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Written Statement for the IMFC

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The Global Economic Outlook

1. **A pick-up in global growth remains elusive.** Disappointing data for the fourth quarter of 2015 has prompted further downward revisions to growth forecasts in most major economies. Global GDP growth is projected to remain at 3% in 2016 – the slowest pace in five years and well below long-run averages – with a slight improvement to 3.3% projected for 2017. The upturn in advanced economies remains insufficient to fuel the global recovery, and the prolonged slowdown in many emerging economies persists.

2. **While global trade flows are showing very marginal signs of recovery following the sharp decline in the first half of 2015, they remain subdued.** Weak trade growth is linked to low investment, commodity price falls and the challenging rebalancing underway in China. The OECD estimates that the contraction of imports by China and other major emerging market economies, and the associated reduction in export demand for advanced economies, affected global GDP growth by around 0.5 percentage points in 2015.

3. **Commodity prices have continued to fall sharply, with oil prices reaching their lowest levels since 2003.** The broad-based price decline across commodities over the past two years suggests that weak demand has driven this result, reinforcing the impact of positive supply shocks, particularly for oil. Low commodity prices should continue to support consumption in commodity-importing economies in 2016, but will restrain investment and intensify financial pressures on commodity-producing firms and commodity-exporting countries.

4. **Supportive macroeconomic policies and lower commodity prices should underpin a modest recovery in advanced economies in the next two years.** This outlook is contingent on further wage increases and strengthened business investment growth, and assumes tensions in financial markets do not re-emerge.

- **In the United States, the domestic private-sector led recovery continues to add momentum, with gains in employment supporting higher household demand.** However, headwinds have intensified, including the drag on exports from the stronger dollar and declining energy sector investment resulting from lower oil prices. Stronger wage growth will be necessary to support domestic demand growth as the labour market approaches full employment.

- **GDP growth should continue to improve in the euro area, although the impetus provided by lower oil prices, very low interest rates and a weaker euro is less than expected.** Investment remains very weak and unemployment is high, particularly in those economies hardest hit by the crisis. Elevated debt burdens and non-performing loans are also hampering the recovery in some countries.

- **In Japan, GDP growth is likely to remain modest, with the tightening labour market yet to bring about substantial nominal wage growth.** Weak growth in key trading partners, especially in Asia, is hampering exports and fiscal headwinds are set to intensify, including in 2017.

5. **Emerging market economies are likely to experience mixed fortunes**. Growth will depend on the space available for policy support, progress in enacting structural reforms and the impact of tighter financial conditions.

- **The OECD's *Going for Growth* report shows that China needs to explore new sources of growth to achieve its goal of doubling GDP per capita between 2010 and 2020.** Complementing the government's commitment to expansionary fiscal policy, the People's Bank of China has eased banks' reserve requirements to improve liquidity following sharp currency outflows in recent months. Recent activity data remain mixed, with stronger fixed asset investment offset by subdued industrial production and sharp declines in trade. In its 13th Five-Year Plan, the government has announced a GDP growth target of 6.5-7% for 2016. The OECD expects GDP growth to moderate gradually over the next two years, as the economy continues to rebalance from manufacturing to services. Managing the rebalancing process together with financial risks will prove challenging, given China's high debt burden and equity and exchange rate volatility.

- **Growth prospects remain relatively robust in India and Indonesia, provided further progress is made in implementing structural reforms and investment strengthens.** In other emerging markets, including Brazil, prospects are weaker. Low commodity prices have catalysed a sharp demand correction, exacerbated by tighter financial conditions and, in some cases, more restrictive monetary and fiscal policies and heightened political uncertainty.

6. **There are several prominent downside risks to the global outlook, stemming from volatile financial markets, escalated geopolitical tensions and the possibility of fragmentation in the European Union.** Financial instability risks are substantial: some emerging market economies have high domestic and foreign currency-denominated debt, and are vulnerable to sharp exchange rate movements and capital outflows, notwithstanding higher reserves and macro-prudential buffers. These risks are compounded in commodity-producing economies and in countries with persistently high external deficits. In Europe, key risks relate to the challenge of coordinating a collective policy response to the refugee crisis, the unpopularity of austerity measures, and centrifugal forces in several countries. The resulting uncertainty could further dampen investment and exacerbate challenging financial conditions, depressing already weak growth in Europe and beyond.

Macroeconomic Policy Requirements for Stronger Growth

7. **A stronger and more comprehensive global policy response —comprising monetary, fiscal and structural actions —is critical to boost the growth outlook and mitigate substantial downside risks.** The sluggish recovery from the global financial crisis confirms that accommodative monetary policy alone is insufficient to catalyse growth and must be complemented by greater use of fiscal and structural levers. Policy strategies that explicitly combine macroeconomic and structural efforts in a common framework are particularly desirable, as they allow full advantage to be taken of their complementarities for demand and resource reallocation. In the context of rising inequality, policy packages should also be designed to integrate the impact of developments on earnings across the income distribution.

8. **Collective fiscal policy actions would help to support demand and provide a more favourable environment for productivity-enhancing structural policies.** China has undertaken substantial additional fiscal stimulus to support growth. In other major economies, fiscal policy is either currently neutral or additional consolidation is being undertaken despite the ability of many governments to borrow for long periods at very low interest rates, effectively increasing fiscal space. Many countries also have room for fiscal expansion to strengthen activity.

9. **Higher collective public investment would boost demand while remaining on a fiscally sustainable path.** Investment spending has a high-multiplier and quality infrastructure projects would

help to support future growth, compensating for the shortfall in public investment seen in many advanced economies in recent years.

10. **In emerging markets, exchange rate adjustments should be encouraged, provided the associated financial risks are carefully managed.** Regulatory and macro-prudential policy measures should be adapted to evolving risks.

11. **Structural reform momentum must be revived, as policies to support demand cannot independently restore sustainable growth.** In recent years, the pace of structural reforms in both advanced and emerging market economies has slowed. Efforts among G20 countries to raise the level of collective ambition on structural reforms have made some progress, but implementation remains lacklustre. Structural reform packages to promote long-term improvements in employment and productivity growth should also focus on possible short-term demand benefits, given the weak global economy.

Understanding the Productivity-Inclusiveness Nexus for Inclusive Growth

12. **Weak global growth is occurring against a backdrop of rising inequalities of incomes, wealth and opportunities.** Rising inequality has been accompanied by a divergence in outcomes for people across a broad range of well-being dimensions, including jobs, health and environment. New challenges have also emerged as a result of the refugee inflow to Europe, the highest since World War II, and the need to integrate refugees into our societies successfully. Additional vulnerabilities have arisen from ongoing geopolitical tensions across the world and the continued menace of terrorism.

13. **In most OECD countries, the gap between rich and poor is at its highest level in 30 years.** In 2012, the average disposable income of the top 10% of earners in the OECD area was about 10 times that of the bottom 10%, up from around 7 times in the mid-1980s. Increasing wage dispersion and poor labour market performance since the global financial crisis are key factors behind these developments. Beyond the impact of the crisis, longer-term structural adjustments engendered by changes in technology and labour market institutions have also contributed to the rise in inequality. In particular, new technologies have placed a premium on high-skilled workers.

14. **At the same time, productivity growth has stalled: average labour productivity growth in OECD countries slowed from an annual rate of 1.8% between 2001 and 2007 to just 0.71% between 2007 and 2013.** The OECD's *Future of Productivity* report attributes this slowing to a breakdown in the innovation diffusion machine. Firms at the global productivity frontier are, on average, more than 10 times more productive than non-frontier firms with respect to labour productivity, and 4 to 5 times more productive in terms of total factor productivity. Investment in knowledge-based capital has also weakened and the pace of business creation has declined. Moreover, poorly-performing firms have remained in the market rather than exiting, trapping scarce resources in unproductive activities.

15. **There is a growing sense of urgency to improve aggregate productivity and ensure a more equitable sharing of the proceeds of growth and improved well-being outcomes.** Addressing both productivity and inequality together is essential to reignite growth. Policy coherence across diverse reform objectives, such as product market competition, labour mobility and financial market robustness, is essential to creating an environment conducive to innovation and resource reallocation. In turn, this would help to reverse the widespread slowdown in productivity and the rise in inequality.

16. **Some reforms, such enhancing competition by easing barriers to entry into product markets, boost both employment and productivity, with gains across the income distribution.** However, additional labour market measures may be needed to support low-skilled and low-income workers, who are the most vulnerable to job losses when competitive pressures intensify. Steps to shift social protection from jobs to individuals are needed in many countries, offering greater scope for the reallocation of jobs and firms that typically underpins dynamic, growing economies whilst ensuring that the dividends of higher growth are shared among the whole population. For emerging economies, stronger social protection is needed to reduce informality and inequality, while fostering domestic consumption.

17. **The efficiency of resource allocation would be further enhanced by measures to reduce barriers to labour mobility, notably those linked to housing markets.** In turn, to ensure that resource reallocation benefits well-being, workers need to be better equipped and offered real opportunities to adapt skills. Adult learning programmes should focus more strongly on skills complementarity with technological progress, reducing skills mismatch and facilitating adaptation to rapid changes in the nature of tasks associated with specific jobs. Improving the matching of skills to jobs would both raise productivity and reduce inequality.

18. **Strengthening employment is also critical to ensure that growth benefits all segments of society, but it is not sufficient.** In several countries, a large and rising share of the growth benefits have accrued to high-income households, while income at the bottom has been stagnant for many years. Reforms to provide better access to high-quality education for students from disadvantaged backgrounds combined with measures to make the tax system more efficient and equitable can also help to make growth more inclusive.

19. **The OECD's 2016 Ministerial Council Meeting, "Enhancing Productivity for Inclusive Growth", will focus on the productivity-inclusiveness nexus.** Discussions will consider policies that respond to productivity growth and inclusion goals in mutually reinforcing ways. Ministers will discuss the ex-ante conditions that drive productivity growth — identifying ways to enhance individual, firm and government contributions to the productive networks of our economies — review outcomes, and discuss policies aimed at ensuring that gains are more widely shared.