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IMFC Statement by Angel Gurría
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OECD

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Written Statement to the IMFC

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Global Economic Outlook

1. **The global economy is now growing at its fastest pace since 2010, with the upturn becoming increasingly synchronised across countries.** This long-awaited lift to global growth, facilitated by policy support, is being accompanied with solid employment gains and a recovery in trade growth following slumps in late 2015 and early 2016. Industrial production has rebounded and confidence measures remain elevated, pointing to improved short-term growth prospects. In the September *OECD Interim Economic Outlook*, global GDP growth is projected at 3½ per cent in 2017 and 3.7% in 2018.

2. **While the improvement in growth is welcome, policymakers must not be complacent.** The effects of prolonged sub-par growth after the financial crisis are still present in investment, trade and wage developments. Improved short-term momentum in the global economy, along with fiscal room created by the current accommodative monetary environment, provides an opportune moment for rebalancing policy to address the structural impediments that must be overcome if strong, sustained and inclusive medium-term global growth is to be secured.

3. **Supportive macroeconomic policies, steady labour market improvements and favourable financial conditions are helping growth to strengthen in the advanced economies.**

- <u>In the United States, GDP growth has picked up to a little over 2% this year, supported by stronger domestic demand and very accommodative monetary policy.</u> Job creation remains strong, but has yet to trigger upward pressure on wage growth, in part due to the scope to bring people back into the labour force and reduce involuntary part-time working. Recent hurricanes have temporarily dampened activity, but reconstruction efforts should provide a mild boost to growth in the next few months. A modest package of corporate and personal tax reductions could help GDP growth to strengthen further in 2018 —to 2.4% —but this remains very uncertain.

- <u>In the euro area, accommodative monetary policy, a mild fiscal easing, rising employment rates and reduced political uncertainty are collectively helping GDP growth to outpace expectations</u> and become more broad-based across countries. Growth is likely to average close to 2% per annum in 2017-18, well above estimated underlying potential rates. Problems from weak credit growth and sizeable non-performing loans (NPLs) have eased, but continue to be constraints in some countries.

- <u>GDP growth in Japan has picked up to around 1½ per cent this year, supported by an upturn in public investment and stronger export growth to Asian markets.</u> Rising corporate profits and continued accommodative monetary policy should continue to support investment, but wage growth remains very weak despite the tightening labour market, and fiscal consolidation may weigh on activity once more in 2018.

- In the United Kingdom, GDP growth has eased to around 1½ per cent in 2017, despite favourable monetary conditions and a postponement of fiscal tightening. Consumption and investment growth have eased, with higher inflation dampening income growth and uncertainty persisting about the outcome of Brexit negotiations. A further slowdown in growth could occur in 2018 if it appears likely that the United Kingdom would exit the European Union in 2019 without an agreed transition period.

4. **Growth in the major emerging market economies is now improving, supporting the global upturn.** Strong infrastructure investment in China in 2016 and the first half of 2017 has been a key driver of this improvement, boosting external demand in other countries, especially in Asia, and contributing to the recovery underway in many commodity-exporting economies.

- Growth in China has surprised on the upside in 2017, at around 6.8%, but is likely to slow gradually over the next year, as stimulus measures ease and efforts continue to stabilise corporate debt and rebalance the economy.

- In India, the transitory effects of demonetisation and of the implementation of the Goods and Services Tax (GST) have led to a downward revision in short-term growth, to 6.7% in the current fiscal year, and business investment remains weak. In the medium-term, the GST reform along with measures to improve the ease of doing business should boost private investment and productivity growth.

- Output has begun to rise in both Brazil and Russia after protracted recessions, supported by monetary policy easing, improved sentiment and some firming in commodity prices. Medium-term growth prospects for Brazil hinge on delivering reforms, including on pensions, to ensure fiscal sustainability and enhance productivity growth.

Strong and sustained medium-term growth is not yet secured

5. **Labour market performance continues to improve but remains very uneven across OECD economies.** While employment rates for prime-age workers have recovered to their pre-crisis levels in the OECD area, the employment rates of male workers and youth have yet to do so. Headline measures of unemployment also understate the extent of remaining slack in labour markets. In the OECD as a whole, the involuntary part-time working rate in 2016 was over 1 percentage point higher than in the pre-crisis decade, with significantly larger gaps in some European countries. Furthermore, wages have largely failed to pick up despite rising employment: real wages have only grown by 0.2% per year since 2008 on average in the OECD countries, limiting gains in household disposable incomes. Real income growth has been particularly weak at the bottom of the distribution, where the ground lost since the crisis by the bottom 10% has yet to be fully recovered.

6. **Business investment is now rising in most OECD economies, but the upturn still remains weaker than the average of past recoveries, implying slow growth of productive capital.** In turn, this contributes to still-weak productivity growth. On the upside, the synchronised upturn in short-term growth could help to stimulate capital spending in advanced economies, given indications that global demand, as well as domestic demand, is an important ingredient for many investment decisions. However, diminished long-term growth expectations, the decline in business dynamism, and medium-term policy uncertainty all remain barriers to a sustained investment rebound.

7. **Faster trade expansion and the deepening of global value chains would help to boost productivity growth.** Despite recent improvements, trade growth remains well below its long-term pace relative to GDP growth. This reflects a combination of cyclical factors, including weak demand for trade-intensive investment activities, but also structural developments, including an apparent slowing, or reversal, in the growth of global value chains. Restoring trade intensity to its pre-crisis path, including by easing trade restrictions that have built up in major economies since the crisis, would help close the shortfall of productivity growth compared with pre-crisis trends. Efforts also need to be intensified to ensure the benefits of open markets are shared more equally across workers, households and regions.

8. **A durable strengthening of growth in emerging market economies is critical if global growth is to return to higher long-term norms, given their rising share of global output and trade.** However, GDP growth has eased overall in these countries since the 2000s, progress in enacting structural reforms has slowed, and demographic headwinds are now appearing in some countries. Stepping up the pace of structural reforms to boost productivity growth, including through more competition-friendly regulations, lower barriers to foreign trade and investment and efforts to raise labour utilisation rates, is essential if medium-term growth prospects in catching-up economies are to improve. Deeper capital markets would also improve the efficiency of capital allocation and boost job growth.

9. **Financial market vulnerabilities persist in advanced and emerging economies.** In advanced economies, the prolonged period of low interest rates has boosted asset price valuations significantly and created financial distortions that will be challenging to resolve. Equity price-earnings ratios are well above their historical averages in some economies, corporate yield spreads remain compressed and measures of stock market volatility are at historic lows, encouraging riskier asset exposures. Such developments create significant risks of volatility if market sentiment were to reverse suddenly. Emerging market economies face challenges relating to their increased exposure to global financial cycles and policy spillovers from developed economies. Their main vulnerabilities are related to past rapid credit growth, especially in China, foreign currency exposures and non-performing loans. Capital flows may also become more volatile if steps to normalise monetary policy in some advanced economies gather pace.

The policy mix needs to be rebalanced to support inclusive growth and manage risks

10. **The policy mix must be rebalanced further to secure robust and inclusive medium-term growth, and to manage risks.** Monetary policy should remain accommodative in some economies, but with an eye on financial stability, the fiscal easing now underway in many economies should be delivered as planned and structural policy efforts should be focussed on measures that support inclusive and sustainable growth. Active and timely deployment of prudential and supervisory policies in both advanced and emerging economies would also help to address financial vulnerabilities. Collective fiscal and structural efforts would have greater impact than individual actions, and would be aided by clear and longer-term commitments to policies and frameworks, including through international coordination.

11. **In the major advanced economies, significant challenges for monetary and financial stability are posed by the continued use of, and exit from, unconventional monetary policies, judgements about the appropriate sequencing of decisions regarding central bank assets and policy interest rates, and the diverging pace of exit across economies.** To minimise financial market volatility and global spillovers, it is essential that any moves to reduce central bank asset holdings are moderate and well-communicated. Gradual increases in policy rates and initial reductions in the Federal Reserve balance sheet remain appropriate in the United States, provided the labour market continues to tighten and inflation approaches the target. In the euro area, asset purchases should be tapered gradually, as planned, before phasing out the negative interest rate policy. Policy should remain highly accommodative in Japan to help raise inflation. Monetary policy requirements differ across emerging market economies. In some, including Brazil and Russia, further accommodation remains possible given declines in current and expected inflation and the fragile recovery. In others, especially China, policy should reduce the heavy reliance of economic growth on credit.

12. **The fiscal stance in many countries is expected to ease under current plans in 2017-18, in line with OECD recommendations, as authorities take advantage of the increase in fiscal space offered by low interest rates.** A stimulus of at least 0.5 per cent of potential GDP is projected over 2017-18 in nearly half of the OECD countries, as well as some emerging market economies. Governments should ensure that this planned fiscal easing is delivered fully and focussed on equity-friendly measures that enhance sustainable growth. All countries have room to improve the quality of their public finances by restructuring spending and tax policies toward a more growth-friendly and inclusive mix, including through the tax and transfer system, public infrastructure and spending on education and health.

13. **Stronger structural reform ambition should aim to address the missing engines of the current global upturn —private investment, trade, and productivity gains.** Efforts to promote business dynamism and create favourable conditions for business investment should be stepped up. More could be done to ease barriers to product-market entry and competition, both domestically and through a renewed commitment to trade and foreign direct investment openness. More competitive product markets would provide a better environment to revive the stalled diffusion of innovation between frontier firms and the rest of the economy, and

address the growing productivity and wage dispersion within economies. In many countries, reforms to insolvency regimes could reduce barriers to corporate restructuring and the personal cost associated with entrepreneurial failure. Such reforms would yield productivity gains by redirecting resources trapped in “zombie” firms towards productive investment.

14. With a more propitious economic outlook, it is now time to implement reform packages to strengthen long-term inclusive growth. Coherent packages of structural reforms can enhance their overall effectiveness by raising their combined economic impact and ensuring that their benefits are widely spread. In particular, reforms to reduce barriers to product market competition, trade and investment should be accompanied by labour-market measures that help vulnerable workers transition to new jobs and develop new skills. Such carefully crafted integrated policy packages would help reap the benefits from innovation and globalisation while dealing with the job losses that are concentrated in specific industries or geographical locations.

15. Alongside these efforts, it is crucial to progress the implementation of policies that address the root causes of the backlash against globalisation, by: stepping up efforts to meet the ambitious commitments set out in the Paris Agreement on Climate Change and 2030 Agenda for Sustainable Development; strengthening social safety nets and enhancing the efficacy of social protection systems; delivering a global level-playing field through an effective and fair global tax architecture, comprehensive and multilateral anti-corruption tools, instruments to tackle counterfeiting and regulate lobbying, and robust standards in responsible business conduct and good corporate governance; and equipping workers with the skills needed to harness the opportunities of rapid technological change.