



# **What is the economic outlook for OECD countries?**

## **An interim assessment**

**Paris, 9th September 2010  
11h Paris time**

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1. Recent high-frequency indicators point to a slowdown in the pace of recovery of the world economy that is somewhat more pronounced than previously anticipated. Against this background and according to the OECD short-term forecasting models, growth could slow in the G7 economies to an annualised rate of about 1½ per cent in the second half of the year (see table opposite). There is nevertheless great uncertainty in the outlook arising from a combination of weaknesses and strengths. In particular:
  - Private consumption growth may be constrained by additional adjustments by households to the balance-sheet losses suffered during the recession and in response to housing market developments, should house prices weaken further. In addition, uncertainty about unemployment could put a damper on the expansion of private consumption. A weak economy and uncertainty in sovereign debt markets might also affect adversely the financial system and private demand growth through deleterious feedback mechanisms.
  - As for strengths, the components of demand that drive the economy during cyclical downturns and upturns, such as private investment, are already at very low levels in relation to GDP. This, coupled with robust corporate profits, would indicate that investment is unlikely to weaken further in the coming months. In addition, inventories are at close to their desired levels, suggesting that a renewed rundown of stocks would be unlikely in the near term. Moreover, although different financial markets have moved in different directions, overall financial conditions in OECD countries have stabilised, although some indicators warrant caution, including the cost of insurance against default, which remains high for banks. Growth remains robust in the large emerging-market economies.
2. As regards inflation, headline measures have picked up somewhat in most major OECD economies due to rising commodity prices and, in some countries, price-level adjustments following indirect tax increases. Nevertheless, underlying inflation rates have continued to moderate, albeit relatively slowly, given the large excess capacity that remains in labour and product markets. Near-term expectations indicate a continued moderation of underlying inflation in most of the major OECD economies. Inflationary pressures have surfaced in some of the large emerging-market economies, prompting a tightening of monetary policy.
3. It is not yet clear whether the loss of momentum in the recovery is temporary – as implied by the balance of strengths and fragilities discussed above – or whether it signals greater underlying weaknesses in private spending at a time when policy support is being removed.
  - If the ongoing slowdown is temporary, the appropriate policy response would be to postpone the withdrawal of monetary support for a few months, while maintaining planned budget consolidation to address unsustainable fiscal positions. Market conditions allowing, the automatic stabilisers should be allowed to work unimpeded around the planned consolidation path.
  - On the other hand, if the slowdown reflects longer-lasting forces bearing down on activity, additional monetary stimulus might be warranted in the form of quantitative easing and commitment to close-to-zero policy interest rates for a long period. Where public finances permit, planned fiscal consolidation could be delayed.

## GDP growth in the G7 economies

In per cent

Annualised quarter-on-quarter growth <sup>1</sup>						
	09Q3	09Q4	10Q1	10Q2	10Q3	10Q4
United States	1.6	5.0	3.7	1.6	2.0 (+/-1.7)	1.2 (+/-1.5)
Japan	-1.0	4.1	4.4	0.4	0.6 (+/-2.5)	0.7 (+/-2.7)
Euro 3 <sup>2</sup>	2.1	1.1	1.5	5.1	0.4 (+/-1.5)	0.6 (+/-1.6)
Germany	3.0	1.2	1.9	9.0	0.7 (+/-1.9)	1.1 (+/-1.8)
France	1.1	2.3	0.7	2.5	0.7 (+/-1.0)	0.3 (+/-1.2)
Italy	1.7	-0.4	1.6	1.5	-0.3 (+/-1.5)	0.1 (+/-1.6)
UK	-1.0	1.7	1.3	4.9	2.7 (+/-1.2)	1.5 (+/-1.3)
Canada	0.9	4.9	5.8	2.0	2.2 (+/-2.2)	2.3 (+/-2.3)
G7	1.1	3.6	3.2	2.5	1.4 (+/-1.7)	1.0 (+/-1.8)

1. GDP releases and high-frequency indicators published by 8 September 2010. Seasonally and in some cases also working-day adjusted. Annualised real GDP growth rates; associated standards error ranges are in parentheses.

2. Weighted average of the three largest countries in the euro area (Germany, France and Italy).

### Underpinnings and status of the interim forecast

Since March 2003, the OECD has presented a brief overview of the near-term prospects in the major OECD economies between each issue of the *Economic Outlook*. This interim assessment should not be seen as a full update of the biannual *Economic Outlook* projections, since it rests on a more limited information set, has a shorter horizon and covers a much smaller number of economic variables and countries. However, it helps evaluate the extent to which the latest *Economic Outlook* projections are still on track for the larger economies.

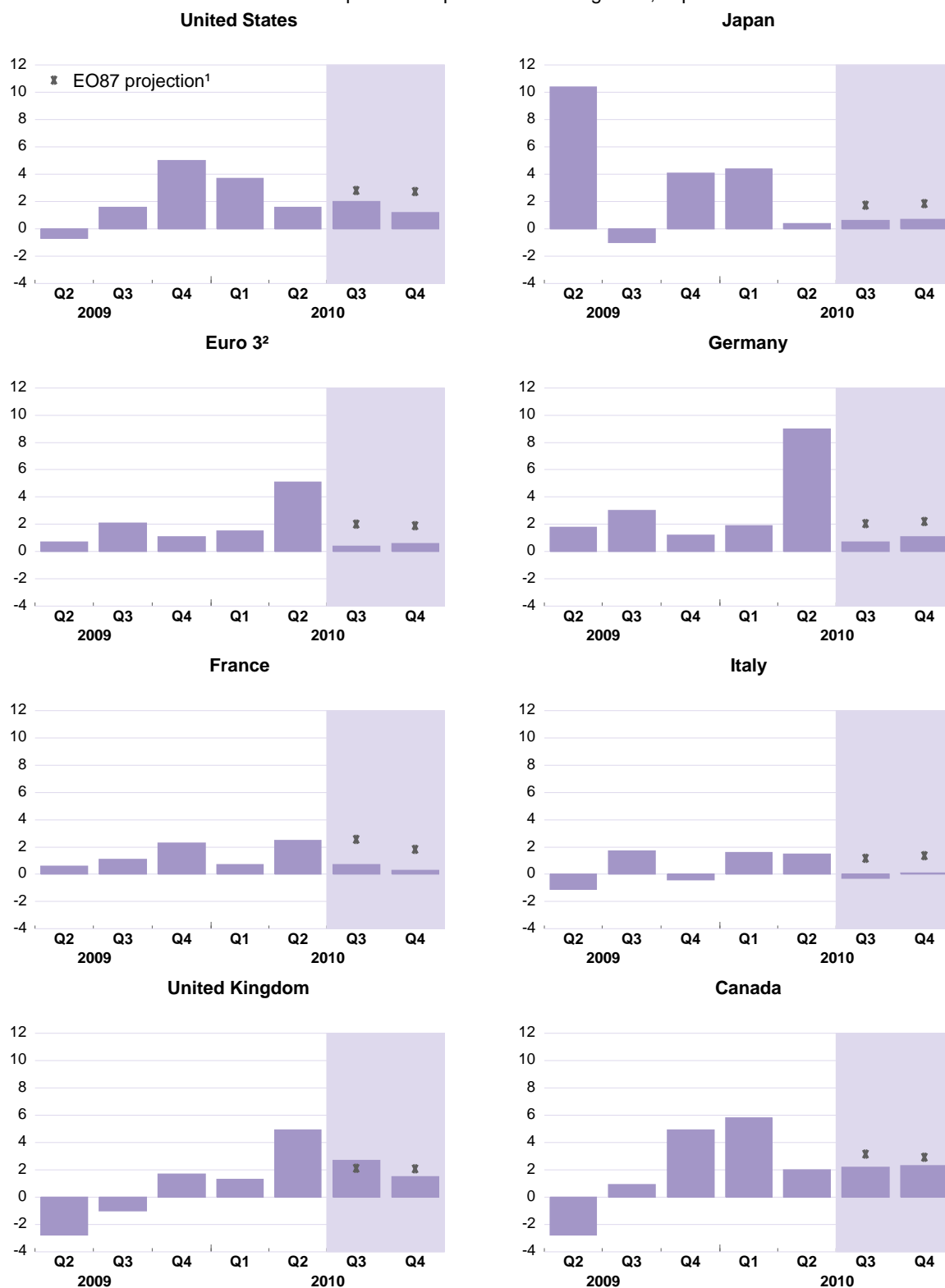
In this context, the main tool is a suite of indicator-based models that serve to forecast real GDP for each of the G7 economies.\* These models cover the two quarters following the last one for which official data have been published. They use a small, country-specific selection of monthly indicators, hard (*e.g.* industrial production, retail sales) and/or soft (*e.g.* business confidence). These models have been shown to outperform a range of other models relying solely on published quarterly data, as regards both forecast-error size and directional accuracy. The weight of the different models varies across countries and over time, according to observed forecasting performance. The models used for the US and the UK economies have been modified to better capture the influence of developments in the housing sector, with the inclusion of various forward-looking housing indicators.

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\* See Pain, N. and F. Sédillot, "Indicator models of real GDP growth in the major OECD economies", *OECD Economic Studies*, No. 40, 2005 and Mourougane, A., "Forecasting monthly GDP for Canada", *OECD Economics Department Working Paper*, No. 515, 2006.

## The pace of recovery could be slower than anticipated

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



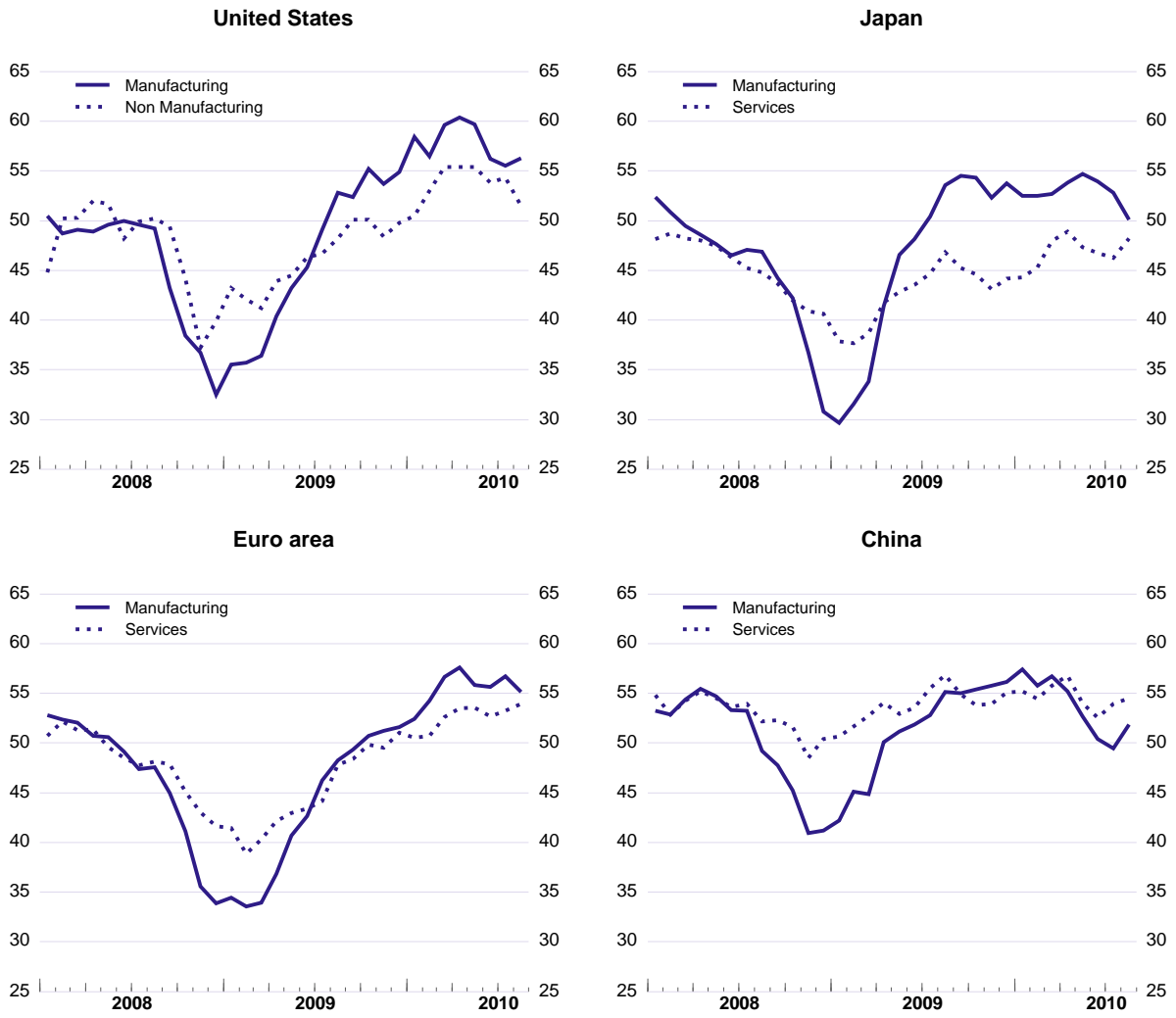
[Click here for underlying data](#)

1. Refers to OECD *Economic Outlook* No. 87 projections (published in May).
2. Weighted average of the three largest countries in the euro area (Germany, France and Italy).

Source: OECD, Quarterly National Accounts database; Datastream; Markit Economics Limited; OECD Economic Outlook 87 database; and OECD Indicator Model forecasts.

# Business confidence has weakened

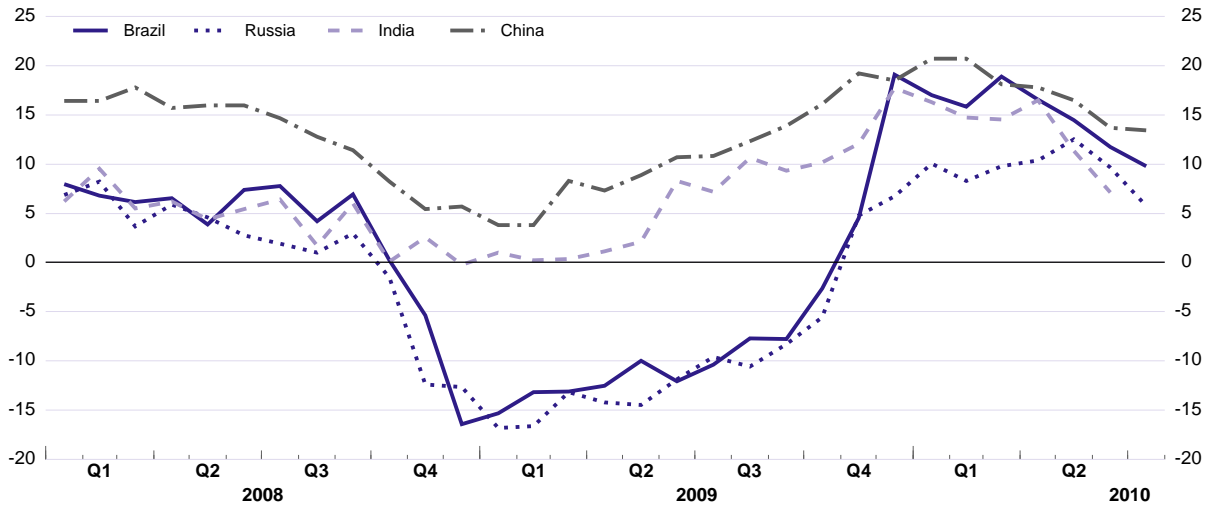
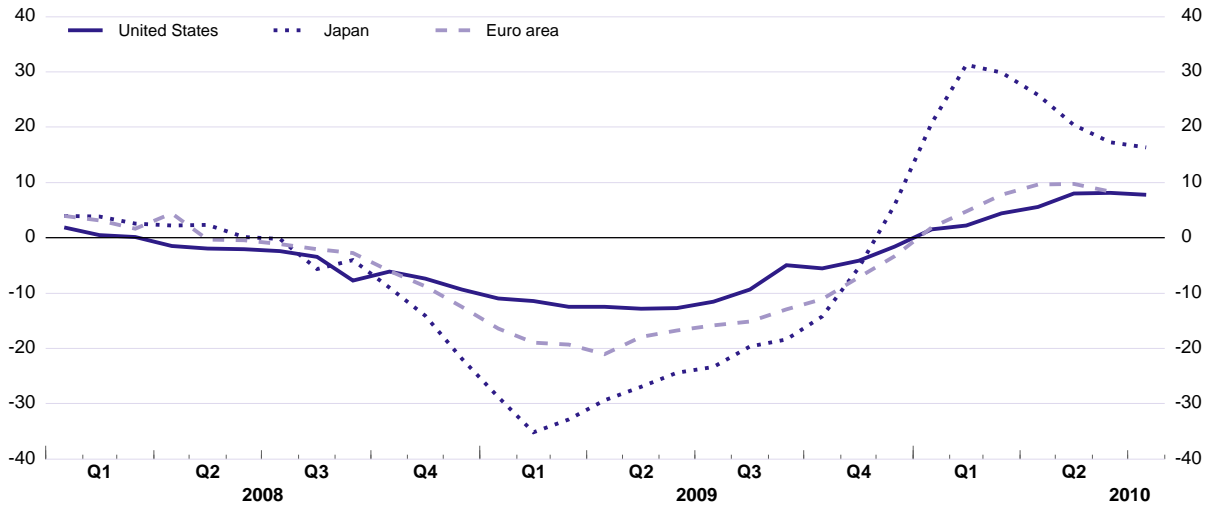
Purchasing Managers' Indices for manufacturing and services



Source: Markit Economics Limited.

# The bounce-back in industrial production is moderating

Year-on-year percentage changes



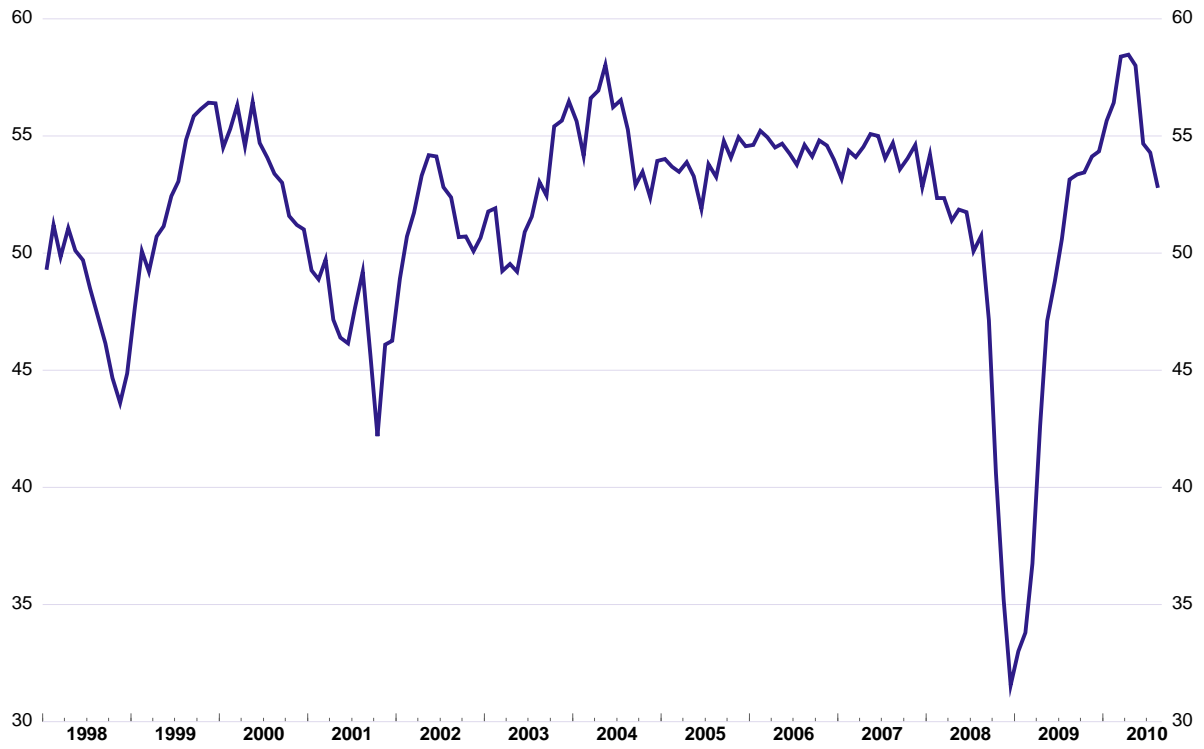
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Note: Data for China are OECD estimates.

Source: Datastream.

## The recovery in world trade is losing momentum

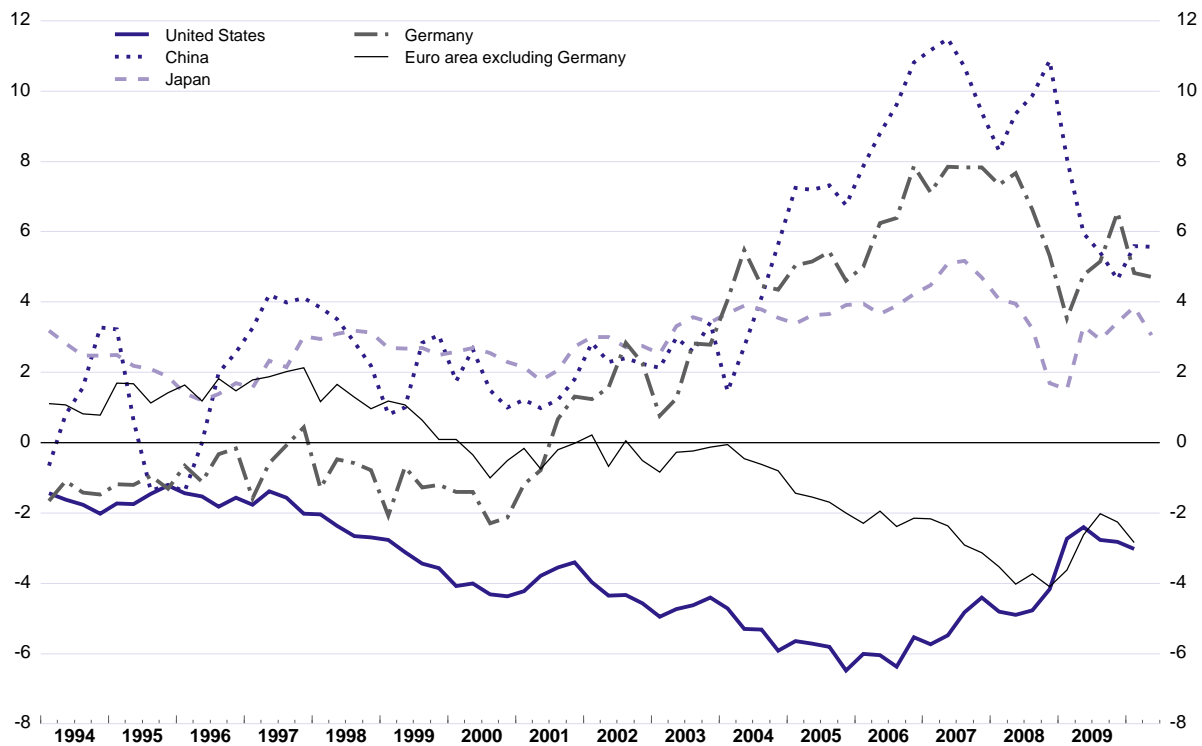
Manufacturing New Export Orders Index



Source: Markit Economics Limited.

## Global imbalances are widening but remain well below pre-crisis levels

Current account balance, in per cent of GDP



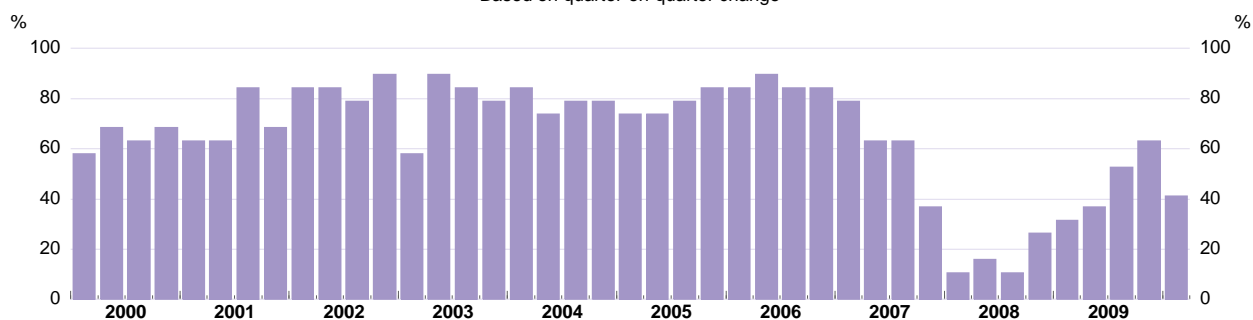
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Source: OECD, Quarterly National Accounts database; and OECD, Main Economic Indicators database.

## The housing market has lost momentum

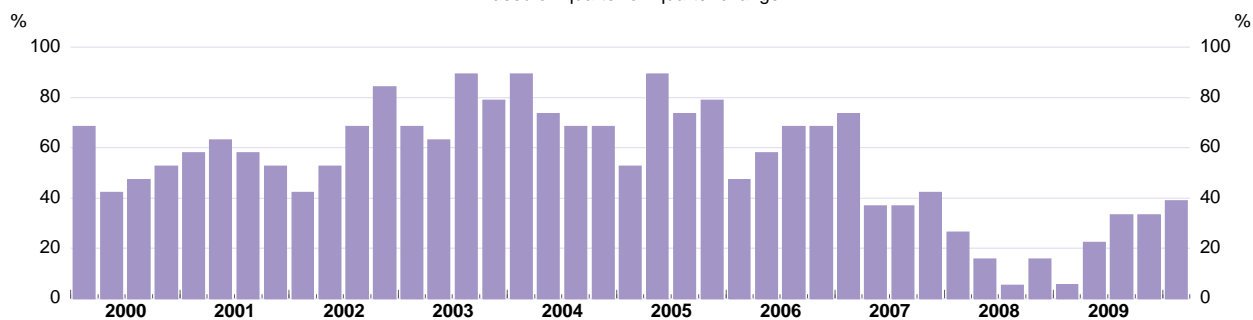
### Proportion of OECD countries with rising real house prices<sup>1</sup>

Based on quarter-on-quarter change



### Proportion of OECD countries with rising real housing investment

Based on quarter-on-quarter change



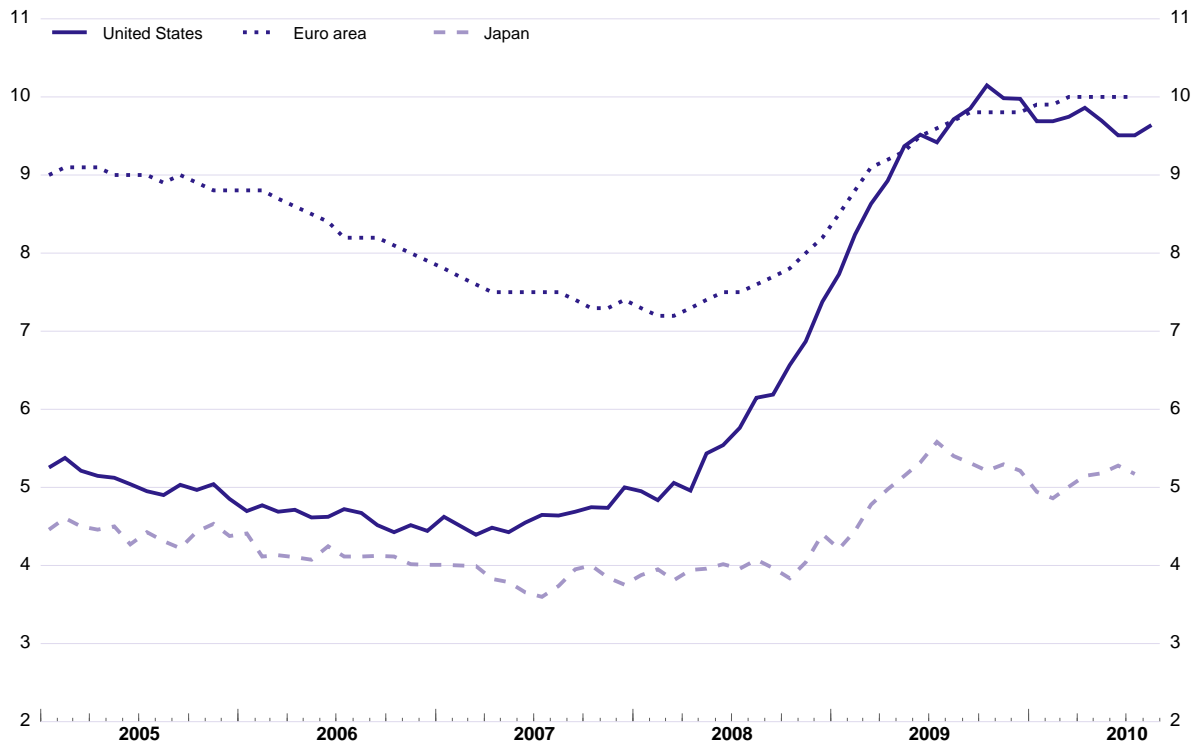
[Click here for underlying data](#)

1. House prices are deflated by the private consumption deflator. Calculation based on 19 countries (17 available in 2010 Q1).

Source: OECD Economic Outlook 87 database; and various national sources, see Table A.1 in Girouard, N., M. Kennedy, P. van den Noord and C. André (2006), "Recent house price developments: the role of fundamentals", *OECD Economics Department Working Papers*, No.475.

## Unemployment rates appear to have peaked, albeit at high levels

In per cent of the labour force

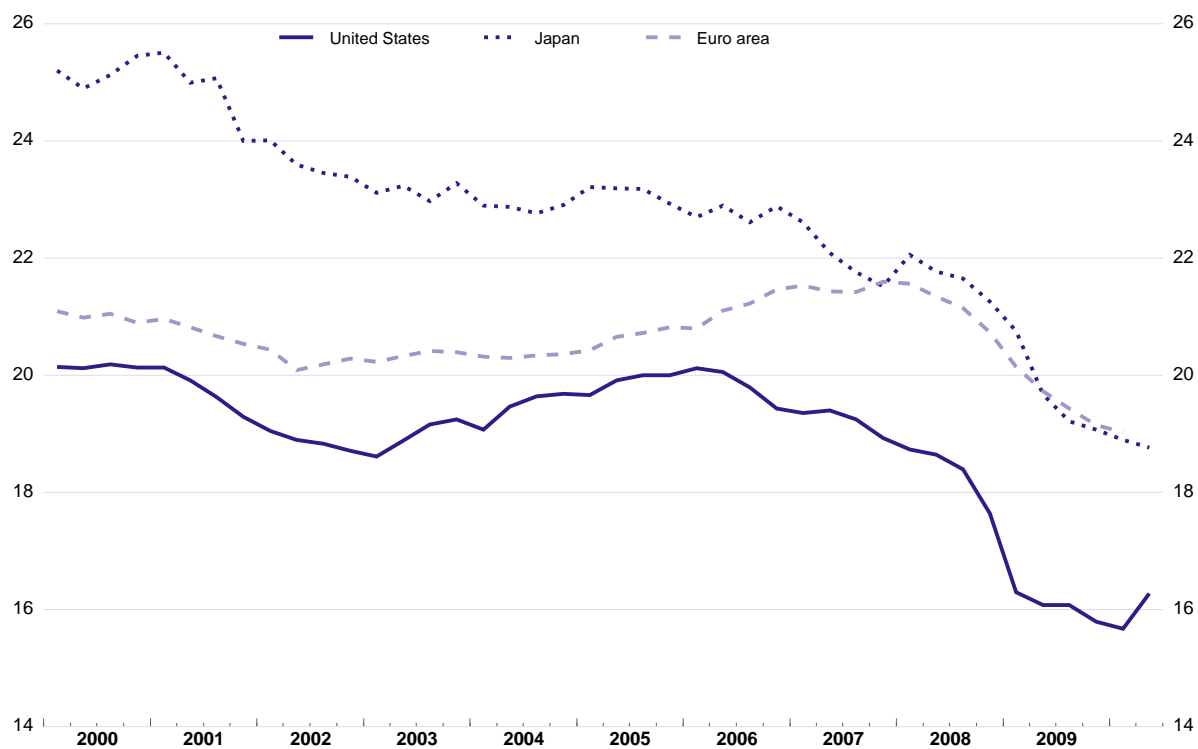


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Source: OECD, Main Economic Indicators database.

## Investment is particularly low

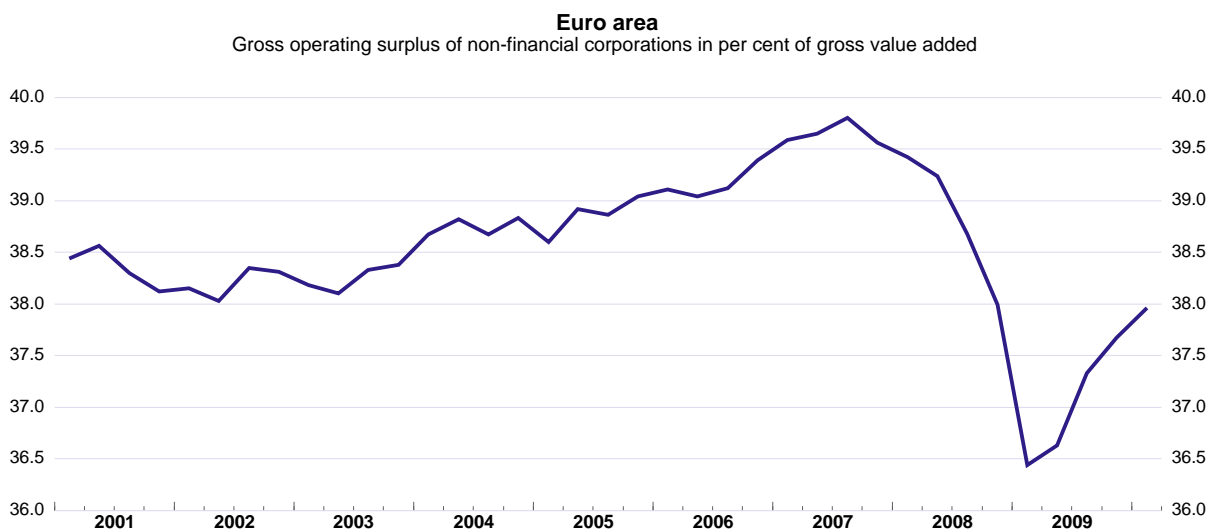
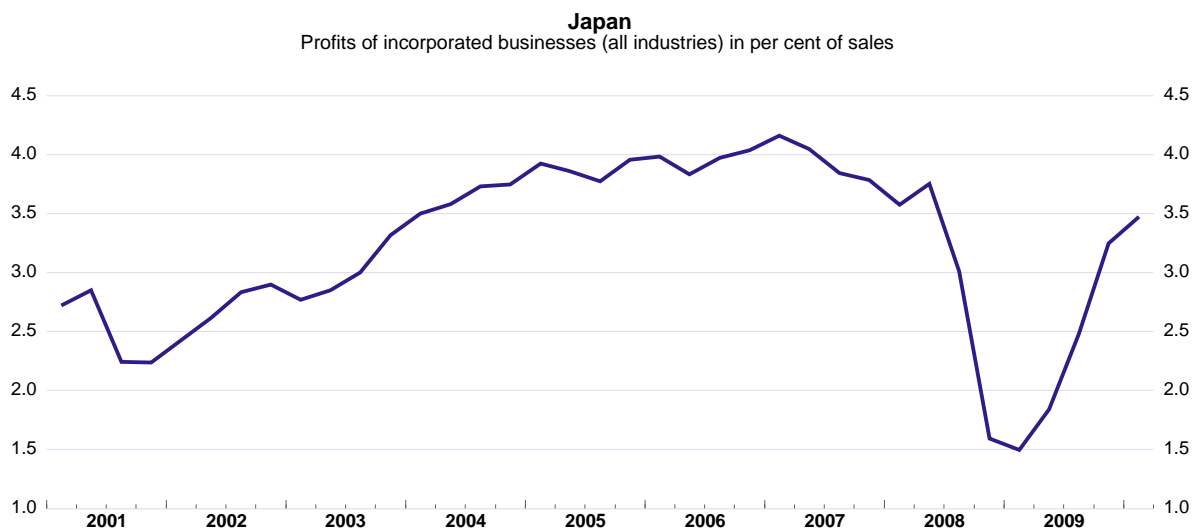
Gross fixed capital formation, in per cent of GDP



[Click here for underlying data](#)

Source: OECD, Quarterly National Accounts database.

## Corporate profits have risen strongly

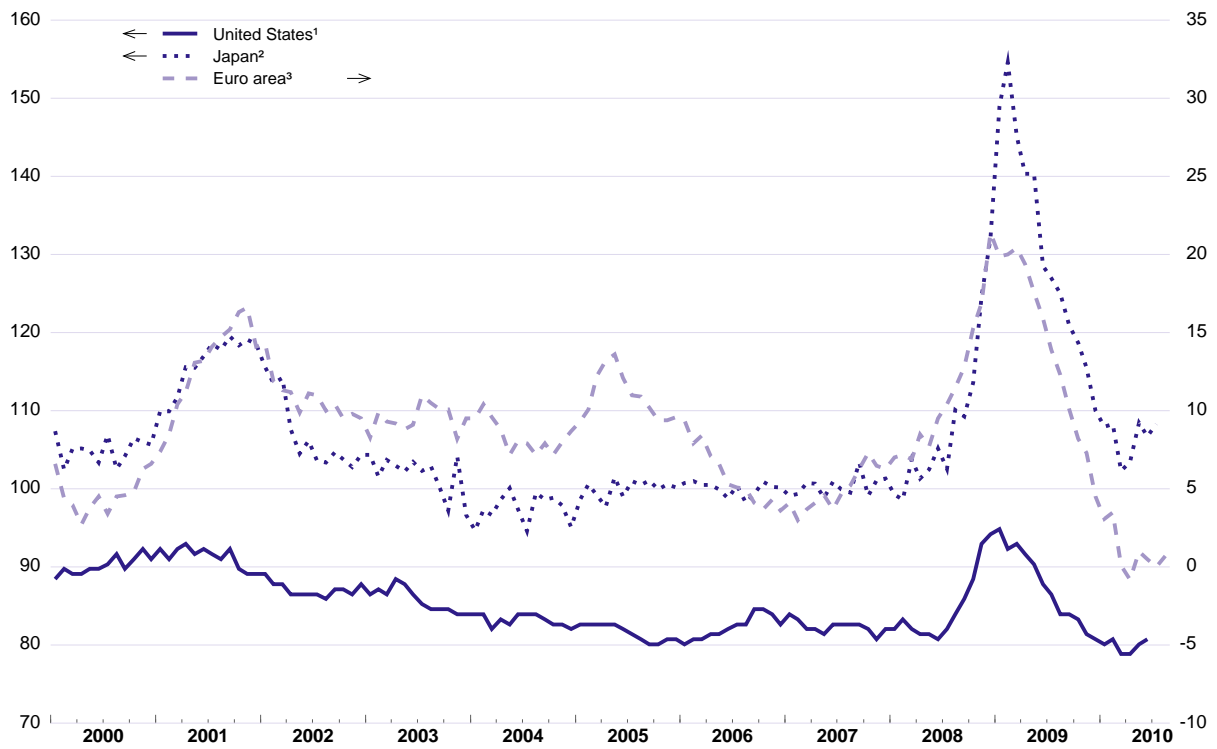


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Note: Seasonally adjusted series.

Source: Bureau of Economic Analysis; Eurostat; and Datastream.

## The build-up in inventories has dissipated



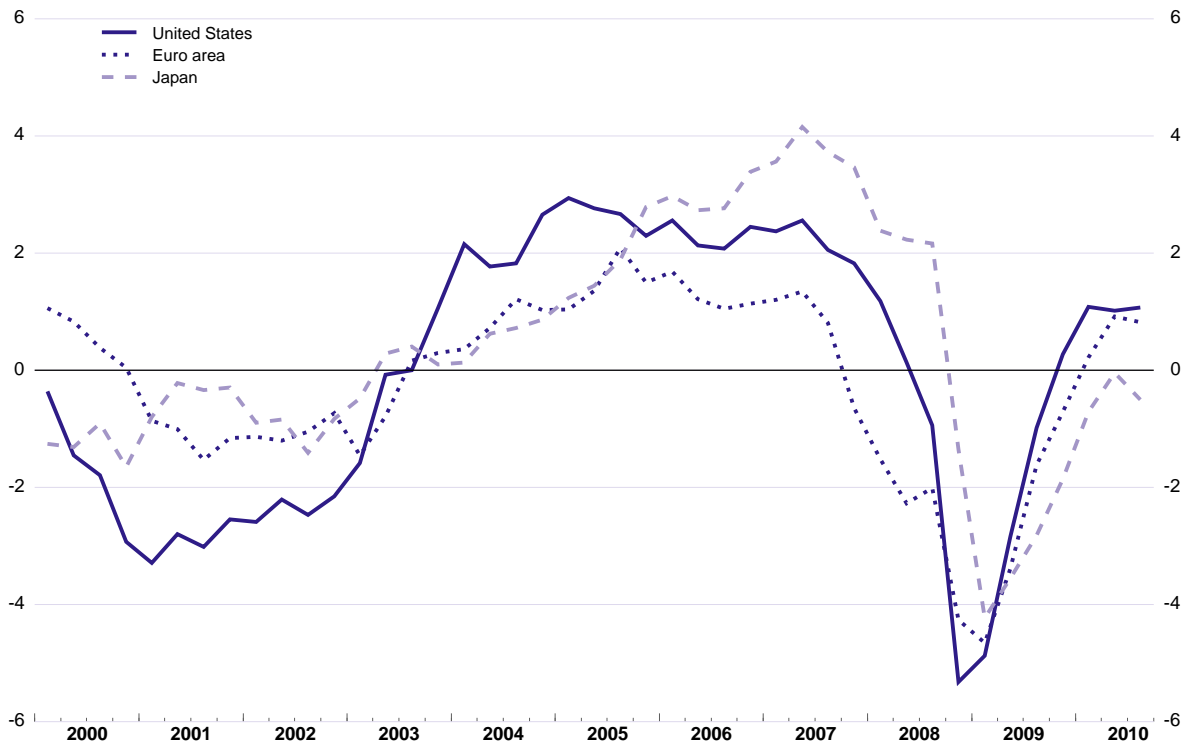
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1. Business inventories/sales ratio, index (Jan. 1992=100).
2. Inventories/shipments ratio, mining and manufacturing, index (2005=100).
3. Stock of finished goods, net balance, relative to normal.

Source: Datastream; and OECD calculations.

## Financial conditions have stabilised

OECD Financial Conditions Index<sup>1</sup>



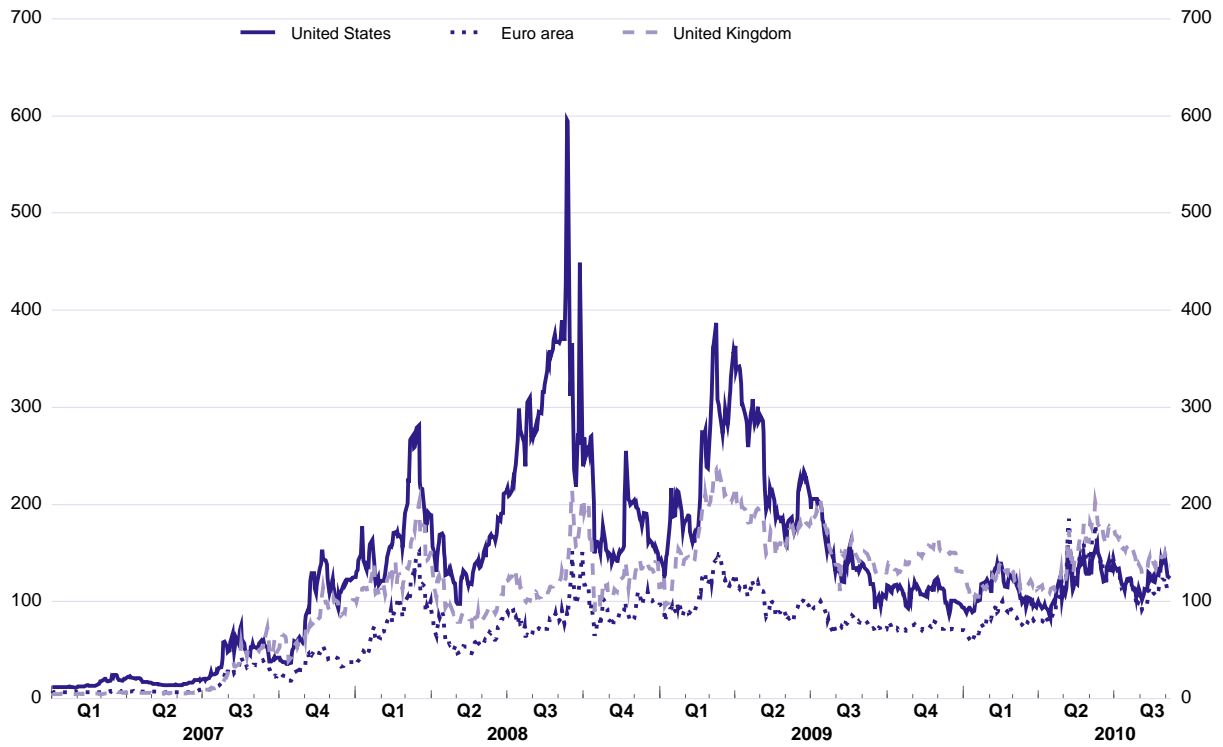
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1. A unit decline in the index implies a tightening in financial conditions sufficient to produce an average reduction in the level of GDP by 1/2 to 1% after four to six quarters. See details in Guichard, S., D. Haugh and D. Turner (2009), "Quantifying the effect of financial conditions in the Euro Area, Japan, United Kingdom and United States", *OECD Economics Department Working Papers*, No.677. Some components of the index are estimates for 2010 Q3.

Source: Datastream; and OECD calculations.

## Bank credit default swap rates are volatile

Basis points



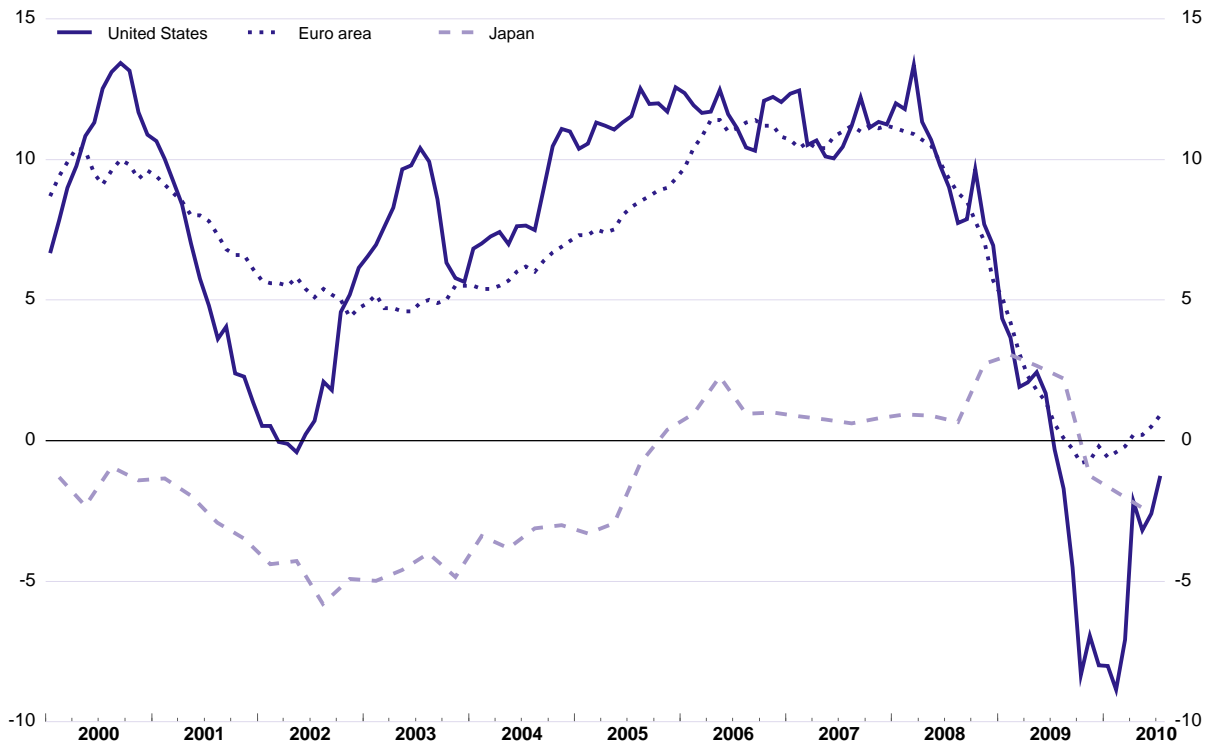
[Click here for underlying data](#)

*Note:* Banking sector five-year credit default swap rates for major banks. Last observation is 6 September 2010.

*Source:* Datastream; and OECD calculations.

## Bank lending continues to be weak

Bank loans to the non-financial private sector, year-on-year percentage changes



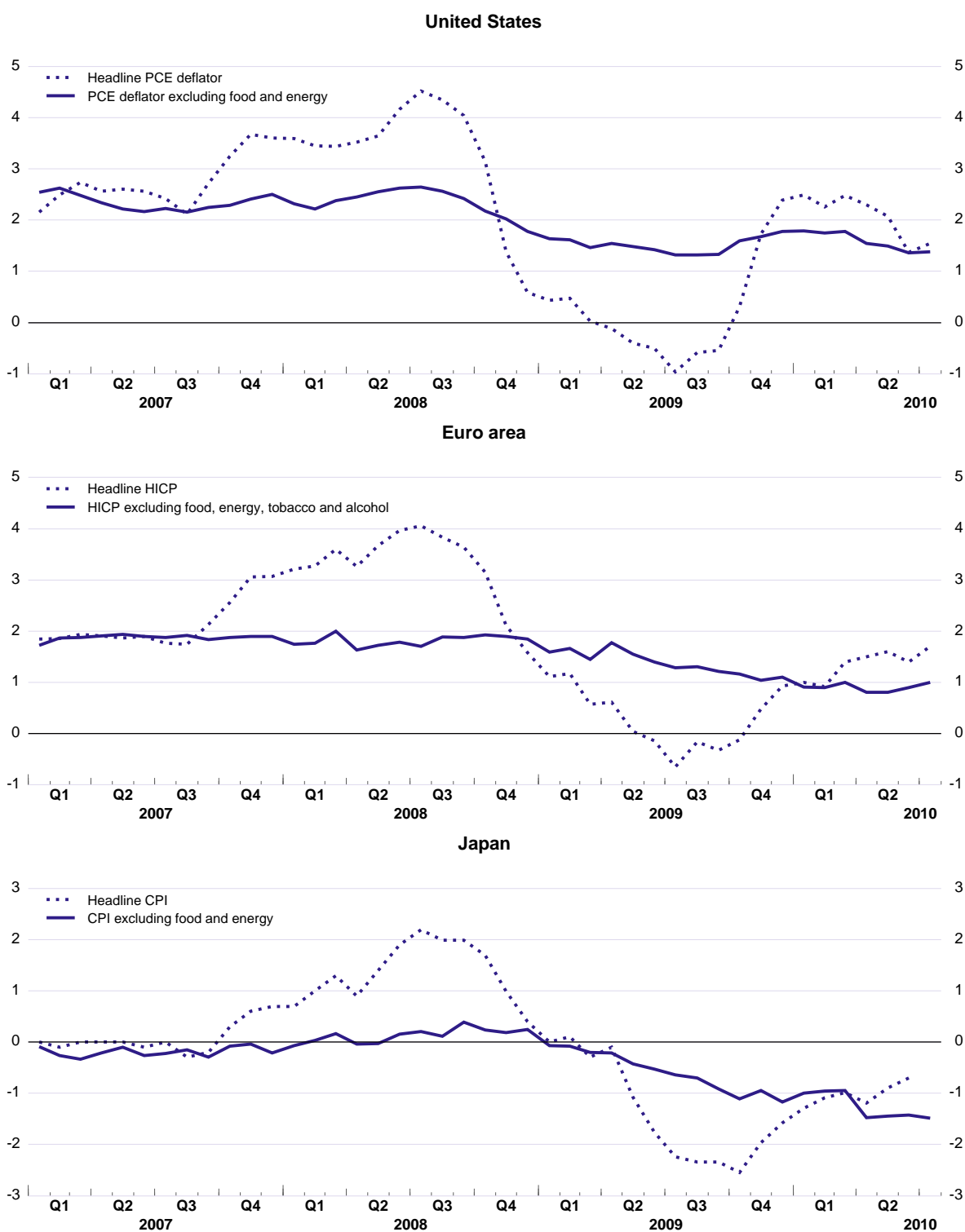
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*Note:* Data refer to all commercial banks for the United States, to monetary financial institutions (MFIs) for the euro area and to all banks for Japan. Year-on-year growth rates are calculated from end-of-period stocks. For the euro area, these are adjusted for reclassifications, exchange-rate variations and any other changes which do not arise from transactions.

*Source:* Datastream.

## Underlying inflation remains low

12-month percentage change



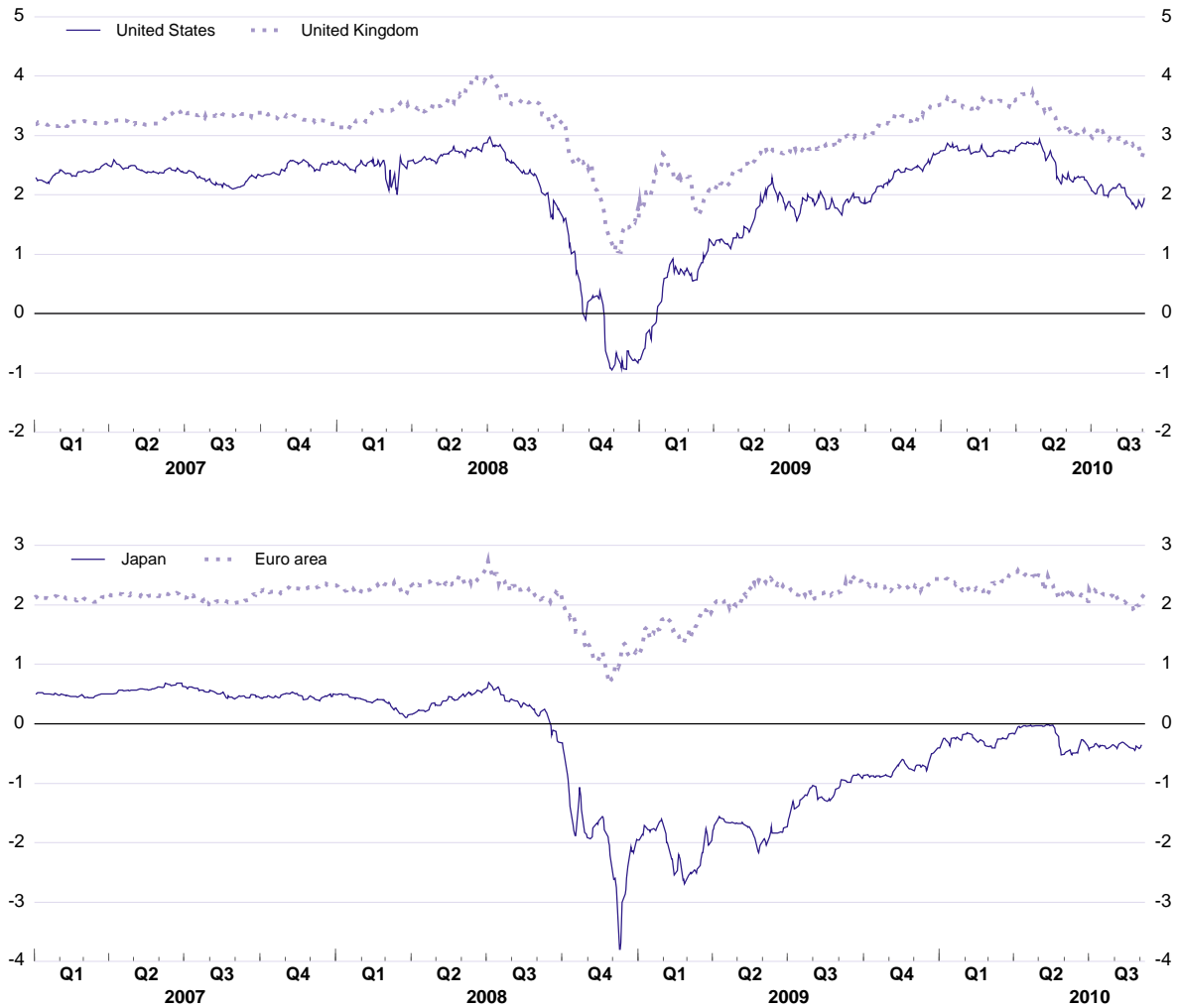
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Note: PCE deflator refers to the deflator of personal consumption expenditures, HICP to the harmonised index of consumer prices and CPI to the consumer price index.

Source: OECD, Main Economic Indicators database; and Eurostat.

## Inflation expectations are trending downwards in some countries

Based on bond yield differentials (Merrill Lynch), in per cent



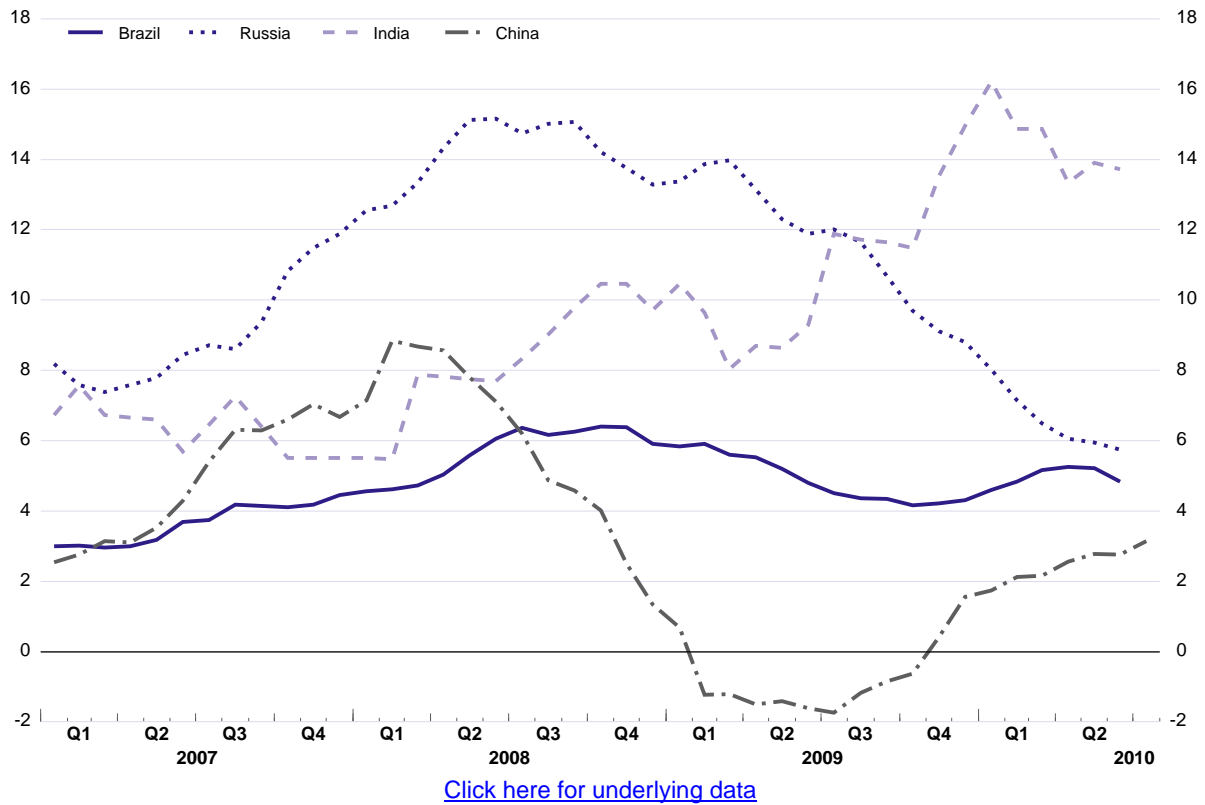
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*Note:* Expected inflation implied by the yield differential between the ten-year government benchmark and inflation-indexed bonds. Last observation is 6 September 2010.

*Source:* Datastream.

## Some emerging-market economies are facing inflationary pressures

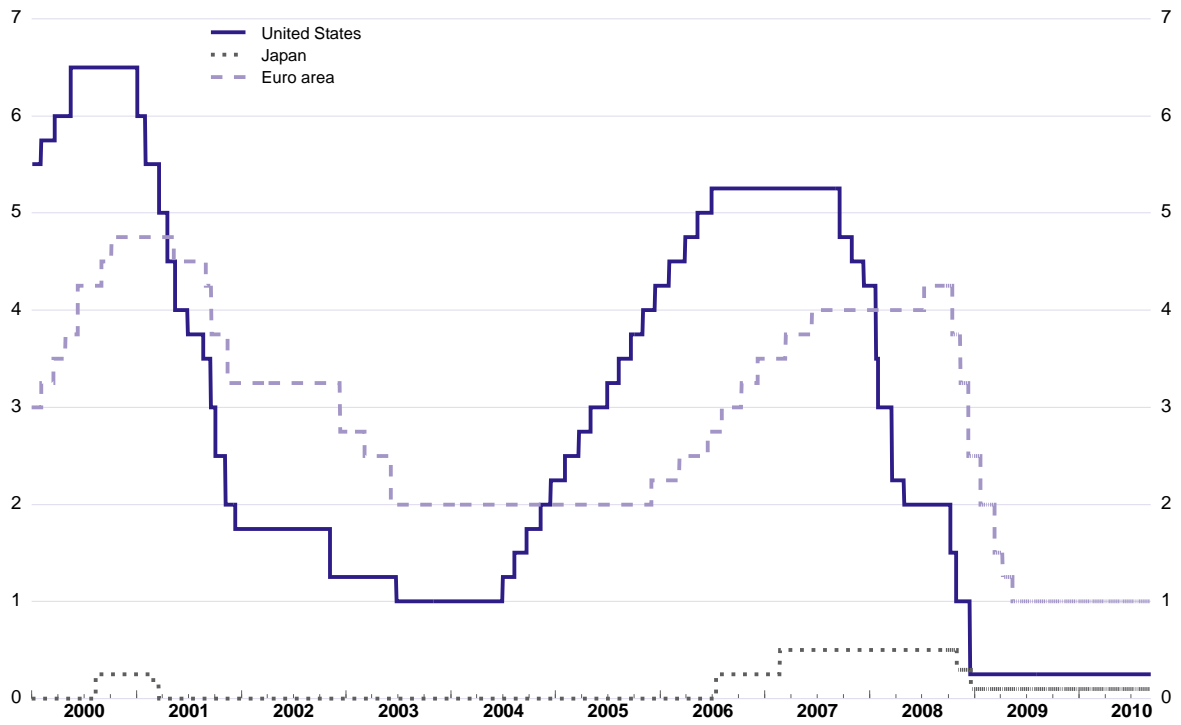
Consumer price index, 12-month percentage change



Source: OECD, Main Economic Indicators database.

## Monetary policy continues to be accommodating in major economies

Policy interest rates, in per cent



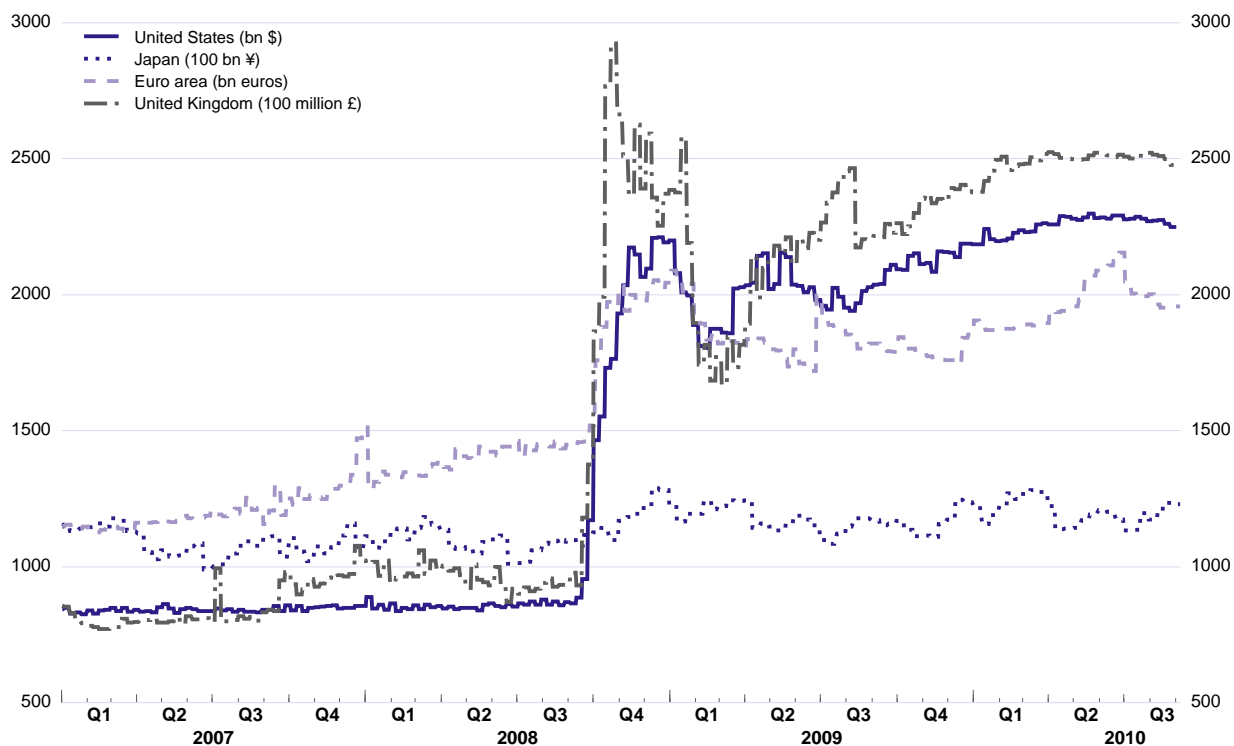
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*Note:* Last observation is 6 September 2010.

*Source:* Federal Reserve; Bank of Japan; and European Central Bank.

## Central bank balance sheets remain enlarged

Central bank liabilities

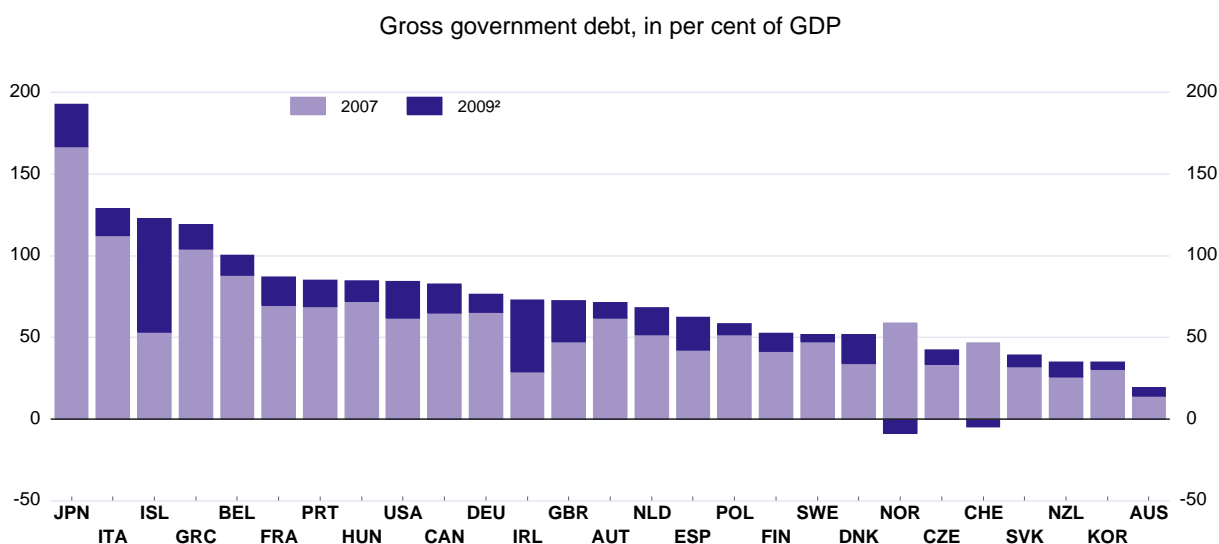
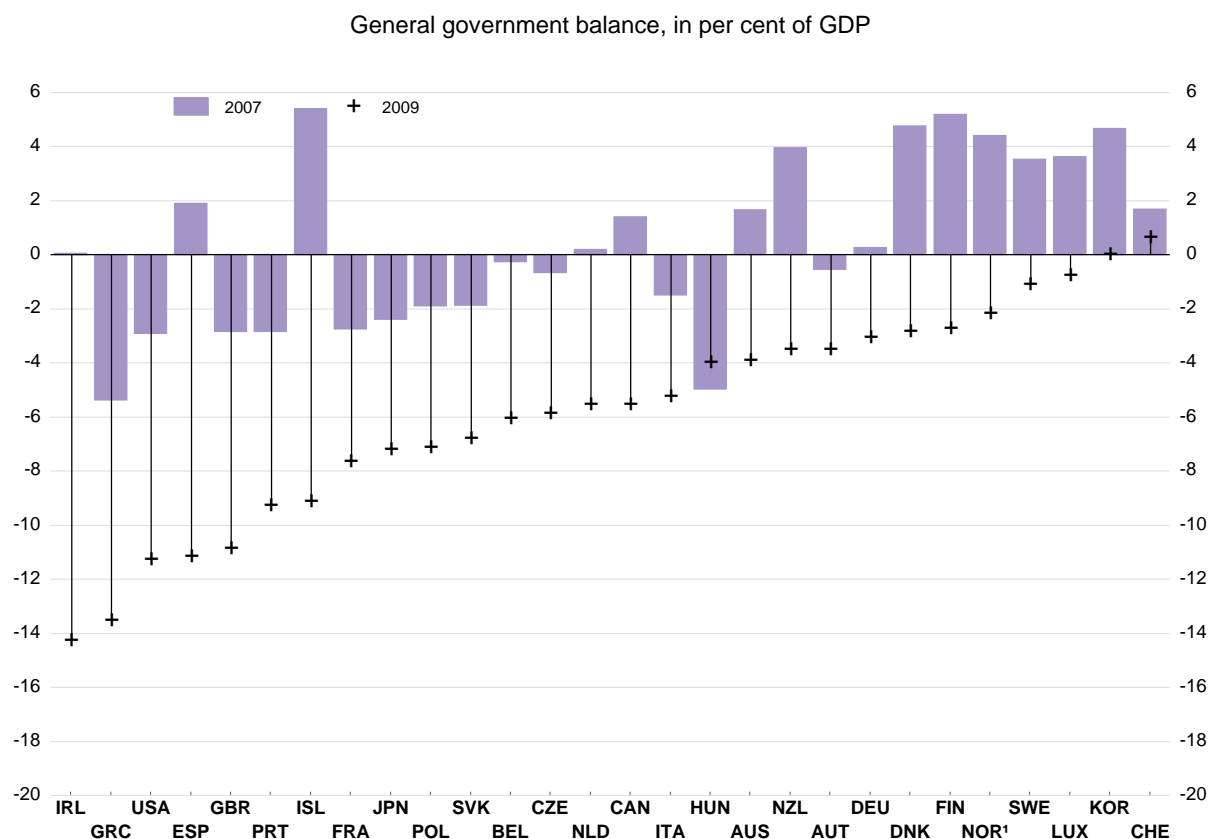


[Click here for underlying data](#)

Note: Last observation is 6 September 2010.

Source: Federal Reserve; Bank of Japan; European Central Bank; and Bank of England.

## Public finances weakened significantly during the recession



[Click here for underlying data](#)

Note: Data for 2009 are estimates for some countries.

1. Mainland Norway only.
2. Change between 2007 and 2009.

Source: OECD, System of National Accounts database; and OECD Economic Outlook 87 database.