PRESS BRIEFING ON THE ECONOMIC OUTLOOK AND POLICY REQUIREMENTS FOR G20 ECONOMIES

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Summary

The near-term outlook

- Uncertainties regarding the short-term economic outlook have risen dramatically in recent months. A number of events, notably related to the euro area debt crisis and fiscal policy in the United States, are likely to dominate economic developments in the coming two years. In an "events-free" scenario and in the absence of comprehensive policy action to resolve current problems, real GDP is projected to grow by about 3.9% this year, 3.8% in 2012 and 4.6% in 2013 on average in G20 countries.[1] This average masks a wide divergence among country groupings, and emerging-market economies are much more buoyant, despite some softening. In the euro area, a marked slowdown with patches of mild negative growth is likely. Growth is also projected to remain weak in the United States, with a gradual pick-up from 2012 towards the end of the projection period. Unemployment is set to remain high in many advanced countries.

- A better upside scenario can materialise if the policy measures that were announced at the Euro Summit of 26 October are implemented promptly and forcefully. These measures go in the right direction and could help restore confidence and create positive feed-back effects that could trigger a scenario of stronger growth.

- In contrast, the outlook would be gloomier if the commitments made by EU Leaders fail to restore confidence and a disorderly sovereign debt situation were to occur in the euro area with contagion to other countries, and/or if fiscal policy turned out to be excessively tight in the United States. OECD analysis suggests that a deterioration of financial conditions of the magnitude observed during the global crisis (between the latter half of 2007 and the first quarter of 2009) could lead to a drop in the level of GDP in some of the major OECD economies of up to 5% by the first half of 2013.

Appropriate policy responses

- To resolve the euro area crisis, it is important to clarify and implement fully and decisively the measures announced on 26 October to break the link between sovereign debt and banking distress, to deal with Greece, to ensure that the sovereign debt crisis does not spread to other European countries and to secure appropriate capitalisation and funding for banks. Detailed information is needed on how the package will be implemented.

- In the advanced G20 economies, interest rates should remain on hold or, where possible, be reduced, notably in the euro area. Central banks should continue to provide ample liquidity to ease financial market tensions. Further monetary relaxation, including through unconventional measures, would be warranted if downside risks intensify. In the emerging-market economies, the stance of monetary policy should be guided by the outlook for growth and inflation, which remains comparatively high.

- Strong, credible medium-term frameworks for fiscal consolidation and durable growth are needed to restore confidence in the longer-term sustainability of the public finances and to build budgetary space to deal with short-term economic weakness. Those advanced economies with sounder public finances can provide additional counter-cyclical support.

- Structural reforms are essential to boost the growth potential of G20 countries, to tackle high unemployment and to rebalance global demand. In view of weak growth in the near term and impaired fiscal positions in most advanced economies, priority should be given to reforms that offer comparatively strong short-term activity gains and facilitate longer-term fiscal consolidation.

- In Cannes, G20 leaders will discuss an Action Plan with bold commitments for mutually reinforcing macroeconomic policies and structural reforms. In 2008, G20 leaders rose to the challenge with a clear and coherent plan and we avoided a second Great Depression. Today, the adoption and implementation of the Action Plan is just as imperative to restore confidence through decisive actions in specific countries and regions.

1. The projections reported in this document are preliminary and will be updated in the OECD *Economic Outlook* No. 90 to be released on 28 November 2011.

Summary of G20 projections

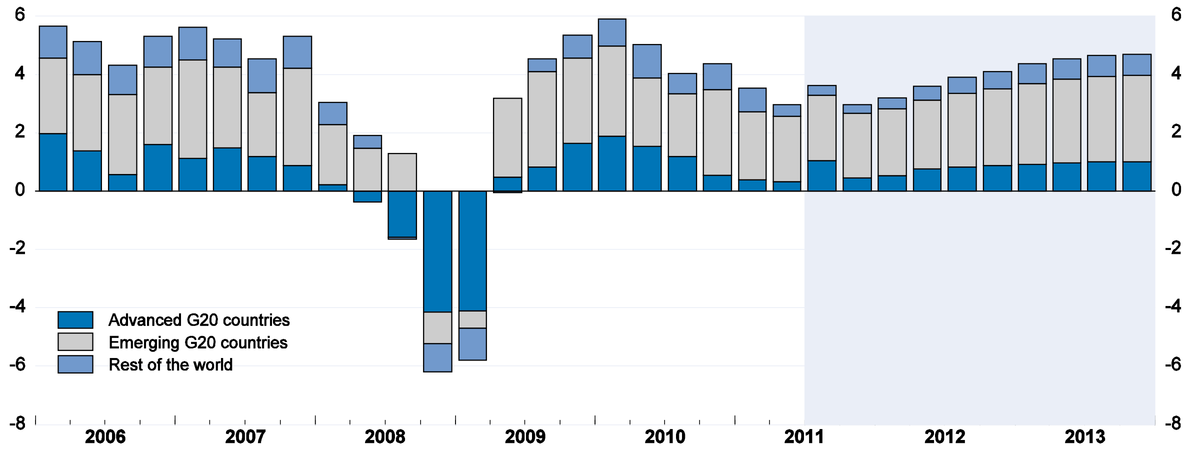
	2010	2011	2012	2013
Real GDP growth	**5.2**	**3.9**	**3.8**	**4.6**
Advanced G20	2.9	1.5	1.5	2.2
United States	3.0	1.7	1.8	2.5
Euro area	1.7	1.6	0.3	1.5
Japan	4.0	-0.5	2.1	1.5
Emerging-market G20	8.5	7.2	6.7	7.4
China	10.4	9.3	8.6	9.5
Unemployment rate (Advanced G20)	**8.4**	**8.1**	**8.2**	**8.0**
Government gross debt/GDP (Advanced G20)	**102.3**	**106.1**	**110.6**	**113.8**
United States	94.2	97.6	103.8	108.7
Euro area	92.8	95.2	97.2	97.6
Japan	200.0	212.3	219.8	227.6
Inflation	**3.3**	**4.4**	**3.5**	**3.0**
Advanced G20	1.5	2.7	1.8	1.3
Emerging-market G20	5.8	6.5	5.5	5.0

Note: The projections refer to averages across G20 countries. Countries are weighted using PPP-based nominal GDP, except for current account balances which use nominal US$ GDP weights and unemployment rates which use labour force weights. The advanced G20 countries comprise Germany, Japan, Korea, Australia, Canada, France, Italy, the United Kingdom, the United States and Spain. The emerging-market G-20 countries comprise China, Indonesia, Russia, Brazil, India, Mexico, South Africa and Turkey. The euro area refers to the aggregate excluding Cyprus and Malta. Inflation refers to headline CPI and the harmonised measure is used for euro-area countries. GDP growth and inflation are defined in per cent, the unemployment rate is defined in per cent of the labour force, and the government debt is defined in per cent of GDP.

Source: OECD.

Contributions to world GDP growth

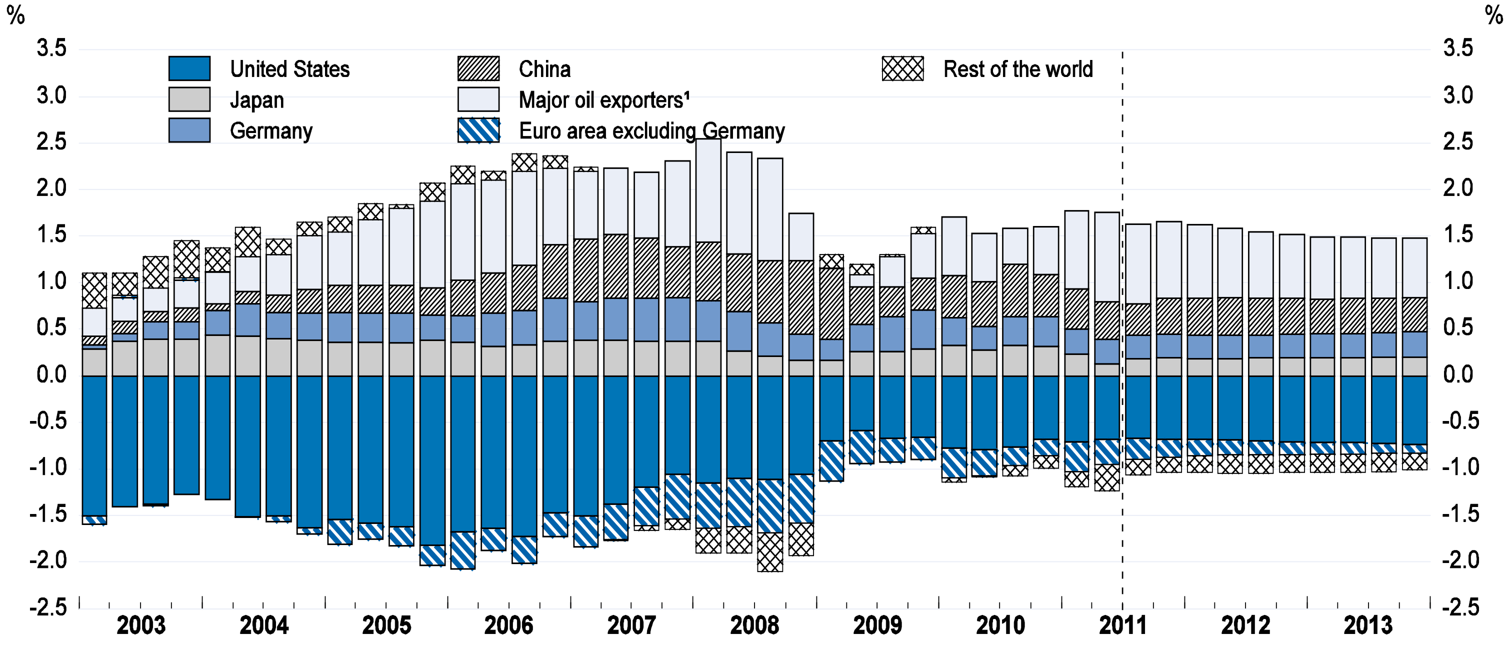
(annualised quarterly, percentage points)



Note: Calculated using moving nominal GDP weights, based on national GDP at purchasing power parities.

Source: OECD.

Current account balances
(in per cent of world GDP)



Note: The vertical dotted line separates actual data from forecasts.

1. Includes Azerbaijan, Kazakhstan, Turkmenistan, Brunei, Timor-Leste, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Russian Federation, Saudi Arabia, United Arab Emirates, Yemen, Ecuador, Trinidad and Tobago, Venezuela, Algeria, Angola, Chad, Republic of Congo, Equatorial Guinea, Gabon, Nigeria and Sudan.

Source: OECD.

1 The outlook for the global economy

Several factors, including heightened perceptions of risk and financial market turbulence, are expected to weigh on the outlook for G20 economies. Business and consumer confidence have weakened, investment decisions are being postponed on the back of greater uncertainty, and household spending has come under pressure from lower equity prices, labour market slack and persistent housing market weakness. Fiscal consolidation may be proceeding more rapidly than previously anticipated. In particular, in an "events-free" scenario and in the absence of comprehensive policy action to resolve current problems, it is expected that:

- **Near-term GDP growth will remain subdued on average in the advanced G20 economies, including the United States, and buoyant but below-trend rates in the emerging-market economies in general**. A marked slowdown with patches of mild negative growth is likely in the euro area. In the absence of decisive policy action to address current problems and steer clear of possible negative events, activity is projected to gather strength only gradually, as risk aversion dissipates and confidence gradually recovers.

- **Inflation will likely peak and then weaken steadily**. Substantial economic slack, together with weaker commodity prices and declining contributions from indirect tax hikes, will bear down on inflation in the advanced economies. However, expectations remain relatively well anchored, and deflation does not appear to pose an immediate risk outside Japan. In the emerging-market economies, headline inflation has risen in the course of the year essentially due to high commodity and food prices, although these effects are expected to dissipate in the near term.

- **Due to slow growth, labour markets will begin to weaken once more, and unemployment will remain high in the advanced economies**. Long-term joblessness has increased in many advanced economies, raising the risk that cyclical unemployment may become entrenched and that those workers with weakest attachment to the labour force fall into inactivity.

- **Global imbalances are poised to remain broadly unchanged over the projection period, following some narrowing since the crisis**. While the Chinese current account surplus is falling in relation to GDP, the combined surplus of the high-saving and oil-exporting countries has risen on the back of still high oil prices. In the absence of structural reform, combined with greater exchange rate flexibility and fiscal consolidation, where necessary, a sustained rebalancing of global demand is unlikely to take place in the near term.

2 Policy requirements for G20 countries

Much of the current weakness is due to a generalised loss of confidence in the ability of policymakers to put in place appropriate responses. It is therefore imperative to act decisively to restore confidence and to implement appropriate policies to restore longer-term fiscal sustainability at a pace that depends on the size of the fiscal challenge as well as the state of the economy and to strengthen long-term growth. The outlook will likely be better than anticipated here if comprehensive action is taken, including the commitments made at the 26 October Euro Summit, to address the euro-area sovereign debt and banking crises.

Resolve the European sovereign debt and banking turmoil

- **The measures identified by the EU Leaders go in the right direction to resolve the euro area sovereign debt and banking crises**. Resolution of the euro area sovereign debt turmoil is recognised to involve a multi-pronged strategy to break the link between sovereign debt and banking distress, to deal with Greece, to ensure that the sovereign debt crisis does not spread to more European countries, and to secure appropriate capitalisation and funding for banks.

- **The elements of the strategy are well thought-out.** However, more detailed information is needed on the specific measures, including the options for EFSF enhancement. A stronger link with structural reform commitments and policy actions to enhance growth and rebalancing in the euro area would be appropriate.

- **Appropriate financial market policies are needed to strengthen confidence in the euro area banking system**. Banks should swiftly implement the requested increase in their capital levels, whilst avoiding a process of generalised bank deleveraging, which could prove extremely disruptive. Governments should be ready to take decisive measures if and where banks are unable to raise equity from markets and should promptly put in place measures to ensure smooth term funding for banks.

- **The costs associated with this ring-fencing strategy are large and, as acknowledged, fiscal governance needs to be strengthened in the euro area**. Thus, resources to prevent contagion could come either directly from the national authorities and/or by increasing or leveraging existing EFSF funds and from greater use of the ECB balance sheet. At the same time, a new fiscal architecture will be put in place for the euro area to counter the moral hazard associated with ring-fencing and to strengthen incentives for fiscal probity in the longer term.

Maintain a supportive monetary stance

- **Monetary policy should remain accommodative in the advanced economies**. Interest rates should be kept on hold, and central banks should provide ample liquidity to calm tensions in financial markets. In some regions where monetary tightening has already begun, interest rates should be lowered, as in the euro area. Policy responses should also involve contingent, including unconventional, measures, if downside risks intensify and the near-term weakness turns out to be more pronounced than envisaged.

- **The emerging-market economies will need to respond to weakening growth in an environment of comparatively high inflation**. Falling commodity prices and slower growth of the global economy will mitigate inflationary pressures, but monetary policy should be eased only moderately and when inflation has come closer to targets. Allowing effective exchange rates to appreciate would help to keep inflation in check in some countries.

Pursue longer-term fiscal consolidation while providing short-term support

- **Countries should put in place strong, credible medium-term frameworks for fiscal consolidation to restore confidence in the longer-term sustainability of the public finances and to build**

budgetary space to deal with short-term economic weakness. Given the downward risks to growth, it is important to anchor expectations about medium- and long-term fiscal discipline in a manner that allows for a temporary easing of the fiscal stance to buffer unexpected weakness.

- **Near-term fiscal policy requirements vary, reflecting the different states of the public finances among different countries**. Those advanced economies with sounder budgetary positions can provide additional counter-cyclical support, whereas others can let the automatic stabilisers work fully or partially around their projected consolidation path in view of a weak near-term outlook. In the United States, the excessive consolidation implied by existing legislation could be smoothed to avoid tipping the economy into recession, whereas planned consolidation should proceed in the euro-area countries under stress. The case for fiscal support is less compelling in the emerging-market economies due to their better growth outlook and ample scope for monetary easing, and despite their generally sounder fiscal positions.

- **Medium-term fiscal consolidation should be complemented with growth-friendly structural reform and measures to contain adverse distributive effects**. In view of weak growth in the near term and impaired fiscal positions in many advanced economies, priority should be given to reforms that offer comparatively strong short-term gains and facilitate fiscal consolidation. At the same time, the mix of revenue and expenditure instruments for delivering consolidation needs to be well targeted to contain adverse distributional effects. This is because unemployment and income inequality have risen and poverty remains a pressing issue in many G20 countries, reflecting the deleterious effects of the crisis on already vulnerable social groups.

Implement growth-friendly structural reform to tackle unemployment and rebalance global demand

- **Cost-effective labour market policies can do much to tackle high unemployment and to prevent currently high unemployment from becoming structural in many advanced economies**. In an environment of constrained budgets, policy responses should focus on strengthening public employment services and training programmes to improve the matching of workers' skills and jobs. Employment protection could also be rebalanced towards less rigid provisions for regular workers and more protection for temporary workers. Where feasible, labour taxation could be reduced on a temporary basis through well-targeted job subsidies for new hires.

- **Pro-competition reform in product markets could serve to improve labour market outcomes relatively quickly**. In particular, regulatory restrictions could be relaxed in sectors where there is strong potential for job creation, such as retail trade and professional services.

- **A durable rebalancing of global demand will require structural reforms in addition to, where necessary, greater exchange rate flexibility and fiscal consolidation.** In particular, in the advanced surplus economies, country-specific measures should be implemented to stimulate investment by reducing regulatory impediments in sheltered sectors. Such initiatives need to be complemented by measures to improve social welfare systems and to liberalise financial markets (while ensuring adequate prudential regulation) in the emerging-market surplus economies.

- **Inside the euro area, structural reforms are essential to reduce internal imbalances**. Product and labour market reforms should be put in place to foster investment in the surplus countries and to boost competitiveness in the peripheral economies. Reforms should be implemented swiftly to lay the groundwork for a resumption of growth and job creation in the weaker economies.

- **In Cannes, G20 leaders will discuss an Action Plan with bold commitments to sound and mutually reinforcing macroeconomic policies and structural reforms**. In times of limited room for macroeconomic policy manoeuvre, structural reforms are important for rebuilding confidence because they can link short and long-term dividends.

- **Decisive action by the G20 can restore confidence and trigger the more optimistic scenario needed for growth and job creation**. In 2008, G20 leaders rose to the challenge with a clear and coherent plan and a second Great Depression was avoided. Today, the adoption and implementation of the Action Plan is just as imperative to restore confidence through decisive actions in specific countries and regions.