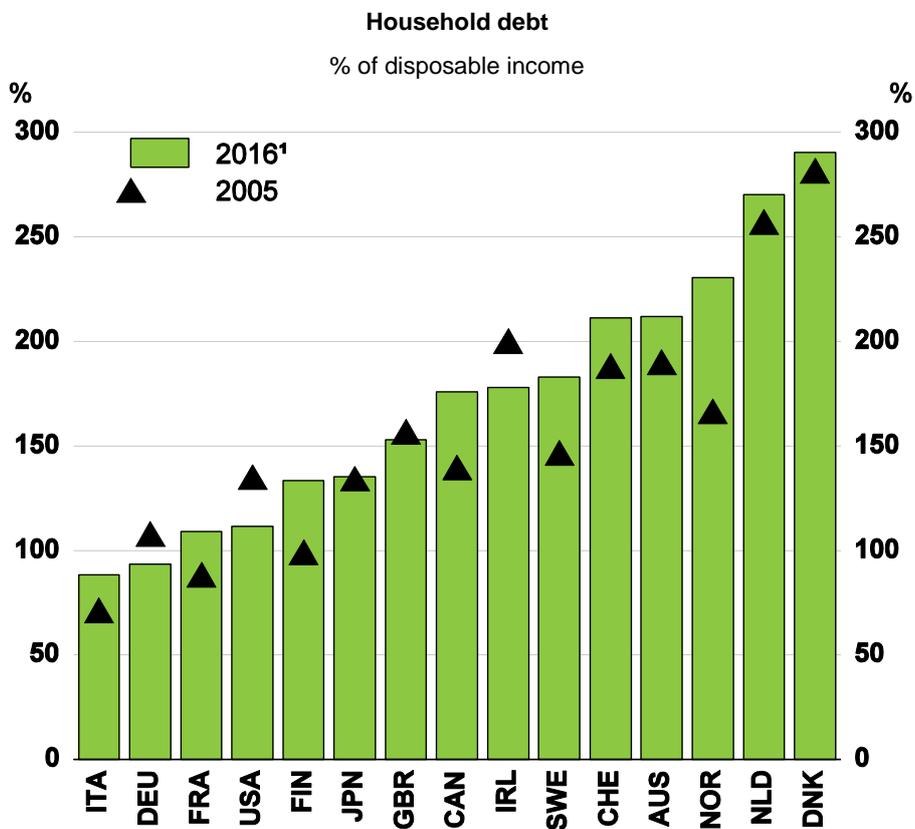
Source: Thomson Reuters; and OECD calculations.



1. Or latest available.

2. 2008 for EMEs and China.

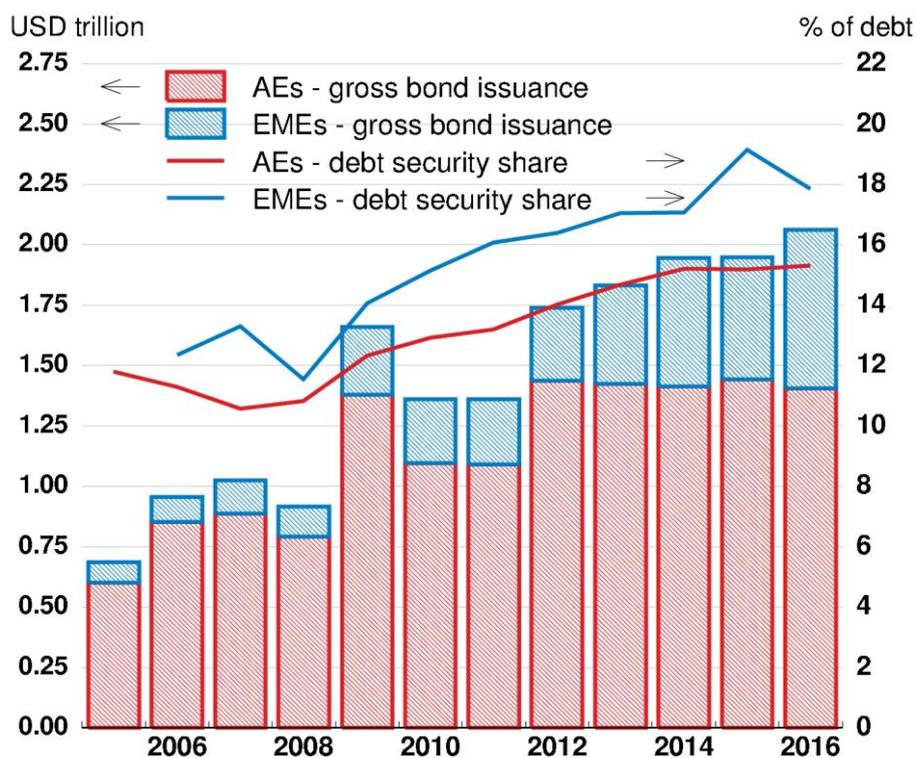
Source: OECD National Accounts; BIS.



1. Or latest available.

Source: OECD National Accounts.

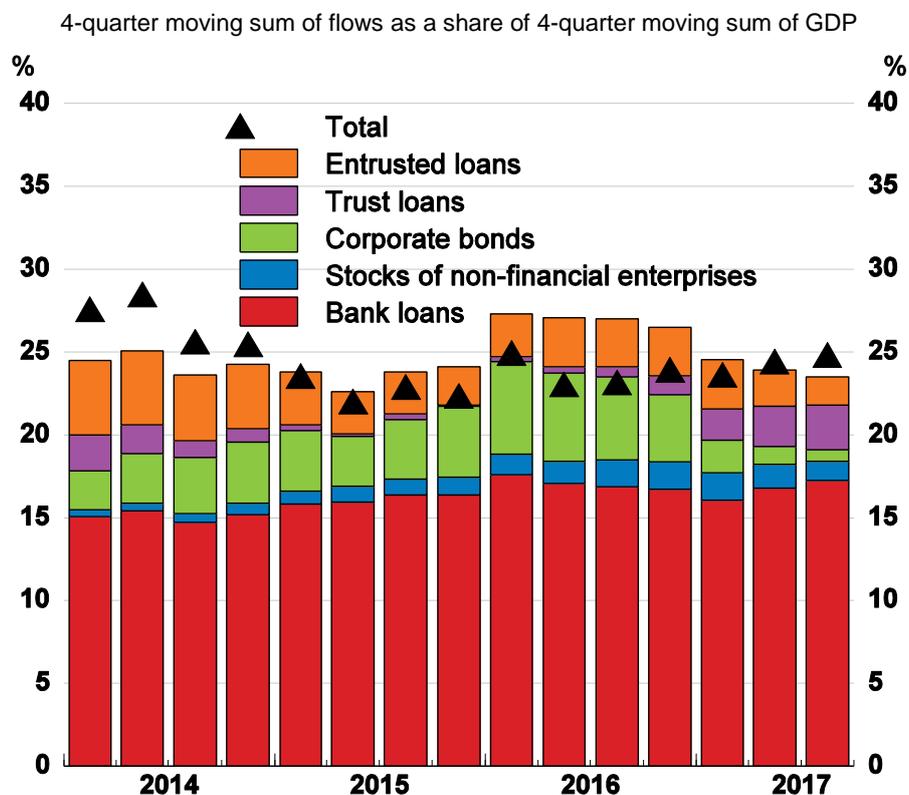
Corporate bond issuance



Note: % of debt refers to the share of debt securities in the total of loans, debt securities and currency and deposits. AEs for advanced economies, EMEs for emerging market economies.

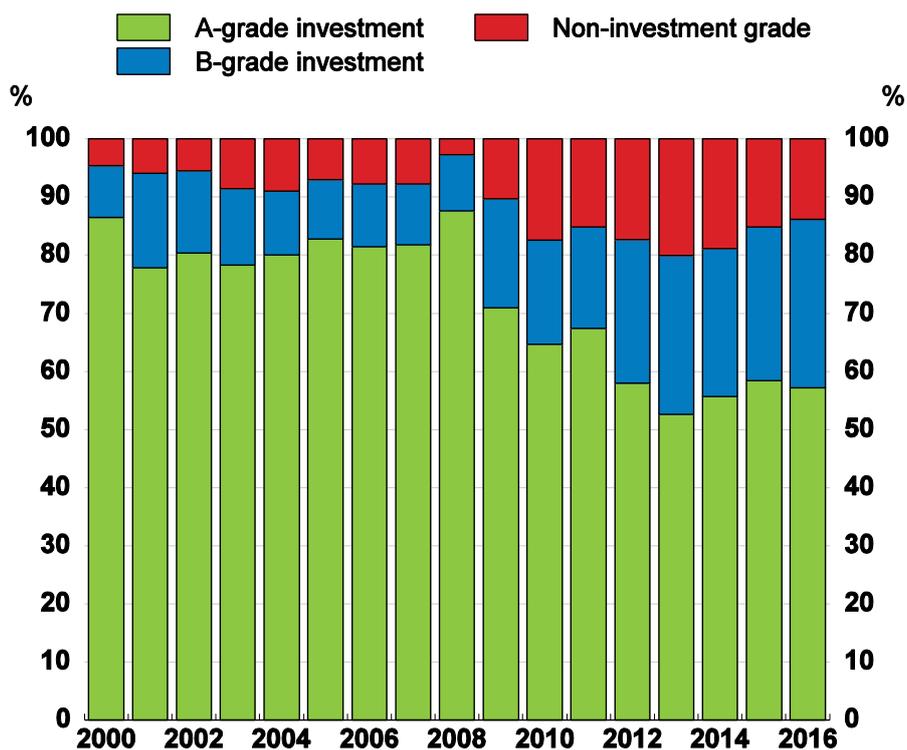
Source: OECD Business and Finance Scoreboard 2017; Bank of International Settlements; OECD financial accounts; and OECD calculations.

Total social financing flows in China



Source: OECD Economic Outlook database; Thomson Reuters; and OECD calculations.

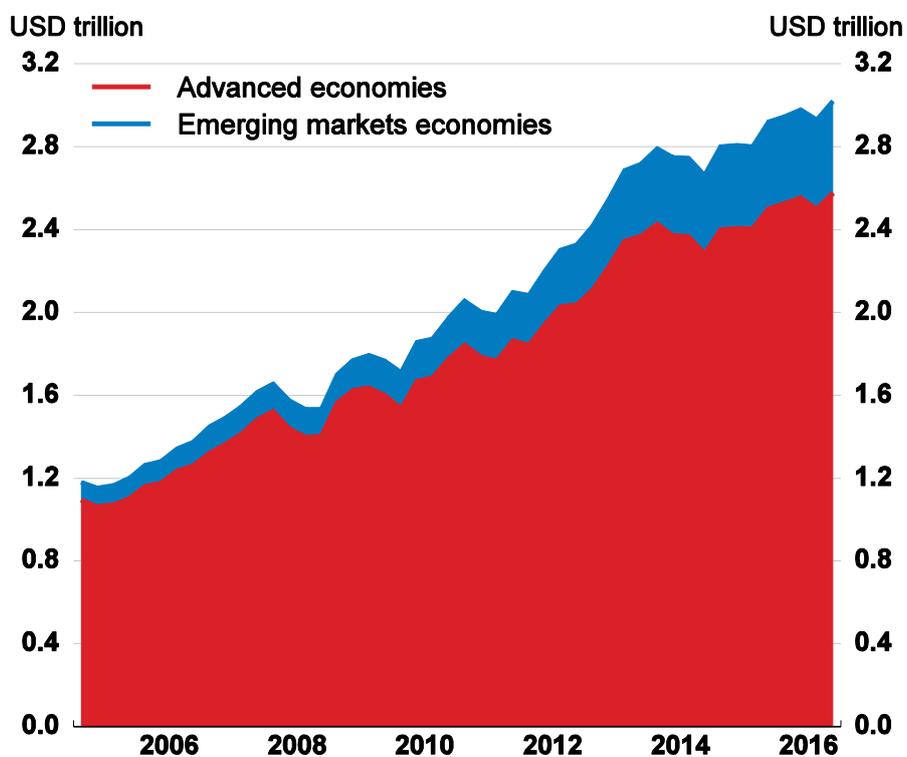
Credit quality of new corporate bonds



Note: Share of new bond issuance by non-financial corporations; covers advanced and emerging economies.

Source: OECD Business and Finance Scoreboard.

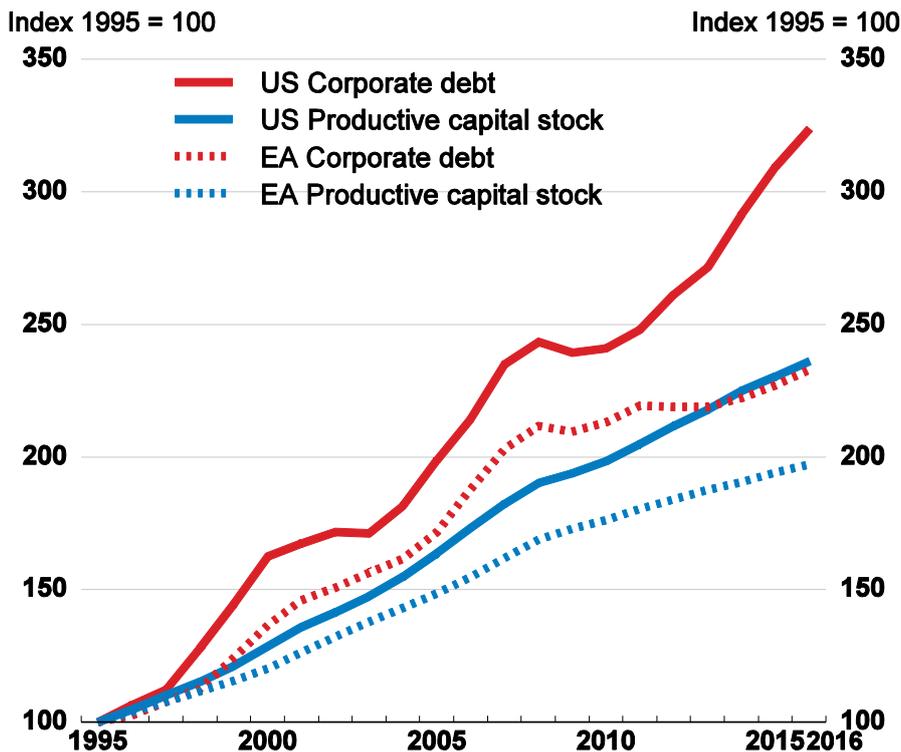
International corporate debt securities



Note: Outstanding stock of international bonds of non-financial corporations.

Source: Bank for International Settlements; and OECD calculations.

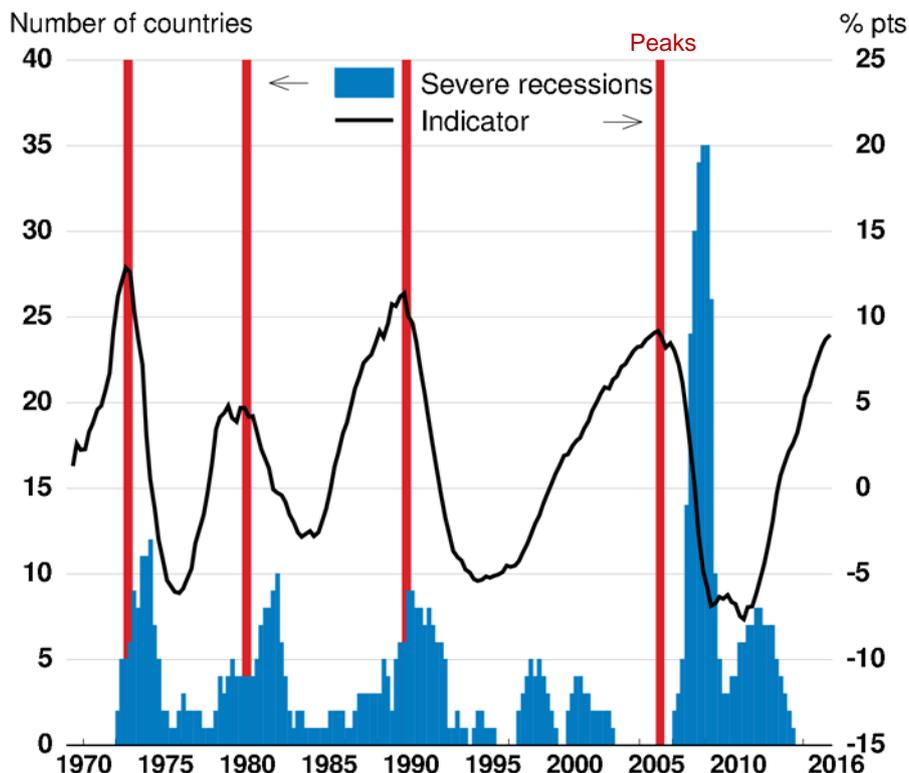
Disconnect between debt and productive capital



Note: Based on nominal series.

Source: OECD National Accounts; OECD Economic Outlook database; and OECD calculations.

Global real house price index

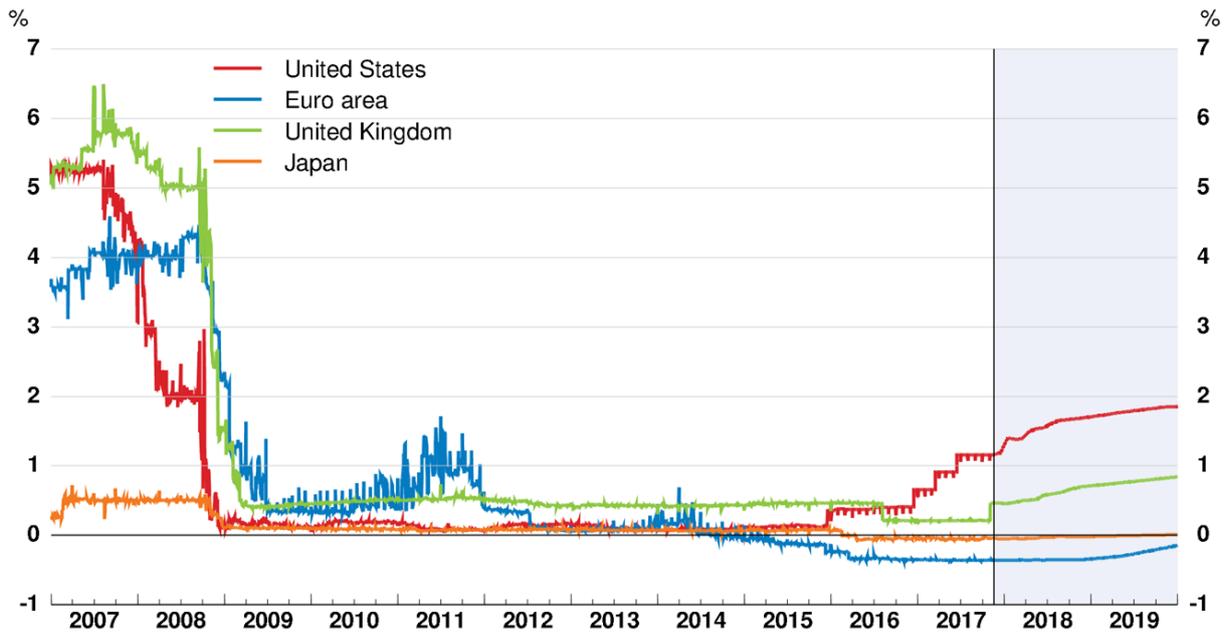


Note: Blue areas represent the number of countries in a severe recession. The global real house price index is constructed as a GDP-weighted average across OECD countries and is measured as deviation from trend.

Source: Hermansen and Röhn (2017), "Economic resilience: The usefulness of early warning indicators in OECD countries", *OECD Journal: Economic Studies*.

Overnight interest rates

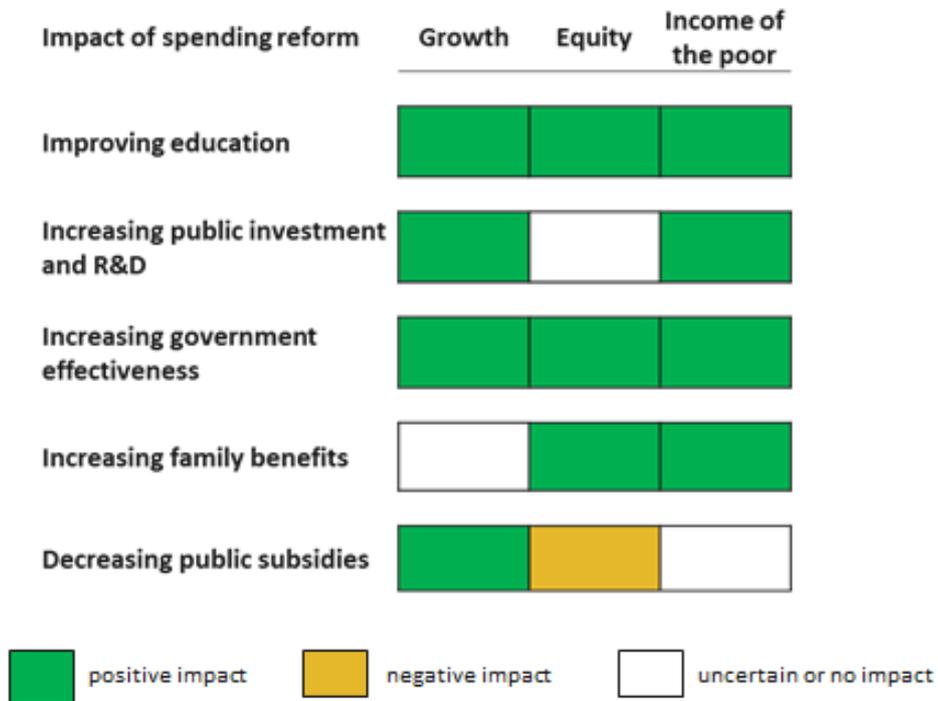
Actual and market expectations



Note: Values in the shaded area are market expectations of overnight rates as of 15 November 2017.

Source: Bloomberg; and OECD calculations.

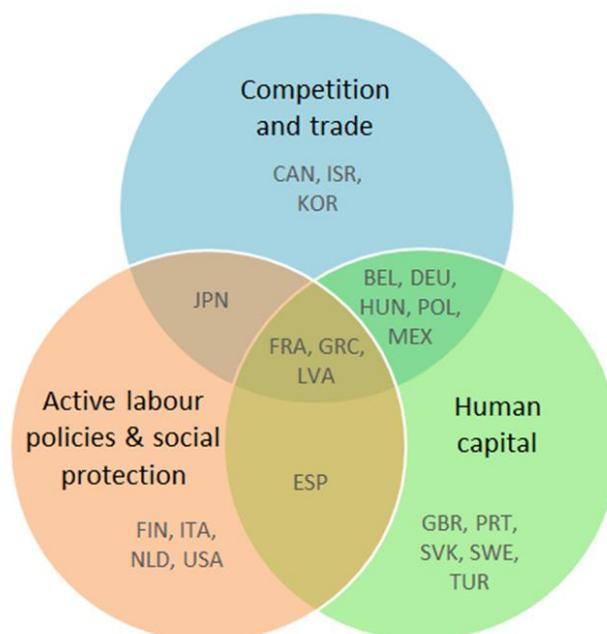
Growth and equity effects of the public spending mix



Source: Fournier and Johansson (2016), "The effect of the size and the mix of public spending on growth and inequality", OECD Economics Department Working Paper.

Policy packages for inclusive growth

Countries with scope to combine reforms

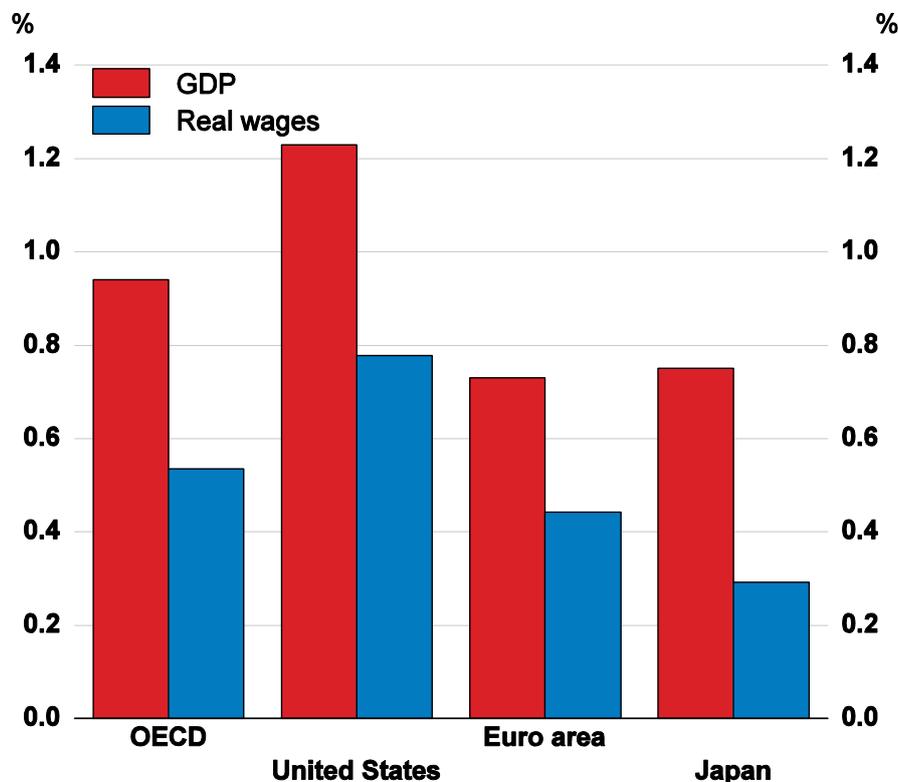


Source: Going for Growth 2017.

Gains from reforms raising productivity by 1 % by 2023

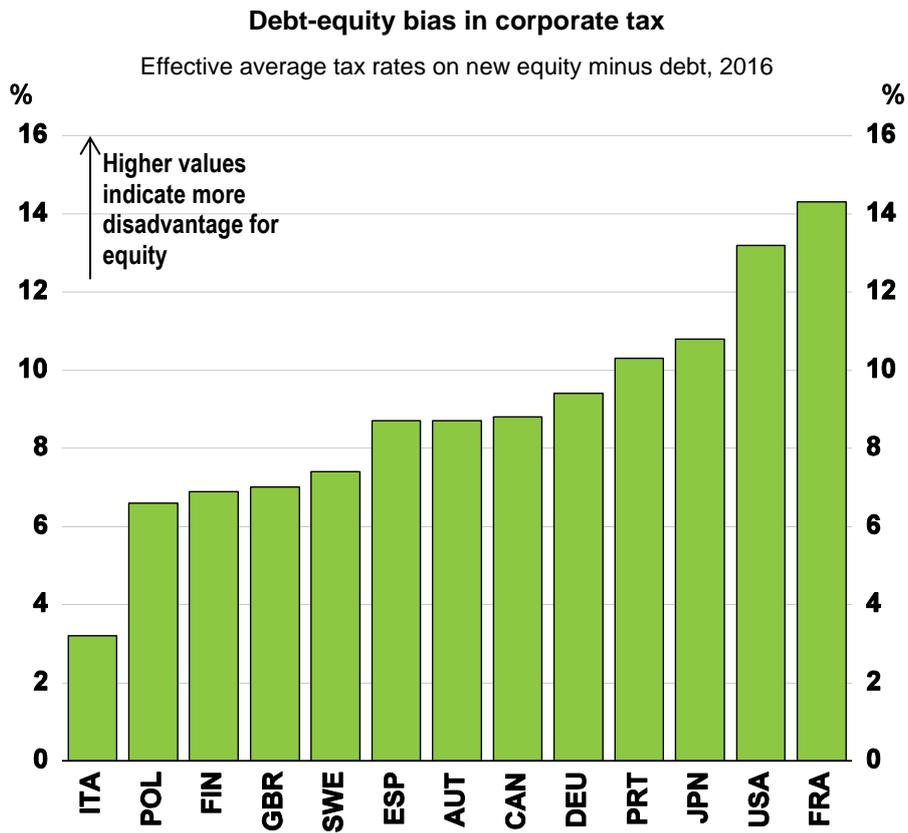
Representing a 20% gain from the current rate of productivity growth for 5 years

Increase in GDP and wages achieved by 2023



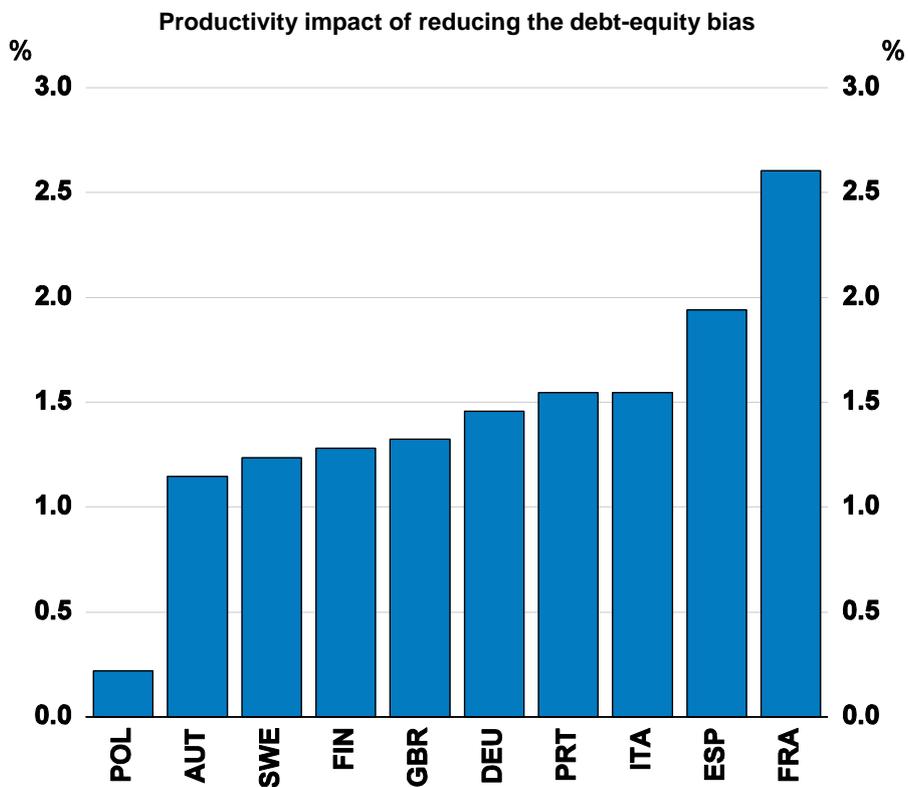
Note: The scenario considers the effects of raising labour-augmenting technical progress by 0.2 percentage point per annum in all of the advanced economies for five years, beginning at end-2017, with the 1% higher level of technical progress being maintained permanently thereafter.

Source: OECD calculations using the National Institute Global Econometric Model.



Note: The debt-equity bias is defined as the percentage point difference between the effective tax rates on equity finance and debt finance.

Source: Centre of European Economic Research (ZEW, 2016).



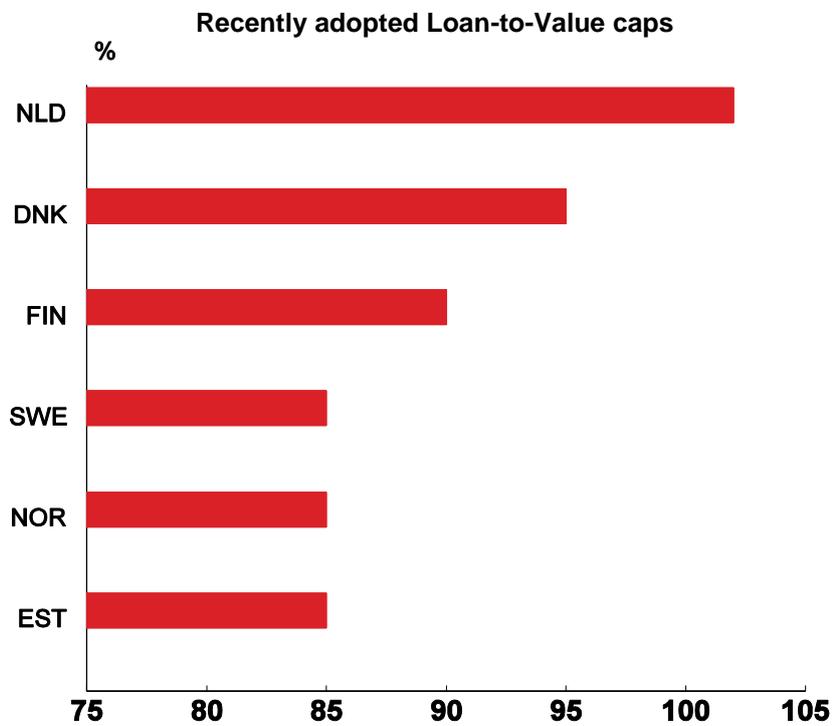
Note: Potential gains to within-firm total factor productivity growth associated with removing the debt-equity bias.

Source: Adalet McGowan, Andrews, Millot (2017), "Insolvency regimes, technology diffusion and productivity growth: Evidence from firms in OECD countries", OECD Economics Department Working Paper.

Recent OECD recommendations to address household debt

Policy area	Countries
Macro- and micro-prudential measures	AUS, CAN, CHE, DNK, GBR, ISR, KOR, LUX, NZL, NOR, SVK, SWE, CHN, RUS, USA.
Housing policies	AUS, FIN, DNK, GBR, IRL, LUX, NLD, NZL, POL, SVK, SWE.
Tax policies	CHE, DNK, LUX, NZL, SWE.

Source: OECD Economic Surveys and Going for Growth 2017.



Source: OECD Economic Surveys.

An integrated approach is needed to enhance resilience and achieve inclusive growth

