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BETTER POLICIES FOR BETTER LIVES

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Conventional signs

$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mb/d	Million barrels per day	Trillion	Thousand billion
. .	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		

Editorial

A fragile global economy needs urgent cooperative action

A year ago, the OECD warned about how trade and policy uncertainties could significantly damage the world economy and further contribute to the growing divide between people. A year later, global momentum has weakened markedly and growth is set to remain subpar as trade tensions persist. Trade and investment have slowed sharply, especially in Europe and Asia. Business and consumer confidence have faltered, with manufacturing production contracting. In response, financial conditions have eased as central banks have moved towards more accommodative monetary stances, while fiscal policy has been providing stimulus in a handful of countries. At the same time, low unemployment and a slight pick-up in wages in the major economies continue to support household incomes and consumption. Overall, however, trade tensions are taking a toll and global growth is projected to slow to only 3.2% this year before edging up to 3.4% in 2020, well below the growth rates seen over the past three decades, or even in 2017-18.

While growth was synchronised eighteen months ago, divergence has emerged between sectors and countries depending on their exposure to trade tensions, the strength of fiscal responses and policy uncertainties. The manufacturing sector, where global value chains prevail, has been hit hard by tariffs and the associated uncertainty on the future of trade relationships, and is likely to stay weak. Business investment growth, also strongly linked to trade, is set to slow to a mere 1¾ per cent per year over 2019-20, from around 3½ per cent per year during 2017-18. However, services, less subject to trade jitters and where most job creation takes place, continue to hold up well. In parallel, growth has weakened in most advanced economies, especially those where trade and manufacturing play an important role, such as Germany and Japan, with GDP growth projected to be below 1% in both countries this year. In contrast, the United States has maintained its momentum thanks to sizeable, albeit waning, fiscal support. Divergence is also visible among emerging-market economies, with Argentina and Turkey struggling to recover from recession, while India and others are benefitting from easier financial conditions and in some instances fiscal or quasi-fiscal support.

Moreover, the global economy remains largely dependent on persistent policy support. Ten years after the financial crisis, with subdued inflation, central bank balance sheets remain at unprecedented levels, interest rates - short and long-term - are historically low, and government debt, except for a few cases, is much larger. With a few exceptions, emerging-market economies have kept large reserve buffers. In short, central banks have barely normalised the monetary policy stance and their support remains essential.

Overall, in spite of unprecedented policy support in the wake of the global financial crisis, the recovery has not been vigorous and lasting enough to translate into higher wages and better standards of living. Since 2010, real GDP per capita, an imperfect proxy for living standards, has increased by only 1.3% per annum in the median OECD country. Even though unemployment is at its lowest rate in nearly four decades, real wages are projected to grow by less than 1.5% per year in 2019-20, below the 2% pace in the decade prior to the crisis in the typical OECD economy. This means that, ten years after the crisis, standards of living have improved too slowly to significantly reduce inequalities, which had widened for the two decades running up to the crisis. For example, for median households in the large advanced economies, the pace of increase in real disposable income has fallen since the crisis, except in the United States.

The outlook remains weak and there are many downside risks that cast a dark shadow over the global economy and people's well-being.

- First, the mediocre growth outlook is conditional on no escalation of trade tensions, which cut across the Americas, Asia and Europe. Simulations in this Outlook's first chapter show that renewed tensions between the United States and China could shave more than 0.6% from global GDP over two to three years.
- Second, manufacturing and services do not work in isolation. While services have remained buoyant, providing a buffer, it is unlikely that they decouple for long from manufacturing. More than a third of manufacturing gross exports comes from services, and services contribute, directly or indirectly, to more than half of global exports. In addition, manufacturing crucially depends on investment, which is not only an engine of growth and employment today but also shapes tomorrow's growth and living standards.
- Third, China remains a source of concern, as the deployment of monetary, fiscal and quasi-fiscal tools not only has uncertain effects on activity, but might continue to fuel non-financial corporate debt, already at a record high level. We estimate that a 2-percentage point reduction in domestic demand growth in China, sustained for two years and combined with heightened uncertainty, could reduce global GDP by 1¾ per cent by the second year.
- Finally, private sector debt is growing fast in major economies. The global stock of non-financial corporate bonds has almost doubled in real terms compared with 2008, at close to USD 13 trillion, and the quality of debt has been deteriorating, including a heightened stock of leveraged loans. A new bout of financial stress could erupt.

Looking ahead, trade tensions are not only hurting the short-term outlook but also medium-term prospects, calling for urgent government action to reinvigorate growth. The global economy was expanding in sync less than two years ago, but challenges to existing trade relationships and the multilateral rules-based trade system have now derailed global growth by raising uncertainty that is depressing investment and trade. The post-World War II process of globalisation driven by multilateral agreements that allowed ever-increasing trade openness is being challenged.

Against this backdrop, we strongly urge governments to use all the policy tools at their disposal. Primarily, based on a common diagnosis about trade issues, taking into account the interdependence of economies with production chains split across borders, it is imperative to reignite multilateral trade discussions. Then where demand is weak, in the euro area for example, rather than further relying on monetary policy, governments should take advantage of the low-interest rate environment to complement structural efforts with fiscal stimulus where public debt is relatively low. Such a combination can address the current weakness, enhance resilience and boost long-term growth in a sustainable way for the benefit of all. Policy priorities include investing in infrastructure, especially digital, transport and green energy, enhancing people's skills, and more generally implementing policies that favour equal opportunities. For example, in the euro area, combining structural reforms that lift productivity growth by 0.2 percentage point per year for five years and a three-year fiscal stimulus of the order of 0.5% of GDP in countries with lower debt to finance public investment would not only result in higher growth in the short term, but raise GDP by around 1% in the longer term.

Reforms are also needed to reap the benefits of digitalisation for all. The special chapter of this Economic Outlook analyses the changes arising from digitalisation and the package of policies required to help digitalisation translate into stronger and more inclusive growth. Digital technologies change the way firms produce goods and services, innovate, and interact with other firms, workers, consumers, and governments. These technologies offer a vast potential to enhance firm productivity and ultimately living standards, but the gains have been disappointing so far. Labour productivity has slowed sharply across OECD countries over the past decades and only a small share of “superstar firms” are benefiting from digitalisation. Weak productivity growth has led to sluggish wage growth and routine tasks performed by low and medium-skilled workers are increasingly being automated. These trends have far-reaching implications for living standards and inclusiveness.

Governments and companies need to implement a range of policies to promote an efficient and inclusive digital transformation. Reaping the benefits of digitalisation requires changes in business practices, work organisation and skill composition that imply a vast reallocation of resources within and across firms and industries. These changes can take time and entail transitory adjustment costs that can be painful for vulnerable groups. A range of reforms are thus needed: education to enhance people’s cognitive skills; training to raise technical and managerial skills; business access to funding capacities for investment in intangible assets and R&D, especially in equity; as well as evolving competition policy to adapt the regulatory environment to changes to business models created by the digital transformation and ensure efficient resource reallocation. If governments and companies take action to address these shortfalls, adoption of digital technologies and gains from digitalisation may finally be up to our expectations.

Over the past year, some downside risks to global growth have materialised as trade and policy uncertainty have weakened business and household confidence. Growth is set to remain subpar as trade tensions persist, while contributing to the divide between people. Governments can and must act together to restore growth that will be sustainable and benefit all.

21st May 2019

Laurence Boone

OECD Chief Economist

1 General assessment of the macroeconomic situation

Introduction

Global growth has slowed abruptly over the past year, with the weakness seen in the latter half of 2018 continuing in the early part of 2019 amidst persisting trade tensions. Trade and investment have moderated sharply, especially in Europe and China, business and consumer confidence have declined and policy uncertainty remains high. At the same time, financial market conditions have eased, helped by moves towards a more accommodative monetary policy stance in many economies, and favourable labour market conditions continue to support household incomes and spending in the major economies. Sizeable fiscal and quasi-fiscal easing is occurring in a handful of countries, including China, but in most economies fiscal policy is offering only limited support for growth. Overall, given the balance of these different forces acting, global GDP growth is projected to ease from 3½ per cent in 2018 to a sub-par rate of 3.2% this year, before edging up to 3.4% in 2020 (Table 1.1). This slowdown is widespread, with growth set to moderate this year in almost all economies. Trade growth is projected to weaken further this year, to around 2%, the weakest rate since the global financial crisis and checking the speed at which global output growth can rebound from its current soft pace. Inflationary pressures are set to remain mild, with few strains on capacity in most economies.

Table 1.1. Global growth remains weak

OECD area, unless noted otherwise

	Average 2011-2018	2017	2018	2019	2020	2018 Q4	2019 Q4	2020 Q4
				Per cent				
Real GDP growth[1]								
World[2]	3.4	3.7	3.5	3.2	3.4	3.2	3.3	3.3
G20[2]	3.6	3.9	3.8	3.4	3.6	3.4	3.6	3.6
OECD[2]	2.0	2.6	2.3	1.8	1.8	1.8	1.9	1.7
United States	2.3	2.2	2.9	2.8	2.3	3.0	2.7	2.1
Euro area	1.2	2.5	1.8	1.2	1.4	1.1	1.3	1.4
Japan	1.2	1.9	0.8	0.7	0.6	0.2	0.6	0.9
Non-OECD[2]	4.6	4.6	4.5	4.3	4.6	4.4	4.4	4.6
China	7.1	6.8	6.6	6.2	6.0	6.4	6.1	6.0
India[3]	7.1	7.2	7.0	7.2	7.4			
Brazil	0.1	1.1	1.1	1.4	2.3			
Unemployment rate[4]	6.9	5.8	5.3	5.3	5.2	5.2	5.3	5.2
Inflation[1,5]	1.6	2.0	2.3	2.0	2.3	2.5	2.0	2.3
Fiscal balance[6]	-4.0	-2.2	-2.8	-3.0	-2.9			
World real trade growth[1]	3.7	5.5	3.9	2.1	3.1	2.9	2.3	3.3

1. Percentage changes; last three columns show the increase over a year earlier.
2. Moving nominal GDP weights, using purchasing power parities.
3. Fiscal year.
4. Per cent of labour force.
5. Private consumption deflator.
6. Per cent of GDP.

Source: OECD Economic Outlook 105 database.

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The balance of risks continues to be on the downside, with growth outcomes potentially being substantially weaker if negative risks materialise or interact. Key risks include a prolonged period of higher tariffs on trade between the United States and China; further steps to raise new trade barriers, particularly additional tariffs on trade between the United States and the European Union; a failure of policy stimulus to prevent a sharper slowdown in China; continuing policy uncertainty and prolonged sub-par growth in Europe, including lingering uncertainty about Brexit; and financial vulnerabilities from high debt and deteriorating credit quality. On the upside, decisive actions by policymakers to reduce policy-related uncertainty and strengthen medium-term growth prospects, including measures that reduce barriers to trade, would improve confidence and investment around the world.

Against this background, the key policy priorities are to ensure sufficient support for demand, reduce policy-related uncertainty, enhance resilience against risks and strengthen prospects for medium-term growth that provides opportunities for all. Multilateral dialogue should be restored to avoid new damaging trade restrictions and to take advantage of the opportunities of openness that benefit all economies. Central banks should remain supportive and ensure long-term interest rates stay low. Fiscal and structural policies should be focussed on actively addressing medium-term challenges, whilst ensuring adequate support for demand over the projection period. In the euro area, combined action across countries, involving renewed reform efforts, augmented by targeted fiscal measures where space exists, is needed to strengthen medium-term prospects in all member states and provide additional near-term support to area-wide growth. Scope exists to ease monetary policy in many emerging-market economies if inflation continues to decline towards target, provided investor confidence is retained. In all countries, improved reform ambition is needed to enhance living standards, improve medium-term prospects for investment and productivity, and make growth more inclusive by allowing the benefits to be distributed more widely.

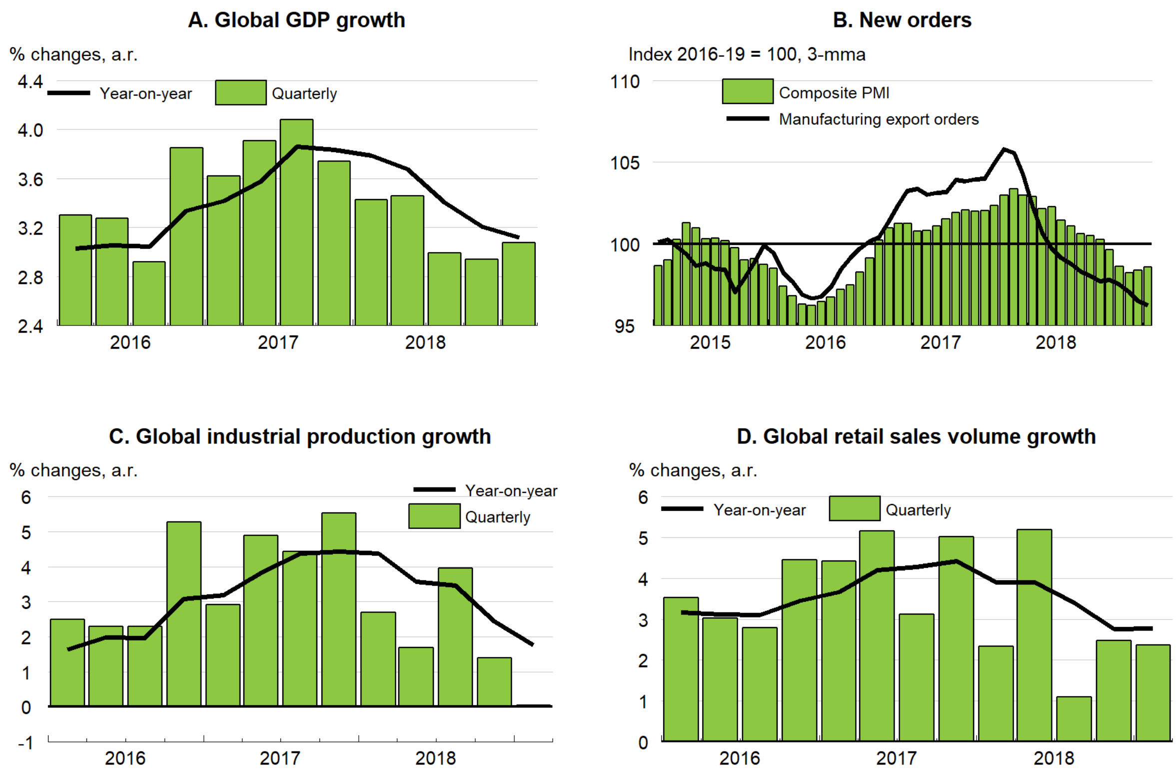
In the event of an even sharper or more protracted global growth slowdown than currently projected, co-ordinated policy action across countries would provide the most effective and timely counterweight, with fiscal policy measures likely to offer the most support in the short term. To enhance the effectiveness of such actions, preparation is needed now, with identification of well-targeted growth and income enhancing measures that can be rolled out rapidly if required.

Global growth is set to remain weak

Global GDP, trade and investment growth have fallen sharply

Global growth has slowed sharply over the past year, amidst heightened policy uncertainty, persistent trade tensions and declines in business and consumer confidence. In the latter half of 2018, world GDP growth declined to around 3% on a quarterly basis (Figure 1.1, Panel A), and appears likely to have improved only slightly in the first quarter this year. This is the weakest pace since 2015-16, in part reflecting the deep recessions occurring in some emerging-market economies and widespread weakness in industrial sectors (Figure 1.1, Panel C). Confidence indicators have also eased markedly in many OECD countries, especially in the euro area and Japan where growth has proved weaker than expected, and, until recently, in China. In contrast, confidence has held up in the United States, although growth has started to moderate as the support from fiscal policy wanes. At a sector level, incoming new orders remain at a low level in manufacturing (Figure 1.1, Panel B), but are holding up in service industries, possibly reflecting the relative buoyancy of consumer spending, including retail sales (Figure 1.1, Panel D), and so far limited spillovers from the weakness in manufacturing sectors (Box 1.1).

Figure 1.1. Global growth has lost momentum



Note: GDP, industrial production and retail sales aggregation use PPP weights. GDP growth in the first quarter of 2019 based on currently available data and projections for the remaining economies. Data in Panel D are for retail sales in the majority of countries, but monthly household consumption is used for the United States and the monthly synthetic consumption indicator is used for Japan. Data for India are unavailable for Panel D.

Source: OECD Economic Outlook database; Markit; OECD Main Economic Indicators database; Refinitiv; and OECD calculations.

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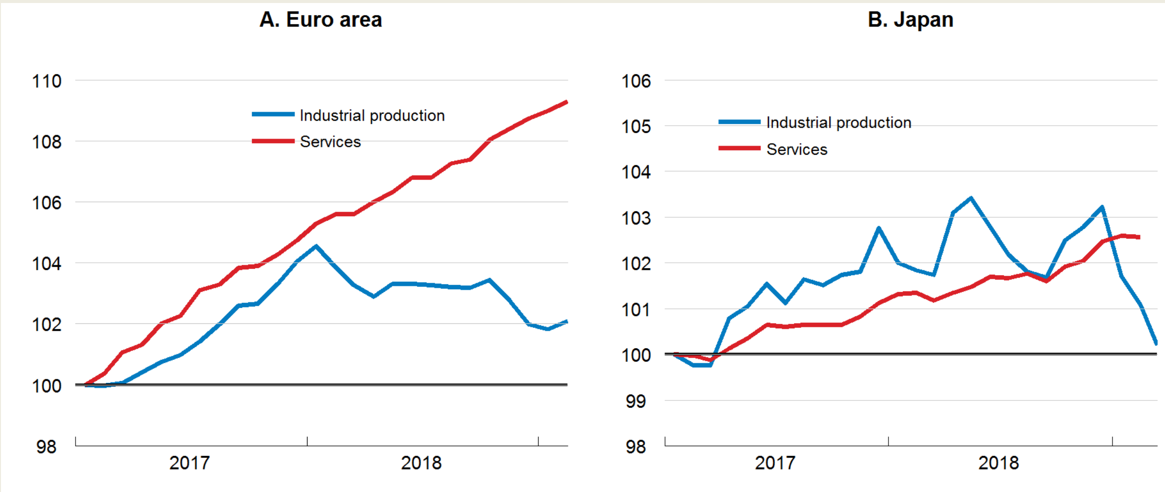
Box 1.1. Linkages between manufacturing and service sectors

The current downturn in the global manufacturing cycle has so far had only limited spillovers to the service sector, where output has been more resilient in many economies (Figure 1.2). A key question is whether this situation can persist if there is an extended industrial slowdown. This box examines the linkages between the manufacturing and market services sectors in the G7 economies, and the extent to which they have common driving factors. The evidence suggests that despite sizeable direct connections via supply chains, the linkages between manufacturing and service sector developments have eased in recent years in some major economies, helped by an underlying divergence in the behaviour of the different expenditure components that drive demand in each sector.

Figure 1.2. Industrial and service sector output have recently diverged

Index Jan. 2017 = 100, 3-month moving average



Note: Services output excludes financial and public services in the euro area. Tertiary sector output in Japan.
Source: Eurostat; METI; and OECD calculations.

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Supply-chain linkages

There are direct supply-chain linkages between manufacturing and services industries. Service sector outputs, particularly market services such as transport, communication and business services, are used as intermediate inputs in manufacturing.

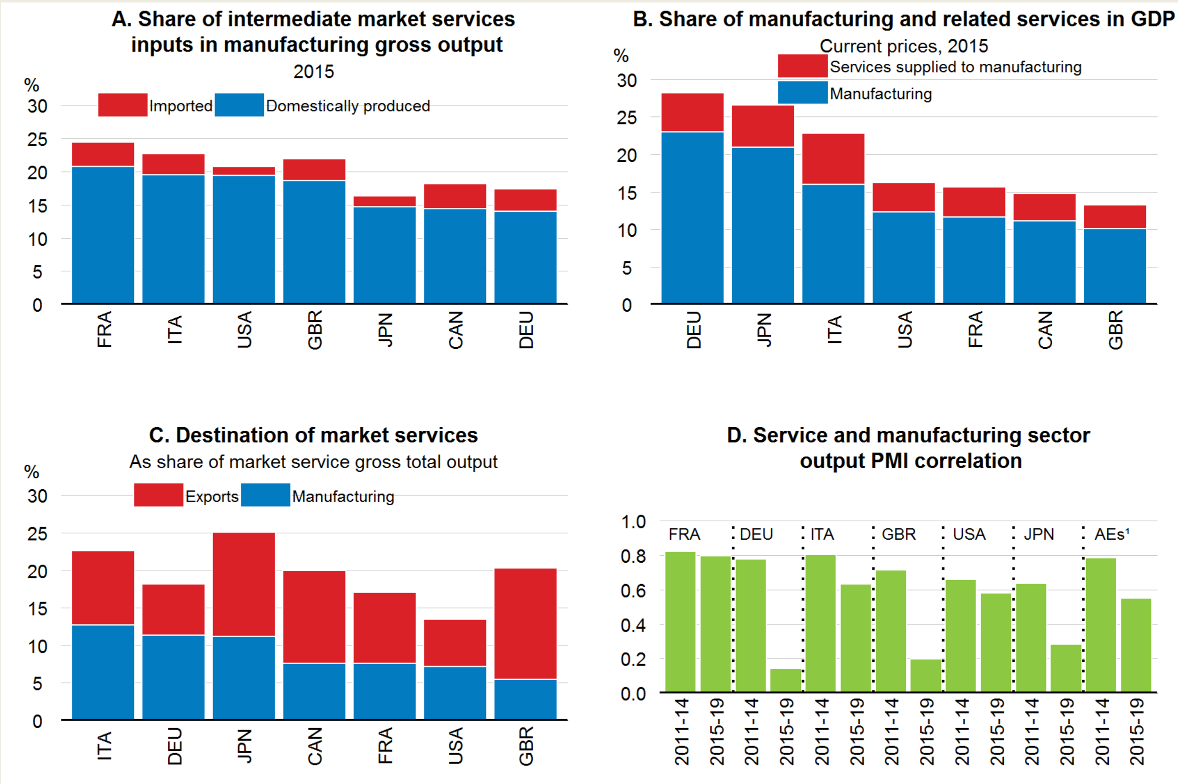
- In 2015, the share of market services inputs in gross output in the manufacturing sector ranged from 24% in France to 16% in Japan, amongst the G7 economies (Figure 1.3, Panel A), with the majority of these inputs being produced domestically. Differences across countries in part reflect the extent to which some services production is outsourced or produced internally within manufacturing companies.
- Overall, in the G7 economies, the combined share of value-added output in the manufacturing sector and the output of market services that is used as an intermediate input in manufacturing ranged from 13% to 28% of GDP in 2015 (Figure 1.3, Panel B). The share of externally produced market services in manufacturing output was relatively large in Italy, accounting for close to 7% of GDP.

Domestic service sectors have also become more exposed to the global business cycle over time because of rising exports of services.

- The share of domestic market services gross output that is exported has risen over time, representing 10.5% of output in 2015 in the average G7 economies, up from 9% in 2005.

Overall, in the median G7 economy, about 20% of market services gross output went either to the manufacturing sector or was exported in 2015 (Figure 1.3, Panel C). The service sectors in Italy, Japan and the United Kingdom appear the most exposed to the global business cycle on these metrics, either because of the extent to which services supply inputs to domestic manufacturing or, as for the United Kingdom, because of a relatively high level of services exports.

Figure 1.3. Manufacturing and service sectors inter-linkages



1. AEs refers to the Markit aggregate for the advanced economies.
Source: OECD National Accounts database; OECD Input-Output Tables; Markit; and OECD calculations.

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The declining correlation between output growth in manufacturing and services sectors

In event of a recession or a shock common to all sectors, such as a severe tightening of financial conditions, there is little reason to expect any substantial decoupling between industrial and service sectors. Outside such periods, there may be differences in the key factors underpinning demand for services and manufactures. Business survey indicators highlight a continued positive correlation between manufacturing and service output, but it has declined noticeably in recent years in almost all major economies (Figure 1.3, Panel D), particularly in Germany.

One possible factor behind the recent divergence between manufacturing and service sector developments may be the extent to which they are driven by different components of expenditure, and, in particular, the strength of consumption growth relative to investment and trade growth since the global financial crisis.

- On average in the G7 economies, around two-fifths of gross output in market services sectors is produced directly for private and public consumption in the domestic economy, whereas this represents only one-fifth of gross output in manufacturing.[1]
- In contrast, around two-fifths of manufacturing sector gross output is produced for domestic investment and export demand, whereas this represents only one-sixth of gross output in market services.

- Relatedly, around one-half of final household consumption expenditure is on domestically-produced market services, on average in the G7 economies. In contrast only around one-quarter of gross fixed capital formation is on domestically-produced market services.

In the decade prior to the crisis, the year-on-year growth rates of private consumption and total (or business) investment were strongly positively correlated in almost all G7 economies (with the exception of the United Kingdom). This association has declined in the post-crisis period (from 2011 onwards), with the growth rates even becoming negatively correlated in some countries, including the United States. A similar pattern can be observed for export growth; this remains strongly correlated with business investment growth in most G7 countries, but is weakly or negatively correlated with consumption growth since 2011. There are also differing developments within exports, with international passenger traffic and tourism remaining more robust than other components of trade (Figure 1.4, Panel D).

The decoupling between consumption and other demand components can be partly explained by improving labour market outcomes and wealth effects that have helped to support consumption growth in recent years, while policy uncertainty and, more recently, trade restrictions have weighed on trade and investment. If this pattern persists, as is the case in the baseline projections in this *Outlook*, then output growth in service sectors should continue to hold up even if manufacturing output growth remains soft. However, if manufacturing output weakens further around the world, this may not persist, with adverse effects on wages and employment in industrial sectors likely to weaken aggregate household income and spending.

1. In the median G7 economy, just under one-half of market services output is used as intermediate consumption (by another service provider in about 70% of the cases), the rest being destined for final expenditure.

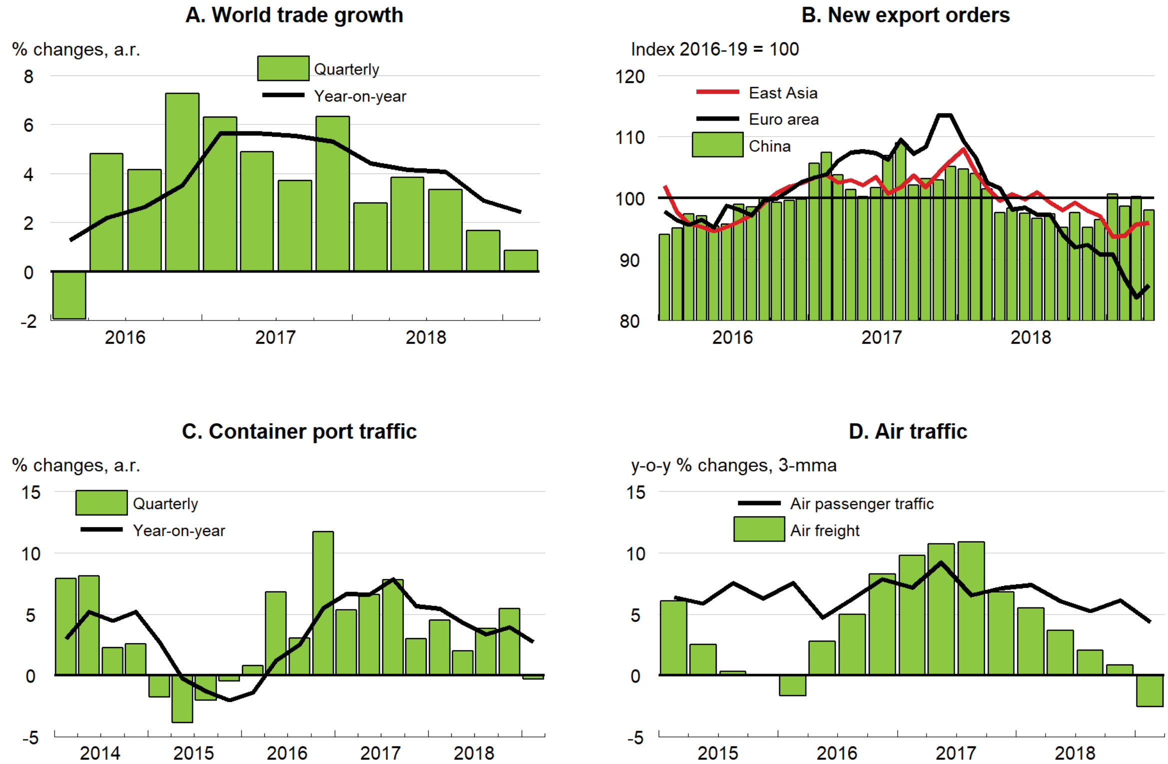
Global trade volume growth, a key artery of the global economy, has slowed abruptly, from around 5½ per cent in 2017 to around ¾ per cent in the first quarter of 2019 (Figure 1.4, Panel A). High-frequency indicators suggest that near-term trade prospects remain weak. Export orders are still at a low level, particularly in the euro area (Figure 1.4, Panel B) and Germany, where survey measures are currently lower than at any time during the euro area crisis. Global industrial production has stalled in recent months, and both container port traffic and air-freight traffic indicators have weakened (Figure 1.4, Panel C and D). In Europe, trade growth has declined, reflecting weak external and internal demand (Figure 1.5), and merchandise import growth has slowed sharply in China.

A number of factors are contributing to the slowdown in trade. Many of these factors are likely to persist for some time, pointing to soft trade growth prospects for much of this year.

- The series of new tariffs and retaliatory counter-measures introduced in 2018 are having a negative effect on output and incomes (OECD, 2018a; Amiti et al., 2019),[1] and there have been marked declines in trade flows and increases in prices in some targeted sectors, particularly in the United States and China. Additional bilateral tariffs between the United States and China have just been announced, and risks remain that further measures may be implemented this year, including new restrictions in specific trade-sensitive sectors such as cars and car parts.

[1] While some economies enacted trade-facilitating measures last year, these were outweighed by new restrictive trade policy measures (WTO-OECD-UNCTAD, 2018).

Figure 1.4. Global trade growth has slowed



Note: Figures for world trade growth in the first quarter of 2019 are based on currently available data and projections for the remaining economies. East Asia export orders are a PPP-weighted average of Japan, Korea, Malaysia, the Philippines, Thailand, Chinese Taipei and Vietnam.
Source: OECD Economic Outlook 105 database; Markit; Institute of Shipping Economics and Logistics; International Air Transport Association; and OECD calculations.

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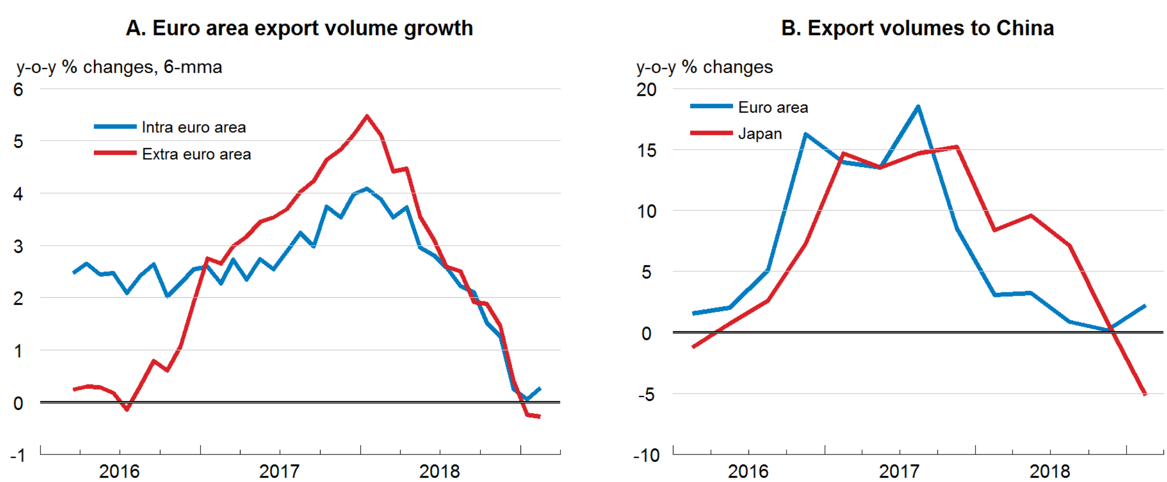
Figure 1.5. The slowdown in trade growth has been particularly sharp in Europe and China



Note: Merchandise export volumes. Seasonally and working-day adjusted for the euro area and seasonally adjusted for Japan.
Source: Eurostat; Bank of Japan; and OECD calculations.

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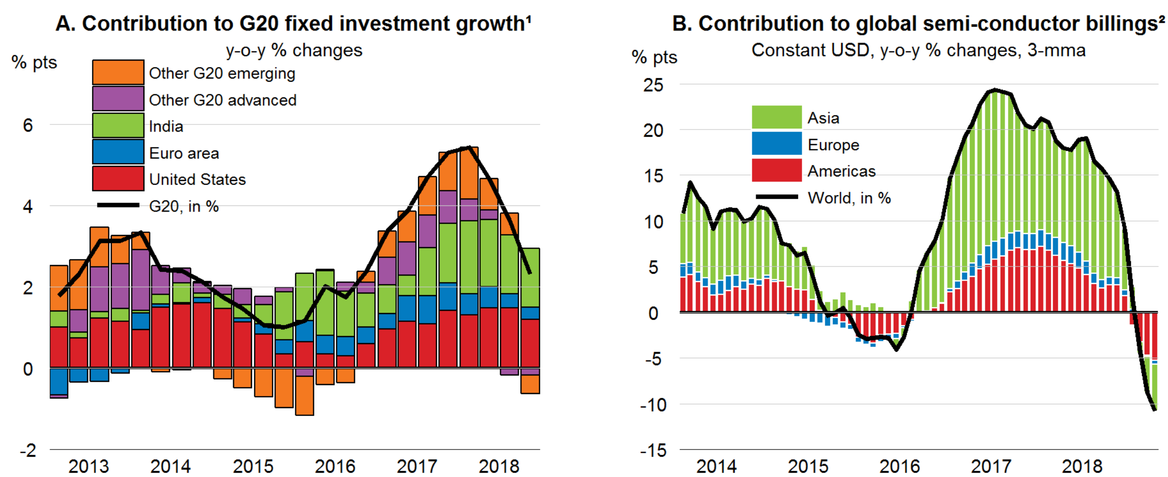
- Weaker investment growth (Figure 1.6, Panel A), a relatively trade-intensive category of expenditure, has also contributed to the trade slowdown, with rising trade tensions having added to policy uncertainty and adversely affected business investment.[2] Amongst the G20 economies for which timely data are available, annual fixed investment growth has halved, from around 5% in 2017 to 2½ per cent at the end of 2018.
- In Asia, a sharp downturn in the global semi-conductor cycle (Figure 1.6, Panel B), and softer domestic demand growth in China account for much of the recent weakness in merchandise trade growth seen in countries such as Japan (Figure 1.5, Panel B) and Korea. US merchandise trade with China has also declined sharply, reflecting higher trade barriers, with export and import volumes in the first quarter of 2019 around 16% and 13% lower respectively than a year earlier.
- In Europe, strong regional supply-chain linkages magnify the swings in trade (Ollivaud and Schwellnus, 2015), given the importance that economies such as Germany and Italy have as export markets for other European economies. These add to the specific drags exerted by the deep recession in Turkey and the slowdown in trade with the United Kingdom.

Figure 1.6. Weaker investment has contributed to the trade slowdown



1. G20 fixed investment excludes China and Saudi Arabia, due a lack of quarterly data. The euro area aggregate includes only Germany, France and Italy. 'Other G20 advanced' includes Australia, Canada, Japan, Korea and the United Kingdom. 'Other G20 emerging' includes Argentina, Brazil, Indonesia, Mexico, Russia, South Africa and Turkey.
2. Semi-conductor billings in nominal USD for Asia and Europe are deflated using US semi-conductor import prices, and nominal billings in the United States are deflated using US semi-conductor export prices.
Source: OECD Economic Outlook 105 database; World Semi-Conductor Trade Statistics; Bureau of Labor Statistics; and OECD calculations.

StatLink https://doi.org/10.1787/888933933216

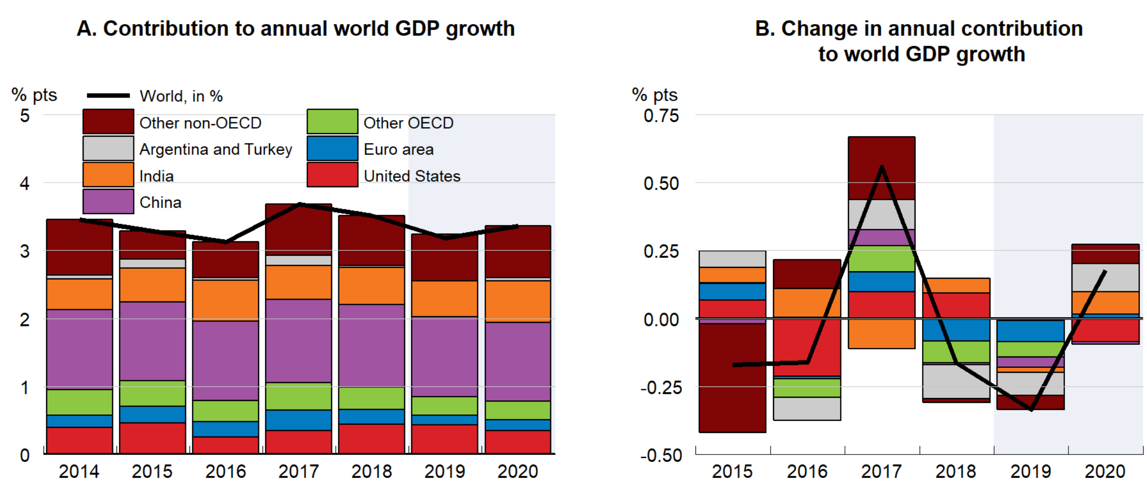
[2] In the United States, survey-based estimates suggest that tariff increases and trade policy tensions may have reduced gross investment by 4.2% in the manufacturing sector in 2018 (Federal Reserve Bank of Atlanta, 2019).

Financial conditions and commodity prices are cushioning the extent of the slowdown. Financial market conditions have improved since the start of the year, with the significant repricing of risk seen in late 2018 being partially reversed amidst signals of more accommodative monetary policy than previously expected (see below). Equity prices have strengthened, long-term government bond yields have declined, and spreads on corporate bonds and emerging-market bonds have narrowed. However, the introduction by the United States of higher tariffs on imports from China has recently heightened volatility in asset prices. Supply restrictions by OPEC and Russia, and the impact of sanctions on output in Venezuela and Iran, have helped to push up oil prices this year, despite softer global demand growth. However, at the USD 70 per barrel assumed in the projection period, prices remain below the levels seen during the latter half of 2018.

Global growth is set to remain at a modest pace

Overall, recent economic and financial developments, and the materialisation of some downside risks, point to subdued global growth prospects. Global GDP growth is projected to ease to a below-trend rate of 3.2% this year and 3.4% in 2020, well below the rates seen in 2017-18 (Figure 1.7, Panel A), but on a par with 2015-16. The extent of the slowdown will depend on the continuing resilience of household spending, the speed at which the current recessions in some major emerging-market economies, notably Turkey and Argentina, start to fade and the strength of the subsequent recovery. Indeed, the sharp slowdowns and projected gradual recoveries in Turkey and Argentina account for around two-fifths of the decline in global growth between 2017 and 2019, and the rebound in 2020 (Figure 1.7, Panel B). High policy uncertainty and weak confidence are set to weigh further on business investment and trade prospects, and slow the pace at which growth can pick up from its current low rate, despite the support offered by improved financial conditions.

Figure 1.7. Global growth is set to remain modest



Note: Calculated using PPP weights.
Source: OECD Economic Outlook 105 database; and OECD calculations.

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In the advanced economies, improved labour market conditions, lower headline inflation and, in some countries, modest supportive fiscal measures targeted at lower-income households and strong minimum wage increases should help to support real income growth and household spending. Sustained monetary policy support also continues to underpin activity. However, overall, fiscal policy appears set to offer less support than desirable in most countries; in the median OECD economy, fiscal easing is projected to remain modest at around 0.3% of GDP in 2019, with little further easing projected in 2020 (see below).

- GDP growth in the United States is projected to moderate to around 2¾ per cent in 2019 and 2¼ per cent in 2020 as the support from fiscal easing slowly fades. Solid labour market outcomes and supportive financial conditions continue to underpin household incomes and spending, but higher tariffs are adding to business costs and prices, and the growth of business investment and exports has moderated.

- GDP growth in Japan is set to remain at around 0.7% per annum in 2019 and 2020. Severe labour shortages and capacity constraints continue to stimulate investment, but confidence has eased and export growth has weakened. Stronger social spending and a temporary boost to public investment will cushion the immediate impact of the scheduled increase in the consumption tax rate in October 2019, but fiscal consolidation efforts are set to resume in 2020.

- GDP growth in the euro area is projected to remain moderate, at just under 1¼ per cent in 2019 and between 1¼ and 1½ per cent in 2020. Wage growth and accommodative macroeconomic policies, including modest fiscal easing, provide support for household spending, but policy uncertainty, weak external demand and low confidence are likely to weigh on investment and trade growth.

Growth prospects in the emerging-market economies are collectively projected to be broadly steady over 2019-20, but this masks diverging developments in the major economies. The pause in monetary policy normalisation in the advanced economies and lower oil prices have reduced near-term risks, but weak global trade, and significant adjustment challenges from past financial market tensions continue to impede growth in many countries.

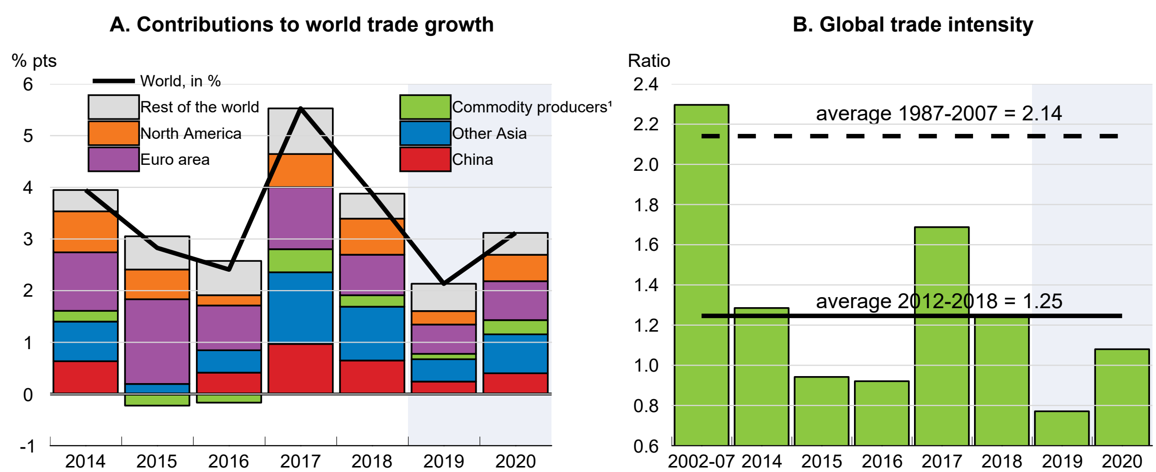
- GDP growth in China is projected to moderate gradually to 6% by 2020. Import, investment and credit growth have slowed and trade tensions are adding to uncertainty, but new fiscal and quasi-fiscal stimulus measures are being implemented and monetary policy has eased. The extent and effectiveness of the new fiscal measures are difficult to gauge, but could amount to around 1% of GDP this year if local governments fully utilise the increase in their special bond quota (equivalent to ¾ per cent of GDP) to finance infrastructure spending. Scope remains for further policy support if required, but this would add to the challenges in achieving the necessary deleveraging of the corporate sector and aggravate risks to financial stability.
- GDP growth in India is projected to strengthen to close to 7¼ per cent in FY 2019 and close to 7½ per cent in FY 2020, with improved financial conditions, fiscal and quasi-fiscal stimulus, including new income support measures for rural farmers, and recent structural reforms all helping to support domestic demand.
- A gradual recovery is set to continue in Brazil, with GDP growth projected to pick up to around 1½ per cent this year and 2¼ per cent in 2020. Low inflation and improving labour markets provide support for private consumption, and successful implementation of reforms, particularly the pension reform, would help to reduce uncertainty and enhance investment.

Global trade and investment growth are projected to remain subdued

Global trade volume growth (goods plus services) is projected to slow further in 2019, to around 2%, before increasing to around 3% next year. At this pace, trade intensity would not only remain weak by pre-crisis standards, but would be below the average pace achieved over 2012-18 (Figure 1.8). The slowdown in trade growth this year is projected to be broad-based across economies, with the largest contributions coming from Asia and North America, together with a further easing in Europe. As in 2015-16, a sharp slowdown in trade growth in China is a key contributor to the overall softness of global trade. Import volumes in China are projected to rise by around 3¼ per cent per annum in 2019-20, after having risen by around 7½ per cent per annum on average in 2017-18. A prolonged period of heightened trade barriers between the United States and China in 2019, or the introduction of new trade restrictions, would reduce trade growth further in 2019 and 2020 (see below).

The weak projected pace of trade growth is consistent with the subdued outlook for investment in many economies. Recent survey indicators generally suggest that investment prospects are easing, despite significant capacity constraints in countries such as Japan and Germany. Production of capital goods is also currently weak in the major OECD economies. Continued policy uncertainty, skills and infrastructure shortages (European Investment Bank, 2018), a step-down in expectations of future global GDP growth, and a decline in business dynamism in some countries are all factors that reduce incentives to invest. In the OECD area, business investment growth is projected to ease to around 1¾ per cent per annum on average over 2019-20, from 3½ per cent per annum during 2017-18.

Figure 1.8. Global trade growth is set to remain subdued



1. Commodity producers include Argentina, Australia, Brazil, Chile, Colombia, Indonesia, Norway, New Zealand, Russia, Saudi Arabia, South Africa and other oil-producing countries.
2. World trade volumes for goods plus services; global GDP at constant prices and market exchange rates. Period averages are the ratio of average annual world trade growth to average annual GDP growth in the period shown.
Source: OECD Economic Outlook 105 database; and OECD calculations.

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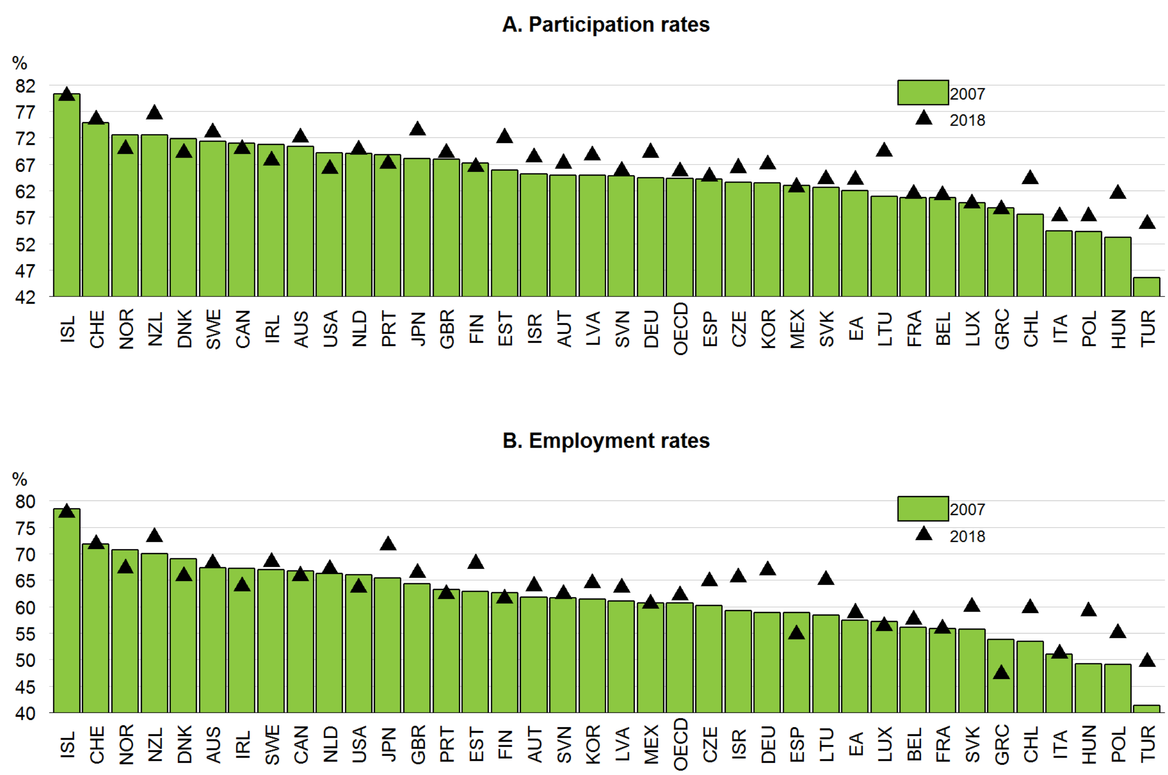
Labour markets remain supportive and wage growth is rising modestly

Labour market conditions are continuing to improve in most OECD economies, despite the slowdown in output growth. The OECD-wide claimant unemployment rate is at its lowest level since 1980, and in the OECD economies as a whole, employment and participation rates have risen markedly in the past five decades, helped by past reforms that have boosted job creation, lowered barriers to labour force participation, and limited pathways to early retirement. Nonetheless, in the median OECD economy, aggregate participation and employment rates are only around 1 percentage point above their levels in 2007, prior to the financial crisis (Figure 1.9), and the quality of new job creation has not always matched the quantity.

Outcomes have differed markedly across economies. In some, including Japan and Germany, both employment and participation rates have risen steadily over the past decade, and are now several percentage points higher than in 2007. Other countries, such as Sweden, Australia and New Zealand, already among the countries with the highest participation and employment rates in 2007, have also seen further improvements since then. In contrast, in the United States, amongst the best performing countries in 2007, employment and participation rates declined by 2-3 percentage points between 2007 and 2018. Amongst the countries with lower participation and employment rates in 2007, significant improvements have occurred in Turkey, Hungary, Poland and Chile, but little overall change has occurred in a number of other countries, including Italy and France, despite recent improvements in employment growth.

Figure 1.9. Labour market conditions are improving in most economies



Note: As a per cent of the population aged 15-74 years.
Source: OECD Economic Outlook 105 database.

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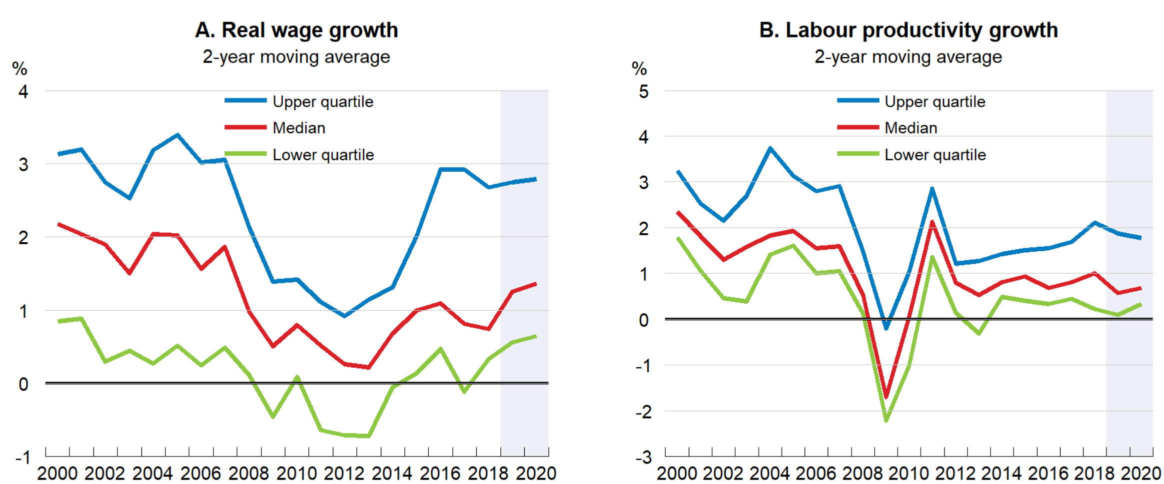
Steady employment growth is set to continue in most economies in 2019-20, albeit at a moderate pace. OECD-wide employment growth is projected to be around 0.9% per annum on average, down from 1½ per cent per annum in 2017-18. While this will help to support household incomes in the near term, the counterpart, given subdued output growth, is a continuation of very weak labour productivity growth for a further period, with adverse implications for medium-term growth prospects.

Nominal wage growth has begun to pick up in most OECD economies, but real wage growth remains moderate, in part due to still-modest labour productivity growth (Figure 1.10). Nonetheless, signs remain that spare capacity is diminishing, with unemployment rates in many advanced economies now below estimated sustainable rates and survey indicators still pointing to labour shortages, particularly for higher-skilled workers. Overall, in the median OECD economy, real wages are projected to rise by just over 1.3% per annum on average in 2019-20, up from around ¾ per cent per annum on average in 2017-18. Such an outcome would be much weaker than in the decade prior to the crisis, where real wage growth was closer to 2% per annum in the median OECD economy. Real wage growth is projected to be relatively robust in Germany, the United States and several Central European economies reflecting tight labour market conditions, as well as Korea, where minimum wages are being raised by a further 11% this year.

Inflation is set to remain moderate

Amongst the advanced economies, headline consumer price inflation in the median economy is projected to decline to 1½ per cent in 2019 (reflecting lower commodity prices) and increase slightly in 2020 to around 2% (Figure 1.11, Panel A). In the United States, where spare capacity remains limited but economic growth is moderating, inflation is likely to rise only slowly, to around 2¼ per cent by the end of 2020. In Japan, inflation is also projected to increase, but this will largely reflect the increase in the consumption tax rate; excluding the impact of the consumption tax increase, inflation is set to rise to only around 1% in 2020. In contrast, in the euro area, headline inflation is projected to decline from 2018 due to weak aggregate demand pressures and lower energy prices, with core inflation edging up to just below 1½ per cent by the end of 2020.

Figure 1.10. Wage and productivity growth remain moderate in the advanced economies



Note: Based on a sample of 33 OECD economies. Real wages are measured as compensation per employee deflated by the private consumption deflator. Labour productivity is measured as output per person employed.
Source: OECD Economic Outlook 105 database; and OECD calculations.

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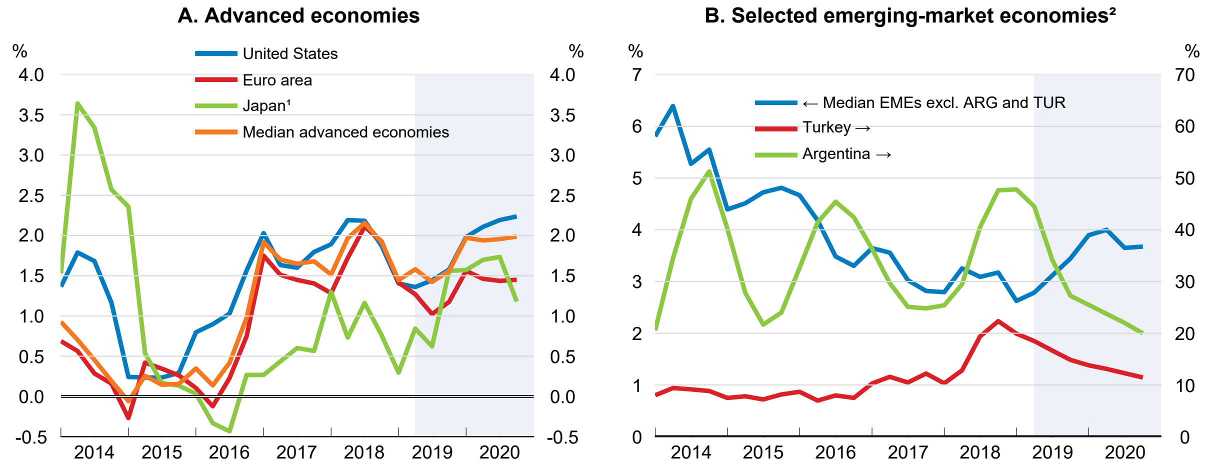
Figure 1.11. Moderate headline inflation is expected to persist in many advanced and emerging-market economies

Year-on-year percentage changes



1. Inflation is not adjusted for changes in the consumption tax rates.
2. Selected emerging-market economies (EMEs) include: Argentina, Brazil, Chile, China, Costa Rica, India, Indonesia, Mexico, Russia, South Africa and Turkey.
Source: OECD Economic Outlook 105 database; and OECD calculations.

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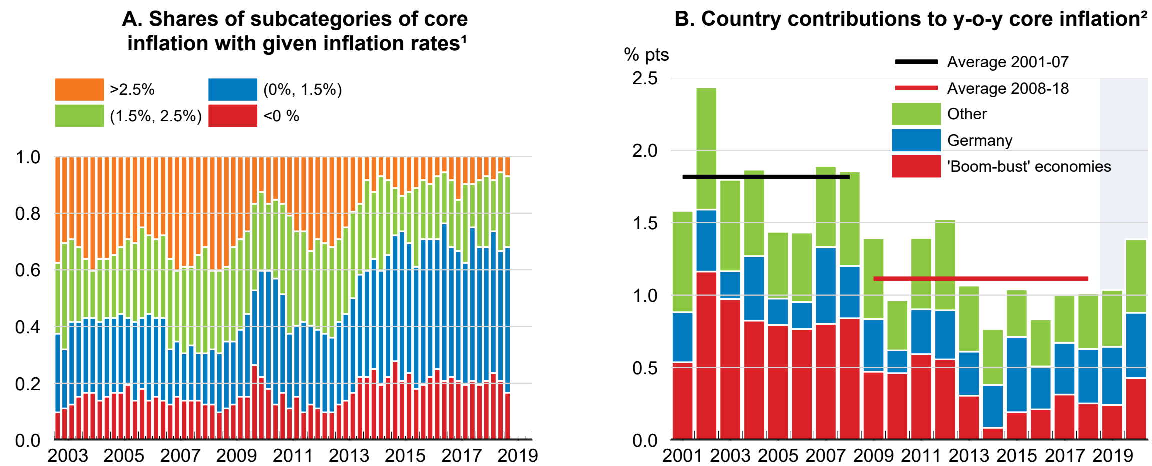
The prolonged period of very low inflation in the euro area seems to reflect persistent hysteresis effects, resulting in subdued aggregate demand growth, still sizeable under-employment and a slight decline in inflation expectations.[3] There has been a persistent change in the distribution of individual prices of goods and services since the start of the global financial crisis. The share of goods and services with positive but low annual inflation rates (below 1.5%) has risen substantially and that of goods and services with relatively high inflation rates (above 2.5%) has declined (Figure 1.12, Panel A). This change was particularly large in Italy and, thus, is linked with a change in the contributions of individual countries to area-wide inflation. Countries that were the hardest hit by recessions have had subdued inflation in recent years, and contributed significantly less to euro area inflation than prior to the crisis when their economies were booming (Figure 1.12, Panel B).

[3] For instance, market-based longer-term inflation expectations derived from inflation swaps and bond yield differentials point to a decline in expected inflation by ¾ percentage point on average between 2008-12 and 2013-19.

Figure 1.12. Factors behind low inflation in the euro area



1. Calculations are based on 72 subcategories of the core harmonised consumer prices index for the euro area. Core indices exclude food and energy.
2. Contributions to the euro area-wide core inflation. "Boom-bust" euro area economies include: Greece, Ireland, Italy, Portugal and Spain.
Source: Eurostat; OECD Economic Outlook 105 database; and OECD calculations.

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The link between aggregate domestic economic activity and inflation has not been very strong. There is evidence that inflation rates of only some individual categories of goods and services react to aggregate capacity measures.[4] This may suggest that for many goods and services, technological progress, product-specific demand pressures, international trade, and competition in the domestic retail sector may be more relevant for price dynamics than economy-wide capacity utilisation measures and general inflation expectations. Thus, aggregate inflation may be a poor indicator of the price pressures stemming from aggregate cyclical activity.

In many emerging-market economies, consumer price inflation is also expected to remain relatively stable close to recent historically moderate levels (Figure 1.11, Panel B). The main exceptions are Argentina and Turkey, where inflation has shot up due to large depreciations of the domestic currencies. With a gradual easing of imported inflation, consumer price inflation should also decline gradually. However, headline inflation in these two economies is still projected to remain in double digits until the end of 2020.

[4] Stock and Watson (2018) show that the cyclical component of inflation is sensitive to aggregate cyclical activity only for a few components of total inflation in the United States and the euro area. These components are primarily services and goods that could be considered locally priced. Also, according to simple regressions for the G7 economies using quarterly data for the 2001-18 period, the annual inflation rate of only 30-40% of core inflation components is generally linked to economy-wide output or unemployment gaps, with the exception of Italy where the share is between 50% and 60%. Goods tend to be less responsive to country-specific gaps than services. Analysis based on a dynamic factor model yields similar results. With the exception of France and Japan, the share of individual goods and services with a significant and positive correlation with the underlying inflation trend, as measured by the estimated common unobservable factor, is well below 50%.

Key issues and risks

The balance of risks remains on the downside. Concern about negative risks may be already weighing on confidence and adding to uncertainty, and thus discouraging investment and trade. Growth outcomes would be weaker still if downside risks were to occur or interact, including from further steps to raise trade barriers, persisting policy uncertainty and prolonged sub-par growth in Europe, a disorderly Brexit, a sharper slowdown in China, and renewed financial market repricing. On the other hand, if these risks were to be addressed, thus providing businesses and households with greater confidence about the future, the economic outlook would be stronger than currently anticipated.

An intensification of trade restrictions would have significant costs

Continued uncertainty about trade policies remains a significant source of downside risks to global investment, jobs and living standards. Higher trade restrictions reduce living standards for consumers, particularly lower-income households, and add to production costs for businesses. The projections assume that the tariff increases imposed by the United States and China in 2018 are maintained, but do not incorporate the additional bilateral measures announced this May, or possible further extensions, given the uncertainties about how US-China trade arrangements may evolve. However, this points to sizeable downside risks for output and trade growth (see below). On the other hand, if the United States and China succeed in concluding a trade agreement in the near term, the tariff increases imposed in 2018 and this year could be reversed, providing a modest stimulus to growth, trade and household real incomes, although the overall global welfare gains under managed trade are likely to be lower than under free trade.

The tariffs imposed by the United States and China in 2018, which are incorporated in the projections, have already started to slow growth and add to inflation. By 2021, the level of output in the United States and China is estimated to be around 0.2-0.3% lower than otherwise, with world trade reduced by around 0.4% (OECD, 2018a). US consumer price inflation is also being raised, by around 0.2 percentage point in both 2019 and 2020.

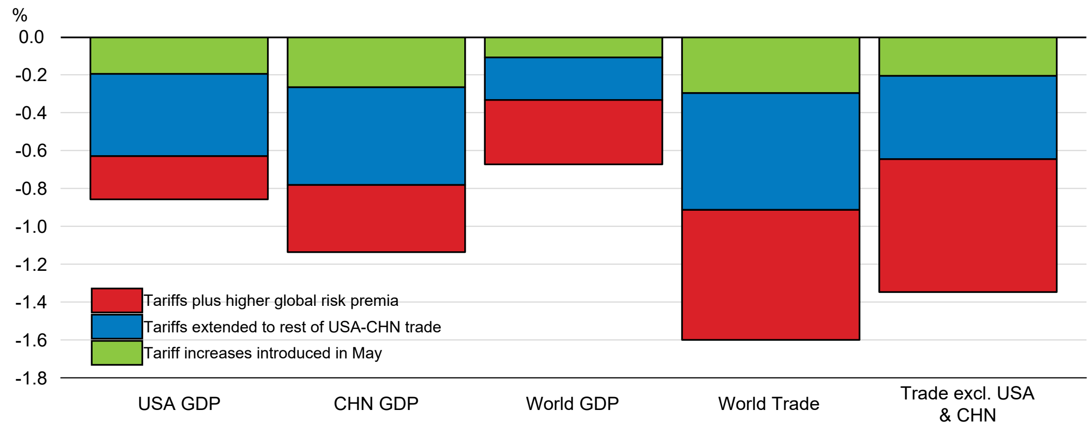
The new round of tariff increases announced in May could add to these effects considerably if they are maintained, with the United States raising the tariffs on USD 200 billion of merchandise imports from China from 10% to 25% and China taking equivalent retaliatory action on USD 60 billion of merchandise imports from the United States. There is also a risk of additional tariffs being implemented in the future, covering the full spectrum of trade between the United States and China.

Simulations on the NiGEM global macro-model illustrate the potential additional adverse effects that the newly-announced tariff measures and possible further extensions may have on global output and trade, and the extent to which these would be magnified if they heightened uncertainty further (Figure 1.13).

- The new measures announced this May, if maintained, are estimated to potentially reduce GDP further in the United States and China by an additional 0.2-0.3% on average by 2021 and 2022 (relative to baseline), with US consumer prices pushed up by a further 0.3% in 2020. This would double the impact of the tariff increases introduced during 2018.
- Under a hypothetical scenario in which the United States and China impose 25% tariffs on all remaining bilateral trade (assumed to occur from July this year), the short-term costs are considerably higher and broader. Global trade would be close to 1% below baseline by 2021, with import volumes in the United States and China declining by around 2%. Output would also decline, by around 0.6% relative to baseline in the United States and 0.8% in China. Close trading partners would also start to be adversely affected, as demand contracts in two major export markets.

Figure 1.13. The adverse effects from higher US-China tariffs could intensify further

Impact on the level of GDP and trade by 2021-22, per cent difference from baseline



Note: The first scenario shows the impact of the United States raising tariffs on USD 200 billion of imports from China from 10% to 25% from mid-May 2019 (with reciprocal action by China on USD 60 billion of imports from the United States). The second scenario shows the additional impact if tariffs of 25% are imposed on all remaining bilateral non-commodity trade between China and the United States from July 2019. The final scenario adds in the impact from a global rise of 50 basis points in investment risk premia that persists for three years before slowly fading thereafter. All tariff shocks are maintained for six years. Based on simulations on NiGEM in forward-looking mode.
Source: OECD calculations.

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- Further uncertainty about trade policies, and a growing concern that new restrictions might be applied on a much wider range of items affecting many economies, is likely to check business investment plans around the world. A rise of 50 basis points in investment risk premia in all countries for three years would raise the cost of capital and add to the negative effects on output from tariffs, with the level of global GDP 0.7% below baseline by 2021 and global trade declining by around 1½ per cent. OECD-wide business investment would decline by around 2½ per cent by 2021, with investment down by around 3¼ per cent in the United States.

Risks also remain that other new restrictive measures could be implemented later in 2019, affecting a broader range of countries or targeting specific products. The possibility of new US restrictions in specific trade-sensitive sectors such as cars and car parts is a particular concern, given the significant cross-country value-chain linkages in this sector and the scale of trade, especially in Europe. Such measures could add considerably to the costs of the tariff increases imposed so far and adversely affect business investment plans around the world.

The decline in trade intensity that results from the imposition of higher tariffs also has adverse effects on productivity and living standards in the medium term via lower competition, reduced scope for specialisation, and the slower diffusion of ideas across national borders (Haugh et al., 2016; Guillemette and Turner, 2018). In contrast, steps to lower tariffs, reduce unnecessary costs from non-tariff measures and liberalise trade in services would bring widespread gains (OECD, 2019a; OECD, 2019b).

Brexit-related uncertainties still persist

Uncertainty remains about the nature of the UK-EU trading relationship in the short and medium term as well as the timing of the withdrawal of the United Kingdom from the European Union (Brexit). The possibility that a withdrawal agreement will not be reached before the newly-extended exit date still remains a serious downside risk and near-term source of uncertainty. The current projections for UK GDP growth are conditional on the assumption of a smooth Brexit, with a transition period lasting until the end of 2020.

If the United Kingdom and the European Union were to separate without an agreement, the outlook would be significantly weaker. OECD analysis suggests that the increase in tariffs between the two economies from WTO rules coming into effect would further reduce GDP by around 2% (relative to baseline) in the United Kingdom in the next two years (Kierzenkowski et al., 2016). This would add to the adverse effects on GDP and business investment already seen relative to expectations prior to the vote in 2016.

The effects could be stronger still if a lack of adequate border infrastructure and a loss of access to EU trade arrangements with third countries were to cause serious bottlenecks in integrated cross-border supply chains. The costs would also be magnified if this also induced a decline in business and financial market confidence and disruptions in financial markets. In such a scenario, the likely adverse effects in the United Kingdom would generate sizeable negative spillovers on growth in other countries. Although contingency measures to soften the impact of a no-deal outcome are being taken by both sides, separation from the EU without an agreement would still be a major adverse shock, given that the United Kingdom is an important trading partner for many countries.

In the European Union, the impact of any scenario that resulted in trade between the United Kingdom and the European Union being undertaken on WTO terms would vary across member states. Some smaller countries with strong trade and investment links with the United Kingdom would be relatively exposed, including Ireland, the Netherlands and Denmark, resulting in significant adjustment costs in particular regions or sectors. OECD estimates suggest that their bilateral exports to the United Kingdom could decline by around 15% in the medium term in the event of trade being undertaken on WTO terms, with the strongest impacts being in the agri-food and machinery and equipment sectors (Arriola et al., 2018; Smith et al., 2018; Smith et al., 2019).

The slowdown in China and spillovers to the rest of the world

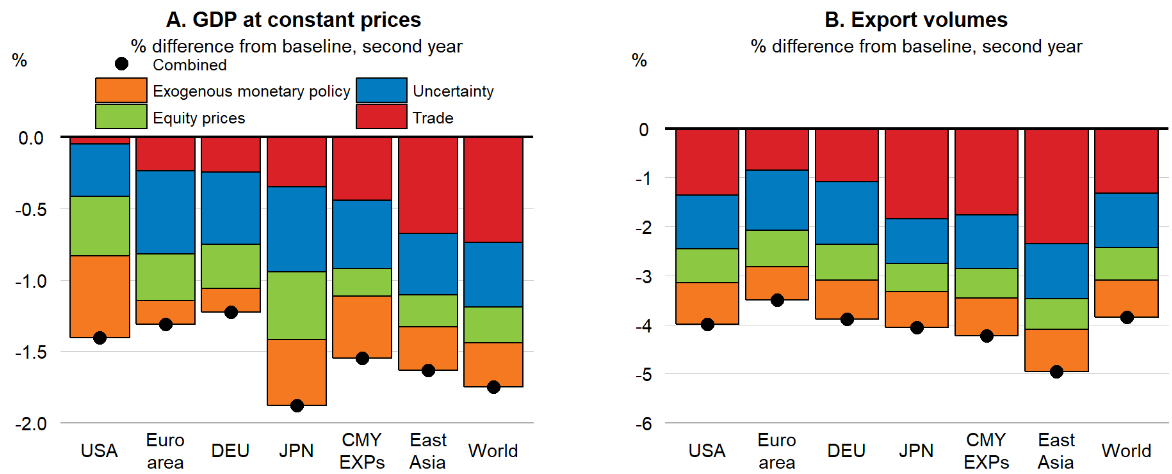
The baseline projections for China assume that the policy stimulus measures now being undertaken will offset the underlying softness in trade and private demand seen in recent months and prevent a sharp slowdown in growth. While signs have started to emerge that growth is now stabilising, risks remain that renewed policy stimulus either proves to be insufficient or less effective than anticipated. A much sharper unexpected slowdown in China would have significant adverse consequences for global growth and trade given the rising trade and financial linkages China now has around the world.

A key feature of the experience in 2015-16, when global trade and output growth also slowed markedly, was the extent to which weaker domestic demand growth in China resulted in a sharp slowdown in Chinese import volume growth. In turn, this reduced export volume growth and GDP growth in all economies.[5] The slowdown in China was also reflected in global financial markets, with risk premia widening on corporate and emerging-market bond spreads during 2015-16, and global equity prices declining by around 10%. Illustrative simulations, using the NiGEM global macroeconomic model, highlight the adverse effects that a repeat of such developments might have on global growth and trade.

- By itself, an unanticipated decline of 2 percentage points in the growth rate of domestic demand in China for two years could lower global GDP growth by close to 0.4 percentage point per annum, with the impact on Japan, commodity-producing economies and other economies in East Asia being higher than elsewhere (Figure 1.14, Panel A). Chinese import volume growth could decline by around 3¼ percentage points per annum on average in the first two years, hitting export volume growth in key trading partners, including Germany and many Asian economies (Figure 1.14, Panel B).

[5] OECD estimates suggest that import volume growth in China slowed from an average annual pace of over 9% in 2013-14, to under 5% in 2015-16, with world trade growth slowing by around 1 percentage point between the same periods.

Figure 1.14. A sharper slowdown in China would hit growth and trade around the world



Note: Simulated impact of a two-year decline of 2 percentage points per annum in domestic demand growth in China, and a rise of 50 basis points in investment risk premia and decline of 10% in equity prices in all economies. The red bars show the contribution from the direct slowdown in trade; the blue bars show the additional contribution from adding higher uncertainty; the green bars show the contribution from lower equity prices; and the orange bar shows the additional effects if monetary policy is not able to act. Commodity exporting economies (CMY EXPs) include Argentina, Brazil, Chile, Indonesia, Russia, South Africa and other non-OECD oil-producing economies. East Asia includes Korea and the Dynamic Asian Economies.
Source: OECD calculations using NiGEM.

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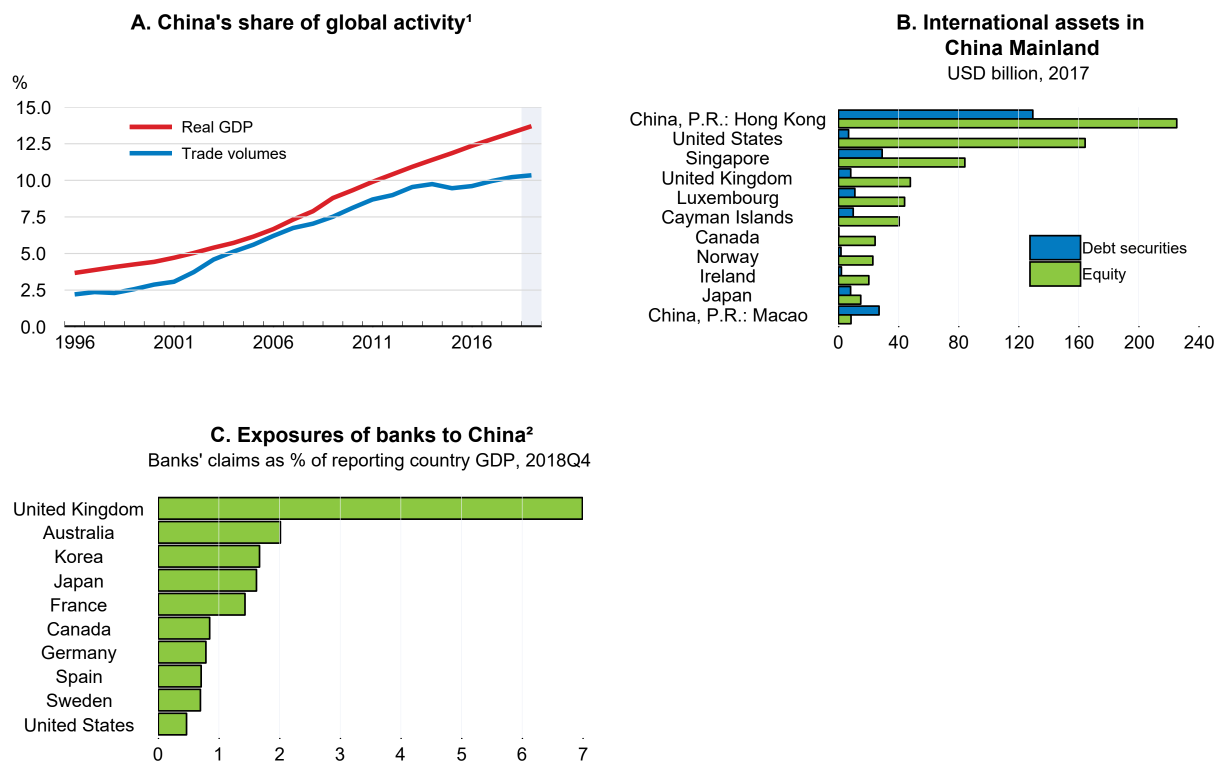
- Greater uncertainty could add to these costs significantly, particularly in the advanced economies, by raising investment risk premia in financial markets and the cost of capital for companies. A fall in equity prices would further raise the cost of capital and also slow consumers' expenditure through adverse effects on household wealth. Incorporating an additional rise of 50 basis points in global investment risk premia and a decline of 10% in global equity prices for two years, the combined shock reduces global GDP growth by 0.7 percentage point per annum on average in the first two years and global trade growth by close to 1½ per cent per annum. The financial shocks add significantly to the cost of the initial demand shock in many advanced economies, although neighbouring economies in Asia continue to be the most heavily affected.
- Spillovers from the slowdown from China would be larger still if monetary policymakers around the world were not able to react because of limited policy space. If policy interest rates were fixed, the overall impact of the combined set of shocks would rise further, hitting global GDP growth by 0.8-0.9 percentage points per annum over the first two years, and lowering global trade growth by 1¾ percentage points per annum on average in the same period.

In contrast to trade, China's integration into global financial markets remains modest (Figure 1.15).[6] The exposures of advanced economies via financial assets are not large, with a few exceptions, including the United Kingdom, Korea and Australia and some financial centres (including Luxembourg, Singapore and

[6] The share of China's foreign portfolio assets in world international portfolio liabilities, and the share of portfolio liabilities vis-à-vis non-residents in world international portfolio assets, are small compared with G7 countries and relatively large compared with other BRIICS. However, this does not account for the fact the Chinese economy is significantly larger than the economies of other BRIICS. The integration of Chinese RMB-denominated assets is advancing fast, spurred by the inclusion of such assets in global bond benchmark indices. For example, local currency Chinese bonds are being phased into the Bloomberg Barclays Global Aggregate Index; when fully accounted for, scheduled at the end of 2020, they would represent 5½ per cent of the index (based on data as of end-January 2018).

Ireland), and are more important for equities than debt securities.[7] For most advanced economies, bank exposures to China are also small both in absolute terms and relative to exposures to all other EMEs and to other individual large advanced economies. However, the ultimate aggregate exposures could be larger if exposures via financial centres are fully taken into account. Moreover, even if national exposures are small, individual financial institutions can still be vulnerable to developments in China; if such institutions are large and strongly interlinked with other domestic and global institutions, negative China-related shocks could spread widely.

Figure 1.15. Trade linkages with China remain more important than financial linkages



1. Global GDP and trade in goods and services are measured at constant prices and market exchange rates. Trade in goods and services is measured as the average of import and export volumes.
2. Ultimate risk basis.
Source: Bank for International Settlements; IMF Coordinated Portfolio Investment Survey (CPIS); OECD Economic Outlook 105 database; and OECD calculations.

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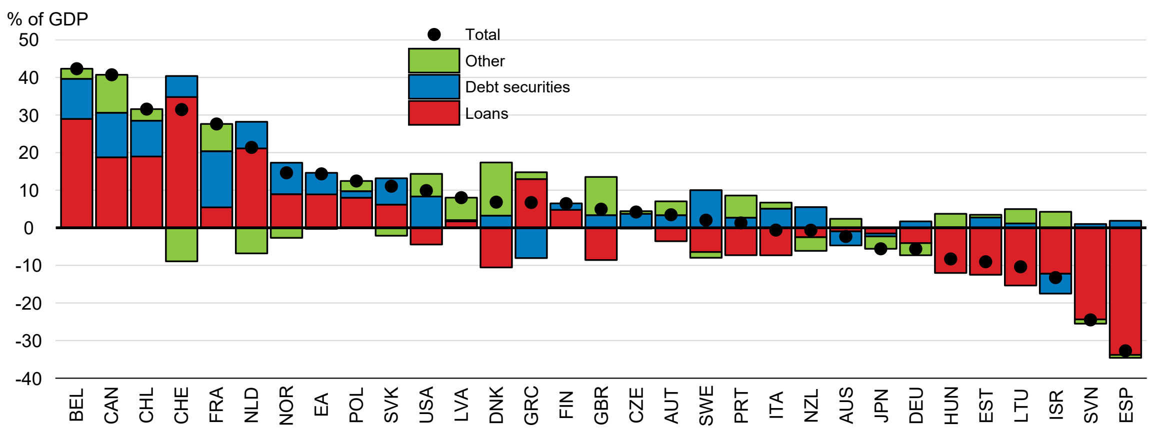
[7] Advanced economies' holdings of Chinese debt securities and equities are small relative to holdings of debt securities of other large advanced economies and in some cases are no bigger than holdings of some other BRIICS' debt securities.

Financial vulnerabilities remain from high private debt and poor credit quality

High debt of non-financial corporations and its deteriorating quality could pose a risk to financial stability in a weakening economic environment. In the context of highly accommodative monetary policy, the debt-to-GDP ratio of non-financial corporations has increased in many advanced economies; in some cases, exceeding the prior historical peaks reached in 2008 (Figure 1.16; OECD, 2017). This increase took place on the back of a notable surge in bond financing.[8] In addition, strong risk appetite and loose financial conditions contributed to a deterioration in corporate credit quality (Box 1.2). Even if interest rates remain low for longer than previously expected, solvency risks associated with high debt have increased due to the current global slowdown, which is likely to reduce firms' revenue growth. Corporate stress could trigger a change in investors' risk appetite and result in widespread sell-offs in corporate bonds. Even limited market shocks have the potential to produce large price corrections because non-investment-grade corporate debt is typically much less liquid. The current composition of corporate bonds may also increase the risk of fire-sales, as a high share of corporate bonds is rated just above non-investment grade (Çelik and Isaksson, 2019; Figure 1.17, Panel B). If these bonds are downgraded to non-investment grade, institutional investors who are bound by rating-based regulatory requirements will be obliged to sell them.

Figure 1.16. The debt of non-financial corporations has increased in many OECD economies

Change in debt between 2007 and 2017



Note: On a consolidated basis, except for Canada, the euro area, Japan, New Zealand, Switzerland and the United States.
Source: OECD Economic Outlook 105 database; OECD National accounts database; and OECD calculations.

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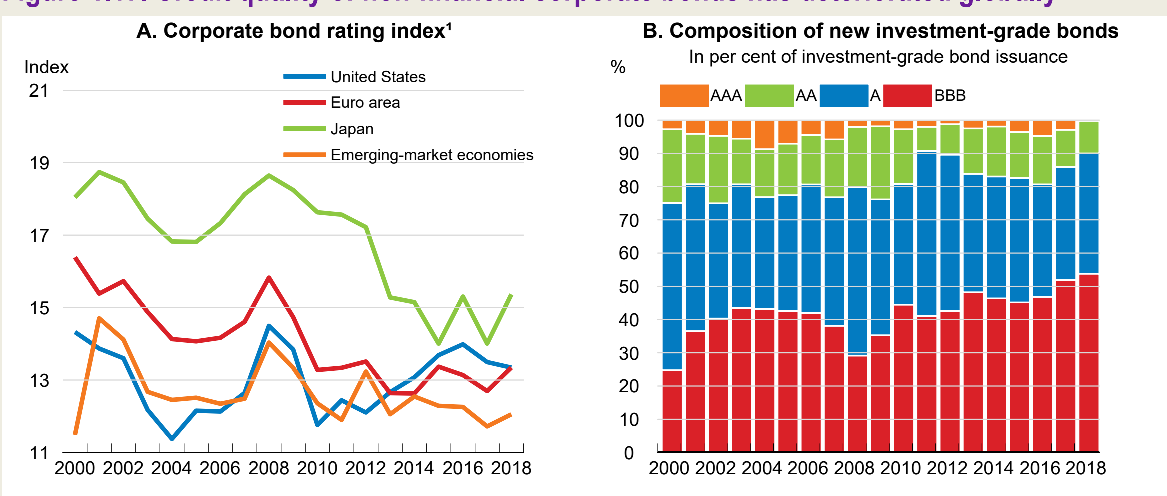
[8] The stock of non-financial corporate bonds in advanced economies at the end of 2018 reached over USD 10 trillion, rising by nearly 70% in real terms since 2008 (Çelik and Isaksson, 2019). A steady increase in net bond issuance was observed across most advanced economies, including in Europe where external finance is nevertheless still primarily based on bank credit.

Box 1.2. Corporate credit quality has deteriorated

Since the financial crisis, strong risk appetite and loose financial conditions have contributed to a surge in sub-investment grade assets, such as high-yield bonds and floating-interest-rate leveraged loans (Figure 1.17). In bond markets, there has been a strong issuance of high-risk debt securities and a weakening of covenants, i.e. the legal provisions to protect investors in the event of a default or restructuring, including in emerging-market economies (Çelik and Isaksson, 2019). This makes it more difficult for investors to prevent losses.

Leveraged loans in the main advanced economies have increased rapidly over recent years to an estimated USD 1.3 trillion. However, this figure includes only leveraged loans that are sufficiently large and traded to be captured within industry indexes such as the S&P Global Levered Loan Index. A more comprehensive assessment of the full leveraged loan market indicates that the loans outstanding are currently above USD 2.1 trillion (2½ per cent of global GDP in 2018) (Figure 1.18; Patalano and Roulet, 2019). Leveraged loans have often been issued on the basis of fragile business metrics such as earnings "add-backs".[1] These could underestimate actual leverage ratios and circumvent covenants that limit additional debt. Around 60% of leveraged loans are "covenant-lite" and, despite protecting investors from interest rate risk, they tend to be riskier than high-yield bonds, as they offer lower call protection,[2] poorer liquidity and more limited transparency and regulation in case of a default (Bank of England, 2018). A sizeable share of leveraged loans at a global level are bundled in collateralised loan obligations (CLOs), and sold to investors, including investment funds and insurance companies.[3]

Figure 1.17. Credit quality of non-financial corporate bonds has deteriorated globally



1. The lower the value of the index, the lower the quality of bonds.
Source: Çelik and Isaksson (2019), "Corporate Bond Markets in a Time of Unconventional Monetary Policy", *OECD Capital Market Series*, OECD Publishing, Paris.

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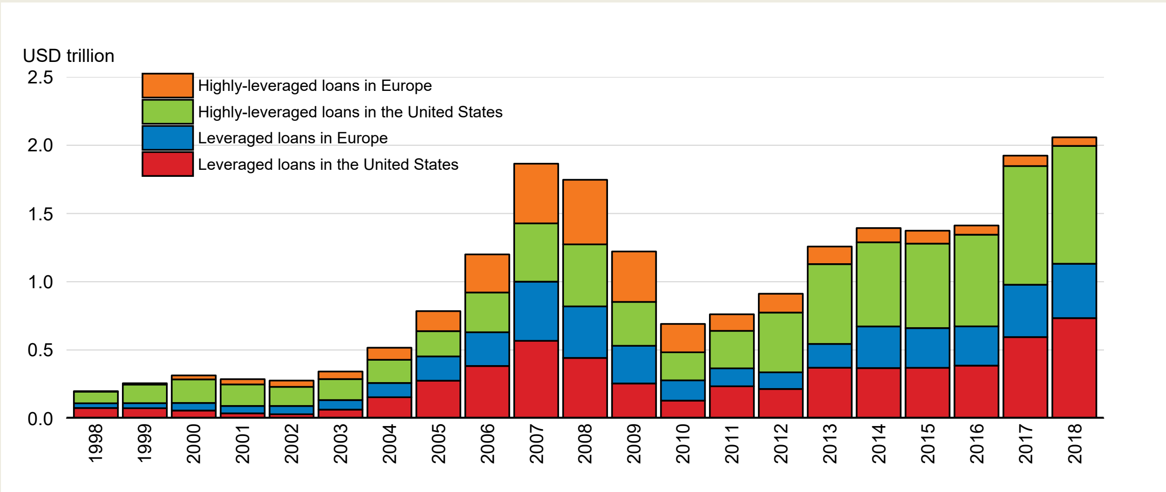
Figure 1.18. Leveraged loans outstanding in Europe and in the United States



Note: The outstanding amount is calculated based on loan issuance but excludes the value of drawn and undrawn revolving credit facilities. A linear amortisation schedule is assumed for term loans and other amortising loans (i.e. mortgages, equipment, construction and commercial loans). All other term loans are not amortised as they are repayable at maturity. To account for loan re-financing, a 40% early repayment ratio is assumed.
Source: Patalano, R., D. and C. Roulet (2019), "Structural Developments in Financial Intermediation: The Rise of Debt and Non-Bank Credit Intermediation", *OECD Working Paper*, forthcoming, OECD Publishing, Paris.

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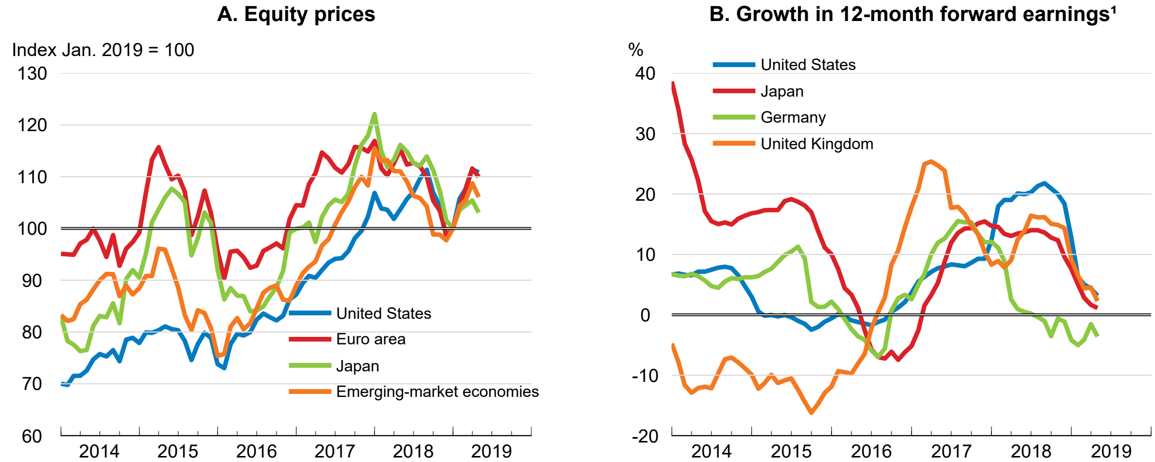
1. Earnings “add-backs” are adjustments to company earnings before interest, taxes, depreciation and amortisation (EBITDA) used to gain access to debt markets. They include future cost savings or increases in sales that are not set to materialise in the short term. Add-backs in the past years have become an accepted part of the loan syndication process, as – in principle – they should provide a more realistic view about the company’s future ability to service its borrowing.
2. Leveraged loans are continuously callable at par. Therefore, their price stays at or near par during a strong market environment, limiting possible upside price surprises.
3. Around 45% of the stock of global leveraged loans in institutional investors’ portfolios are held through collateralised loan obligations (CLOs), and 30% by investment funds and insurance companies. The remaining share is unallocated, because it is unclear who the end-investors are (Bank of England, 2018).

An apparent disconnect between recent equity market dynamics and projected corporate fundamentals may signal a risk of correction. It also underlines how sensitive these markets have become to changes in expectations of future interest rates. Since January 2019, stock markets have picked up once again, on the back of a rebound in investor sentiment, though this was dented in May by renewed trade tensions between China and the United States (Figure 1.19, Panel A). In the major advanced economies, the increase in equity prices was partly a reaction to central banks’ communication implying that policy interest rates were likely to be lower for longer. However, at the same time, expected corporate earnings growth has continued to be revised down (Figure 1.19, Panel B), due to projections of weaker economic growth, increased labour cost pressures on profit margins and, in the United States, the waning effects of the corporate tax reduction.

Figure 1.19. Changes in equity prices seem to be disconnected from expected corporate earnings



1. Earnings are 12-month forward forecasts from the IBES.
Source: Refinitiv; and OECD calculations.

StatLink https://doi.org/10.1787/888933933463

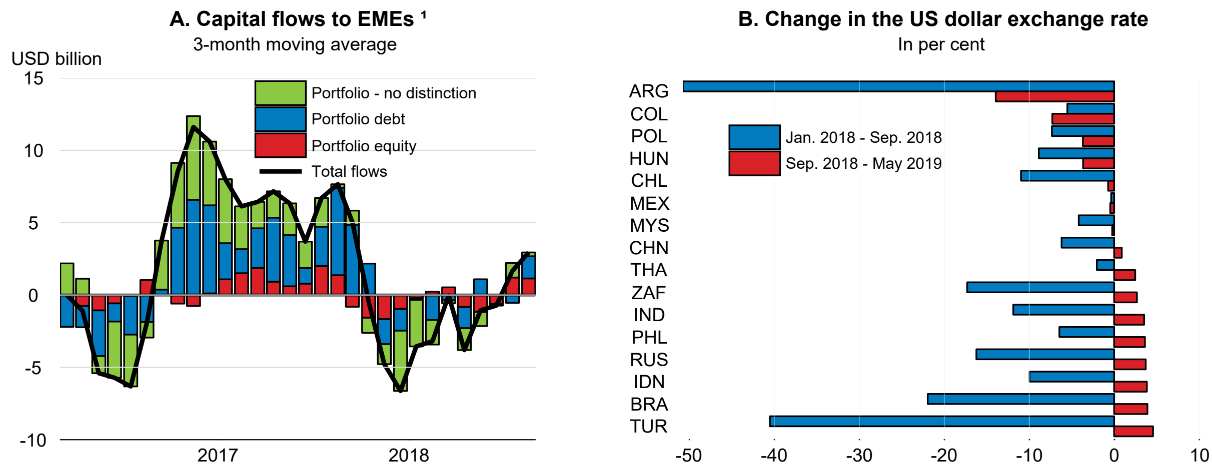
Financial conditions in emerging-market economies have improved this year, but vulnerabilities persist. Many emerging-market economies experienced financial stress in 2018, reflecting both US monetary policy normalisation and idiosyncratic domestic factors. After key central banks in advanced economies signalled a pause in the normalisation of monetary policy, tensions eased in many countries, with their currencies recovering part of the 2018 losses vis-à-vis the US dollar and signs that capital inflows have picked up (Figure 1.20). Despite these improvements, emerging-market economies remain vulnerable to a widespread reduction in risk appetite in the context of trade tensions and weak global economic growth. Vulnerabilities stem from various imbalances related to current account deficits, foreign currency-denominated debt and a rapid increase in the debt of non-financial corporations.[9]

Financial stress has intensified in Turkey and Argentina amid increased political uncertainty and continued macroeconomic imbalances. In Turkey, bond yields and credit default swaps have risen considerably since the start of 2019 and the exchange rate has weakened again. The country's large external financing needs and dwindling net foreign exchange reserves represent a significant risk in event of a further depreciation of the national currency.[10] Risks also remain high in Argentina, where the benchmark interest rate has increased sharply, as the monetary policy framework to keep base money constant was extended to support the peso after it hit a record low against the US dollar, and to reduce inflation.

[9] Debt securities of non-financial corporations in emerging-market economies increased almost six-fold between 2008 and 2018 in real terms, driven primarily by China, with the outstanding stock of bonds reaching USD 2.78 trillion at the end of 2018 (Çelik and Isaksson, 2019).

[10] The stock of foreign-currency-denominated short-term foreign debt was USD 171 billion in February 2019, around 25% of GDP. In mid-May 2019, net foreign currency reserves reported by the central bank amounted to around USD 26.6 billion, without taking into account off-balance sheet swap liabilities.

Figure 1.20. Market sentiment vis-à-vis emerging-market economies has improved



1. Capital flows by non-residents (international liabilities) for a subgroup of emerging-market economies (EMEs) for which monthly capital flow series are available (Argentina, Brazil, Bulgaria, Chile, Hungary, India, Pakistan, the Philippines, Poland, Romania, Turkey and Ukraine).
Source: Refinitiv; and OECD calculations.

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Policy considerations

Policymakers need to act to ensure sufficient support for demand, prevent downside risks from materialising, enhance resilience and strengthen medium-term growth prospects. The projected near-term weakness in the euro area warrants a combination of policy responses among member countries. In the event of an even sharper global growth slowdown than projected, co-ordinated policy action within countries and across countries would provide the most effective counterweight. Preparing for such an eventuality now by planning additional growth-enhancing measures that can be rolled out rapidly would increase the effectiveness of policy response.

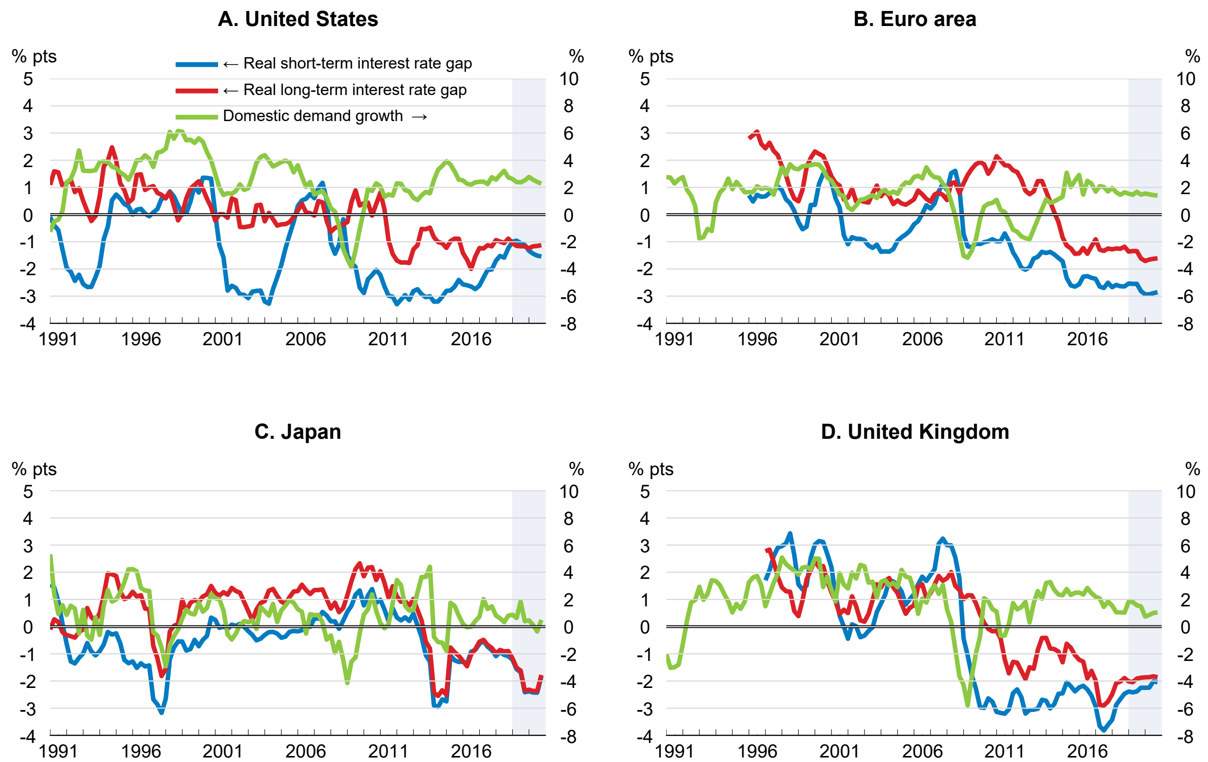
Monetary policy considerations

In the main advanced economies, given rising uncertainty, contained inflation and weaker growth prospects, the monetary authorities have either paused policy normalisation or added modest stimulus, with monetary policy remaining highly accommodative (Figure 1.21):

- In the United States, the more uncertain economic outlook and already advanced stage of policy normalisation, together with uncertainties about the longer-term level of equilibrium interest rates, justify the Federal Reserve's decision to pause further interest rate increases. If downside risks materialise and the economy and inflation slow more than currently projected, the monetary policy stance could be eased. On the other hand, if economic growth and inflation turn out to be stronger than anticipated and downside risks dissipate, further interest rate increases would be required. The Federal Reserve has also decided to slow the pace at which it reduces its holdings of US Treasury securities between May and September and subsequently to keep them constant by reinvesting all maturing securities.[11] Thus, monetary policy implementation will continue to operate with an ample supply of excess reserves (the so-called floor system).

[11] However, it intends to maintain the pace of reducing its holdings of agency debt and mortgage backed securities, with some share of the principal payments being reinvested in Treasury securities.

Figure 1.21. Monetary policy remains highly expansionary



Note: The real interest rate gap is the difference between the real interest rate and year-on-year real potential GDP growth, as a proxy of the neutral interest rate. The real interest rate is calculated as either a short or long-term interest rate minus year-on-year core consumer price inflation (i.e. consumer price inflation excluding prices of food and energy). In Japan, inflation is not corrected for the effects of increases in consumption tax rates. All data are at quarterly frequency. Domestic demand growth is the year-on-year percentage change.
Source: OECD Economic Outlook 105 database; and OECD calculations.

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- In the euro area, the ECB has strengthened forward guidance regarding policy interest rates and announced that it expects them to remain at present levels at least until the end of 2019 (compared with summer 2019 communicated previously). After ceasing net asset purchases in December 2018, the ECB committed to reinvest the principal payments from maturing securities until well past the date when it started raising policy interest rates. The monetary authorities also announced new targeted longer-term refinancing operations (TLTROs), to be launched in September, to replace a similar scheme that is about to expire, as some banks could find it too costly to access wholesale markets for funding.
- The Bank of Japan has maintained the negative policy rate, continued to purchase assets to fix the 10-year government bond yield at close to zero and strengthened forward guidance by announcing that it intends to maintain interest rates low for a prolonged period, at least until around spring 2020. The Bank of Japan has also extended the special funding schemes for banks.

In the euro area, the transmission of monetary policy could be made more effective by improving the profitability and balance sheets of banks. In this respect, supervisors and national authorities should increase efforts to accelerate the disposal of non-performing loans, as these still remain high in some banks. They should also encourage banks to address long-standing structural problems of low cost efficiency, limited revenue diversification and bank overcapacity (ECB, 2018). The potential side effects of sustained monetary stimulus on the profitability of the banking sector, via flat yield curves and negative interest rates on deposits at the ECB, should also continue to be evaluated, together with potential ways to alleviate these effects.

While prolonged monetary policy stimulus is warranted to return inflation to the target, it may involve undesirable side-effects, such as inflated asset prices and high debt. This can ultimately complicate the eventual normalisation of monetary policy as it may expose excesses and raise financial stability concerns. To minimise such side-effects, supervisory macroprudential policies should be actively used, even though there are concerns about their effectiveness (Box 1.3), and their implementation and calibration can be challenging. Their effectiveness depends on efficient micro and macro supervision and, where relevant, successful co-operation among different regulatory bodies.

Box 1.3. Macroprudential policies: Their use and effectiveness

Macroprudential policy tools have been used in many economies since the global financial crisis to make the financial system more resilient to shocks and to address emerging vulnerabilities. These tools supplement microprudential measures and supervision that aim to ensure that individual institutions are solid, which is a prerequisite for a sound financial system. In the environment of prolonged low inflation and low policy interest rates over the past decade, macroprudential policy tools have also been employed to help attenuate the negative side effects of accommodative monetary policy aimed at raising inflation closer to target.

Current macroprudential measures

Macroprudential policies can operate at either the lender or the borrower level. At the lender level, they are generally implemented through additional bank capital buffers (e.g. a capital conservation buffer, a countercyclical capital buffer or higher risk weights for specific exposures) alongside the introduction of the Basel III framework. The most commonly used macroprudential policy tools targeted at borrowers are loan-to-value (LTV), debt-to-income (DTI), and debt-service-to-income (DSTI) limits. They primarily apply to mortgage loans provided by banks, as the real estate sector is an important target of macroprudential policy, reflecting the destabilising effects of excessive housing-related lending in many countries in the past (Cournède et al., 2019).

To date, lender-based macroprudential policy instruments have been adopted in a number of countries, in both advanced and emerging-market economies, with the introduction of the Basel III framework. With some signs of the financial cycle maturing, several predominantly European countries have already activated countercyclical capital buffers and, in many of these countries, the buffers are to be increased (Table 1.2).[1] In France, the buffer will be introduced in July 2019 and then raised to 0.5% of risk-weighted assets in April 2020, reflecting strong growth in the indebtedness of non-financial corporations and households. Notwithstanding increased use of such buffers, they are not applied in many large economies, including the United States, China, Japan and Germany.

Table 1.2. The use of counter-cyclical buffers

Country	Current rate	Announced future rate	Motivation for changing the CCyB rate
Bulgaria	0%	0.5% from 01/10/2019 0.75% from 01/01/2020	High growth of credit, especially for households
Czech Republic	1.25%	1.5% from 01/07/2019 1.75% from 01/01/2020	Robust credit growth with easy financial conditions
Denmark	1%	1.5% from 01/01/2020 2% from 30/06/2020	The economy is in an upswing, and financial conditions are expansionary
France	0%	0.25% from 01/07/2019 0.5% from 02/04/2020	Strong increase in the indebtedness of NFCs and households
Hong Kong	2.5%	-	High credit growth and high housing prices
Iceland	1.25%	1.75% from 15/05/2019 2% from 01/02/2020	Rapid increase in household debt and house prices
Ireland	0%	1% from 05/07/2019	Strong increase in mortgage lending
Lithuania	0.5%	1% from 30/06/2019	Strong credit growth, strong real economy, and banks' high profitability
Luxembourg	0%	0.25% from 01/01/2020	NA
Norway	2%	2.5% from 31/12/2019	High house price inflation and a continued rise in household debt
Slovak Republic	1.25%	1.5% from 01/08/2019	NA
Sweden	2%	2.5% from 19/09/2019	High increase in the indebtedness of NFCs and households
United Kingdom	1%	-	The CCyB rate is set to be 1% in a standard risk environment

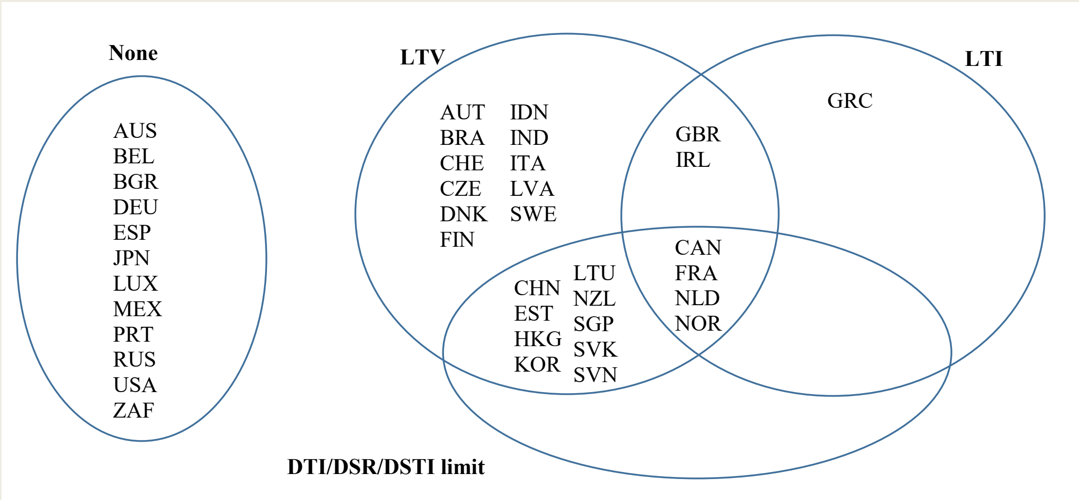
Note: Counter-cyclical buffers (CCyB) are expressed in per cent of risk-weighted assets.
Source: National authorities; European Systemic Risk Board; and Financial Stability Board.

As for borrower-based macroprudential policy tools, LTV limits are the most widely employed (Figure 1.22), particularly in countries with rapid mortgage credit and house price growth (Cournède et al., 2019). LTV limits are useful as the cap can be adjusted for different types of borrowers, such as first-time buyers, buyers of a second property or investors.[2] Most of the countries using LTV limits combine them with either LTI or DTI/DSR/DSTI limits, and in four cases in Figure 1.22 all three limits are used. Still, several economies do not implement any statutory borrower-based regulatory measures although in some of them, like in the United States, regulators issue prudential guidance.

Effectiveness of macroprudential policy

Empirical evidence on the effectiveness of macroprudential policy is still limited and tentative. This partly reflects the short experience in using such measures. Most measures have been implemented in response to the last global financial crisis and have not been tested over a full financial cycle. However, tighter macroprudential policies are found to be associated with lower bank credit growth and house price inflation (Akinci and Olmstead-Rumsey, 2018). Measures intended to limit house price inflation are more effective in countries where bank finance is important (Akinci and Olmstead-Rumsey, 2018), but seem to be less effective in more developed and open economies, as their application comes with greater cross-border borrowing (Cerutti et al., 2017). Macroprudential measures, in particular LTV limits, seem to be more effective during booms than busts (Cerutti et al., 2017; Richter et al., 2018).

Figure 1.22. The use of borrower-based macroprudential measures



Note: LTV stands for loan-to-value, LTI stands for loan-to-income, DTI stands for debt-to-income, DSR stands for debt service ratio, and DSTI stands for debt-service-to-income. Only binding regulatory measures are shown; prudential guidance is not included.
Source: National authorities; European Systemic Risk Board; and Financial Stability Board.

1. In Switzerland, a capital surcharge is applied to mortgage loans.
2. For instance, in New Zealand, tighter LTV limits are imposed for investors (70%) than for owner-occupiers (80%). In Canada, borrowers with a new mortgage loan in specific geographic areas where housing prices have increased rapidly need to meet tighter LTV limits.

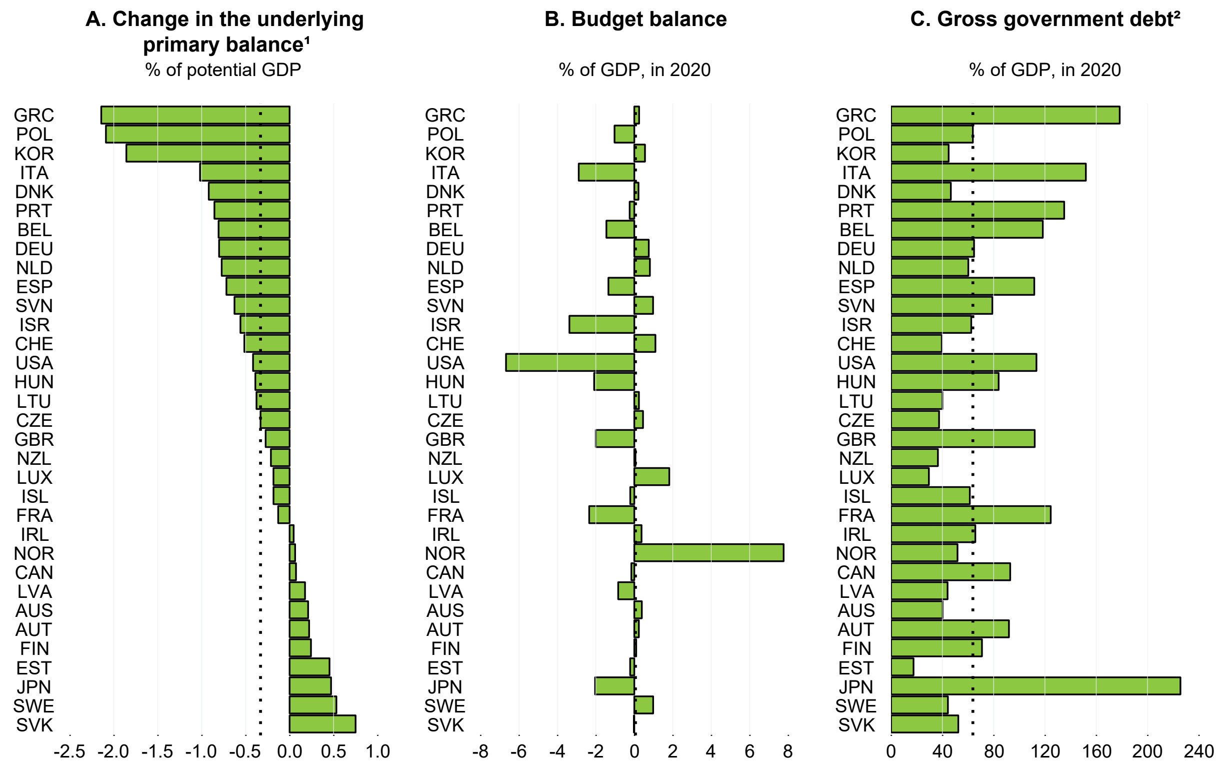
Fiscal and fiscal-structural policy considerations

In the majority of OECD economies, the fiscal policy stance is expected to be eased slightly in 2019-20, with the median easing over these two years combined of around 0.3% of potential GDP (Figure 1.23, Panel A).[12] In some countries, this reflects an appropriate reaction to weaker economic growth. In the euro area, combined actions, involving renewed reform efforts and fiscal support where space exists, is needed (see below). Budget balances are expected to deteriorate in 2019-20 in nearly half of the OECD countries despite still falling net interest payments and some cyclical improvement in primary balances in a few cases (Figure 1.23, Panel B). Nonetheless, gross debt is set to decline relative to GDP in most countries, helped by nominal GDP growth, with a notable exception of the United States. Even so, in several countries, public debt and budget deficits will remain high (Figure 1.23, Panel C).

The appropriate stance of fiscal policy depends on policy needs and constraints, and thus differs across countries and areas. If downside risks for the global economy were to materialise, co-ordinated fiscal policies would be required more generally to help limit the downturn. As discussed below, there is scope in some economies to ease fiscal policy without compromising debt sustainability.

[12] The projection assumes an unchanged fiscal stance in general, unless discretionary measures have been voted or have been announced and are likely to be implemented soon (Annex 1.A). In Italy, the projected fiscal easing in 2020 includes about half of the legislated increase in the VAT rate.

Figure 1.23. Projected fiscal positions



Note: Vertical lines show medians.

1. Change between 2018 and 2020.

2. Based on the national accounts definition.

Source: OECD Economic Outlook 105 database; and OECD calculations.

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Assessing the need for fiscal easing for stabilisation purposes is inherently challenging, reflecting uncertainties about the real-time estimates of the cyclical position of the economy. In general, fiscal stimulus is desirable in countries with GDP below estimated potential output and unemployment above its estimated equilibrium level, particularly if the scope for additional monetary policy support is limited. This is still the case for many European countries. However, estimates of spare capacity are subject to considerable uncertainty and can be revised significantly, especially around major cyclical turning points. Even if spare capacity is limited, additional fiscal measures may be appropriate if inflation remains low, actual growth remains sluggish and there is significant need for new infrastructure, which is currently the case for some euro area countries. An expansionary fiscal stance in some countries could also help to address external imbalances, with fiscal easing offsetting large private financial surpluses and thus helping to reduce large current account surpluses.[13]

[13] Germany and the Netherlands have very large current account surpluses (Figure 1.26), which are identified as external imbalances according to the EU Macroeconomic Imbalances Procedure (European Parliament, 2019). In Germany, this imbalance reflects subdued investment, including in the public sector.

In many euro area and other advanced economies, fiscal room has expanded as a result of prolonged monetary policy stimulus. Despite rising debt-to-GDP ratios, government interest payments declined in relation to GDP between 2010 and 2018 in many OECD countries (Figure 1.24). This reflected both lower market interest rates and transfers of profits from central banks, which were boosted by interest earned from government bonds that they purchased, and nominal GDP growth. Together, macroeconomic and structural policies could provide additional support to the public finances by making it possible to achieve higher nominal GDP, particularly if the normalisation of monetary policy were to be delayed (Figure 1.25). In this context, implementing growth-enhancing structural reforms could contribute to such a favourable outcome, although in some countries government debt would still remain high in the longer term.[14]

Several OECD countries seem to have scope to ease fiscal policy without compromising debt sustainability. A commonly used benchmark for debt-sustainability assessment is the difference between the effective interest rate paid on (net) debt and nominal GDP growth (so-called r-g). If the difference is negative, as is currently the case and expected to remain so for the majority of OECD countries (Figure 1.26), then debt will eventually stabilise over time. However, depending on the path of the primary balance, this may still imply that debt rises relative to GDP, which may not be desirable. Alternatively, the scope for fiscal easing could be estimated by calculating the primary balance needed to stabilise debt in relation to GDP at a given level. These two indicators are not enough to assess public debt sustainability fully, and other aspects, like the level of taxes, potential growth and future liabilities related to population ageing and health care should be taken into account.

- In this context, countries that have a primary balance above the level necessary to stabilise the debt ratio at recent levels, and relatively low government debt, may engage in fiscal easing whilst still having a gradual decline in gross debt in relation to GDP in the near term (Figure 1.27).[15] This is the case for several European countries, including Germany, the Netherlands, Sweden and Switzerland. In the Netherlands and Germany, where the difference between the actual and debt-stabilising balance is particularly large, fiscal stimulus does not need to use all of the space available so as to avoid an excessively pro-cyclical fiscal stance and to ensure a sustained downward debt trajectory. Some other European countries, like Belgium, Spain and the United Kingdom, also could lower budget balances without increasing debt. However, their relatively high level of public debt calls for prudence in undertaking fiscal easing.
- In contrast, in some countries, including France, Japan and the United States, current primary budget balances are adding to, and in Italy sustaining, already-high government debt, and thus further fiscal stimulus risks undermining future debt sustainability. In these countries, the authorities could still support economic activity by changing the structure of spending and taxes towards areas that are more conducive to economic growth. For example, a budget neutral policy could increase spending on growth enhancing components – like education and public investment in health, and research and development – while cutting growth-reducing spending – such as subsidies in sectors that restrict competition and distort effective resource allocation (OECD, 2016a).

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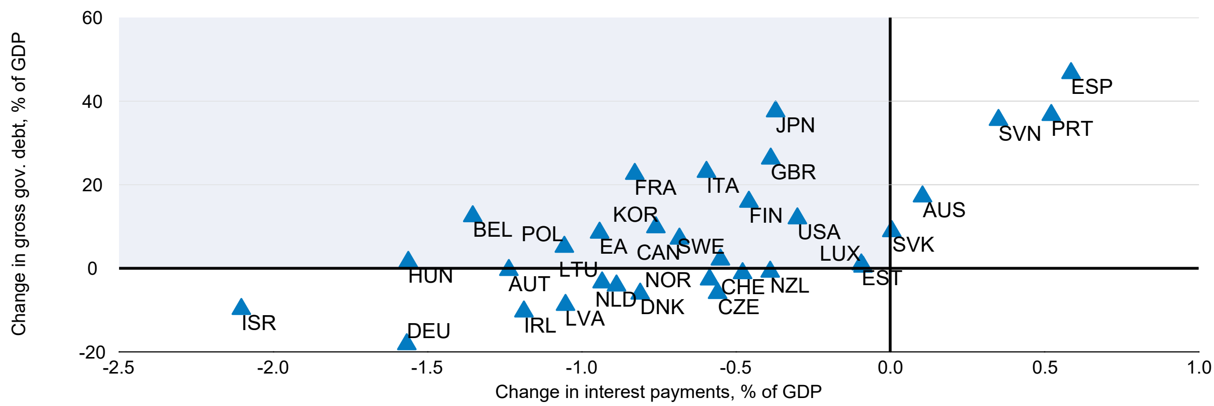
[14] For instance, significant new reforms to ease regulation in the energy, transport and communication sectors and boosting spending on active labour market policies in G7 economies could increase the GDP level on average by 1% after five years (OECD, 2018a).

[15] The primary balance needed to stabilise debt shown here is only indicative. It is calculated based on the 2018 differential between the effective interest rate paid on government debt and nominal GDP growth rate. This balance will not be stable over time. It will decline if the interest-growth differential falls and it will increase with a higher gross debt-to-GDP ratio if the interest-growth differential is positive, all other things being constant. If the fiscal stimulus is effective in rising nominal GDP growth, it would likely help to improve debt dynamics by lowering the interest-growth differential.

Figure 1.24. Interest payments on government debt have declined in many countries despite higher debt

Changes between 2010 and 2018



Source: OECD Economic Outlook105 database; and OECD calculations.

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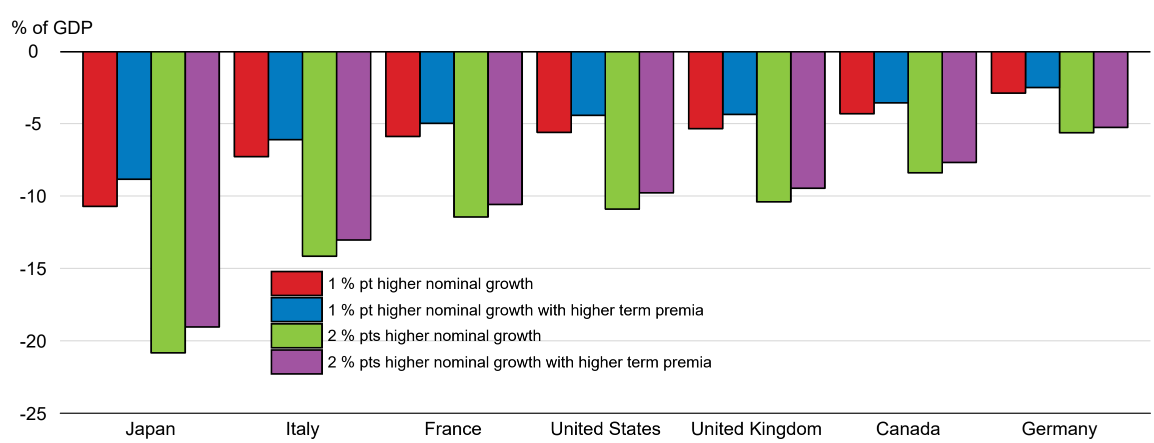
Figure 1.25. Higher nominal GDP growth could create additional fiscal space in the medium term if monetary policy does not react

Debt-to-GDP ratio after five years, difference from baseline



Note: Higher nominal growth by 1 or 2 percentage points (% pts) relative to baseline (nominal interest rates, nominal primary budget balances and nominal government financial assets are as in baseline). Higher term premia imply higher 10-year bond yields by 0.5 percentage point relative to baseline (with short-term interest rates kept as in baseline).
Source: OECD Economic Outlook 105 database; and OECD calculations.

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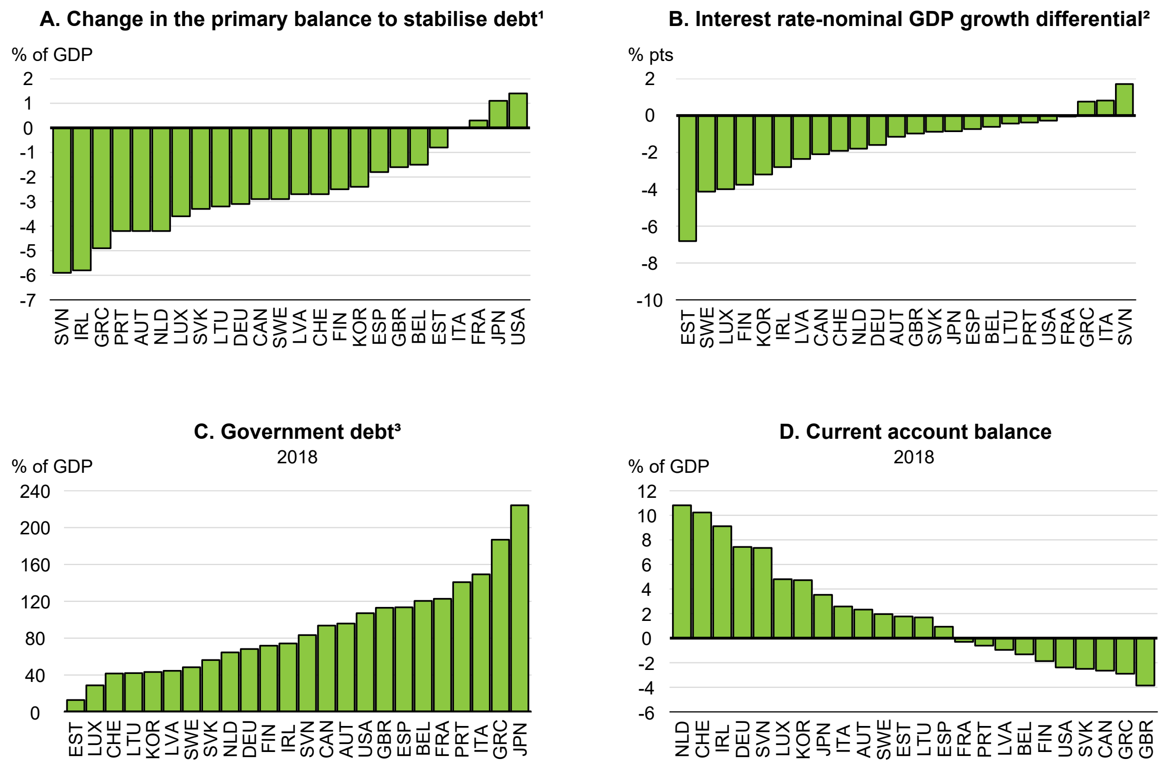
Figure 1.26. The need and room for fiscal stimulus differs across OECD countries



1. The change in the primary balance to stabilise debt is the difference between the primary balance that would stabilise the debt-to-GDP ratio at its 2018 level and the primary balance projected for 2019, based on the assumption that the nominal value of government financial assets does not change. A positive value implies that a country should tighten fiscal policy to stabilise the debt-to-GDP ratio.
2. The average difference between the effective interest rate paid on net debt (*r*) and nominal GDP growth (g) for 2016-18 (the so-called *r-g*). *r* is the weighted difference between the implied interest rate paid on government financial liabilities and the implied interest rate earned on government financial assets, where the weights are the share of financial liabilities and assets in net debt, respectively.
3. Government debt refers to the national accounts definition.
Source: OECD Economic Outlook 105 database; and OECD calculations.

StatLink https://doi.org/10.1787/888933933577

The current modest growth rates in the euro area, and the limited scope for substantial additional monetary policy support, highlight the important role that combined structural and fiscal policy efforts could play in lifting growth. Indeed, some additional well-targeted fiscal easing is required now in those euro area countries with fiscal space. Such easing would help the benefits of structural reforms to appear more quickly, provide some additional near-term support to demand, and thus allow monetary policy to remain accommodative for longer, and ultimately deliver higher output in the short and medium term (Box 1.4).

Box 1.4. A combination of reforms is needed in the euro area to strengthen growth prospects

Euro area growth has slowed considerably over the past year and is projected to remain subdued through the rest of 2019 and 2020. This adds to the challenges facing policymakers from the low rate of potential output growth, currently estimated to be around 1¼ per cent per annum. Poor medium-term prospects, reinforced by short-term demand weakness and the slump in business confidence act as disincentives to invest, raising the risk that the current slowdown in the euro area becomes entrenched and current expectations of weak medium-term growth become self-fulfilling. New policy measures are thus required to enhance area-wide growth prospects in the medium term and strengthen short-term demand in the euro area.

Actions by all countries, involving renewed structural reform efforts augmented by targeted fiscal support where space exists, along with continued low interest rates, offer the best prospects for restoring growth and improving living standards over time. A well-designed combination of country-specific structural and fiscal measures, accompanied by monetary policy keeping interest rates low for a longer period, can reinforce the benefits of each policy measure and mitigate the short-term side effects of others, to the benefit of the euro area as a whole. Supportive macroeconomic policies can help to bring forward the effects of structural reforms, particularly at a time when growth is soft, as reforms typically have a faster impact in a more favourable economic environment (Bouis et al., 2012; OECD, 2016b).

- Structural reforms are needed in all member states to improve medium-term productivity and living standards. For instance, further liberalisation of product markets, especially in services, would help to improve the diffusion of new ideas and technologies between firms and across countries and boost total factor productivity (TFP) growth. Stronger competitive pressures would also encourage firms to expand and upgrade the quality of their capital stock and innovate, thereby helping to revive growth. Such reforms take time to have their full effect.
- In those euro area countries with fiscal space, a temporary and well targeted additional fiscal stimulus could help to facilitate the necessary improvement in medium-term growth prospects, and also offset the current weakness in growth. Moreover, there would be positive short-term output spillovers for the rest of the euro area, particularly if interest rates remain low. New fiscal measures focused on investment, including digital infrastructure, and support for low income households and displaced workers could help to bring forward some of the medium-term benefits of reforms and foster confidence. At the same time, firms would be encouraged to spend, because of stronger aggregate demand pressures and improved infrastructure, and help would be provided to compensate workers and households displaced by the impact of stronger competitive pressures on less efficient companies.
- Other member states in which fiscal space is currently limited, should refrain from additional stimulus measures that could increase sovereign risk premia. However, they should also look for budget-neutral changes that would help to strengthen growth and make it more inclusive.
- Limited additional monetary policy measures by the ECB could also provide some modest support for demand in the near term, if needed, but cannot do much to offset to weak medium-term growth prospects. Keeping interest rates low for a longer period can nonetheless provide important synergies at times when fiscal and structural actions are being undertaken. In particular, forward guidance that recognises the likely positive medium-term effects of new well-designed structural reforms on output can help to hold down long-term interest rates and thereby allow private investment to strengthen more quickly than it otherwise might have.

Illustrative scenarios, using the NiGEM global macro model, highlight the benefits that can be obtained from combined action across euro area countries and policies. The different policy measures considered are:

- Productivity-enhancing structural reforms are undertaken in all euro area economies. These are assumed to consist of measures that raise TFP growth by 0.2 percentage point per annum for five years, beginning in 2019, with the 1% higher level of TFP being maintained permanently thereafter. This offsets part of the slowdown in TFP growth experienced since the crisis. In the euro area as a whole, OECD estimates suggest that the annual average contribution of TFP to potential output growth between 2007 and 2017 was around 0.2 percentage point weaker than in the pre-crisis decade, at 0.3 percentage point.[1]

- A three-year debt-financed increase in government investment of 0.5% of GDP per annum in Germany and the Netherlands, two of the euro area countries with fiscal space (see main text). In both economies, budget and current account surpluses point to an excess of saving relative to investment. Net general government fixed investment (gross investment less capital consumption) has been close to zero in Germany for an extended period, and has slowed in the Netherlands to around ⅓ per cent of GDP per annum since 2013, from 0.9% of GDP per annum on average in the previous decade. No fiscal measures are implemented in other euro area economies, including France, Italy and Spain. A number of smaller euro area economies might also have space for additional fiscal measures, which would enhance the area-wide effect of the stimulus.
- Monetary policy is assumed to be set in a way that takes into account the longer-term supply-side gains that arise from enhanced structural reforms. In effect, this means forward guidance is being used to help interest rates stay low for longer, recognising that area-wide inflationary pressures will be somewhat lower in the medium term at any given level of demand.[2]

The combined actions help to bring forward the medium-term impact of structural reforms. Euro area GDP growth is raised by around ¼ percentage point in the first year and 0.2 percentage point in the second year; in the longer term, the level of GDP is around 1% higher (Figure 1.27). The full impact of stronger structural reforms emerges gradually over time, continuing to build even as the direct influence of the fiscal stimulus measures wanes.

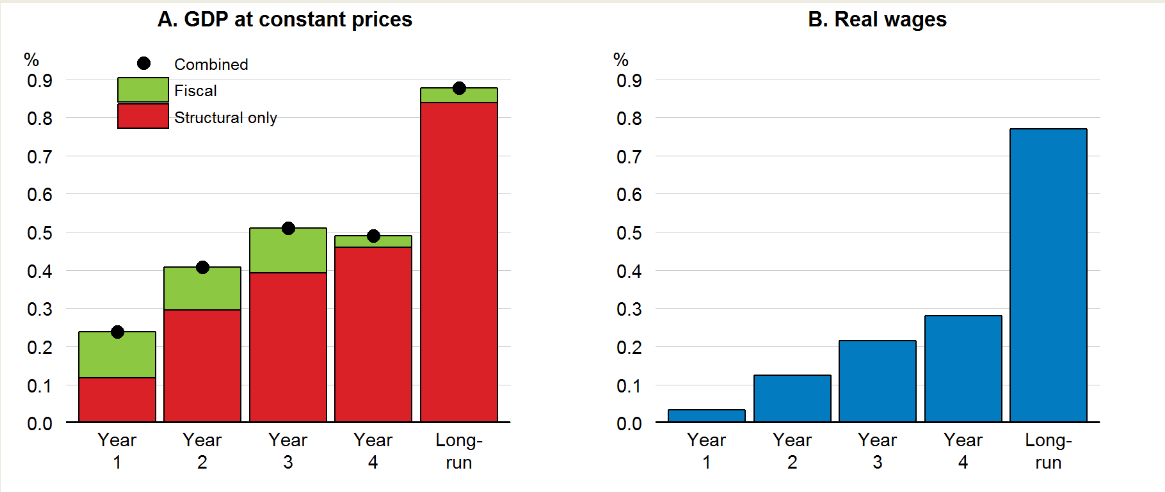
- Business investment rises relatively rapidly, by around 1% in the first year in the economies undertaking fiscal stimulus and 0.8% in the euro area as a whole, helped by expectations of higher future output and somewhat lower long-term interest rates, and the capital stock continues to accumulate over time.

- Co-ordinated action also offers benefits for workers. Nominal and real wages also rise gradually over time, as they adjust towards a higher level of labour productivity. In turn, this helps to strengthen consumer spending.

- There are small, but positive spillovers for other economies, particularly close trading partners. At their peak, in the third year of the combined measures, the level of export volumes is raised by between ½ and ¾ per cent in the EU economies that are not members of the euro area. In the longer term, there are small positive effects on the level of output in these economies as well, of around 0.2% in the Czech Republic, Hungary and Poland and around 0.1% on average in the remaining countries.

Figure 1.27. The impact of combined policy support in the euro area

Difference from baseline in euro area aggregates



Note: Real wages are measured as compensation per employee deflated by the private consumption deflator.
Source: OECD calculations using NiGEM.

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There are clear synergies from taking complementary actions across different policy areas. Accommodative monetary policy helps to raise the longer-term output gains from structural reforms. After a decade, the impact of reforms on GDP is higher when accompanied by more accommodative monetary policy. The initial stimulus from public investment provides a further boost, helping to bring forward the medium-term gains to output and wages produced by structural reforms. All told, the impact of reforms on GDP after a decade is close to one-quarter higher when combined action is taken than if reforms are undertaken without macroeconomic policy support.

1. There are a number of ways in which an increase of 1% in the level of TFP over five years can be achieved, especially if a collection of reforms are undertaken simultaneously in a number of different policy areas, as is necessary for many countries. The synergies from a set of well-designed incremental reforms might also augment the benefits from each reform taken in isolation. The policy priorities set out for each euro area country in the forthcoming OECD *Going for Growth* report are different, but frequently include steps to: streamline permits and licenses; improve the transparency of regulation; reduce barriers to entry in network industries, professional services and retail sector; and strengthen collaboration between research institutes, universities and industry. EU-wide reforms could reinforce such efforts, particularly if renewed progress is made in completing the Single Market. Stronger government investment in physical and digital infrastructure can also enhance potential output in the longer term by raising the capital stock.
2. Monetary policy in NiGEM follows a two-pillar rule, responding to both the deviation of inflation from target and the deviation of nominal GDP from (its baseline) target. In this case, the nominal GDP target was raised by 1%, reflecting the positive long-term supply shock.

From the perspective of stabilising the economy in the short and medium term, the fiscal authorities should choose measures with high multipliers. Empirical evidence on which measures are the most effective is not settled though. Most macroeconomic models suggest that a temporary increase in public investment has the highest short-term multiplier, with somewhat lower multipliers for transitory increases in public consumption and the lowest multipliers for temporary tax cuts (Barrell et al., 2012; and Cournède et al., 2013). By adding to the capital stock, an increase in public investment also has some longer-term effects (OECD, 2016a). However, a recent overview of empirical research over the past decade suggests that debt-financed temporary tax-based fiscal stimulus may be more efficient than public-consumption-based stimulus, though the relative strength differs depending on the methodology employed (Ramey, 2019). In any case, with persistently low interest rates in many OECD economies, fiscal multipliers may currently be higher than otherwise, and the risk of crowding-out effects from public spending reduced, especially if the fiscal stimulus were to lower real interest rates, at least for a period, by increasing expected inflation (Christiano et al., 2011; Coenen et al., 2012; Farhi and Werning, 2016; Miyamoto et al., 2018; Ramey and Zubairy, 2018).

Macroeconomic policy requirements in emerging-market economies

Although financial stress has eased in most emerging-market economies, underlying vulnerabilities persist and weak global trade, financial stability risks and significant adjustment challenges from past financial market tensions continue to impede growth in many countries. Policy requirements differ across the individual economies depending on their situation.

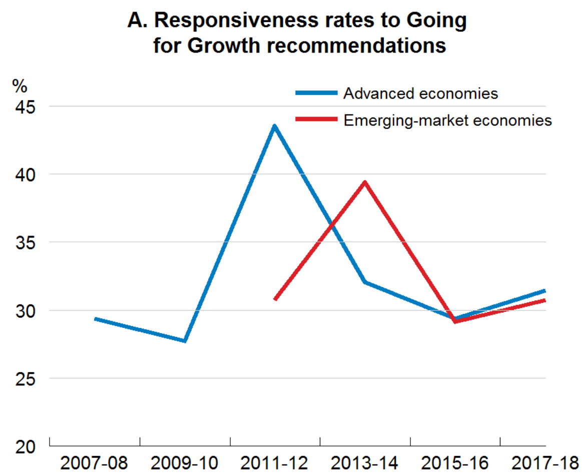
- In China, both fiscal (including quasi-fiscal) and monetary policies have been eased, as appropriate given demand weakness, and scope remains for further measures if the underlying strength of the economy is weaker than anticipated or policy instruments are less effective than in the past. However, careful targeting is needed to avoid adding to high indebtedness of non-financial corporations and medium-term deleveraging challenges.
- Other emerging-market economies, such as India and Mexico, with flexible exchange rate frameworks and manageable exposures to foreign currency denominated debt, also have scope to ease monetary policy as inflation declines, while taking the opportunity to improve their fiscal positions if needed.
- A tighter policy stance remains necessary in those emerging-market economies, such as Argentina and Turkey, where concerns persist about the sustainability of fiscal or external positions, or the health of the banking sector, in order to retain investors' confidence. Nominal interest rates can go down as inflation moderates from its current high rates, but there is limited scope to lower real interest rates substantially. The priority in these economies is to undertake reforms that enhance the prospects for fiscal and financial sustainability in the medium term.

Many emerging-market economies, including China, India, Russia and Turkey, would benefit from increased fiscal transparency, which might help to reduce the risk premia they face in global financial markets. They do not publish estimates of the general government budget balance and debt according to international accounting standards, preventing an objective assessment of public finances for the total government sector, including local governments. Moreover, in many of these economies, quasi-fiscal measures, involving state-owned banks and companies and various contingent liabilities, are more common than in advanced economies. Reporting such measures would be welcome as it would allow a better assessment to be made of the fiscal risks faced by these countries.

Structural policy ambition needs to be improved in all countries

The prospects for strong and sustained improvement in living standards and incomes in the medium term remain weaker than prior to the crisis in all economies. As documented in the forthcoming edition of OECD Going for Growth, structural reform efforts have stabilised in both advanced and emerging market economies in recent years, but at a level below that achieved in the aftermath of the crisis (Figure 1.28). Improved reform ambition in both advanced and emerging-market economies would help to enhance living standards, strengthen medium-term prospects for investment and productivity, and allow the benefits of growth to be distributed more widely. New initiatives by governments to reduce the unnecessary costs of non-tariff measures or to tackle barriers to cross-border services trade would also bring benefits to all economies and consumers.

Figure 1.28. The pace of reforms and potential output growth have both slowed



1. Based on OECD estimates of potential output growth for 46 economies, aggregated using PPP weights.
Source: OECD (2019), *Going for Growth*, forthcoming; and OECD Economic Outlook 105 database.

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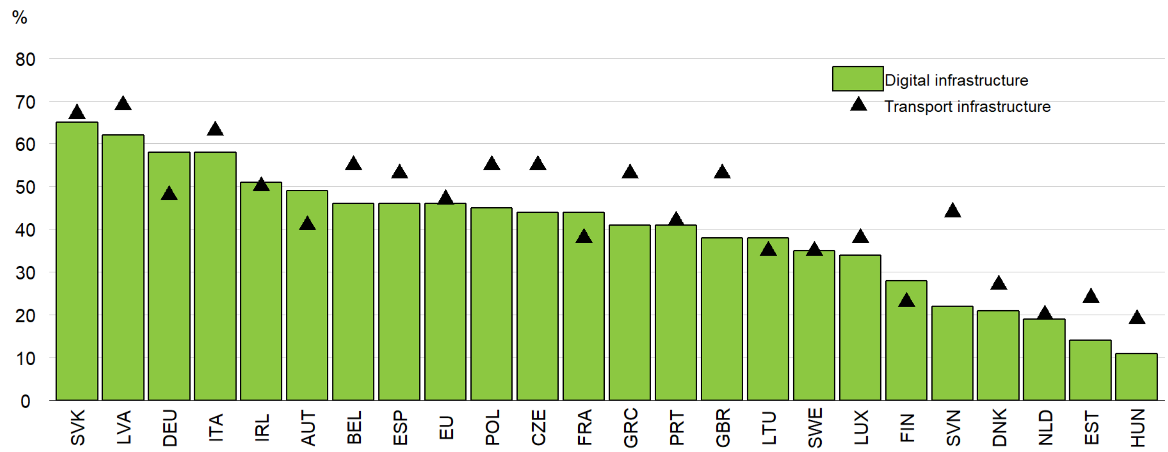
Stronger reforms are needed to promote business dynamism and knowledge diffusion and enhance innovation capacity. Further measures are also essential to help restore trust and confidence in government, and promote equality of opportunity, as highlighted in the OECD Risks that Matter survey (OECD, 2019c). Amongst the key measures to take are steps to help workers acquire the new skills necessary to enable them to benefit from fast-changing labour markets, as set out in the OECD Skills Outlook (OECD, 2019d). This would help create new opportunities for those workers and regions most exposed to the impact of global integration and the challenges brought by the ongoing digital transformation of societies, as stressed in the updated OECD Jobs Strategy, the OECD Framework for Policy Action on Inclusive Growth, and the OECD Going Digital project OECD (2019e). Improved efficiency of tax and transfer policies, including better targeting of transfers, also needs to be an integral part of well-designed policy packages to respond to people's concerns about public services and social benefits, by helping to make work pay and by strengthening real income growth amongst poorer households (Causa et al., 2018).

Reforms to improve digital infrastructure are a high priority in some countries to help businesses harness the productivity-raising power of high-speed internet access, cloud computing and other new technologies. Indeed, in Europe, around one-half of firms cite access to digital infrastructure, or a lack of adequate transport infrastructure, as being obstacles to investment (Figure 1.29), with these factors tending to be closely correlated across countries.

Moreover, across countries, the share of firms citing access to digital infrastructure as an obstacle to investment is significantly negatively correlated with the shares of firms having access to high-speed (or superfast) broadband and adopting digital technologies such as cloud computing (Figure 1.30), and positively associated with the share of firms having only lower-speed broadband. This suggests that continued investment in communication networks is needed to increase the availability of high-speed internet access and make it more affordable. In turn, this should enhance take-up and usage by firms and households (OECD, 2019e) and enhance productivity growth, as discussed in Chapter 2.

Figure 1.29. Infrastructure gaps are an obstacle to business investment in Europe

% of firms naming an issue as an obstacle to investment



Source: European Investment Bank (2018), *EIB Investment Report 2018/19: Retooling Europe's Economy*, European Investment Bank, Luxembourg.

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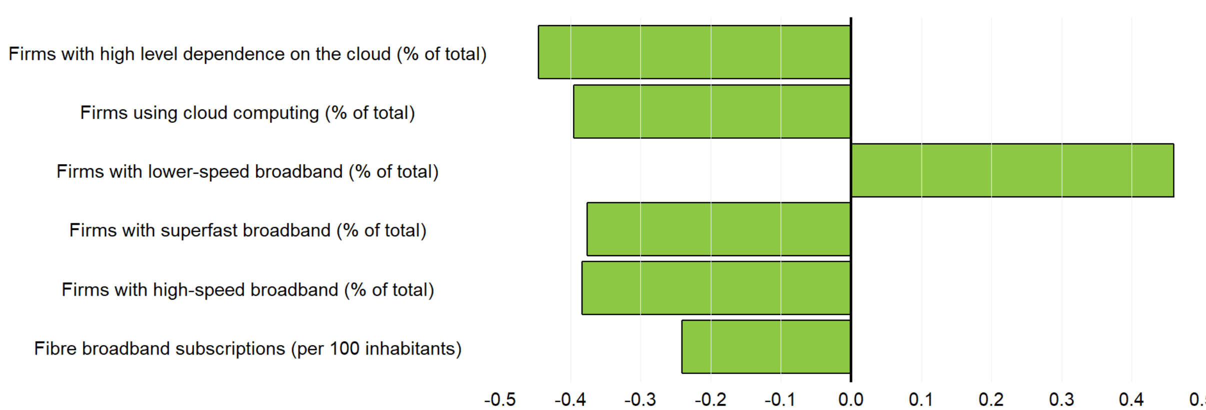
Figure 1.30. Infrastructure gaps are associated with lower broadband speeds and lower adoption of digital technologies

Cross-country correlation between firms citing digital infrastructure as an obstacle to investment and different digital economy indicators in 2018



Note: Based on the 23 EU countries who are member states of the OECD. High-speed and superfast broadband refer to broadband speeds of at least 30 Megabits per second (Mbps) and 100 Mbps respectively. Lower-speed broadband refers to speeds of less than 10Mbps.
Source: European Investment Bank; OECD Broadband Portal; Eurostat; and OECD calculations.

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Targeted government investment may have a role to play in establishing high-speed networks and helping to overcome digital divides across regions if private sector initiatives to provide access to high-speed broadband networks are not sufficient, including in countries such as Germany (OECD, 2018b). Governments can also implement pro-competitive reforms to incentivise private investment, by reducing barriers to entry, streamlining rights of way (including approvals), enabling the sharing of network infrastructure, and ensuring adequate competition in fixed and mobile broadband markets.

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Annex 1.A. Policy and other assumptions underlying the projections

Fiscal policy settings for 2019-20 are based as closely as possible on legislated tax and spending provisions and are consistent with the growth, inflation and wage projections. Where government plans have been announced but not legislated, they are incorporated if it is deemed clear that they will be implemented in a shape close to that announced. Where there is insufficient information to determine budget outcomes, underlying primary balances are kept unchanged, implying no discretionary change in the fiscal stance. In the euro area countries, the stated targets in Stability Programmes are also used.

Regarding monetary policy, the assumed path of policy interest rates and unconventional measures represents the most likely outcome, conditional upon the OECD projections of activity and inflation, which may differ from the stated path of the monetary authorities.

Structural reforms that have been implemented or announced for the projection period are taken into account, but no further reforms are assumed to take place.

The projections assume unchanged exchange rates from those prevailing on 26 April 2019: one US dollar equals JPY 111.6, EUR 0.88 (or equivalently one euro equals USD 1.14) and 6.70 renminbi.

The price of a barrel of Brent crude oil is assumed to remain constant at USD 70 throughout the projection period. Non-oil commodity prices are assumed to be constant over the projection period at their average levels from March 2019.

The projections for the United Kingdom use a technical assumption of a smooth Brexit with a transition period lasting until the end of 2020, following a formal exit from the European Union. The end of the transition period is assumed to occur smoothly, but the final outcome of the agreement on the future relationship between the European Union and the United Kingdom is assumed to be uncertain through 2020.

Tariffs that have been introduced by the United States and China on their bilateral trade in 2018 are maintained throughout 2019 and 2020 in the projections, and no other tariff measures are assumed (including the higher US tariffs on imports from China and the response by China announced in mid-May 2019).

The cut-off date for information used in the projections is 15 May 2019.

2 Digitalisation and productivity: A story of complementarities

Introduction and overview

Digital technologies are transforming our lives and our economies. They change the way firms produce goods and services, innovate, and interact with other firms, workers, consumers and governments. These technologies seem to offer a vast potential to enhance firm productivity and ultimately living standards. For example, cloud computing gives firms access to flexible data storage and processing capacities, online platforms can make their interactions with consumers more fluid, and artificial intelligence enables them to automate increasingly complex tasks (OECD, 2019a).

However, despite ongoing digitalisation, labour productivity growth has declined sharply across OECD countries over the past decades (Figure 2.1). This is not just a measurement issue. Uncertainties around productivity measurement have increased, notably due to digitalisation and the growing importance of intangible assets (e.g. algorithms, data), and they deserve further research, but most researchers assess that mismeasurement is not the main reason of the observed productivity slowdown.[1]

The productivity slowdown reflects both lower multifactor productivity growth and weak capital accumulation.[2] It has multiple and partly interlinked causes, some related to the global financial crisis and its aftermath (e.g. reduced credit availability affecting tangible and intangible investment) and some to more structural factors, such as a decline in business dynamism and the poor performance of low-productivity firms.[3] The productivity slowdown started before the crisis and, a decade after the crisis, productivity growth remains weak despite some recent improvement. This suggests that structural factors play an important role in the slowdown.

The aggregate productivity gains from digitalisation have not been sufficiently large to offset these headwinds, at least not to date. This contrasts with the late 1990s, when a previous wave of digitalisation associated notably with the diffusion of personal computers lifted productivity growth, at least in the United States. The disappointing productivity gains from the current wave of digitalisation have become a major economic puzzle, sometimes called the “modern productivity paradox” in reference to the earlier productivity paradox formulated by Robert Solow in 1987.[4] Shedding light on this paradox requires looking in detail at the channels through which digitalisation can support firm productivity and living standards, the reasons why they may be impaired, and the policies that can activate them.

This chapter argues that digitalisation has supported productivity, but that economy-wide productivity gains have been disappointing due to shortfalls in key complementary factors and policies. Indeed, digital technologies are characterised by strong complementarities (i) between the technologies themselves; (ii) with firms’ capabilities and assets, such as technical and managerial skills, organisational capital, innovation and financing capacity; and (iii) with policies that promote competition and an efficient reallocation of resources in the economy. Shortfalls in these complementary factors have slowed the diffusion of digital technologies and reduced the associated productivity benefits.

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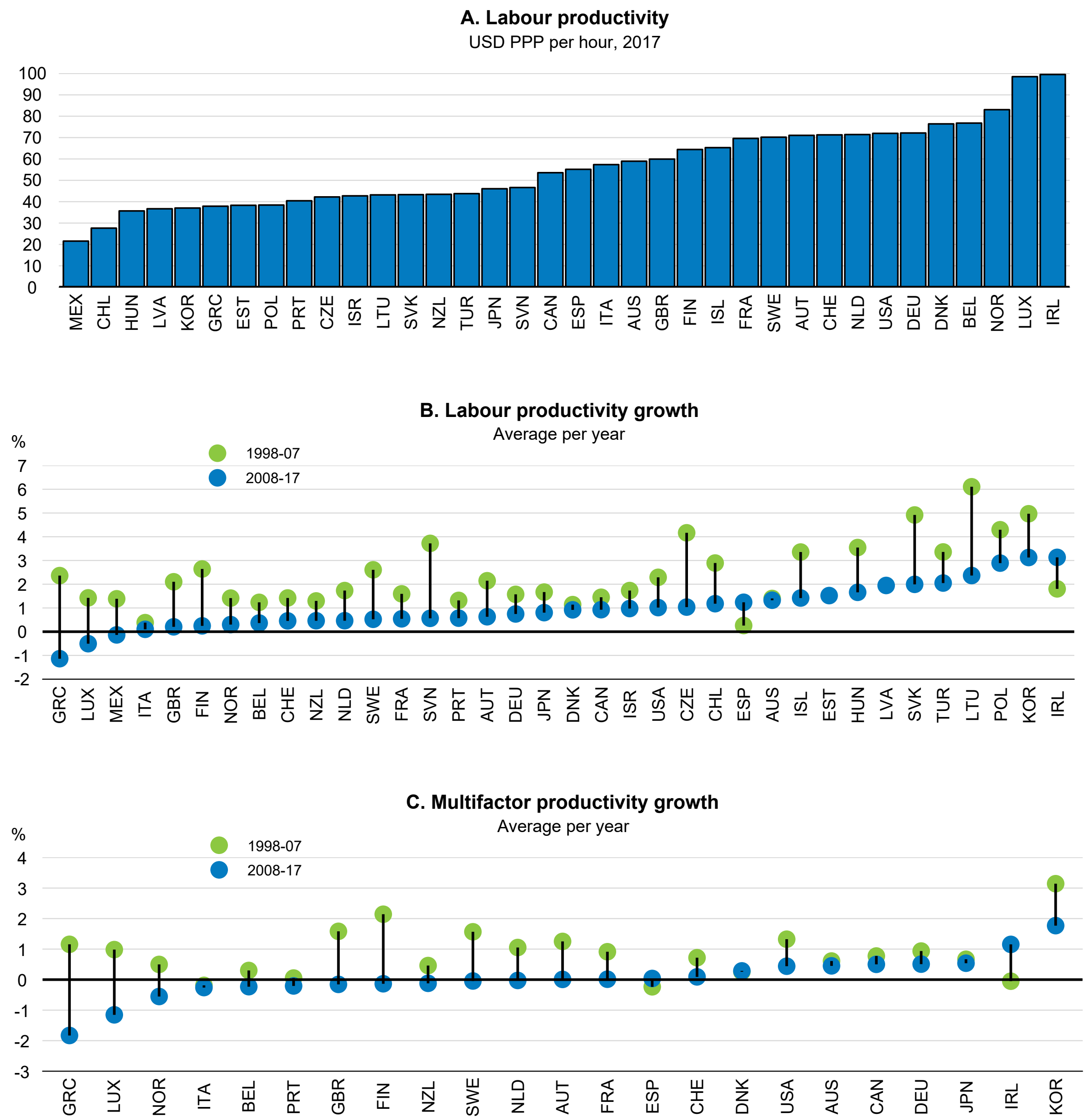
[1] See, for example, Ahmad et al. (2017), Syverson (2017) and Sichel (2019).

[2] See, for example, Ollivaud et al. (2016) and OECD (2019b). Multifactor productivity (MFP) can be defined as the overall efficiency with which labour and capital inputs are used together in the production process.

[3] See, for example, OECD (2015a), Berlingieri et al. (2019) and Calvino et al. (2019).

[4] Robert Solow wrote in 1987 in a New York Times article that “you can see the computer age everywhere but in the productivity statistics”. On the modern productivity paradox, see Brynjolfsson et al. (2017).

Figure 2.1. Productivity growth has declined sharply across OECD countries



Note: Labour productivity is measured as GDP per hour worked. Multifactor productivity growth is measured as a residual, i.e. that part of GDP growth that cannot be explained by growth in labour and capital inputs assuming a Cobb-Douglas production function. Data on multifactor productivity growth are only available for a subsample of countries. For Ireland, the data on productivity growth (Panels B and C) exclude the foreign-owned multinational enterprise dominated sector and cover 2000-16 (source: Irish Central Statistics Office). For Latvia and Estonia, data on labour productivity growth over 1998-2007 are missing.

Source: OECD Productivity Statistics Database; and OECD Compendium of Productivity Indicators.

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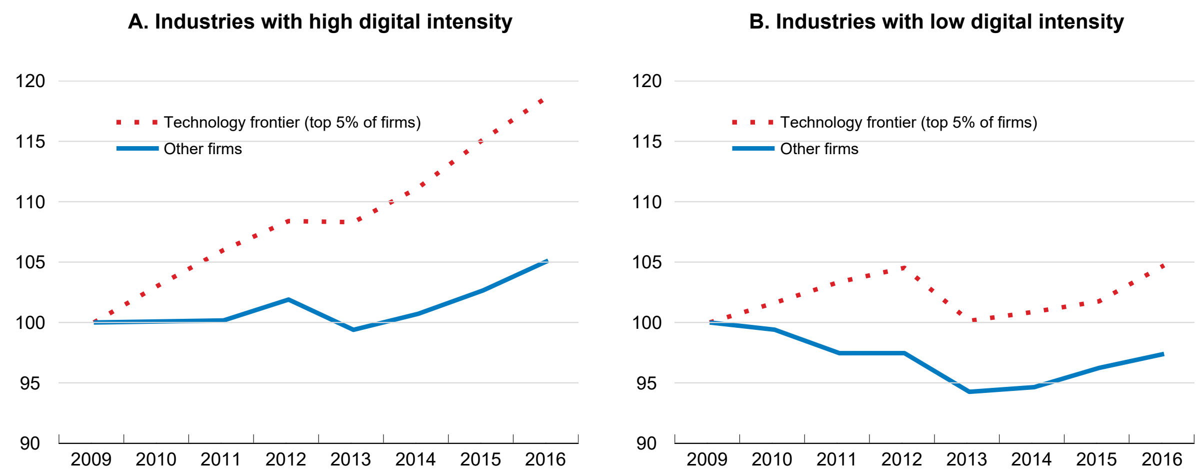
Gains from digitalisation have not spread evenly across firms. Firms having better access to key technical, managerial and organisational skills have benefitted more than other firms. These firms already tended to be more productive than the average firm and digitalisation has contributed to increase their lead (Figure 2.2). In addition, the low marginal costs and strong network effects that characterise certain digital activities tend to benefit a small number of highly productive "superstar" firms that other firms increasingly struggle to compete with. Even in relatively low-tech industries (e.g. accommodation and food services) the growing availability of online user ratings and reviews tends to shift demand towards the more productive firms. Looking ahead, new technologies, such as artificial intelligence, that require complex skills, large intangible investments (e.g. in R&D, algorithms and data) risk further increasing the edge of the most productive firms relative to the less productive ones.

Figure 2.2. Productivity dispersion across firms has increased, especially in digital intensive sectors

Average multifactor productivity, index 2009 = 100



Note: The "technology frontier" is measured by the three-year moving average of log multifactor productivity, based on the Wooldridge (2009) methodology, on average among the top 5% of companies across 25 OECD countries, i.e. those with the highest productivity levels, in each 2-digit industry (among manufacturing and market service industries, excluding finance) and in each year. The "other firms" lines correspond to the average of the same variable among all firms excluding the top 5% in each industry and year. Industries are classified either as having "high" or "low" digital intensities based on the methodology in Calvino, F. et al. (2018), "A Taxonomy of Digital Intensive Sectors", *OECD Science, Technology and Industry Working Papers*, No. 2018/14, OECD Publishing, Paris.

Source: OECD calculations using Orbis data, following the methodology in D. Andrews, C. Criscuolo and P. Gal (2016), "The Best Versus the Rest: The Global Productivity Slowdown, Divergence Across Firms and the Role of Public Policy", *OECD Productivity Working Papers*, No. 5, OECD Publishing, Paris.

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These trends have far-reaching implications for living standards and inclusiveness. Weak productivity growth has led to sluggish average wage growth, even more so in countries where wages have “decoupled” from productivity over the past decades (OECD, 2018a). In addition, the increasing dispersion in productivity performance across firms has been mirrored in an increasing dispersion in average wages across firms, contributing to rising income inequalities between workers (Berlingieri et al., 2017). Within firms, digitalisation has so far benefitted mainly high-skilled workers, while routine tasks performed by low and medium-skilled workers have been increasingly automated. At the same time, a small but fast-growing share of workers has been shifting to flexible work arrangements on “gig economy” platforms, where they generally enjoy less protection and fewer benefits than regular workers. In the future, digital technologies (e.g. automated translation) may enable more automation and offshoring of certain service tasks to low-wage countries.[5] This would potentially bring efficiency gains, but also put further pressure on labour conditions in advanced economies, raising crucial questions about the future of work (OECD, 2019c).

Policies have a key role to play to promote an efficient and inclusive digital transformation by ensuring that the necessary complementary factors are in place. This involves a range of priorities, such as upgrading skills, ensuring adequate access to high-speed internet, promoting an efficient reallocation of resources across and within firms, dealing with new competition challenges (e.g. data-driven network effects and switching costs in online platform markets), addressing financial and tax systems’ potential biases against intangible investments, and transitioning to more digital government services. In addition, the central role of data in digital economies and its implications for policies requires further analysis.

To exploit potential complementarities between policies, a consistent policy agenda based on a whole-of-government approach is warranted, and broader issues related to digitalisation, such as taxation, labour relations, consumer protection, privacy, trust and cybersecurity also need to be addressed (OECD, 2019a). As digitalisation is global in nature, further international dialogue on issues such as regulation and standards interoperability, and competition and taxation policies, is crucial. Finally, as non-inclusive digitalisation can undermine equality of opportunities and exacerbate income gaps, policymakers should strive to bridge “digital divides” and create the conditions to help lower-skilled workers and less-productive firms to catch up with best performers. Enhancing skills is a key priority in this respect.

This chapter describes recent progress in digitalisation and assesses how it has influenced productivity and inclusiveness, based notably on recent OECD work[6] and in the broader context of the OECD Going Digital project (Box 2.1), the transition agenda for the Future of Work presented in the *OECD Employment Outlook 2019*, as well as the *OECD Skills Outlook* and *Jobs Strategy* (OECD, 2018b; OECD, 2019c; OECD, 2019d). In turn, it discusses the complementarities inherent to the efficient adoption of digital technologies, and the policy challenges and priorities to promote a successful digital transformation.

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[5] In contrast, progress in advanced robotics may lead to some reshoring of certain manufacturing tasks to advanced economies.

[6] This chapter builds on recent studies on the drivers of digital adoption by firms (Andrews et al., 2018), the productivity gains from adoption (Gal et al., 2019), policies to harness the benefits of digital adoption (Sorbe et al., 2019), the productivity implications of online platform development (Bailin et al., 2019) and the emergence of gig economy platforms (Schwellnus et al., 2019).

Box 2.1. The OECD Going Digital project

The Going Digital project is an OECD initiative to examine how the digital transformation affects policymaking across a large spectrum of policy areas. The project brings together the expertise of all relevant OECD committees and bodies to draw lessons from national experiences and policy experimentation across OECD countries and other economies.

The first phase of the project culminated with the March 2019 Going Digital Summit and the publication of two synthesis reports: "Going Digital: Shaping Policies, Improving Lives" and "Measuring the Digital Transformation: A Roadmap for the Future". It identified seven policy dimensions that allow governments – together with citizens, firms and stakeholders – to shape digital transformation and improve lives: 1) access; 2) use; 3) innovation; 4) jobs; 5) social prosperity; 6) trust; and 7) market openness.

The second phase of the project will take place in 2019-20. It aims to help countries implement an integrated policy approach to the digital transformation, especially through further development of the Going Digital Toolkit (including indicators, policy notes and innovative policy examples) and Going Digital national reviews. It will also address new opportunities and challenges through analysis of frontier technologies, notably artificial intelligence and blockchain, with an ongoing focus on jobs, skills and social inclusion, and on productivity, competition and market structures (including the evolving role of platforms and SMEs).

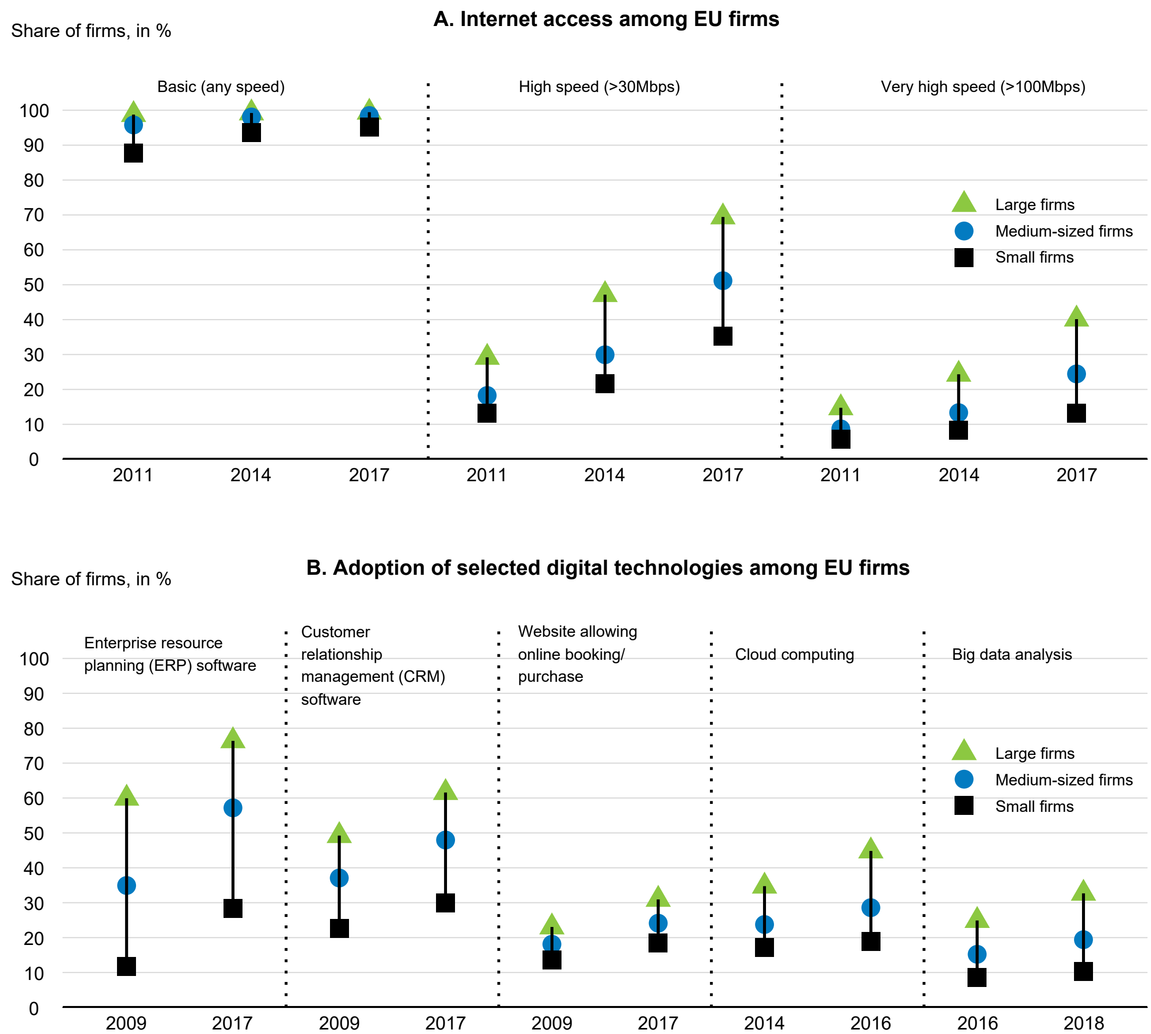
For more information, see https://www.oecd.org/going-digital/.

Digitalisation has accelerated but remains incomplete

Digitalisation is a complex and multi-dimensional process enabled by rapid increases in computing power, data storage capacity and communication speed. These two factors have brought about the emergence of a vast and diverse ecosystem of technologies, some already used for a decade or more (e.g. front and back-office management software, cloud computing) and some at an earlier stage of adoption (e.g. artificial intelligence, blockchain, internet of things). This fast-evolving ecosystem is characterised by strong complementarities between technologies and an increasingly central role of data as a source of value (OECD, 2015b). These technologies are transforming the way firms produce goods and services, but also how firms interact between themselves and with consumers, since these interactions are increasingly intermediated by online platforms.

The Internet is a key enabler of digital technologies. The possibility to access the Internet at basic speed is almost universal in OECD countries. In contrast, access to high-speed internet, which is critical to the use of recent data-intensive technologies, can remain expensive and difficult, especially in rural and remote areas. Encouragingly, it has been increasing rapidly over recent years in European countries (Figure 2.3, Panel A).

Figure 2.3. Internet access and adoption of digital technologies are increasing



Note*:* The data cover firms with at least 10 employees in the European Union (EU28). Small firms are those having 10-49 employees, medium-sized firms 50-249 employees, and large firms 250 employees and above. In Panel B, selected years correspond to the first and last year available in the data for each technology at the EU level (for example, data on cloud computing are only available in 2014 and 2016).
Source: Eurostat Digital Economy and Society Statistics.

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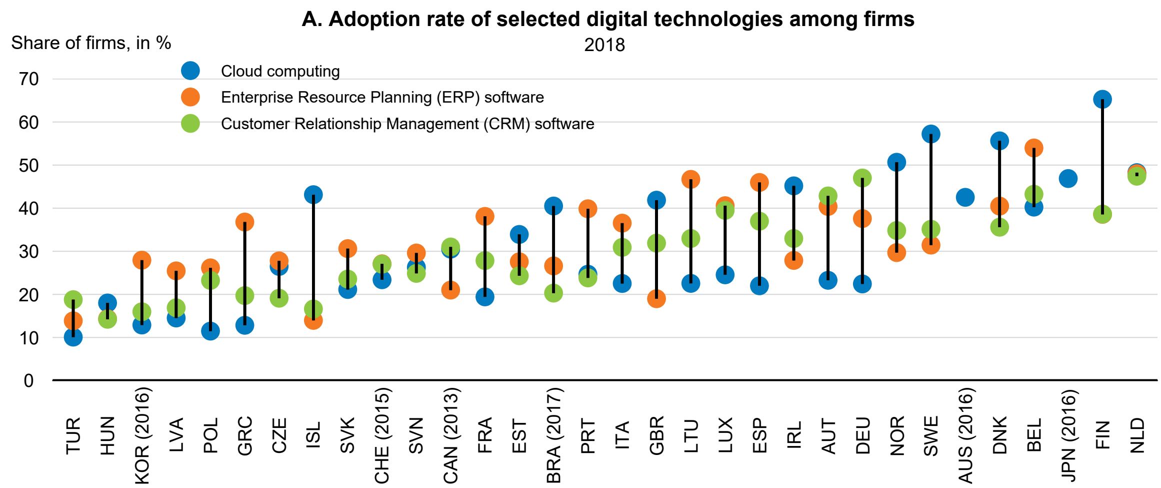
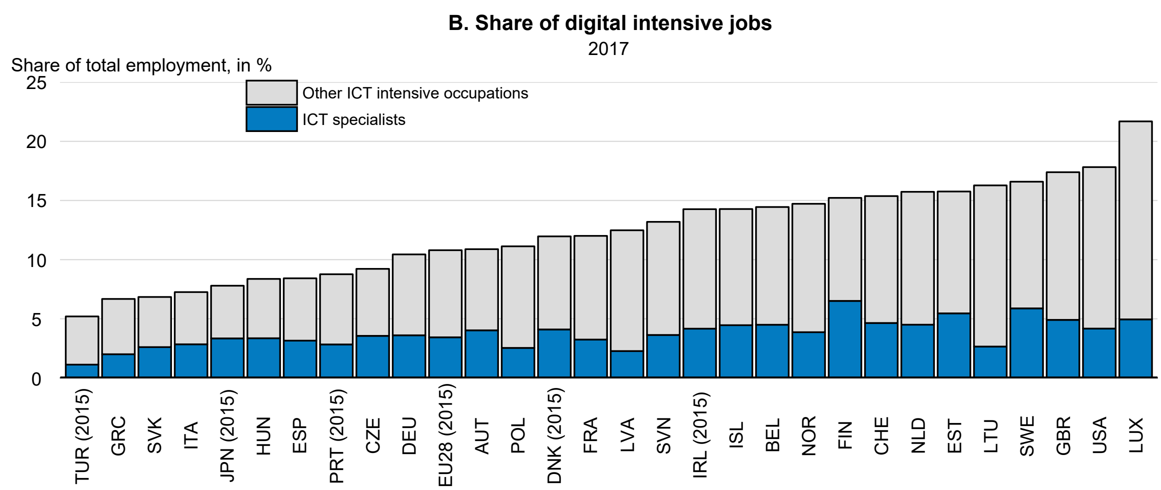
Firms' adoption of digital technologies has also increased substantially in recent years (Figure 2.3, Panel B). However, adoption remains uneven across countries (Figure 2.4). Disparities in adoption across industries and firms may reflect to some extent intrinsic differences in technological needs. For example, activities involving more routine tasks stand to gain more from digitalisation. However, these differences do not explain all disparities in adoption. Indeed, small firms generally gain more from adopting cloud computing than larger firms, possibly because it allows them to increase scale flexibly without mass, but adoption of cloud computing has been higher among large firms (Bloom and Pierri, 2018; Gal et al., 2019). Similarly, manufacturing industries have tended to gain more from digitalisation, but adoption of digital technologies has on average been higher in services (Hagsten, 2016; Dhyne et al., 2018; Gal et al., 2019). This suggests a potential for further adoption of existing digital technologies, which could support productivity beyond the (harder-to-assess) potential offered by new technologies that are still relatively untested or under development (e.g. artificial intelligence and blockchain).

Figure 2.4. Digitalisation has been uneven across countries





Note: In Panel A, countries are ranked according to the average adoption rate across the three technologies. Only firms with at least 10 employees are covered, except for Japan (at least 100) and Switzerland (at least 5). ERP and CRM data refer to 2017 unless otherwise specified. On cloud computing, data for Australia is fiscal year 2015/16; for Canada, it refers to enterprises that have made expenditures on "software as a service"; for Iceland, it refers to 2014; and for Korea, to 2015. OECD countries for which data are not available are omitted.
Source: OECD (2019e), *Measuring the Digital Transformation: A Roadmap for the Future*, sections 4.2 and 6.1, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264311992-en.

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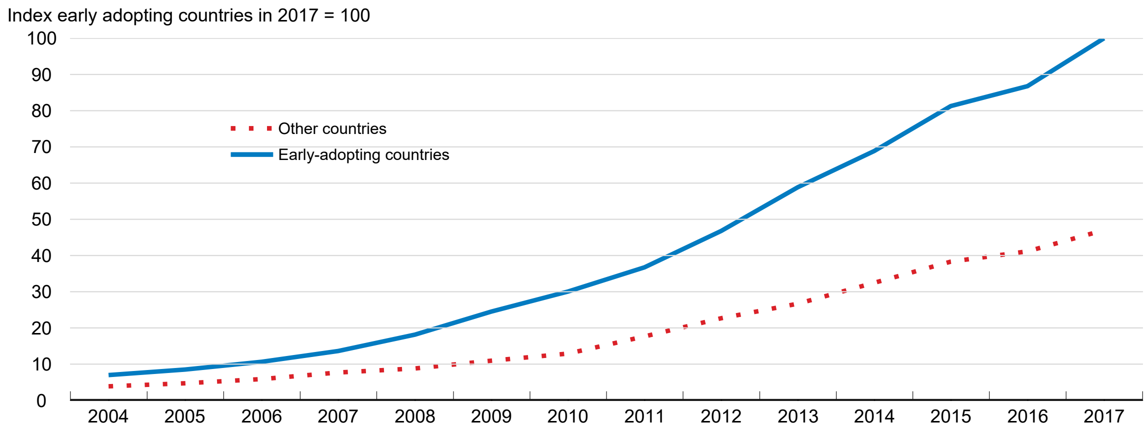
Another dimension of digitalisation is the rapid development of online platforms. Platforms increasingly link consumers to service providers – either firms or self-employed workers – in sectors such as personal transport, accommodation, food service, retail trade, finance, entertainment and personal services (OECD, 2019b). As illustrated by Figure 2.5, platform development has been remarkably fast on average since the mid-2000s, but its speed has differed across countries. Taken together, four sectors where platforms have become frequent intermediaries (hotels, restaurants, retail trade and taxis) represent roughly a quarter of non-farm business employment in OECD countries. Partly overlapping with this, self-employed workers on "gig economy" platforms, which match workers with clients on a per task basis, represent 0.5 to 3% of overall employment depending on the estimates – a relatively small but fast-growing share (Schwellnus et al., 2019). Business-to-business (B2B) platforms, while much less widespread than business-to-consumer (B2C) ones, are also gaining ground.

Figure 2.5. Online platforms are developing fast, but unevenly across countries

Use of online platforms in selected industries (hotels, restaurants, taxis and retail trade)



Note: Popularity of the largest relevant platforms in each industry, based on the number of Google searches for each platform, as a share of total Google searches in each country. Unweighted average of the four selected industries (hotels, restaurants, taxis and retail trade). "Early-adopting countries" is the unweighted average of the five countries in the sample with above-average platform development (France, Italy, Spain, the United Kingdom and the United States). "Other countries" is the unweighted average of the five other countries in the sample (Belgium, Germany, Hungary, Poland and Sweden).

Source: Bailin, A., P. Gal, V. Millot and S. Sorbe (2019), "Like It or Not? The Impact of Online Platforms on the Productivity of Service Providers", *OECD Economics Department Working Papers*, No. 1548, OECD Publishing, Paris.

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As further discussed below, the adoption of digital technologies depends both on firms' capabilities (e.g. managerial and technical skills, access to financing) and incentives (e.g. a competitive business environment) with strong complementarities between the two (Andrews et al., 2018). In contrast, there is little empirical evidence on what drives the development of online platforms across countries and industries. A range of factors are likely to matter, such as technical accessibility (e.g. Internet access, smartphone penetration rates), the perceived quality of platform service (e.g. reliability of user reviews and ratings), the existence of barriers to cross-border digital trade, the way platforms and platform-based activities are taxed, and labour market rules both concerning work on platforms and elsewhere. Sectoral regulations can also play an important role in platform development. For example, overly strict regulation of an activity may contribute to undersupply and invite the development of alternative platform-based services (e.g. Uber vs taxi services). In turn, countries have taken different approaches to the regulation of new types of service providers enabled by platforms (e.g. ride hailing and home sharing services), affecting their development.

Digitalisation can support productivity in various ways

Digital technologies can allow firms to improve product design and production processes, automate routine tasks, perform certain tasks remotely, and facilitate relations with suppliers and clients, among other things. They can also have positive spillovers for other firms, including low-tech ones – for example, online platforms can reduce information asymmetries between (often low-tech) service firms and consumers, and also enable firms to access wider markets, giving productive firms more opportunities to grow. More broadly, digital technologies offer prospects of boosting longer-term productivity, as they can support research and innovation by firms and governments and have the potential to enhance skills, for example thanks to online courses and educational games (OECD, 2016a; OECD, 2019g).

At the same time, certain (relatively less-explored) implications of digital technologies may also undermine productivity. For example, high exposure to screens and an overflow of information and potential distractions can contribute to sleep deprivation and reduce workers' ability to focus. There is evidence of a causal association between greater access to high-speed internet and lower quantity and quality of sleep and, in turn, that lower sleeping duration can undermine labour productivity (Billari et al., 2018; Gibson and Shrader, 2018). Another potential issue is "cyberloafing", i.e. employees' personal use of the Internet at work, which is generally perceived as detrimental to productivity, although the scant empirical evidence in this area is mixed (Koay and Soh, 2019).

Looking ahead, artificial intelligence will extend the range of automatable tasks, including routine cognitive tasks that are typical of service activities, while further development of communication technologies will increase possibilities to outsource service tasks (Sorbe et al., 2018; Baldwin, 2019). While these technologies offer many possibilities, the magnitude of their future effect on productivity remains difficult to assess at such an early stage, and debates between techno-optimists and pessimists are not settled. What is more certain is that regardless of these effects, a greater diffusion of existing technologies (e.g. broadband internet, cloud computing and online platforms) could already yield clear productivity benefits, as discussed in the remainder of this section.

Adoption of digital technologies can support firm productivity

A vast literature has documented the existence of positive links between the adoption of digital technologies and firm and industry-level productivity.[7] For example, OECD estimates suggest that a 10-percentage point increase in the share of firms using high-speed broadband internet (cloud computing) at the industry level is associated with a 1.4% (0.9%) increase in multi-factor productivity for the average firm in the industry after 1 year, and 3.9% (2.3%) after 3 years across EU countries (Gal et al., 2019).

While the association is clear, causality between digital adoption and productivity can be difficult to establish, because more productive firms are more likely to adopt new technologies. Nevertheless, a number of studies relying on exogenous drivers of digital adoption, such as changes in the availability or quality of network infrastructure, find evidence that digital adoption can support productivity.[8] At the aggregate level, however, effects of the adoption of digital technologies are difficult to assess systematically, due to the variety of technologies involved and limitations in the coverage of data on technology adoption. Figure 2.6 illustrates the orders of magnitude involved, building on the adoption rates among EU firms with at least ten employees (see Figure 2.3) and the estimates of adoption-productivity links in Gal et al. (2019). Taken at face value, these results suggest that gains from digital adoption have been substantial. Adoption at the average annual rate observed among EU firms over recent years (between 1 and 3 percentage point per year depending on the technology) may have increased MFP by about 1% every year in the average firm if the gains from the various technologies considered are added up. However, these estimates probably represent an upper bound of actual gains since they assume that the estimated effects are fully causal. In addition, effects for individual firms, industries and countries can vary widely around these averages as they depend on complementary factors (e.g. available skills), as discussed below.

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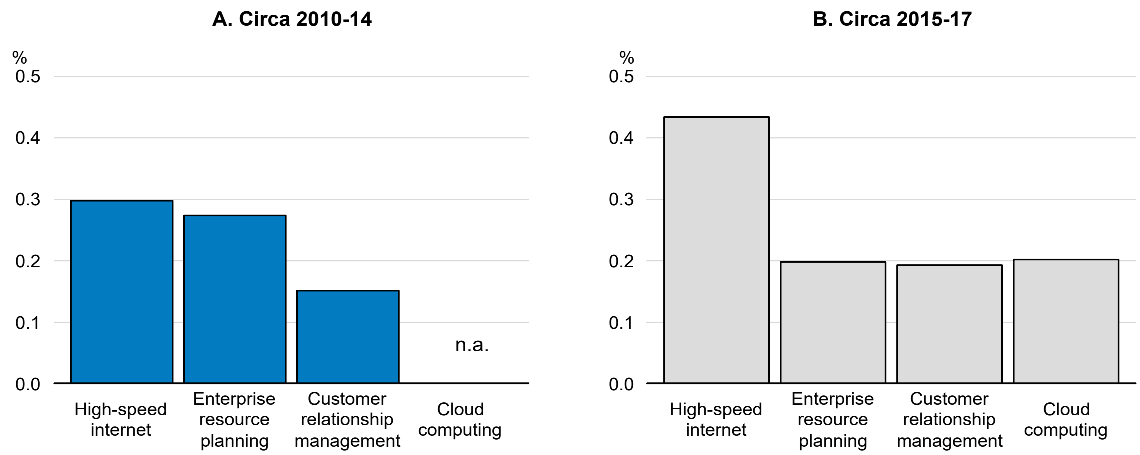
7 See for example the reviews in Draca et al. (2009), Syverson (2011) and Gal et al. (2019).

8 Grimes et al. (2011) find that broadband adoption boosted firm productivity by 7–10% in New Zealand. Based on Norwegian data, Akerman et al. (2015) find that broadband internet supports the marginal productivity of high-skilled workers, but reduces that of lower-skilled ones. DeStefano et al. (2019) find that cloud computing enhances the productivity of small firms based on UK data. In contrast, DeStefano et al. (2018) find no effect of high-speed broadband internet on productivity, but a positive effect on firm size.

Figure 2.6. Adoption of digital technologies has supported firm productivity

Annual gain in multifactor productivity associated with technology adoption (average EU firm)



Note: The exact sub-periods (based on available data) are the following: 2011-14 and 2014-17 for high-speed internet, 2009-13 and 2013-17 for Enterprise Resource Planning software, 2009-14 and 2014-17 for Customer Relationship Management software, and 2014-16 for cloud computing. The effects correspond to the average annual change in the adoption of each technology among EU firms with at least ten employees, multiplied by the elasticity between digital adoption and multifactor productivity growth estimated by Gal et al. (2019). To avoid potential double counting due to collinearity between the adoption of different technologies, the effects are computed using the contribution of each technology to the first principal component of the adoption rate of the selected technologies, and the sensitivity of productivity growth to this first principal component (Table 2, column 7 in Gal et al., 2019). The effects presented correspond to productivity gains after three years, which are obtained by iterating on the error-correction model on which the estimation relies.

Source: OECD calculations based on Gal, P., G. Nicoletti, T. Renault, S. Sorbe and C. Timiliotis (2019), "Digitalisation and Productivity: In Search of the Holy Grail – Firm-Level Empirical Evidence from EU Countries", *OECD Economics Department Working Papers*, No. 1533, OECD Publishing, Paris.

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Online platforms can also stimulate firm productivity

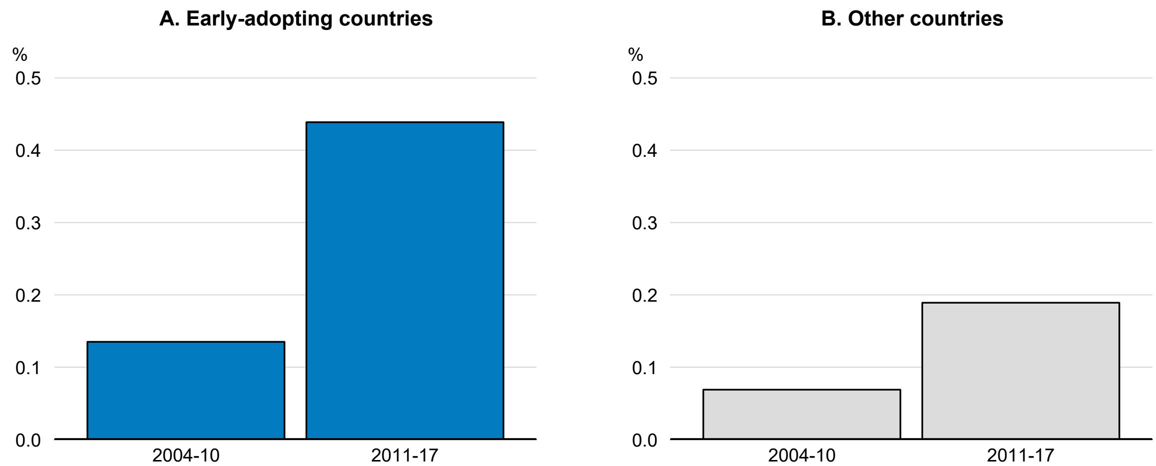
A less-explored aspect of digitalisation is that the development of online platforms can also support firm productivity (Bailin et al., 2019). For example, user ratings and reviews can reduce information asymmetries between consumers and service providers, thereby intensifying competitive pressures by shifting demand toward better-rated providers and incentivising service providers to offer better value for money. In addition, platforms can also bring efficiency gains to service providers by taking care of and rationalising certain side-activities, such as managing bookings and processing payments. Platforms can also enhance capacity utilisation (e.g. hotel occupancy rates) by improving matching efficiency and making the real-time availability of services easily visible online.

Cross-country empirical analysis in four industries (hotels, restaurants, retail trade and taxis) suggests that platform development has enhanced the productivity of existing service firms over the past decade. The effects are substantial – about 0.4% every year over 2011-17 (i.e. about 2.5% in total) for the average service firm in these industries in the countries experiencing relatively fast platform development (Figure 2.7). This order of magnitude is roughly similar to the one found for the effect of increased access to high-speed internet (Figure 2.6).[9] Similar to technology adoption, effects for individual firms, industries and countries can vary around these averages depending on complementary factors, including the intensity of competitive pressures among platforms, as further discussed below.

[9] Since platform development and access to high-speed internet are probably correlated, there would be a risk of double counting if one would sum the effect of greater high-speed internet access and that of platform development.

Figure 2.7. Online platforms can enhance the productivity of service firms

Annual gain in multifactor productivity of the average firm in selected service industries associated with online platform development



Note: “Early-adopting countries” is the average of the five countries in the sample where the platform development indicator is above median on average over the 2004-17 period (France, Italy, Spain, the United Kingdom and the United States), while “other countries” is the average of the five other countries in the sample (Belgium, Germany, Hungary, Poland and Sweden). The figures are unweighted averages of the effects across four selected industries (hotels, restaurants, taxis, retail trade).
Source: Bailin, A., P. Gal, V. Millot and S. Sorbe (2019), “Like It or Not? The Impact of Online Platforms on the Productivity of Service Providers”, *OECD Economics Department Working Papers*, No. 1548, OECD Publishing, Paris.

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In addition, there is an important conceptual distinction between so-called “aggregator” platforms, which connect users to existing service providers (e.g. Booking.com, Tripadvisor), and “disruptor” platforms, which enable new types of service providers (e.g. Airbnb, Uber).[10] The positive effects presented above come from aggregator platforms, while there has been on average no significant effect of disruptor platforms on the productivity of incumbent service firms.[11] The effect of disruptor platforms on aggregate productivity therefore depends solely on the productivity of the new providers they enable (e.g. ride-hailing and home-sharing services) relative to that of existing firms, which is difficult to assess on a systematic basis due to data limitations and conceptual issues.[12]

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[10] This distinction was originally made in Sorbe et al. (2018) and Bailin et al. (2019).

[11] This absence of a significant average effect may reflect opposing forces. On the one hand, greater competition from disruptors may incentivise incumbents to increase their productivity, for example by adopting some efficiency-enhancing features from the disruptors (e.g. taxi firms developing online reservation apps). On the other hand, competition from disruptors may reduce demand for incumbents, lowering their productivity until they adjust capacity downwards.

[12] On the one hand, innovative features such as efficient matching algorithms can give new types of providers a productivity advantage over existing providers. For example, Uber drivers have been found to spend less time idle than taxi drivers – their average driving time per hour can be up to 50% higher than taxis (Cramer and Krueger, 2016). They have also been found to offer on average lower waiting times for consumers (Rayle et al., 2015) and to do less detours than taxis (Liu et al., 2018), which both suggest a higher quality of service (which may not be visible in productivity figures). On the other hand, “disruptor” platforms also allow more non-professionals to participate in markets, who are likely to be on average less productive than specialised professionals (Schwellnus et al., 2019). Another important question is whether the capital used by these new service providers is a resource that was previously idle (e.g. a dwelling not

Complementarities and main policy challenges

The propensity of digital technologies to boost productivity, and ultimately living standards, depends crucially on complementary factors. This is because reaping the benefits of digitalisation generally requires changes in business practices, work organisation, skill composition, and a reallocation of resources within and across firms and industries. These changes can take time and involve transitory adjustment costs, meaning that effects on productivity may materialise with a lag (Brynjolfsson et al., 2018).

A vast body of research highlights the complementarities associated with digitalisation: (i) between different technologies, for example between back and front-office management software; (ii) with firms' assets or investments, such as technical, managerial and general cognitive skills, financing capacities, organisational capital, intangible assets and R&D investment; and (iii) with policies, such as the propensity of the regulatory environment to promote competition and efficient resource reallocation.[13] Shortfalls in these complementary factors may explain why adoption of digital technologies and gains from digitalisation have, to date, been weaker than anticipated.

Higher-skilled workers and more productive firms are generally better placed to exploit these complementarities than other workers and firms. As a result, these firms have tended to benefit relatively more from digitalisation (Figure 2.8), while lagging firms are failing to catch up with them (Berlingieri et al., 2019). About half of the increase in productivity dispersion across firms over 2010-15 can be related to digitalisation (Gal et al., 2019). In an extreme form of this dispersion, there is a risk that certain highly productive "superstar" firms escape competition, thanks to firm-specific intangible assets (e.g. data and algorithms), especially in industries characterised by low marginal costs and strong network effects.

Policies have a key role to play in encouraging further diffusion of digital technologies in the economy and addressing these challenges. Action in a range of policy areas has the potential to stimulate this diffusion by enhancing firms' capabilities and incentives to adopt, and thereby to support productivity (Figure 2.9). To ensure that these productivity gains translate into higher living standards and well-being for all, policymakers should focus on the productivity-inclusiveness nexus and aim to create the conditions for less productive firms and lower-skilled workers to catch up (Berlingieri et al., 2019; OECD, 2018c). Enhancing skills is a priority since it can offer a double dividend of boosting productivity while supporting inclusiveness.

Skills are crucial in a digitalised economy

The digital transformation implies vast shifts in skill demand (Grundke et al., 2018; OECD, 2019d). The demand for skills that are easier to substitute with digital technologies has been declining, while the returns to skills that are complementary to technologies have been increasing. In general, this has put downward pressure on the wages and employment prospects of low-to-medium skilled workers that perform routine tasks, while supporting the wages of higher-skilled workers that benefit from working with digital tools. In addition, the development of "gig economy" platforms, while offering increased flexibility for workers and firms, also tends to offer workers lower protection and benefits than regular employment.

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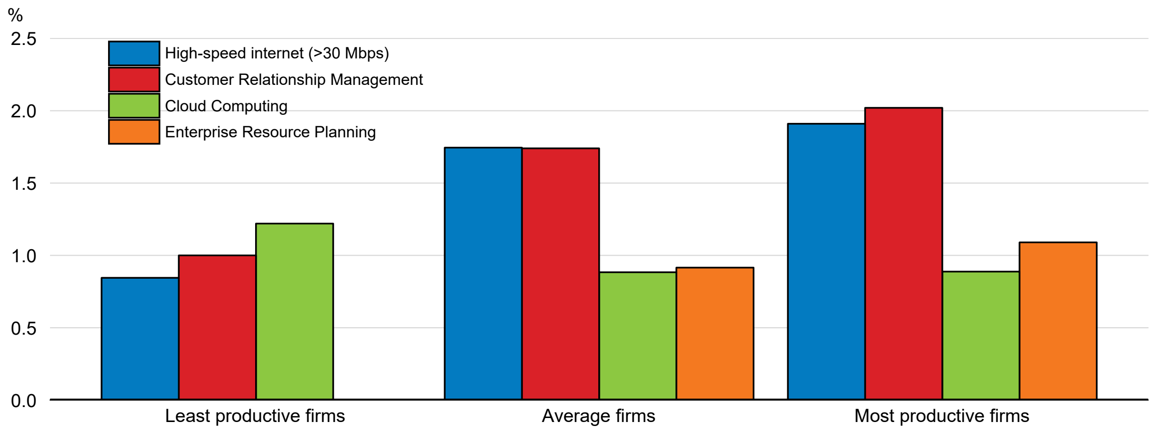
occupied during the owners' holidays) or one that is fully dedicated to this service and therefore has opportunity costs (e.g. a dwelling rented on home sharing platforms during the whole year).

[13] See, for example, Aral et al. (2006) and Bartelsman et al. (2017) on complementarities between different technologies; Bloom et al. (2012), Corrado et al. (2017) and Mohnen et al. (2018) on complementarities with skills, intangibles and R&D; and Conway et al. (2006), Bartelsman (2013) and Bailin et al. (2019) on complementarities with regulations that promote competition and resource reallocation.

Figure 2.8. More productive firms have benefitted more from digitalisation

Firm-level increase in multifactor productivity associated with an increase in the industry-level adoption rate of selected digital technologies by 10 percentage points



Note: "Least productive firms" corresponds to the first quartile of the productivity distribution in each industry-country-year cell, "average firms" to the second and third quartiles and "most productive firms" to the fourth quartile. Results for Enterprise Resource Planning for the least productive firms are omitted since they are not statistically significant. Effects are estimated over 2010-15 for EU firms with at least ten employees. The only technology for which less productive firms benefit more than more productive ones is cloud computing, which may reflect that it requires less complementary investments in organisation and skills.

Source: Gal, P., G. Nicoletti, T. Renault, S. Sorbe and C. Timiliotis (2019), "Digitalisation and Productivity: In Search of the Holy Grail – Firm-Level Empirical Evidence from EU Countries", *OECD Economics Department Working Papers*, No. 1533, OECD Publishing, Paris.

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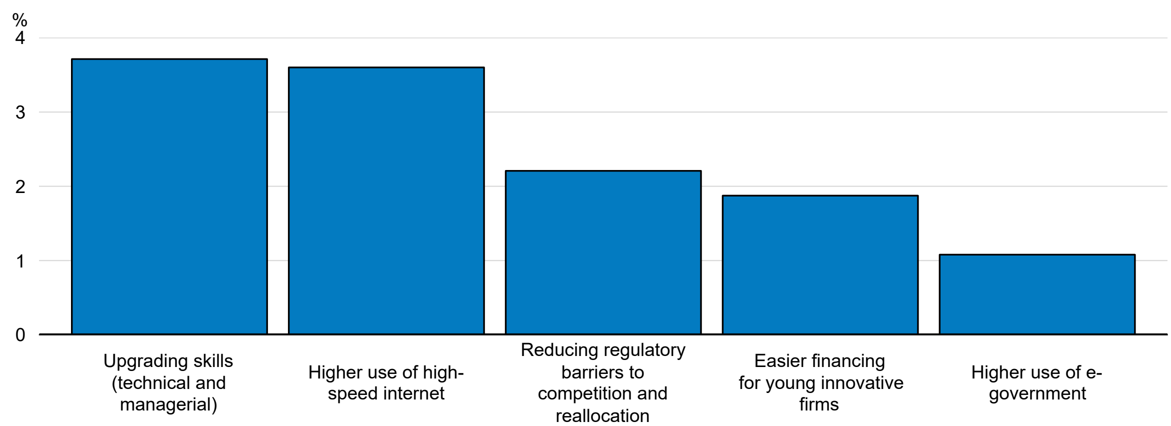
Further technological advances will increase the range of automatable tasks, offering the potential to enhance productivity, but also involving important transition costs. While automation has started with manual routine tasks in manufacturing activities, it is increasingly affecting "cognitive routine" tasks that are typical of service sectors. As the performance of artificial intelligence is improving – for example, it has recently surpassed average human abilities at speech and image recognition – more tasks will be automated, even potentially in relatively high-skilled occupations. This means that certain jobs will disappear, but above all that the nature of many jobs will change. For example, Nedelkoska and Quintini (2018) assess that 14% of jobs in OECD countries are highly automatable, and that another 32% may undergo significant changes due to automation. At the same time, new tasks and jobs will appear and labour demand may not necessarily decline overall (Gregory et al., 2019). Still, ensuring that the labour force has the right skills for this new environment and reducing personal costs for displaced workers will pose considerable challenges.

Skill shortages can reduce the benefits from digitalisation, especially among less-productive firms, as it is more difficult for them to attract skilled workers than for more productive firms (Figure 2.10). Several types of skills matter in a digitalised economy: (i) advanced technical skills for digital specialists, (ii) generic digital skills for other workers, and (iii) complementary skills to work in a digitalised environment, including general cognitive skills, interpersonal skills as well as managerial and organisational skills (OECD, 2016b; Grundke et al., 2018).

Figure 2.9. A range of policies can support productivity by promoting greater diffusion of digital technologies

Effect on multifactor productivity of the average EU firm of closing half of the gap with best-performing EU countries in a range of structural and policy areas, after 3 years



Note: The effects correspond to the estimated productivity gains associated with greater diffusion of high-speed internet, cloud computing, and Enterprise Resource Planning (ERP) and Customer Relationship Management (CRM) software resulting from closing half of the gap with best EU countries in a range of structural and policy areas. "Upgrading skills" covers participation in training (for both high and low-skilled), quality of management schools and adoption of High Performance Work Practices (HPWP). "Reducing regulatory barriers to competition and reallocation" includes lowering administrative barriers to start-ups, relaxing labour protection on regular contracts and enhancing insolvency regimes. "Easier financing for young innovative firms" covers the development of venture capital markets and the generosity of R&D tax subsidies. Structural and policy indicators are measured circa 2016. The detailed description of the sub-indicators used and the best-performing EU country for each sub-indicator can be found in Annex B of Sorbe et al. (2019).

Source: Sorbe, S., P. Gal, G. Nicoletti and C. Timiliotis (2019), "Digital Dividend: Policies to Harness the Productivity Potential of Digital Technologies", *OECD Economic Policy Papers*, No. 26, OECD Publishing, Paris.

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Good managerial skills are associated with greater and more efficient diffusion of digital technologies (Andrews et al., 2018; Gal et al., 2019). This is probably because digitalisation generally requires changing business processes, for which good management is crucial. For example, High-Performance Work Practices (HPWP) can increase firms' internal flexibility to adapt to technological change (OECD, 2016c).[14] While policies cannot directly affect the managerial and organisational performance of firms, good management practices can be promoted indirectly, for example by encouraging their adoption in public administrations and government-owned enterprises. Enhancing product market competition can also encourage firms to improve their management practices and contribute to the exit or restructuring of certain firms that are very poorly managed. The quality and accessibility of relevant education and training (e.g. business schools) and more flexible job transitions across and within firms are also likely to support average management quality. Finally, avoiding tax rules overly favourable to family transmission of firms may also help if family transmission is associated with poor management quality.[15]

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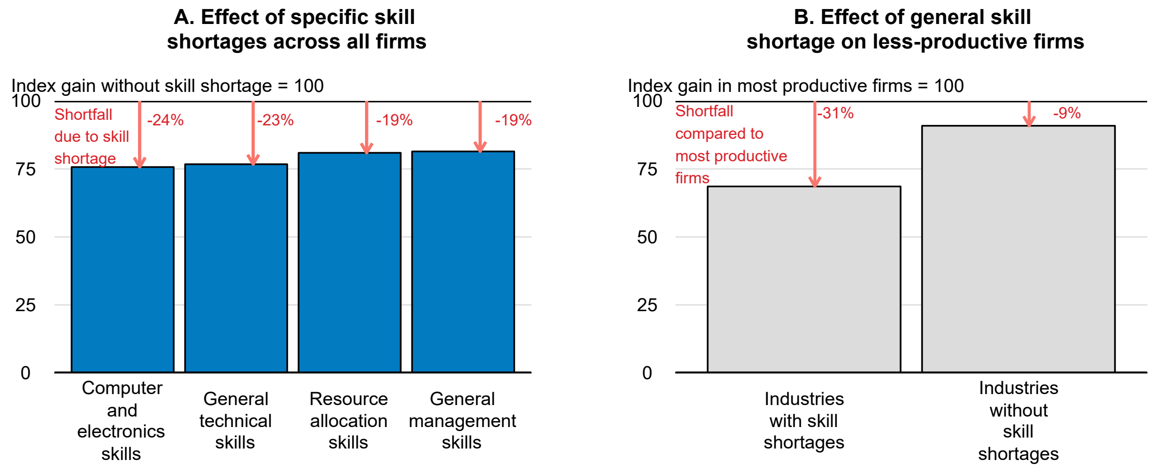
[14] HPWP include an emphasis on teamwork, autonomy, task discretion, mentoring, job rotation and applying new learning. They also encompass management practices – bonus pay, training provision and flexibility in working hours – that provide incentives for workers to deploy their skills at work more fully (OECD, 2016c).

[15] Openness to trade and foreign investment can also be beneficial for management practices since multinationals are, on average, better managed than other firms (Bloom and Van Reenen, 2010).

Figure 2.10. Skill shortages reduce digitalisation gains, especially among less productive firms

Productivity gain associated with digitalisation



Note: The situation with (without) skill shortages is defined as the 75th (25th) percentile of the distribution of skill shortages across industries and countries (source: OECD Skills for Jobs database, www.oecdskillsforjobsdatabase.org). In Panel A, "Computer and electronics skills" refers to the knowledge of circuit boards, processors, chips, electronic equipment, computer hardware and software, including application and programming. "General technical skills" refer to the capacity to design, set-up, operate and correct malfunctions, involving application of machines or technological systems. "Resource allocation skills" capture the ability to allocate resources efficiently. "General management skills" refer to how well managers motivate, develop and direct people as they work, and identify the best people for each job. In Panel B, "most productive firms" are the 25% most productive firms in each industry and "less productive firms" are those between the 25th and the 50th percentile of the productivity distribution in each industry (i.e. firms with below-median productivity, but not among the least productive) and skill shortages are measured with a broad indicator covering both managerial and technical skills. All results are based on the estimated link between the adoption of a mix of selected technologies (high-speed internet, cloud computing, ERP and CRM software) and multifactor productivity among EU firms over 2010-15.

Source: Gal, P., G. Nicoletti, T. Renault, S. Sorbe and C. Timiliotis (2019), "Digitalisation and Productivity: In Search of the Holy Grail – Firm-Level Empirical Evidence from EU Countries", *OECD Economics Department Working Papers*, No. 1533, OECD Publishing, Paris; Sorbe, S., P. Gal, G. Nicoletti and C. Timiliotis (2019), "Digital Dividend: Policies to Harness the Productivity Potential of Digital Technologies", *OECD Economic Policy Papers*, No. 26, OECD Publishing, Paris.

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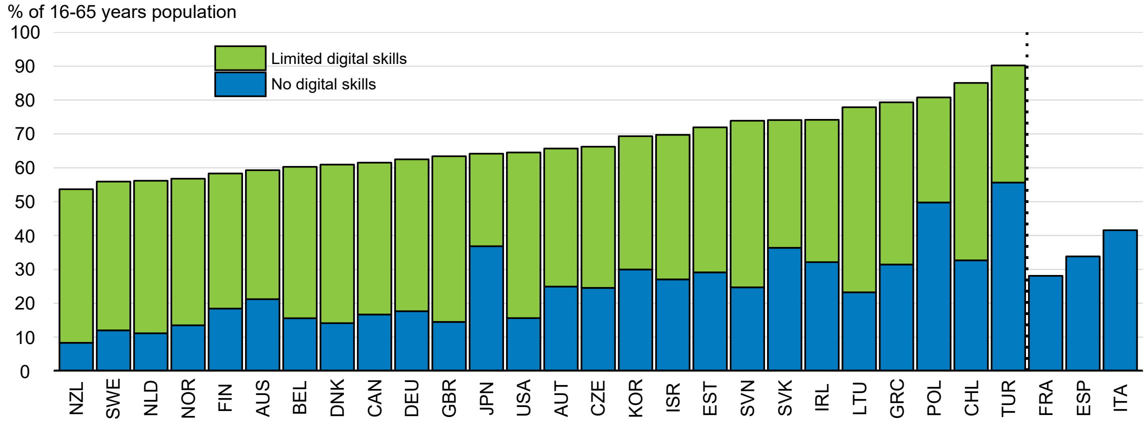
Digital-related technical skills are lacking among adults in many OECD countries (Figure 2.11). Both initial education and subsequent training have a role to play to enhance these skills. Addressing gender gaps in STEM field studies (science, technology, engineering and mathematics) would help in this respect. For example, women account for less than 20% of entrants into tertiary level computer science programmes in OECD countries (OECD, 2017a).

More broadly, "foundation skills" such as literacy and numeracy are important prerequisites for the development of the skills demanded in the digital economy (OECD, 2016b). Looking ahead, it is essential for individuals to have sufficiently strong and versatile initial skills to be able to strive in an environment of fast-changing technologies and increasingly long working lives. Interestingly, digital technologies have the potential to enhance education outcomes, but this requires not just investing in the technologies themselves, but also in complementary skills for teachers and in re-thinking teaching practices to make the best of existing technologies (OECD, 2016a).

Figure 2.11. Many adults lack digital skills in OECD countries

Share of adults lacking digital skills, 2015



Note: "No digital skills" includes adults who have had no computer experience, failed the ICT core test (e.g. capacity to use a mouse or scroll through a web page) or opted out of taking the test (their ICT skills could not be assessed directly, but indirect evidence suggests that they are likely to be poor). "Limited digital skills" includes adults scoring below or at level 1 of proficiency in problem solving in technology-rich environments, which involves use of widely available and familiar technology applications, such as e-mail software or a web browser, to complete simple tasks requiring little or no navigation or commands. Data are missing for countries that did not participate in the PIAAC Survey. Data for the United Kingdom refer to England, and data for Belgium refer to Flanders. Data on limited digital skills are missing for France, Italy and Spain, as they did not participate in the problem solving in technology-rich environments assessment.
Source*:* OECD Survey of Adult Skills (PIAAC).

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Higher participation of workers in training, especially among low-skilled workers, supports the adoption of digital technologies, attesting to the importance of lifelong learning. Beyond training quantity, its quality is also important. Increasing participation of low-skilled workers in training can be challenging since their propensity to participate is about three times lower than for higher-skilled workers, but it can offer the double dividend of increasing productivity while reducing inequalities. Along with broader active labour market policies, including job matching services, good training can also reduce personal costs of job displacement due to technological disruptions.

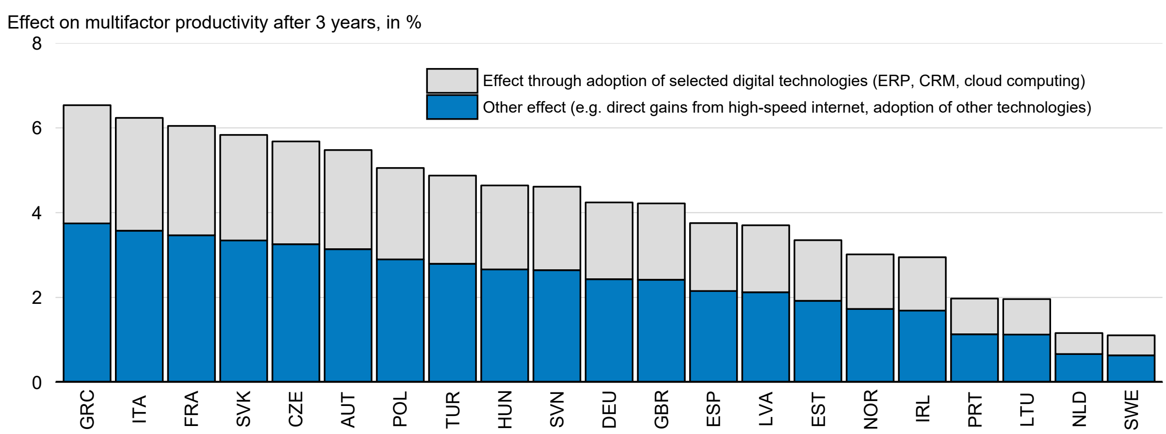
In many OECD countries, adult learning systems need to be improved to prepare for the challenges ahead. The following priorities stand out: (i) improving coverage and inclusiveness by helping adults make informed choices, tackling barriers to participation and encouraging employers to offer training; (ii) better aligning training content with the skill needs of the labour market; (iii) enhancing incentives to improve training quality by publicly assessing the quality of providers; (iv) ensuring adequate financing, including through public funding and incentives for employers and individuals to contribute; and (v) strengthening governance mechanisms to improve coordination between different actors involved in the adult learning system (OECD, 2019j).

Promoting affordable access to high-speed internet can support productivity

A number of policies are relevant to increase the availability of high-speed internet and make it more affordable, which in turn should enhance take-up by firms. To improve coverage, including in rural and remote places where market failures may lead to suboptimal private investment, governments may invest directly in high-speed networks or subsidise private investments in networks, using call for tenders to identify the providers best able to deliver the infrastructure needed (OECD, 2018d). These decisions should be informed by socio-economic cost-benefit analyses. Governments should also ensure that technical enablers are in place (e.g. spectrum, internet protocol and exchange points). In addition, pro-competitive reforms in telecommunication sectors (e.g. encouraging the emergence of new entrants or enabling infrastructure sharing) can reduce prices and in many cases also spur investment (OECD, 2019a). Overall, greater access to high-speed internet is associated with higher productivity, notably because it enables the adoption of productivity-enhancing technologies (Figure 2.12).

Figure 2.12. Increased access to high-speed internet is associated with higher productivity

Effect associated with closing half of the gap in high-speed internet access to the best-performing EU country



Note: Estimated effect on multi-factor productivity (MFP) of the average firm after three years associated with increasing high-speed broadband internet access to close half of the gap with the best performing country in the sample (Denmark). The estimation sample used to assess the elasticity of productivity to high-speed internet access covers EU firms with at least ten employees over 2010-15. Cross-country differences in high-speed internet access correspond to 2018 values, or latest available data.
Source: Sorbe, S., P. Gal, G. Nicoletti and C. Timiliotis (2019), "Digital Dividend: Policies to Harness the Productivity Potential of Digital Technologies", *OECD Economic Policy Papers*, No. 26, OECD Publishing, Paris.

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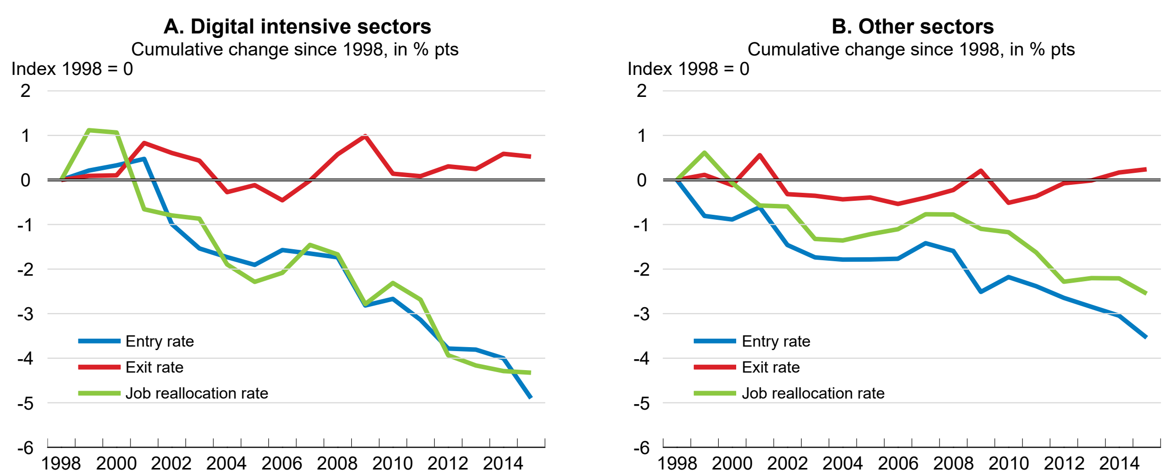
The regulatory environment should promote the efficient reallocation of resources

Digitalisation can profoundly change production structures as new firms and activities emerge and grow, while others disappear or become less labour-intensive. Reaping the full benefits of this transformation requires the efficient reallocation of labour and capital across firms, industries and regions. This is especially important since business dynamism appears to have declined over the past decades across OECD countries (Figure 2.13) although recent data on firm entries have been encouraging.[16] Even though business dynamism is generally higher in digital intensive sectors, it has declined more in these sectors than in the rest of the economy.

Enhancing business dynamism requires reducing barriers to entry and growth of young innovative firms, facilitating a smooth exit of the least productive firms, and enabling fluid movements of labour and capital from declining to growing firms and industries. This involves a range of policies in labour and product markets. For example, lowering administrative barriers to start-ups, facilitating labour transitions by ensuring that employment protection is not overly restrictive, and improving insolvency regimes have been found to support productivity-enhancing resource reallocation generally, and the diffusion of digital technologies specifically.[17] Promoting residential mobility and improving the recognition of skills and qualifications across jurisdictions can also help to reduce labour market mismatches (Andrews et al., 2011; Sorbe et al., 2018).

Figure 2.13. Business dynamism has been trending down



Note: This figure reports average within-country-industry trends of job reallocation, entry and exit rates for the period 1998-2015 in a sample of 15 mostly OECD countries. Each point represents the cumulative change in percentage points since 1998. The figures are based on the year coefficients of regressions within country-sectors, with and without interaction with a dummy variable capturing digital intensity of the sector. The dependent variables are alternatively job reallocation rates of incumbents, entry rates or exit rates.
Source: Calvino, F. and C. Criscuolo (2019), "Business Dynamics and Digitalisation", *OECD Science, Technology and Industry Working Paper*, No. 62, OECD Publishing, Paris.

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[16] On the decline in business dynamism, see for example Decker et al. (2018), Bijnens and Konings (2018), Akcigit and Ates (2019) and Calvino and Criscuolo (2019). On recent data on entries, see OECD (2019h).

[17] See, for example, Haltiwanger et al. (2014), Andrews et al. (2018) and Calvino and Criscuolo (2019).

Financial constraints can hinder the growth of young, innovative and digital intensive firms, and more broadly firms' investments in digital technologies. This is because digitalisation often involves transition costs, which can be difficult to overcome because intangible capital is harder to collateralise than physical capital (Demmou et al., 2019). As a result, ensuring sound and well-functioning financial systems and preventing potential legacies from past crises from crowding out financing to new projects and firms would generally support digitalisation.

In addition, policies should aim to address market failures in the financing of young innovative firms. Many countries have put in place schemes to support access to a range of financing instruments, especially equity.[18] Nevertheless, equity financing remains less favourable for tax purposes than debt financing in most OECD countries. A more level treatment would further help firms relying on hard-to-collateralise intangible assets. In addition, gender gaps in the financing of start-ups should be further investigated (Lassébie et al., 2019).

Interestingly, there is evidence that the development of online platforms, especially "aggregators", can stimulate efficiency-enhancing labour reallocation across firms, possibly because firms with better reviews and ratings tend to attract more demand (Bailin et al., 2019). There is also evidence that the effects of online platform development on the productivity of service firms are more favourable when employment protection and administrative barriers to entrepreneurship are less strict. This is possibly because less strict rules allow firms to adjust more flexibly to rapid changes in demand. Indeed, platform development can lead to rapid demand increases, for example for firms with good user ratings, or declines, for firms having bad ratings or facing competition from new types of providers enabled by "disruptor" platforms.

Regarding these new types of activities (e.g. ride hailing and home sharing), the way to regulate them also raises important questions. These activities sometimes start in a regulatory vacuum and benefit from tax and regulatory arbitrage compared with existing activities. At the same time, they can offer a way to circumvent regulations that are overly favourable to incumbents (e.g. taxis in certain countries). Overall, offering new activities a temporary window to experiment in a controlled environment (e.g. with "sandbox" policies) can stimulate innovation and allow new business models to emerge. At the same time, policymakers should, in the long term, aim to ensure a level tax and regulatory playing field between competing activities to avoid distorting the allocation of resources in the economy.

Such a level playing field can be achieved by relaxing certain rules on existing activities (e.g. eliminating certain licensing requirements that have become obsolete and create undue entry barriers) while gradually submitting the new types of activities to tax rules and product and labour market regulations equivalent to those in existing activities. In particular, this can involve more protection for gig economy platform workers, such as introducing minimum standards for removal from a platform, considering allowing self-employed platform workers to bargain collectively when the platform is their de facto employer[19] and giving them access to social protection and training. The first collective agreement of this kind was signed in 2018 between a Danish platform for cleaning in private homes (Hilfr.dk) and the largest trade union in the country (3F).

[18] See for example OECD (2018e) and OECD (2019i).

[19] This is generally prohibited under current antitrust rules to avoid cartel behaviour by self-employed workers. Potential changes to these rules to reflect the economic situation of platform workers would have to avoid undermining broader antitrust policy.

Digitalisation poses new challenges regarding competition

Digitalisation is a mixed blessing for competition. Positively, certain digital technologies allow firms to gain scale without mass and information to spread more easily, which can help young innovative firms entering markets and challenging larger incumbents. In contrast, many digital activities (e.g. online platforms) are characterised by low marginal costs, strong multi-sided network effects and a central role of data and algorithms as sources of value, which can result in winner-takes-most dynamics. For example, the median market share of the largest online platform across the industries and countries considered in Bailin et al. (2019) is 64%. In the large majority of cases, the leading platform was already the largest one in the two previous years.

The overall implications of this situation are difficult to assess. On the one hand, concentration could enhance efficiency to the extent that a larger pool of users and data on transactions can enable a platform to improve its algorithms and the reliability of its ratings. In addition, a certain degree of market power can reflect a legitimate rent for past innovation and even be the sign of healthy competition (OECD, 2018f). On the other hand, market power can – if it is too entrenched – allow firms to use strategic patenting or buy smaller innovative firms to stifle competition (OECD, 2018g) and ultimately undermine innovation, living standards and inclusiveness.

Recent OECD work points to signs of increasing market power, especially in digital intensive industries. Mark-ups have been increasing since the early 2000s, especially in digital intensive industries (Calligaris et al., 2018). In addition, the number of global mergers and acquisitions (M&A) has more than doubled since 2003 – with the largest increases in digital intensive sectors – contributing to increasing concentration at the industry level both in North America and in Europe (Bajgar et al., 2019a,b).

While these issues deserve more analysis, preliminary empirical evidence suggests that rising market power is in some cases becoming detrimental to economic efficiency. Díez et al. (2018) find evidence of higher mark-ups being correlated initially with increasing and then decreasing investment and innovation rates, especially in highly concentrated sectors, consistent with the inverted U-shape relationship between the intensity of competition and innovation described by Aghion et al. (2005).

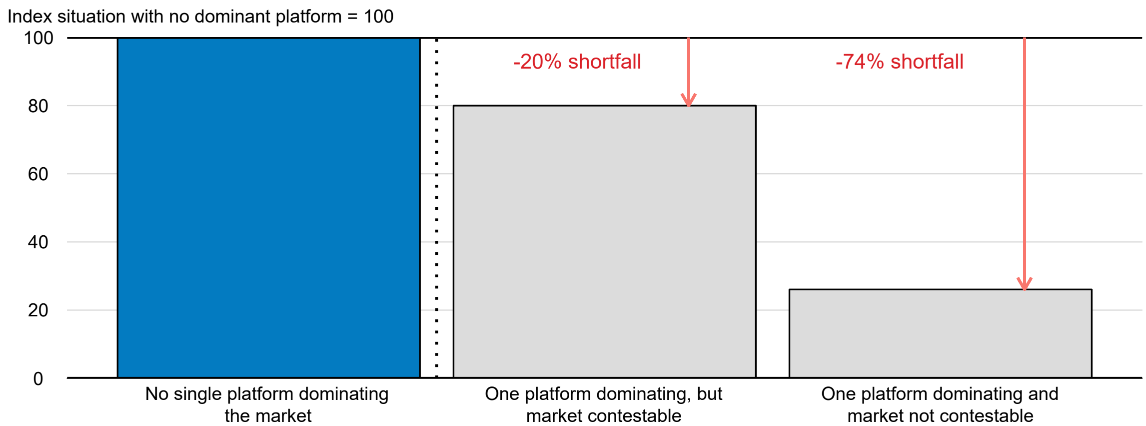
In line with this, the productivity gains associated with online platform development are found to be weaker when a platform market is dominated by a single platform and when this domination is persistent over time (Figure 2.14). Thus, beyond concentration, it is the contestability of platform markets that matters for efficiency. For example, a dominant platform missing pressure from potential competitors may lack incentives to innovate and invest in trustworthy ratings and reviews.[20] It may also use its monopoly or monopsony position to extract economic rents from service providers or users, for example by charging high fees or offering unfavourable conditions to certain users.

Digitalisation creates other challenges for competition policy. One arising issue is algorithmic collusion. In situations where algorithms are left in charge of pricing decisions, they may maintain prices above the competitive equilibrium level without being explicitly programmed to collude or directly communicating with each other (OECD, 2017b; Calvano et al., 2018). This is a challenge since competition law infringement is generally assessed based on evidence of an agreement to collude. Another potential issue is that certain online platforms act both as direct sellers and as marketplaces where other providers can sell their products. As a result, these platforms are in a position to offer a preferential treatment to their own products (e.g. higher visibility) and also have access to valuable data about their competitors and market trends.

[20] The existence of user review and rating systems is probably an important productivity-enhancing feature of online platforms. However, as discussed in Box 2.1 of Bailin et al. (2019), building and maintaining trustworthy user review and rating systems can be difficult and costly, due notably to cognitive biases and strategic actions in rating behaviour.

Figure 2.14. Non-contestable platform markets generate weaker productivity gains

Effect of platform development on average service firm productivity, depending on the structure of the platform market



Note: “No single platform dominating the market” is defined as the situation where the market share of the largest platform in a given industry and country is below the median in the sample (i.e. a market share of 64%). “One platform dominating, but market contestable” is defined as the situation where the largest platform has a market share above the median in the sample, but was not consistently the largest in the two previous years. “One platform dominating and market not contestable” corresponds to the remaining case, i.e. where the largest platform has above-median market share and was already the largest over the two previous years (a proxy for lack of contestability). The first two bars are not statistically different from each other at the 1% level, whereas the third one is significantly lower than the first one. The effects are estimated over 2004-16 in a sample of ten OECD countries and four industries (hotels, restaurants, taxis and retail trade).
Source: Bailin, A., P. Gal, V. Millot and S. Sorbe (2019), “Like It or Not? The Impact of Online Platforms on the Productivity of Service Providers”, *OECD Economics Department Working Papers*, No. 1548, OECD Publishing, Paris.

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Existing competition policy tools can already do a lot to address these challenges. Digitalisation calls for using them with increased vigilance and further taking into account the characteristics of digitalised markets, including the need for timely decisions as markets can evolve fast. For example, mergers must be carefully scrutinised for their impact on dynamic competition, including innovation (OECD, 2018h). Merger notification thresholds could be modified, as recently done by certain countries (e.g. Austria, Germany) to ensure that the potential anticompetitive acquisition of nascent competitors (e.g. small, but innovative and data-rich) is not overlooked. Ex-post assessments of merger decisions can also help to develop lessons learned and evaluate the evolution of post-merger markets. More broadly, competition policies could also make more frequent use of market studies, to make holistic assessments of how competition is functioning in markets, and how to improve it. Competition authorities must also remain vigilant to ensure that dominant firms do not abuse their position, for example with exclusionary practices that prevent competitors from entering the market. The nature of competition in so-called “zero price markets” (including dimensions such as privacy and innovation) should also be further explored (OECD, 2018i). Finally, there is scope for greater international co-operation among competition authorities, for example through enhanced information sharing and investigation assistance.

Regulatory policy can also help enhance competition by reducing entry barriers for start-ups and switching costs between online platforms. For example, switching costs can be influenced by rules on data portability (e.g. can the reputation earned on a platform be transferred to another platform?), multi-homing (i.e. the possibility for service providers to use several platforms at the same time) and best-price clauses (i.e. clauses where platforms guarantee to their users that they get the best available price for a service, reducing consumers’ incentives to test other platforms). However, these rules can be complex to design and involve trade-offs. For example, the lack of data portability may undermine platform market contestability, but too much portability could pose privacy concerns, and practical aspects of portability entail important challenges (e.g. lack of standard formats in the context of fast-evolving business models of platforms; Digital Competition Expert Panel, 2019).

Another avenue to promote competition in digitalised markets and to enable greater benefits from digitalisation is to reduce cross-border barriers to digital trade (Figure 2.15). Similar to "traditional" trade, digital trade can be expected to bring productivity benefits by enhancing specialisation and competition, enabling access to cheaper and better quality inputs for firms, and supporting the diffusion of digital technologies. As most international agreements on trade pre-date the emergence of digital trade, supporting its development will require continued international dialogue to improve the interoperability of differing regulatory regimes, including on sensitive issues such as cross-border data flows, but also ensuring coherence between trade, competition and taxation policies (López González and Ferencz, 2018).

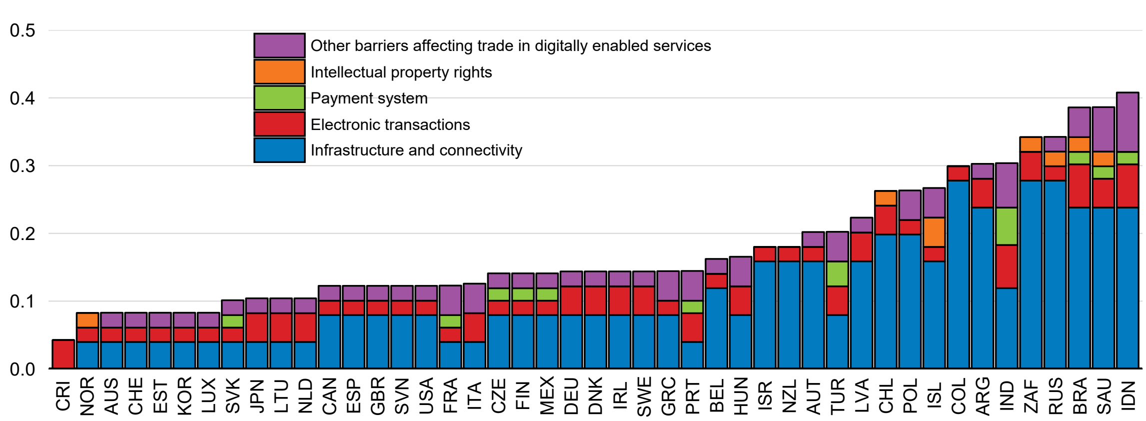
Digital government should be further advanced

Countries across the OECD are increasingly relying on digital government (Figure 2.16). Digital government entails the use of digital technologies in the provision of government services (e.g. administrative procedures for individuals and firms, e-procurement) but also more broadly the promotion of innovation in the public sector and expanded civic engagement including through open government data initiatives. Similar to digitalisation in businesses, experience suggests that successful shifts to digital government involve complementary investments in rethinking and reorganising government processes and services (OECD, 2018j).

Greater reliance on digital government can enhance the productivity of the public sector and also tends to stimulate firms' adoption of digital technologies (Andrews et al., 2018). This may be because digital government can foster the development of digital skills among the population, encourage firms to adopt digital technologies to facilitate their interactions with public authorities, and help them to improve their services thanks to the wider availability of data.

Figure 2.15. There are large cross-country differences in barriers to digital trade

OECD Digital Services Trade Restrictiveness Index (Digital STRI), 2018



Note: Higher values indicate higher barriers to digital trade. The underlying methodology is described in Ferencz, J. (2019), "The OECD Digital Services Trade Restrictiveness Index", *OECD Trade Policy Papers*, No. 221, OECD Publishing, Paris.
Source: OECD Digital STRI.

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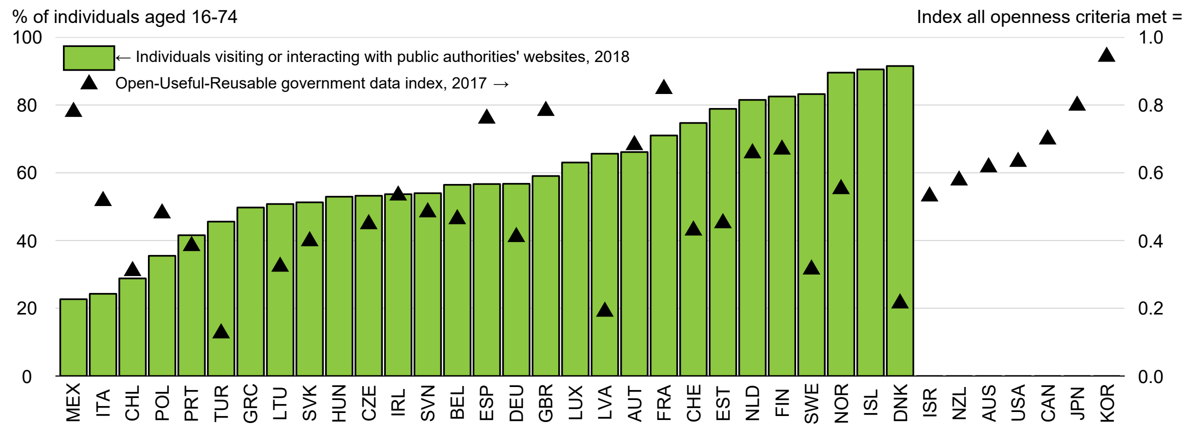
Figure 2.16. The uptake of digital government services differs significantly across countries

Use of digital government services by individuals and government data openness



Note: For Chile, Colombia, Costa Rica, Mexico and Switzerland, data on use of online government services refer to 2017. Data on the use of online government services are missing for Australia, Canada, Israel, Japan, Korea, New Zealand and the United States. Data on government data openness are missing for Greece, Hungary, Iceland and Luxembourg.

Source: OECD, ICT Access and Usage by Households and Individuals, OECD.stat; and OECD, *Open Government Data Report 2018*, OECD Publishing, Paris.

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There are important complementarities between policy areas

The general policy recommendations above have to be tailored to countries' characteristics to address the main bottlenecks to efficient diffusion of digital technologies and development of online platforms. For example, certain countries may need to prioritise physical infrastructure, while others should focus primarily on skills.

At the same time, the existence of positive complementarities between policies should not be overlooked. For example, the positive effects of upskilling can be magnified by a business environment encouraging firms to put these skills to their best use. Acting on several policy fronts can increase the benefits of reforms by about 20% beyond the cumulated impact of the same policies if they were implemented in isolation (Sorbe et al., 2019). Overall, these complementarities highlight the importance of having a consistent transition agenda and a whole-of-government approach to policies related to the digital transformation. In practice, many countries already have a digital economy strategy or an equivalent policy in place, but most of these are still rather narrow in scope and more can be done to establish a governance approach that supports effective co-ordination across relevant government bodies.

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3 Developments in individual OECD and selected non-member economies

Argentina

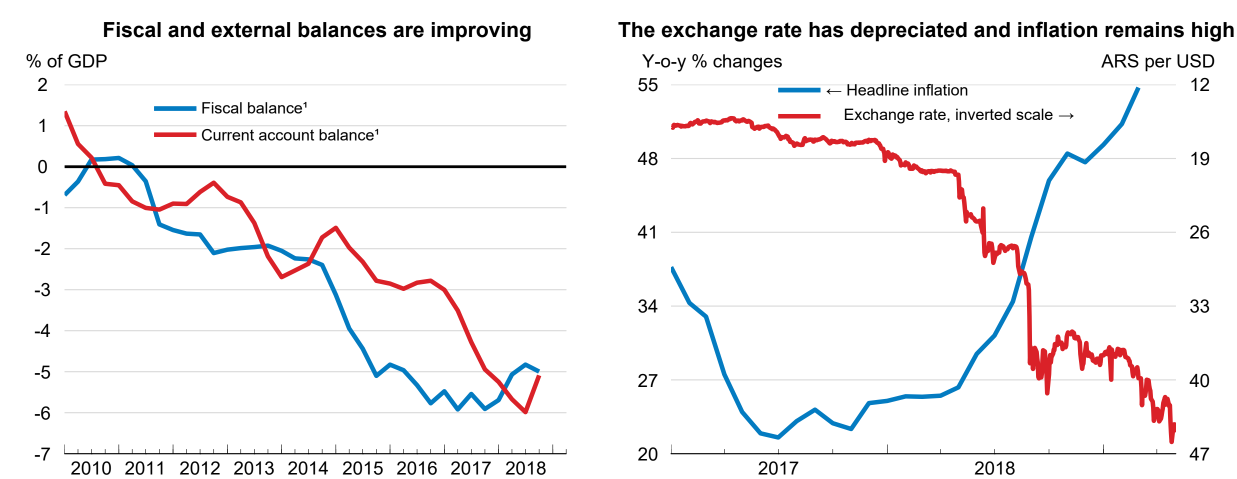
The economy will recover gradually from the financial market turmoil in 2018. A strong currency depreciation has exacerbated high inflation, denting real incomes and investor confidence. Contractive macroeconomic policies and policy uncertainty in the run-up to the October 2019 elections will weigh on the recovery of domestic demand. However, exports will continue to lead the economy out of the recession, supported by the weaker real exchange rate and a strong harvest, although their strength will be severely limited by slow world trade growth. Unemployment is projected not to recede before 2020.

A large and appropriate fiscal consolidation is under way to achieve a primary fiscal surplus in 2020. Monetary policy will remain tight to fight persistently high inflation. Sticking to the announced targets will be crucial to restore confidence, but agreed fiscal room to cushion the social impact of the recession should be used as needed. Reducing barriers to competition and foreign trade is key to stronger growth.

The economy is in recession, but vulnerabilities are being reduced

During 2018, several bouts of capital flight and a weather-related decline in agricultural export revenues triggered a sharp depreciation of the currency, causing significant confidence losses and plunging the economy into recession. Macroeconomic policies responded swiftly with a more frontloaded fiscal consolidation and tight monetary policy. Fiscal and external accounts are already improving visibly, thus reducing imbalances and associated vulnerabilities. At the same time, the exchange rate has remained volatile in recent months and consumer confidence and retail sales have declined. Unemployment remains high at 9.1%, almost 2 percentage points above end-2017.

Argentina



1. Four-quarter moving average.
Source: INDEC; Ministry of Economy; CEIC; and Refinitiv.

StatLink https://doi.org/10.1787/888933933995

Argentina: Demand, output and prices

Argentina	2015	2016	2017	2018	2019	2020
	Current prices ARS billion	Percentage changes, volume (2004 prices)				
GDP at market prices	5 954.5	-2.1	2.7	-2.5	-1.8	2.1
Private consumption	3 924.4	-0.8	4.0	-2.4	-3.2	1.9
Government consumption	1 077.7	-0.5	2.7	-3.3	-3.7	-2.6
Gross fixed capital formation	926.8	-5.8	12.2	-5.8	-16.3	2.3
Final domestic demand	5 928.8	-1.5	4.9	-3.1	-5.3	1.2
Stockbuilding[1]	89.7	0.0	1.1	-0.7	-2.6	0.0
Total domestic demand	6 018.5	-1.6	6.0	-3.7	-10.3	0.9
Exports of goods and services	637.5	5.3	1.7	0.0	22.6	8.0
Imports of goods and services	701.5	5.8	15.4	-5.1	-16.2	3.8
Net exports[1]	- 64.0	-0.1	-1.9	0.7	5.9	0.9
Memorandum items						
GDP deflator	_	41.1	26.0	40.4	40.9	24.9
Current account balance (% of GDP)	_	-2.7	-4.9	-5.0	-1.8	-1.0

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935078

Inflation has risen to 56% year-on-year due to the sharp currency depreciation and has proven more persistent than expected, owing to inertia, transitory supply shocks in the food sector and subsidy withdrawals. This limits the prospects for restoring lost consumer purchasing power, despite recent increases in pensions and social transfers, and ongoing wage negotiations. A more competitive exchange rate and good weather conditions have been supporting exports.

Sticking to policy targets is crucial to restore confidence and reduce inflation

An ambitious fiscal consolidation is aiming at a balanced primary budget for 2019 and a primary surplus of 1% of GDP in 2020, compared to a primary fiscal deficit of 2.4% of GDP in 2018. Fiscal targets were overachieved in 2018, and the bulk of public sector financing is assured by multilateral lenders until end-2020. Public debt is expected to decline relative to GDP, although significant risks remain, including slower fiscal adjustment, higher interest rates or renewed currency depreciation.

A recent rebound in inflation has led the central bank to tighten monetary policy further by extending the current monetary base target until end-2019. Although tight financial conditions will limit investment, a strong commitment to fighting inflation will be crucial to re-anchor inflation expectations and restore lost confidence. Securing greater independence of the central bank by approving the draft bill recently submitted to congress is key for the strategy to restore credibility in the monetary policy regime and bring down inflation.

A modified exchange rate regime now provides greater scope for non-sterilised interventions in support of the central bank's disinflation strategy. Vigilance is nevertheless advisable to avoid a large real exchange rate appreciation that could undermine improvements in export performance.

More progress in structural reform is needed to improve productivity, boost exports and raise growth. Competition remains weak in many sectors, owing to domestic restrictions on firm entry, barriers to entrepreneurship and import restraints. Lower consumer prices resulting from stronger domestic and foreign competition would improve household purchasing power, especially among low-income households. Better access to intermediate inputs would raise productivity and competitiveness of domestic producers, allowing firms to create better-paying and formal jobs. More professional training would help workers prepare for these new opportunities, while more effective unemployment insurance could provide income support for workers as jobs move across firms or sectors. About a third of the workforce is currently in informal employment, lacking any employment protection.

Exports are projected to lift the economy out of recession

As domestic demand remains constrained, exports are projected to drive the recovery, with quarterly growth rates turning positive during 2019. A slowdown of international trade is likely to limit the growth of export demand, but as domestic demand recovers, GDP growth is projected to strengthen to 2.1% in 2020. Policy uncertainty ahead of the October general elections is a key downside risk, while a more vigorous export recovery could constitute an upside risk.

Australia

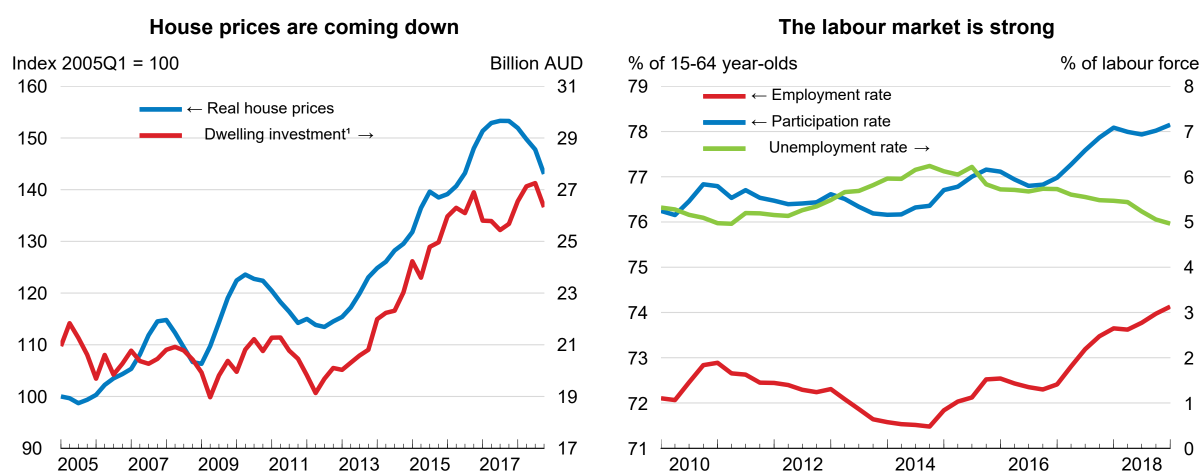
The economy is projected to continue to grow at a steady pace. New capacity in the resource sector will boost exports, although weaker growth in trading partners will slow export growth in 2019. Housing-market cooling will damp construction activity. Business investment and government spending, on the other hand, will support growth. Wages and consumer prices will pick up only gradually.

Monetary policy is projected to remain unchanged until the end of 2020, reflecting moderate price pressures and weaker prospects for economic activity. Risks from the housing market and high household indebtedness warrant continued vigilance. The government budget will be in surplus in 2019, giving ample room to support activity and incomes of the most vulnerable in the event of a downturn.

Business investment and government spending are supporting growth

Non-mining business investment is picking up, and the decline in mining investment is set to bottom out. While favourable terms of trade and additional resource exports are supporting the economy, weak global trade has slowed total exports. Government spending, via the rollout of the services under the National Disability Insurance Scheme and public infrastructure works, is boosting aggregate demand. Housing prices have been falling steadily for more than a year, damping housing investment, construction activity and household consumption. Business and consumer confidence have weakened recently. Rising employment, on the other hand, is boosting incomes and consumption.

Australia



1. Quarterly volumes, expressed at 2016/2017 prices.
Source: OECD Economic Outlook 105 database; OECD Analytical House Price database; and Main Economic Indicators database.

StatLink https://doi.org/10.1787/888933934014

Australia: Demand, production and prices

Australia	2015	2016	2017	2018	2019	2020
	Current prices AUD billion	Percentage changes, volume (2016/2017 prices)				
GDP at market prices	1 640.8	2.8	2.4	2.7	2.3	2.5
Private consumption	949.1	2.7	2.4	2.6	2.4	2.2
Government consumption	301.2	5.2	3.9	4.2	4.6	4.1
Gross fixed capital formation	423.5	-2.5	3.2	2.7	2.5	3.3
Final domestic demand	1 673.8	1.8	2.9	2.9	2.9	2.8
Stockbuilding[1]	4.4	0.1	-0.1	0.1	-0.3	0.0
Total domestic demand	1 678.2	1.9	2.8	3.0	2.6	2.9
Exports of goods and services	323.3	6.8	3.7	4.9	3.3	4.1
Imports of goods and services	360.7	0.4	7.8	4.3	2.5	3.6
Net exports[1]	- 37.4	1.3	-0.9	0.2	0.2	0.2
Memorandum items						
GDP deflator	_	1.1	3.5	2.2	2.5	2.5
Consumer price index	_	1.3	2.0	2.0	1.6	2.3
Core inflation index[2]	_	1.5	1.7	1.7	1.7	2.2
Unemployment rate (% of labour force)	_	5.7	5.6	5.3	5.1	5.1
Household saving ratio, net (% of disposable income)	_	5.5	4.5	3.1	3.4	3.4
General government financial balance (% of GDP)	_	-1.7	-0.8	0.0	0.2	0.4
General government gross debt (% of GDP)	_	42.6	43.9	42.1	40.0	40.2
Current account balance (% of GDP)	_	-3.3	-2.6	-2.2	-1.2	-0.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935097

The unemployment rate is at a five-year low and labour force participation has risen substantially. However, under-employment remains elevated, suggesting remaining labour-market slack. Wage growth has picked up slightly in recent quarters, but remains at low levels historically.

Accommodative monetary policy remains appropriate and there is now fiscal space

Monetary policy remains supportive: the policy rate has been unchanged at 1.5% for more than two years. Inflation remains well below the target range and wages and prices are expected to rise only gradually. House prices are likely to continue a steady decline – albeit from very high levels – with negative effects on household consumption and economic activity. This projection envisages no change in the policy rate over the projection horizon, although market expectations are now tilted towards a cut this year and next. Household indebtedness remains high, although growth in housing credit has eased and credit conditions have tightened, partly driven also by past macroprudential measures. Given the potential financial and macroeconomic risks, supervisors should maintain vigilance.

The government debt-to-GDP ratio has risen in recent years, but remains relatively low in international comparison. Conditional on robust growth, the 2019 budget is committed to future budget surpluses with the aim of reducing public debt, and eliminating net debt by 2030. Budget plans envisage reductions in personal taxation over the short and medium-term and lower taxes on small businesses, financed with strong revenues from economic growth, as well as expenditure control and measures to combat tax avoidance and evasion. However, the priority on combatting socio-economic exclusion, for instance through education reform and improved support for job seekers, should be maintained.

Growth is projected to remain robust

Economic growth will continue at a steady pace, with a slight moderation in 2019 due to slowing global growth and the cooling housing market. Private consumption growth will slow, as households become less willing to draw down savings. Exports, business investment and public demand will support growth over the projection horizon. Inflation will pick up only gradually and the unemployment rate will level out. High indebtedness of households remains a risk. Unexpectedly large corrections in house prices could significantly reduce household wealth and consumption, and affect the construction sector. Global commodity markets remain an important source of income and growth, but also of uncertainty and risk, particularly through exposure to any slowdown and rebalancing in China.

Austria

Output growth is projected to slow to around 1½ per cent in 2019 and 2020. Private consumption remains a key driver of growth, but the slowdown in the euro area is weighing on investment and trade. Inflation is set to remain close to target.

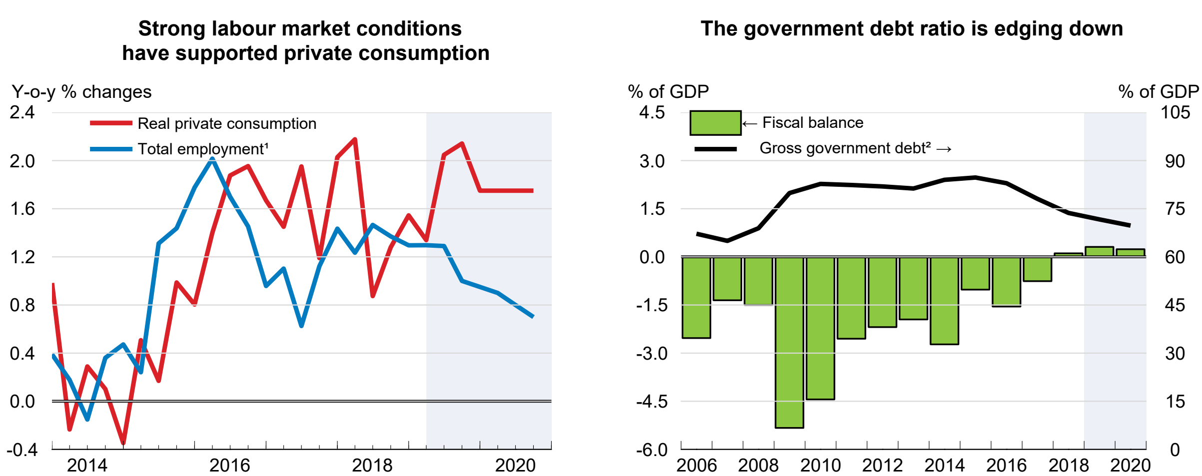
High tax receipts due to robust employment growth will lead to a modest surplus in the government accounts. Even if the ongoing tax reform will slightly decrease the budget surplus in the short term, some fiscal space is available and could be used to let automatic stabilisers operate if cyclical conditions worsen. More active measures could be considered if developments deteriorate significantly. Structural policy should aim to lift productivity growth by fostering competition in service sectors and to better integrate the most vulnerable groups in Austrian society, in particular the low-skilled elderly, migrants and refugees.

Consumption is the key driver of growth

Economic growth is supported by robust domestic demand, in particular from private consumption. Export growth is suffering from weak growth in trading partners, especially in the key export markets, Germany and Italy. In spite of high capacity utilisation in the industrial sector, skills shortages and damped economic activity in the euro area are dragging down business investment.

The outcome of the wage negotiations in autumn of 2018 was above expectations, supporting household consumption growth, together with reductions in charges on unemployment insurance and the "Family Bonus", a tax allowance for families for children. Unemployment continues to fall. The rather slow decrease, however, reflects some structural unemployment and strong labour force growth due to the inflow of foreign labour and increasing labour force participation.

Austria



1. Projection since 2019Q1.
2. Maastricht definition.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934033

Austria: Demand, production and prices

Austria	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices*	344.3	2.1	2.7	2.7	1.4	1.6
Private consumption	181.2	1.5	1.6	1.6	1.8	1.7
Government consumption	68.0	1.7	1.5	0.4	0.9	0.5
Gross fixed capital formation	78.1	4.4	3.9	3.4	2.4	1.7
Final domestic demand	327.3	2.2	2.1	1.8	1.7	1.5
Stockbuilding[1]	4.0	-0.1	0.3	0.5	-0.3	0.0
Total domestic demand	331.3	2.2	2.5	2.2	1.4	1.5
Exports of goods and services	182.8	2.9	4.9	4.0	2.3	2.6
Imports of goods and services	169.9	3.4	5.0	2.8	1.9	2.5
Net exports[1]	13.0	-0.2	0.1	0.7	0.3	0.1
Memorandum items						
GDP deflator	_	1.4	1.2	1.6	2.0	1.9
Harmonised index of consumer prices	_	1.0	2.2	2.1	1.9	2.0
Harmonised index of core inflation[2]	_	1.6	2.1	1.8	1.7	1.8
Unemployment rate (% of labour force)	_	6.0	5.5	4.8	4.6	4.6
Household saving ratio, net (% of disposable income)	_	7.8	6.8	7.4	6.8	6.7
General government financial balance (% of GDP)	_	-1.5	-0.8	0.1	0.3	0.2
General government gross debt (% of GDP)	_	108.4	101.7	95.9	93.8	91.9
General government debt, Maastricht definition (% of GDP)	_	82.9	78.1	73.7	71.7	69.7
Current account balance (% of GDP)	_	2.5	1.9	2.3	2.4	2.4

* Based on seasonal and working-day adjusted quarterly data; may differ from official non-working-day adjusted annual data.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935116

More efficient government spending and structural reforms are key for stronger long-term growth

Robust wage and consumption growth have contributed to healthy fiscal revenues and have more than offset lower receipts from social security contribution cuts and the introduction of the “Family Bonus”. Though the reform of the personal and corporate tax system will be fiscally neutral in the long-term, the budget surplus is projected to decrease moderately. Fiscal policy should use the leeway public finances provide, particularly if there is a more pronounced downturn than expected.

The long-term sustainability of the public finances could be improved by addressing the efficiency of government disbursements and ensuring that all measures are well targeted. Additionally, misalignments of spending and taxing responsibilities across government layers hamper cost-efficiency. There is scope for structural reforms to boost productivity by simplifying licence systems and further liberalising market entry in services sectors. Moreover, addressing the debt-bias of the corporate tax system and ensuring sufficient provision of private venture and growth capital would help in tackling the general lack of risk capital in the economy, which impedes innovative activity and the scale-up of young firms and start-ups.

Economic activity is set to be less dynamic

Output growth is projected to slow to around 1½ per cent in 2019-20. Household consumption will be a key driver of economic activity, as weak external demand attenuates investment and trade growth. Exports will still grow slightly faster than imports, implying that net trade will contribute positively to output growth over the projection horizon and further increase the current account surplus.

Investment and trade may surprise on the upside in 2020, if global trade growth recovers. Even though healthy increases in the amount of internal funds in recent years have strengthened firms' equity ratios, continued heavy reliance on bank loans make the Austrian economy vulnerable to potential stress in the European banking sector. Moreover, economic growth in Austria is exposed to a further deterioration of global trade disputes and to a more severe and prolonged slowdown of the German economy.

Belgium

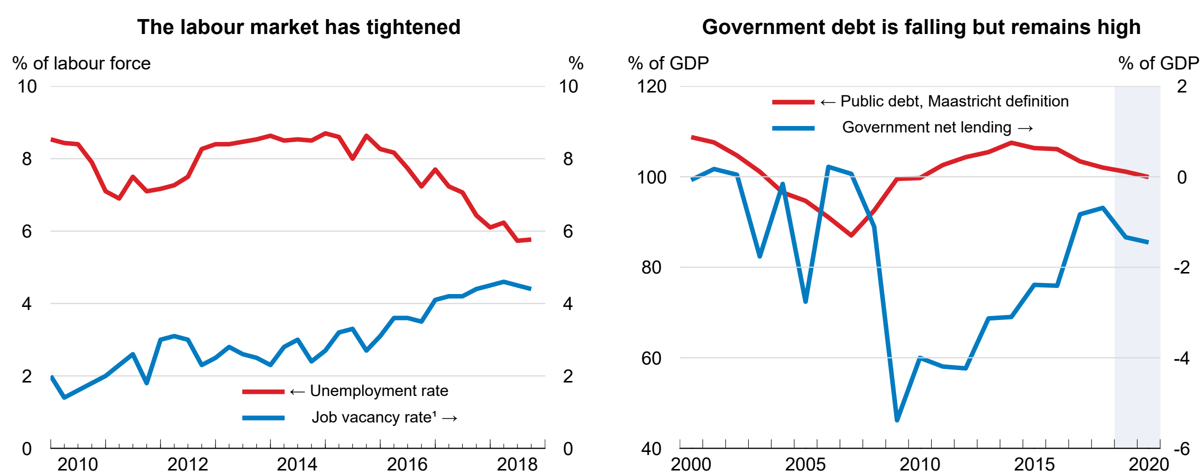
Economic growth is projected to slow to around 1¼ per cent in 2019 and 2020 as export growth weakens. Private consumption will be an important driver of growth, owing to employment gains and increased purchasing power of households. Government investment will be strong in 2020, and private investment will support growth over the projection period. Headline inflation will ease as past pressures, such as rising electricity prices, dissipate, but core inflation will edge up.

Fiscal policy will provide modest support to growth in 2019 and 2020, due to planned reductions in labour taxation. Productivity and external cost competitiveness would benefit from strengthened competition in professional services and from simplified administrative procedures and requirements to start a business. Further reductions in transaction taxes on property and improving public transport infrastructure would make growth greener.

Growth continues to moderate

Private consumption growth has decreased as consumer confidence fell, despite continued employment growth supported by labour tax cuts. However, consumer confidence shows some signs of stabilising. Following a significant increase in business investment, business confidence has deteriorated in recent months. Export growth has slowed due to lower growth in Belgium's main export markets. Inflation has fallen, reflecting a decline in energy prices. Wage growth has accelerated in a tight labour market.

Belgium



1. Business sector.
Source: OECD Economic Outlook 105 database; and Eurostat.

StatLink https://doi.org/10.1787/888933934052

Belgium: Demand, output and prices

Belgium	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2016 prices)				
GDP at market prices	411.1	1.5	1.7	1.4	1.2	1.3
Private consumption	210.0	1.7	1.1	1.0	1.1	1.6
Government consumption	97.8	0.0	0.4	0.9	0.9	1.0
Gross fixed capital formation	95.0	3.8	1.8	2.9	3.4	1.7
Final domestic demand	402.8	1.8	1.1	1.4	1.6	1.5
Stockbuilding[1]	2.4	0.2	0.0	-0.3	0.0	0.0
Total domestic demand	405.2	2.0	1.1	1.1	1.7	1.5
Exports of goods and services	332.1	7.6	5.0	3.6	3.0	3.1
Imports of goods and services	326.2	8.5	4.3	3.3	3.6	3.3
Net exports[1]	5.9	-0.5	0.6	0.3	-0.5	-0.2
Memorandum items						
GDP deflator	_	1.8	1.7	1.1	1.4	1.9
Harmonised index of consumer prices	_	1.8	2.2	2.3	1.6	1.5
Harmonised index of core inflation[2]	_	1.8	1.5	1.3	1.5	1.5
Unemployment rate (% of labour force)	_	7.9	7.1	6.0	5.7	5.6
Household saving ratio, net (% of disposable income)	_	3.8	4.0	4.4	5.0	4.9
General government financial balance (% of GDP)	_	-2.4	-0.8	-0.7	-1.3	-1.5
General government gross debt (% of GDP)	_	129.0	122.4	120.4	119.5	118.3
General government debt, Maastricht definition (% of GDP)	_	106.1	103.4	102.0	101.1	99.9
Current account balance (% of GDP)	_	-0.6	0.7	-1.3	-0.8	-0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935135

Productivity, inclusiveness and long-term fiscal sustainability could be enhanced

The budget deficit was 0.7% of GDP in 2018 and is projected to increase to 1.5% of GDP by 2020, with fiscal policy providing modest support to economic activity in 2019 and 2020. As public debt remains high, it is important that the government adheres to its medium-term fiscal targets to ensure a steady reduction of the debt-to-GDP ratio. To further improve the structural balance, greater efficiency in public spending should be encouraged. To boost economic growth and job creation, the authorities have developed the National Pact for Strategic Investments, with approximately 150 billion euros of investment envisaged in the areas of digital transformation, education, health care, energy and transport.

To better leverage productivity gains from digitalisation, the dissemination of intermediate ICT skills should be supported through adult education and training, and by generalising access to ICT as a minor/secondary field of study for all tertiary education students. Productivity would also benefit from increased competition, innovation and business dynamism. Ensuring that appropriate financing tools are available for young and innovative firms to scale up and further streamlining public support for R&D and innovation are of particular importance. Regulatory barriers to firm entry and exit should also be reduced and the insolvency regime reformed.

To make growth more inclusive, the labour market performance of immigrant, low-skilled and older workers should be enhanced. Ensuring firms comply with federal legislation to provide workers with at least five working days of education and training per year would help. As the tax wedge on labour earnings remains one of the highest in Europe, labour taxes should be further reduced. Implementation of congestion charges, extending the company car scheme to other means of transport and allowing employees to substitute company cars for cash, improving public transport infrastructure and further reducing transaction taxes on housing would all help to make growth greener.

Growth is projected to stabilise

GDP growth is projected to stabilise at around 1¼ per cent in 2019 and 2020. Private consumption will be an important driver of growth, supported by past and announced additional reductions in labour taxation, and robust wage growth. Favourable financial conditions will support private investment. Public investment will contribute to economic growth in 2020 with the launch of some major public investment projects. Employment growth is projected to continue, albeit at a slower pace, pushing the unemployment rate down to 5.6% in 2020. Underlying price inflation will pick up gradually due to wage pressures resulting from a tight labour market. However, recent reforms of the wage setting system have been designed to better take into account international cost competitiveness. Economic growth could be weakened by continued uncertainty associated with Brexit or lower than expected euro area growth. On the upside, growth could be stronger if tax reductions enhance private consumption more than expected.

Brazil

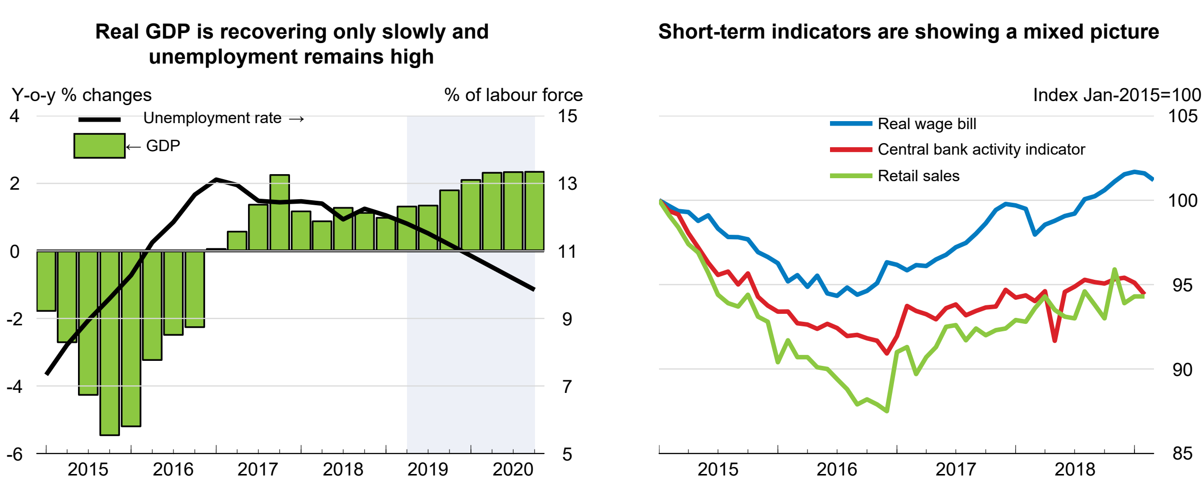
The recovery has recently slowed despite favourable financial conditions but growth is projected to pick up to 2¼ per cent in 2020. An ambitious pension reform proposal to ensure long-term fiscal sustainability has been submitted to Congress, but uncertainty about the implementation of the reform remains. If this uncertainty dissipates, domestic demand is projected to accelerate and unemployment to decline. Given ample spare capacity, inflation is expected to remain below target.

Monetary policy will remain accommodative, supporting household spending. Without major efforts to contain expenditure growth, the sustainability of fiscal accounts remains at risk, especially but not only due to rising pension spending. Rebalancing social spending towards low-income households would reduce inequalities. Achieving stronger growth will require further reform efforts to strengthen productivity, including closer integration into the global economy and lower administrative barriers to market entry.

The expansion has shifted into a lower gear

The economy continues to recover, but the pace has ebbed, especially for investment, as all eyes are set on the ability of the new administration to deliver reforms. Business confidence has started to recede against the background of uncertainty around the reform process. Growth in the services and primary sectors has compensated for a contraction in industrial output and the prospects for agricultural output remain favourable. Inflation and core inflation are below target, despite a minor uptick in recent months, and interest rates have remained low. This, together with moderate wage growth, is supporting private consumption, although unemployment has yet to improve. In particular, the composition of jobs created has been of low quality so far, with a disproportionate number of jobs created in the informal sector. Fiscal indicators continue to deteriorate.

Brazil 1



Source: OECD Economic Outlook 105 database; Central Bank of Brazil; and IBGE.

StatLink https://doi.org/10.1787/888933934071

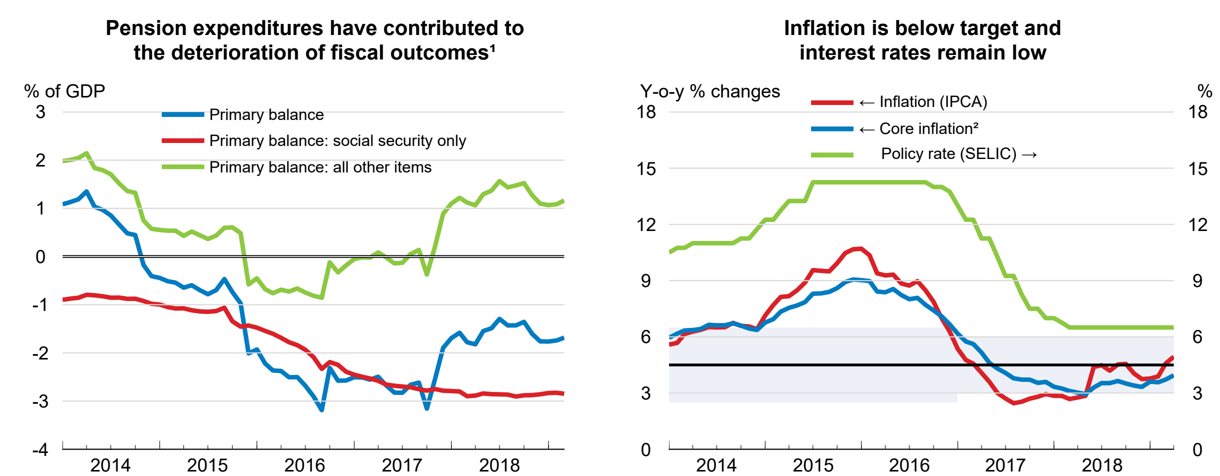
Brazil: Demand, output and prices

	2015	2016	2017	2018	2019	2020
Brazil	Current prices BRL billion	Percentage changes, volume (2000 prices)				
GDP at market prices	5 995.8	-3.3	1.1	1.1	1.4	2.3
Private consumption	3 835.2	-3.9	1.3	1.9	1.9	2.4
Government consumption	1 185.8	0.2	-0.9	0.0	0.5	0.9
Gross fixed capital formation	1 069.4	-12.2	-2.6	4.1	0.7	3.5
Final domestic demand	6 090.4	-4.6	0.3	1.9	1.4	2.3
Stockbuilding[1]	- 25.4	-0.2	0.7	-0.4	-1.0	0.0
Total domestic demand	6 064.9	-4.8	1.0	1.5	0.4	2.3
Exports of goods and services	773.5	0.7	5.7	3.4	7.5	4.2
Imports of goods and services	842.6	-10.4	5.5	7.6	1.6	4.6
Net exports[1]	- 69.1	1.5	0.1	-0.5	0.9	0.0
Memorandum items						
GDP deflator	_	8.1	3.5	3.0	3.7	4.0
Consumer price index	_	8.7	3.4	3.7	3.9	4.0
Private consumption deflator	_	9.2	2.8	2.8	3.8	4.0
General government financial balance (% of GDP)	_	-9.0	-7.8	-7.1	-6.2	-5.9
Current account balance (% of GDP)	_	-1.3	-0.4	-0.8	-0.2	-0.3

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935154

Brazil 2



1. Accumulated over 12 months.
2. Core inflation is defined as the average of the three core inflation measures published by the Central Bank of Brazil.
Source: Central Bank of Brazil; National Treasury; IBGE; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934090

Improving the quality of public finances is crucial for restoring confidence

Low confidence is holding back a stronger recovery in domestic demand, and confidence will improve only with tangible progress on reforms that ensure fiscal sustainability. Gross public debt remains high at 77% of GDP and the primary deficit of 1.5% of GDP falls short of the estimated 2% surplus required to stabilise public debt. The expenditure rule introduced in 2016 will not be met in 2020 without implementing decisive action to reduce the growth of public spending.

While some progress has been made on other expenditure items, the deterioration in the fiscal accounts continues to be driven by rising social security expenditures, most notably old-age pensions. Therefore, pension reform, along the lines of the proposal submitted to congress, remains the key priority to ensure debt sustainability, restore investor confidence and avoid higher financing costs.

The reform proposal would also improve the redistributive impact of pensions and allow for a recalibration of social spending towards more effective social benefits. Due to an indexation to the minimum wage, rising pension benefits have benefitted mostly middle-class households, leaving fewer resources for well-targeted social benefits to fight inequality and poverty, which is concentrated among children and youth. Raising income thresholds in the conditional cash transfer programme Bolsa Família, which costs only 0.5% of GDP, would broaden eligibility and raise benefit levels. This would lift more people out of poverty and strengthen incentives for school attendance and medical check-ups, thus reducing inequalities with respect to education and health.

Reducing the public sector’s high wage bill is also a key priority, as salary levels exceed private sector pay in many areas, particularly at the entry level. However, the recently decided rise in military remunerations is likely to make the case for savings in other parts of the administration more difficult. Efforts to reduce tax expenditures and credit subsidies for private-sector enterprises, which have created fertile grounds for corruption without generating clear benefits for either well-being or productivity, should continue.

With inflation projected to be below target in 2019 and 2020, monetary tightening now appears unlikely before 2020 and financial conditions are projected to remain favourable. Credit has been growing for households, but continues to decline for the corporate sector. Current reform plans to strengthen competition in the financial sector are a promising step to reduce borrowing costs.

Productivity growth will be the main engine of growth in the longer term. Strengthening it will require more competition in many sectors to allow labour and capital to move to activities with strong potential. Closer integration into the global economy would raise efficiency by exposing more firms to foreign competition and improving access to lower cost intermediate and capital goods. Efficiency would also be enhanced by reducing domestic barriers to entry and implementing policies to reduce costs, such as easing tax compliance or improving contract enforcement. A substantial overhaul of the fragmented indirect tax system, with a view towards a unified value added tax, could raise the competitiveness of firms across the country.

Growth is projected to gain momentum

On the assumption of a successfully legislated and implemented pension reform and the associated confidence improvement, growth is projected to increase during 2019 and 2020 and unemployment to decline, including through the creation of more jobs in the formal sector. Low inflation, stronger wage growth and falling unemployment will support private consumption and investment will rise visibly during 2019 as the reforms advance. Structural reforms beyond pensions will support stronger growth momentum in 2020.

Risks are mainly related to the implementation of reforms. The fragmented political landscape, and at times the challenging relationship between different branches of government, is making it difficult to build political consensus for key reforms. If congress fails to approve the ambitious reform agenda of the executive, the expenditure rule would be violated as early as 2020, likely resulting in higher financing costs, lower growth outcomes and possibly a return into recession. On the other hand, a stronger reform momentum stretching beyond the urgently needed pension reform could improve the business climate significantly and lead to stronger growth, including exports. The possibility of rising trade tensions also bears risks for Brazil, as China and the United States are Brazil's two major trading partners.

Canada

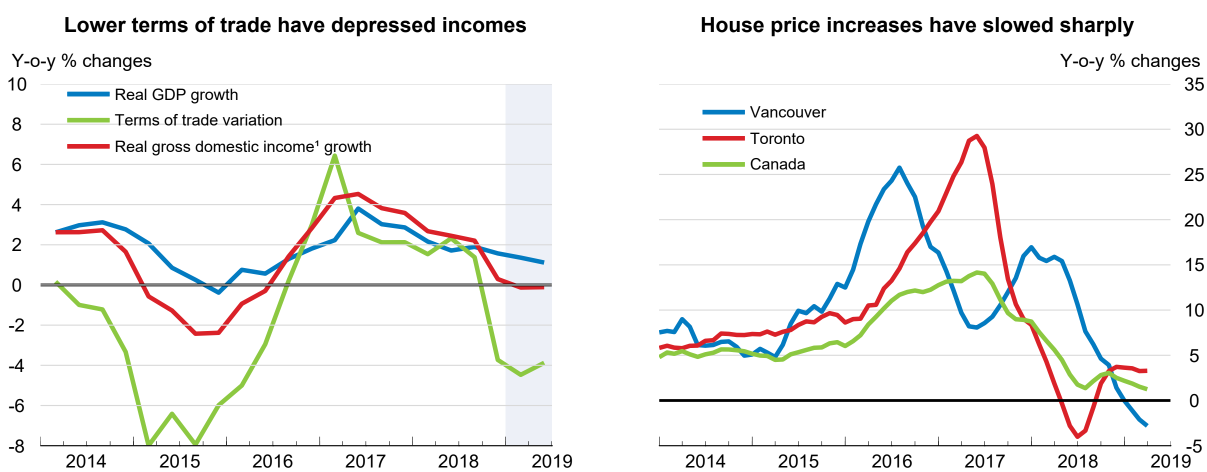
Growth is projected to recover to around 2% (annualised rate) in the second half of 2019. Exports will strengthen in response to an easing in Alberta's mandatory oil production cuts and higher export market growth. Business investment will rise as firms move to increase capacity and productivity and in response to new tax incentives. Employment growth is on course to slow, but the unemployment rate should remain near record lows.

The Bank of Canada is likely to maintain the current degree of monetary stimulus, which should be sufficient to keep inflation near the mid-point of its 1-3% medium-term target band. The fiscal policy stance is set to remain broadly neutral and, with small budget deficits, the debt-to-GDP ratio should continue to edge down. Macroprudential measures have helped take the steam out of the housing market and reduced lending to high-risk borrowers. The supply of affordable housing should be increased and social housing should be better maintained and targeted.

Economic growth has slowed

Economic growth has slowed as households have adjusted consumption expenditure to moderating income growth and higher interest rates, and businesses have cut investment in response to greater global trade policy uncertainty. Growth has also been weighed down by a sharp fall in oil export prices in late 2018, which has reduced domestic incomes, and by mandatory oil production cuts in Alberta. In addition to these cuts, slowing import demand growth in the United States has contributed to the fall in export growth.

Canada 1



1. Real gross domestic income equals real GDP adjusted for changes in the terms of trade.
Source: OECD Economic Outlook 105 database; Teranet; and Bank of Canada.

StatLink https://doi.org/10.1787/888933934109

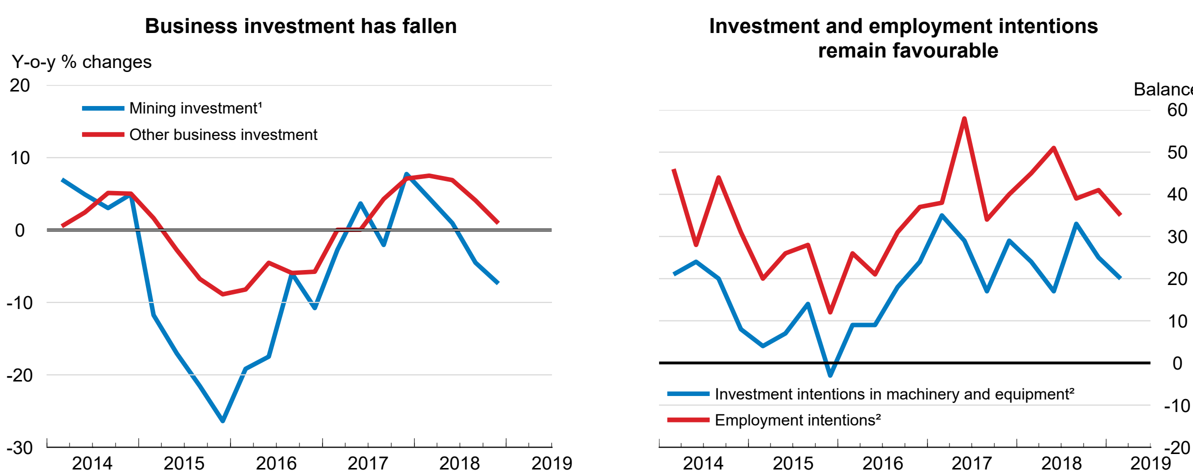
Canada: Demand, output and prices

Canada	2015	2016	2017	2018	2019	2020
	Current prices CAD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	1 990.4	1.1	3.0	1.8	1.3	2.0
Private consumption	1 150.8	2.2	3.5	2.1	1.4	1.5
Government consumption	415.6	1.8	2.1	2.5	2.0	1.8
Gross fixed capital formation	474.7	-4.3	3.0	0.8	-2.8	2.2
Final domestic demand	2 041.1	0.6	3.1	1.9	0.6	1.7
Stockbuilding[1]	- 1.4	0.0	0.8	-0.2	0.0	0.0
Total domestic demand	2 039.6	0.7	3.9	1.7	0.6	1.7
Exports of goods and services	629.1	1.3	1.1	3.3	1.6	3.2
Imports of goods and services	678.3	0.0	4.2	2.9	-0.1	2.7
Net exports[1]	- 49.2	0.4	-1.1	0.1	0.5	0.1
Memorandum items						
GDP deflator	_	0.8	2.5	1.7	0.7	1.7
Consumer price index	_	1.4	1.6	2.2	1.8	2.0
Core consumer price index[2]	_	1.8	1.6	1.9	1.9	2.0
Unemployment rate (% of labour force)	_	7.0	6.3	5.8	5.8	5.8
Household saving ratio, net (% of disposable income)	_	1.6	1.5	1.1	1.7	1.7
General government financial balance (% of GDP)	_	-0.4	-0.3	-0.4	-0.4	-0.2
General government gross debt (% of GDP)	_	98.2	94.3	93.7	93.6	92.9
Current account balance (% of GDP)	_	-3.2	-2.8	-2.6	-2.9	-2.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935173

Canada 2



1. Includes oil and gas. Also includes some engineering structures investment that may relate to other sectors.
2. Percentage of firms expecting higher investment (/levels of employment) minus the percentage expecting less investment (/lower levels of employment).
Source: Bank of Canada (2019), *Business Outlook Survey*, Spring; OECD Economic Outlook 105 database; and Statistics Canada, Table 36-10-0108-01.

StatLink https://doi.org/10.1787/888933934128

A weakening housing market has depressed residential investment and compounded the slowdown in consumption expenditure. Consumer and business confidence indicators have fallen, pointing to weak economic activity in the coming months. Nevertheless, business investment and employment intentions remain healthy outside the energy sector. The mandatory oil production cuts have markedly reduced the discount on Canadian oil in recent months, increasing incomes and paving the way for an easing in the cuts.

Employment growth has picked up markedly and the unemployment rate has remained below 6%, near a 40-year low. Wage growth has slowed from an already modest pace, driven by developments in the oil-producing provinces. Job churn has increased, pointing to stronger future wage growth. Consumer price inflation has receded due to falling energy prices. The average of the Bank's preferred underlying inflation measures has edged down to 1.8%. Expected inflation has declined, with a majority of businesses now anticipating inflation to be in the lower half of the 1-3% medium-term target band over the next two years, and most of the remaining ones expecting inflation to be 2-3%.

The macroeconomic policy stance will gradually move towards neutral

In response to the tightening of macroprudential policy, provincial measures to reduce housing demand (notably foreign buyer transaction taxes in Vancouver and Toronto and a speculation and vacancy tax in major urban areas of British Columbia) and rising mortgage interest rates, the housing market appears to have achieved a soft landing, although there are large regional differences in conditions. Nationwide house prices stabilised (year-on-year) in early 2019, largely reflecting price growth of around 3% in Toronto, Canada's largest housing market, declines in Vancouver (the second largest market) and Calgary and small increases in most other large urban markets. In Vancouver, adjustment is still occurring to the measures aimed at slowing the market and considerable housing supply is in the pipeline, pointing to further easing, while in Calgary prices should stabilise once adjustment to the fall in oil prices is complete. A housing market soft landing will support gradual deleveraging by households, a process that is already underway; household credit growth has slowed to low rates. No further tightening in macroprudential policy is called for at this time. To counter low housing affordability and long waiting lists for social housing, the supply of affordable housing should be increased and the stock of social housing should be better maintained and targeted.

The gradual withdrawal of monetary policy stimulus underway since mid-2017 has paused since late 2018 in response to slowing growth and a deteriorating global economy. With core inflation slightly below the mid-point of the target band and subdued wage pressures, the official rate is likely to remain unchanged until late 2020 and then to be raised to 2.0%, still below the Bank's estimate of the neutral rate (2.25-3.25%). Long-term rates should increase moderately in response to rising global rates.

The fiscal policy stance is projected to remain broadly neutral in 2019-20, with the underlying primary balance set to be approximately stable as a percentage of potential GDP. This reflects a small easing at the federal level and tightening in Ontario, where the budget deficit is set to fall by 0.3% of national GDP over the next two years.

Growth is projected to strengthen

Many of the factors that have depressed growth in recent months – notably falling oil prices, mandatory oil production cuts, tightening macroprudential policies and rising interest rates - will have played out by mid-2019, laying the ground for an increase in growth to around 2%. In addition to an easing in the mandatory oil production cuts, stronger export market growth will support a pick-up in export growth. Business investment should also gather steam as firms seek to expand capacity, increase productivity and benefit from accelerated depreciation allowances following weak investment in recent years. While growth in private consumption will strengthen, it will nevertheless remain somewhat weaker than in recent years, consistent with gentle deleveraging. The unemployment rate is projected to remain around the current lows and real wage growth to edge up but to remain moderate.

A major downside risk is a greater-than-expected increase in mortgage rates, which could impair many households’ ability to service their mortgages, leading to a housing market correction and lower consumption expenditure. Another risk is that the United States-Mexico-Canada Agreement is not ratified or that access to the US market becomes less favourable even if it is ratified. On the upside, an increase in oil prices would boost incomes, as would a resolution of the regulatory difficulties of increasing oil pipeline capacity.

Chile

Economic growth will remain robust, at above 3%, in 2019-20. Supportive financing conditions, high copper prices, the planned tax and labour reforms and positive business sentiment will underpin investment. Low real interest rates and strong wage growth will support private consumption. Stronger growth will start to translate into higher employment growth. However, inequality is still high, driven by persistent low intergenerational mobility.

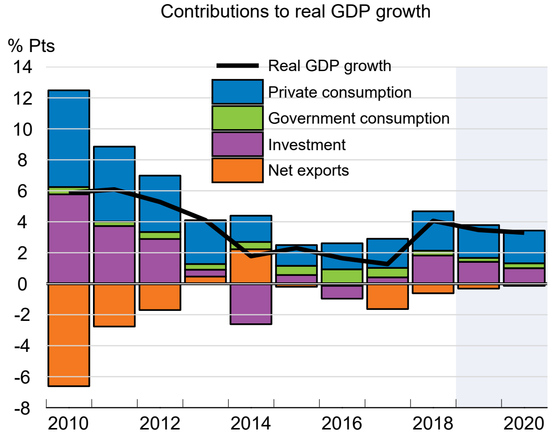
Monetary policy needs to remain accommodative and only start tightening in 2020 as slack dissipates further. The structural fiscal deficit will narrow moderately, according to the medium-term fiscal path set by the authorities, putting the debt-to-GDP ratio on a downward path. The approval and implementation of planned key structural reforms in the areas of taxes, pensions and labour and business regulations would lead to a more favourable growth outlook and more inclusiveness.

Growth has been boosted by investment

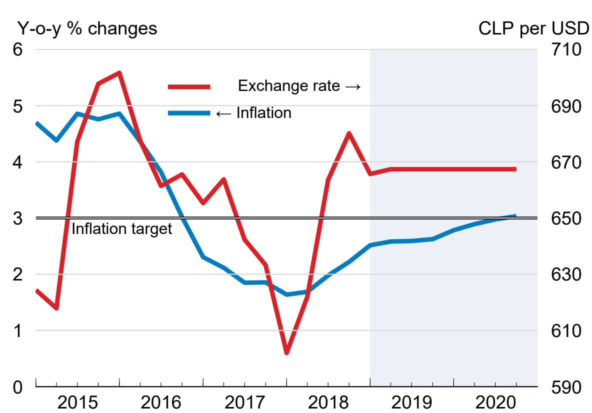
In 2018, the economy grew at its highest rate since 2013, led by investment and buoyant non-mining sectors. Household consumption accelerated amid subdued inflationary pressures and rising confidence. However, while administrative data points to healthy formal employment growth, the unemployment rate has not eased. Excess capacity in the labour market due to a large flow of migrants has contained wage growth. Economic activity slowed down in the first quarter of 2019, amid weather-related disruption to mining and weaker manufacturing output and lower export growth. Inflation remains close to the bottom of the central bank's tolerance range, partly explained by a weaker exchange rate pass-through.

Chile

Robust investment is driving economic growth
Contributions to real GDP growth



Limited exchange rate pass-through contains inflation



Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934147

Chile: Demand, output and prices

Chile	2015	2016	2017	2018	2019	2020
	Current prices CLP billion	Percentage changes, volume (2013 prices)				
GDP at market prices	159 553.3	1.6	1.5	4.0	3.4	3.3
Private consumption	101 220.6	2.6	3.0	4.0	3.4	3.4
Government consumption	20 732.2	7.2	4.4	2.2	1.8	2.2
Gross fixed capital formation	37 934.3	-1.3	-2.7	4.6	5.0	4.5
Final domestic demand	159 887.0	2.3	1.9	3.9	3.5	3.5
Stockbuilding[1]	16.7	-0.5	1.0	0.8	0.3	0.0
Total domestic demand	159 903.7	1.9	3.0	4.8	3.8	3.4
Exports of goods and services	46 870.9	0.5	-1.2	5.1	3.7	3.6
Imports of goods and services	47 221.3	0.9	4.8	7.6	4.8	3.9
Net exports[1]	- 350.3	-0.1	-1.6	-0.6	-0.3	-0.1
Memorandum items						
GDP deflator	_	4.5	4.8	2.0	2.3	3.1
Consumer price index	_	3.8	2.2	2.4	2.2	2.9
Private consumption deflator	_	3.4	2.7	2.0	1.7	2.9
Unemployment rate (% of labour force)	_	6.5	6.7	7.0	6.8	6.4
Central government financial balance (% of GDP)	_	-2.7	-2.7	-1.7	-1.7	-1.5
Current account balance (% of GDP)	_	-1.6	-2.2	-3.1	-3.5	-3.1

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935192

Policy measures are needed for stronger and more inclusive growth

Because inflation has been weaker than expected, the central bank has appropriately halted the tightening that started at the end of 2018. Monetary policy is projected to remain accommodative and start tightening again at a slow and gradual pace as inflation approaches the 3% target and labour market slack shrinks and wages accelerate.

Fiscal policy is broadly appropriate with a gradual consolidation in line with the fiscal rule. Fiscal consolidation will take place by reducing spending growth and will be aided by recent improvements to the fiscal framework with the creation of an independent fiscal council. The planned tax reform will boost investment by simplifying the tax code, accelerating depreciation and speeding up VAT reimbursements. There is still room to increase revenues and make the tax mix more progressive and growth friendly, by raising revenues from environmental, property or personal income taxes while reducing corporate taxes.

Stronger and more inclusive growth will require ambitious reforms in other areas. A comprehensive agenda to bolster the business environment by streamlining regulations and licensing procedures will be key to lifting medium-term growth. Efficient public investment, particularly in education and training, innovation, and digital and transport infrastructure, should foster productivity and more inclusive growth. Boosting skills by enhancing lifelong learning and strengthening active labour market policies is needed to spread the benefits of digitalisation more widely. The pension reform currently under discussion in Congress is expected to raise pensions currently paid out through the publicly funded solidarity pillar, increase future pensions by raising mandatory contributions to privately managed individual accounts, while enhancing competition between pension fund administrators. Aligning the retirement age of men and women and linking it to life expectancy would further improve pension sustainability.

Growth is projected to remain robust

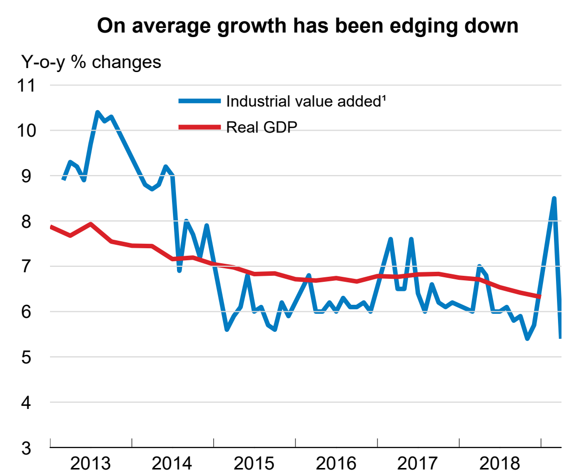
Growth is projected to remain robust on the back of solid macroeconomic fundamentals. Strong investment, aided by supportive financing conditions, high copper prices, the planned tax and labour reforms and positive business sentiment will drive growth and employment. A low and stable inflationary environment and stronger job creation will support private consumption. Government consumption and net exports will remain muted. However, a weaker external environment, driven by trade tensions, regional instabilities and a faster-than-anticipated normalisation of US monetary policy, remain important downside risks. Failure or delay to implement the planned tax reform, and the resulting uncertainty, would also lead to weaker growth. On the upside, full implementation of the ambitious structural reform agenda could raise investment more than anticipated. Faster growth in the region could also deliver higher growth.

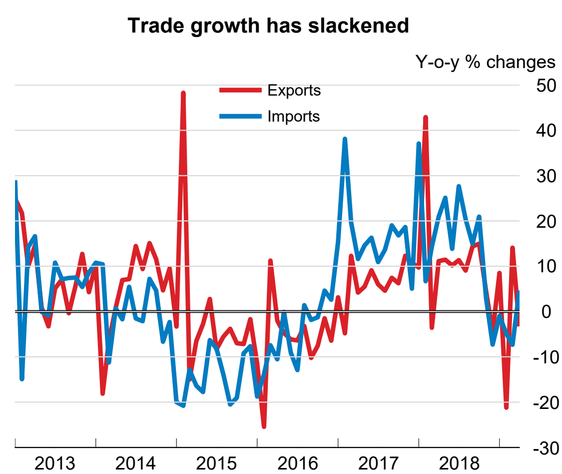
China

Growth is projected to decline gradually in 2019-20 as the economy continues to rebalance. Signs of the slowdown include the weakening of private investment, in particular real estate investment. Housing investment will remain subdued following a series of measures to restrict demand and a deterioration in consumer confidence. Accelerating infrastructure investment will partly make up for that. Consumption will grow steadily on the back of strong growth of disposable incomes. Foreign trade flows will continue to lose momentum as trade tensions have escalated. The current account surplus is projected to turn into a small deficit because of buoyant outbound tourism spending and lower exports due to higher tariffs faced by Chinese exporters.

Monetary conditions had been tightened by the restrictions on shadow banking, but are now being eased somewhat to support economic activity. A broad-based cut in reserves that banks are required to hold with the central bank is supplemented by new targeted tools aiming to increase lending to small, micro and private companies. Perpetual bonds and central bank bill swaps were introduced in early 2019 to boost banks' tier 1 capital. Thanks to a number of additional tax cuts, fiscal policy will remain supportive and hold up consumption amid deteriorating consumer confidence. Government-backed infrastructure stimulus has returned, with the special bond-issuance quota increased by ¾ per cent of GDP, boosting growth but risking the worsening of capital allocation efficiency. Implicit guarantees to state-owned enterprises and other government entities need to be gradually removed to sharpen risk perception. Eliminating restrictions on the entry and conduct of foreign firms is needed to continue to create a level playing field.

China 1





1. Monthly industrial value added data for January and February are not published separately, but the two months combined. The missing data are computed by linear interpolation.
Source: CEIC.

StatLink https://doi.org/10.1787/888933934166

China: Demand, output and prices

China	2015	2016	2017	2018	2019	2020
	Current prices CNY trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	68.6	6.7	6.8	6.6	6.2	6.0
Total domestic demand	66.3	7.7	5.9	7.5	6.5	6.1
Exports of goods and services	14.8	1.9	11.0	4.0	1.6	3.6
Imports of goods and services	12.6	6.3	6.9	8.1	2.8	3.6
Net exports[1]	2.3	-0.7	1.0	-0.6	-0.2	0.1
Memorandum items						
GDP deflator	_	1.1	3.8	2.9	1.4	2.2
Consumer price index	_	2.1	1.5	1.9	1.9	2.1
General government financial balance[2] (% of GDP)	_	-3.0	-3.1	-3.1	-3.4	-3.6
Headline government financial balance[3] (% of GDP)	_	-2.9	-2.9	-2.6	-2.8	-3.2
Current account balance (% of GDP)	_	1.8	1.4	0.3	-0.1	-0.3

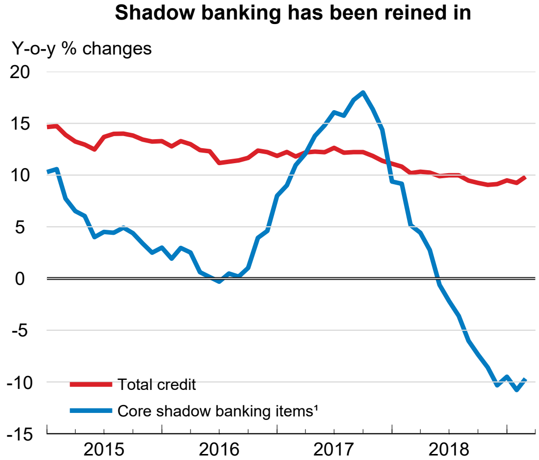
1. Contributions to changes in real GDP, actual amount in the first column.
2. Encompasses the balances of all four budget accounts (general account, government managed funds, social security funds and the state-owned capital management account).
3. The headline fiscal balance is the official balance defined as the difference between revenues and outlays. Revenues include: general budget revenue, revenue from the central stabilisation fund and sub-national budget adjustment. Outlays include: general budget spending, replenishment of the central stabilisation fund and repayment of principal on sub-national debt.

Source: OECD Economic Outlook 105 database.

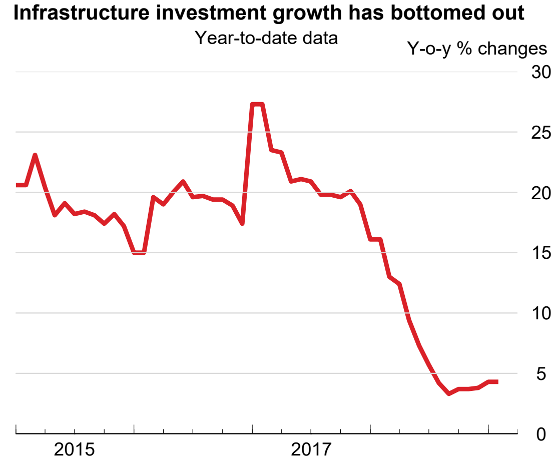
StatLink https://doi.org/10.1787/888933935211

China 2

Shadow banking has been reined in



Infrastructure investment growth has bottomed out



1. Core shadow banking items include entrusted loans, trusted loans and undiscounted bankers' acceptance.
Source: CEIC; and BIS.

StatLink https://doi.org/10.1787/888933934185

The economy shows some signs of weakening on the back of rising global uncertainties

Growth has weakened gradually amid ongoing trade tensions and global uncertainties. Domestic demand, in particular consumption, has remained robust thanks to steadily rising disposable incomes. Infrastructure investment has picked up on the back of the increase of the special bond quotas and the easing of rules for enterprise bond issuance. Business investment remains stable, in particular in services, as the economy continues to rebalance. Real estate investment, in contrast, remains weak, with new residential housing starts plummeting. Trade has weakened as the frontloading of exports has ended and the imports of capital goods have slowed amid rebalancing and gradual moving up the value chain. As tourism imports have remained robust, the current account surplus has declined.

Monetary and fiscal policies will ease, but structural reforms should accelerate

Monetary policy was tightened somewhat over the past year by the restrictions put on shadow banking, which were necessary to maintain financial stability. The authorities exempted banks from tax liabilities related to their lending to smaller and private firms, which came on top of targeted reductions of reserve requirement ratios for banks directing a certain share of their lending to such firms. However, these measures were insufficient to solve the private sector credit crunch. As a new measure, banks are now encouraged to channel 30% of their new lending to the private sector. A large amount of bonds will mature this year, but the ensuing liquidity problems of local government investment vehicles will be eased through loans from the China Development Bank. The relaxation of enterprise bond issuance rules by the National Development and Reform Commission for top-rated firms last year will alleviate refinancing concerns for property firms as well. New credit risk mitigation tools will make bonds more attractive for investors. More stringent reporting and disclosure requirements would make it easier for smaller and private firms to get access to credit.

Fiscal stimulus will hold growth up but better pricing of risk is needed to reduce misallocation of capital. Removal of implicit guarantees to state-owned enterprises and other public entities would help, and the announcement last autumn to let ailing local government investment vehicles exit the market is a step in that direction. Special bond issuance quotas have been increased for 2019 by about 0.7% of GDP, though it is unclear how much of this local governments will be able to actually issue, given the weakening of land right sales, the proceeds of which are the major source of repayment of such bonds. The impact of tax cuts aimed at boosting consumption may be mitigated by adverse confidence effects. A minimum level of public services should be ensured through better allocation of resources to provide more equal opportunities to individuals regardless of their place of birth. Central funding for basic public services, such as education and health, is needed to ensure a sufficient level of service provision.

The recent approval of the new foreign investment law is a major step to ensure that China remains an attractive investment destination. In the longer term, steady inflows should continue as the current account is shifting to deficit and capital outflows intensify due to portfolio diversification by investors. In particular, imposing criminal penalties for the infringement of intellectual property rights is a positive development towards levelling the playing field. Checks and balances to ensure enforcement will be key to its impact.

Growth is projected to slow gradually, but remain robust

Growth is projected to slow further as the economy rebalances. Exports and imports will slow somewhat, the former as a result of the tariffs imposed last year, though a new round of import tariff cuts recently introduced by China, an increased VAT refund on exported products and a lowering of export taxes will mitigate the impact of trade tensions. Easing producer price inflation will also strengthen competitiveness and exports later on this year and in 2020. Consumer price inflation will nonetheless pick up somewhat due to higher fresh food prices, partly reflecting African swine fever, but these one-off pressures will remain benign. Surging overseas tourism will push the current account balance into a slight deficit.

A major upside risk is alleviation of trade tensions, which would not only lift exports but also improve consumer confidence. Downside risks in addition to further escalation of trade tensions stem from financial conditions: reining in shadow banking enhances financial stability and transparency, but may cause funding difficulties by smaller firms, weighing on private investment. An acceleration in corporate deleveraging would help to restore balance sheets amid rising debt service costs, but would slow growth in the short term. The impact of tax cuts may be smaller than expected owing to subdued consumer confidence and the slow pace of structural reforms to boost consumption.

Colombia

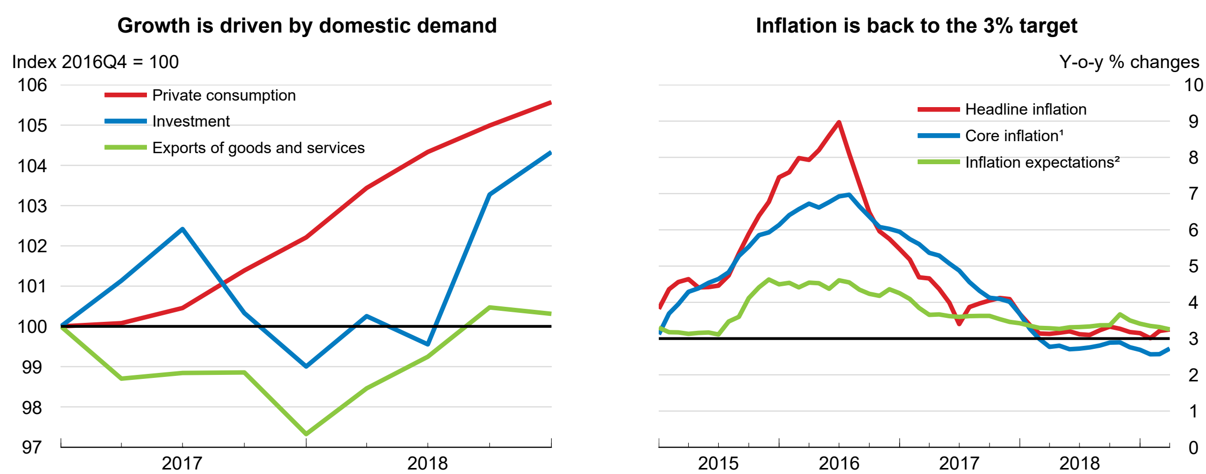
Economic growth will strengthen to around 3.5% in 2019 and 2020, as lower corporate taxes boost investment. Low inflation and interest rates will support consumption. With demand-driven growth and weak export performance, the current account deficit will widen. Poverty has fallen, but inequality and informality remain high.

The mildly accommodative monetary policy stance is appropriate, with inflation expectations close to target and unemployment high. Fiscal policy will need to remain moderately prudent to let the deficit decline gradually in line with the fiscal rule. Boosting productivity requires more competition and openness to trade. A better targeting of social policies and further efforts to reduce labour market informality, by cutting non-wage labour costs further, would reduce inequalities.

Consumption and investment are driving growth

Economic growth continues to gain momentum, underpinned by improving consumer and business confidence and credit markets. Substantial migration inflows from Venezuela are boosting demand. The current account deficit has widened, as imports are rising, particularly of investment goods, while export performance remains weak. The current account deficit remains largely financed by stable foreign direct investment. Unemployment has increased, as employment creation remains feeble and the labour force is increasing due to migration. Price pressures remain contained given the slack in the economy.

Colombia



1. Core inflation excludes primary food, utilities and fuel.
2. Inflation expectations are defined as the 12-month ahead inflation expectations.
Source: Banco de la República; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934204

Colombia: Demand, output and prices

Colombia	2015	2016	2017	2018	2019	2020
	Current prices COP trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	804.7	2.1	1.4	2.7	3.4	3.6
Private consumption	551.0	1.6	2.1	3.5	3.0	3.2
Government consumption	119.2	1.8	3.8	5.9	5.1	3.0
Gross fixed capital formation	188.1	-2.9	1.9	1.1	5.3	4.9
Final domestic demand	858.3	0.6	2.3	3.4	3.7	3.5
Stockbuilding[1]	3.2	0.6	-1.2	0.5	0.3	0.0
Total domestic demand	861.5	1.2	1.2	3.8	4.0	3.5
Exports of goods and services	125.9	-0.2	2.5	1.2	3.0	4.2
Imports of goods and services	182.7	-3.5	1.2	8.0	7.4	3.6
Net exports[1]	- 56.8	0.8	0.1	-1.4	-1.1	-0.1
Memorandum items						
GDP deflator	_	5.1	5.1	3.3	3.0	3.2
Consumer price index	_	7.5	4.3	3.2	3.0	3.1
Core inflation index[2]	_	6.5	4.9	2.9	2.7	3.1
Unemployment rate (% of labour force)	_	9.2	9.4	10.1	11.0	9.9
Current account balance (% of GDP)	_	-4.3	-3.3	-3.9	-4.2	-4.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding primary food, utilities and fuels.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935230

Further structural reforms would boost inclusive growth

The large inflow of migrants from Venezuela is a major social and economic challenge. Migration can help to boost potential growth, which has fallen in recent years due to lacklustre productivity. However, this requires continuing with the integration policies that help absorb migrants in the labour market, as well as investment in education and health care systems. Since these policies entail an unexpected fiscal cost, fiscal targets have recently been revised, with a slower than envisaged reduction of the deficit. This strikes an appropriate balance between spending needs and reducing the central government's structural deficit to 1% to ensure medium-term debt sustainability. Ongoing efforts to improve the tax system and boost public spending efficiency will help to improve the fiscal accounts. Broadening the corporate, VAT, and personal tax bases would also help to increase revenues and make the tax mix more efficient and fair.

Stronger and more inclusive growth requires boosting productivity through structural reforms. Improving ports and customs logistics and reducing regulatory burdens would make firms more competitive and help to create better paying jobs. Reducing trade barriers, streamlining the cumbersome licensing system, and promoting further adoption and use of information technology tools would boost firms' competitiveness and productivity. Improving vocational education, by increasing quality and alignment with labour market needs, would foster skills and inclusiveness. A new tourism strategy would help to realise the large untapped potential in this sector.

Informality has fallen in recent years, but more than half of total employment is still informal. This calls for additional efforts, such as further reducing non-wage labour costs, reviewing the minimum wage system to achieve a more job-friendly level and simplifying procedures for the registration of companies and workers' affiliation to social security. Reforming the pension system is urgent to reduce old-age poverty. Expanding early childhood education, particularly in rural areas, would improve school outcomes and allow more women to take up paid work.

Growth is projected to stay robust

Growth is set to remain strong, supported by higher domestic demand. Investment will be a key driver of growth, aided by a lower tax burden and infrastructure projects. Low and stable inflation and improving financing conditions will support consumption. Upside risks include higher oil prices, which could boost investment further. The tourism sector holds potential for upside surprises, thanks to the end of the armed conflict. Downside risks include regional instability, particularly in Venezuela, additional delays in infrastructure projects, and a spill over of financial volatility in emerging-market economies.

Costa Rica

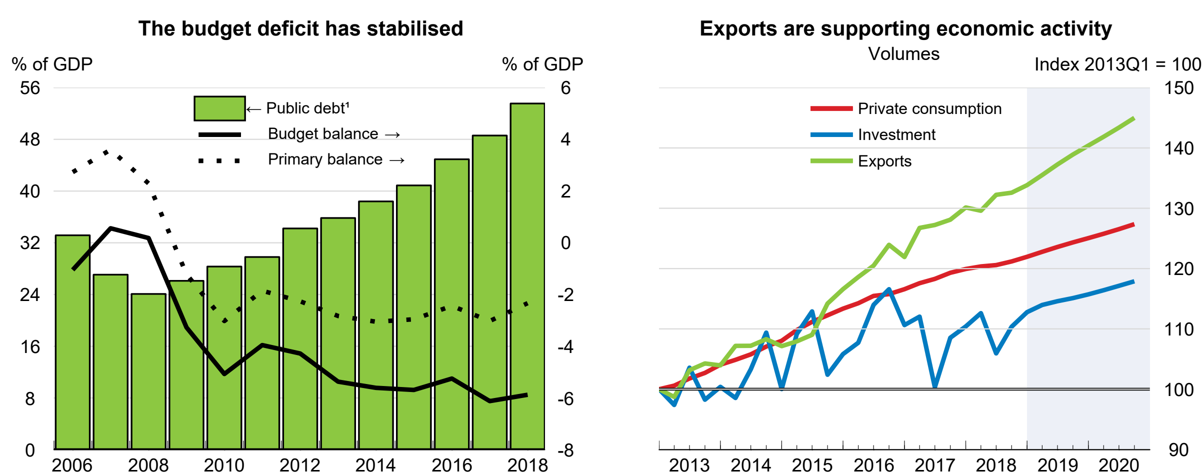
Economic activity is projected to pick up, supported by infrastructure investment and improved business sentiment upon the approval of fiscal reforms. Consumer spending will remain subdued on the back of tax increases, lower credit growth and a temporary increase in inflation, due to the introduction of a fully-fledged VAT tax. However, an improvement in terms of trade will boost disposable income. External demand will remain robust, supported by tourism, high-tech products and business services.

Fiscal consolidation has progressed, and the approved fiscal reform and a temporary tax amnesty has raised additional revenue to help reduce the persistently high public debt. Streamlining the organisation of the public sector, and a public employment reform could help contain the deficit and make the delivery of public services more effective. Additional investment to solve large infrastructure gaps, and measures to reduce labour market mismatches and informality, improve education outcomes and strengthen competition are key to unleash the potential of tourism, lift productivity and reduce inequalities.

Economic activity is picking up

Economic activity decelerated in the last quarters of 2018 as a result of uncertainty about the approval of the fiscal reforms, and labour strikes that hit investment and the retail sector. The currency has stabilised recently in the aftermath of the approval of the fiscal reforms and economic activity has rebounded, particularly in the financial sector, IT and business services. Unemployment remains high owing to labour market and education mismatches, a complex system of multiple minimum wages and high barriers to entrepreneurship, all of which also contribute to a high informality rate.

Costa Rica



1. General government gross debt as a percentage of GDP.

Source: IMF, World Economic Outlook database, April 2019; Banco Central de Costa Rica; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934223

Costa Rica: Demand, output and prices

Costa Rica	2015 Current prices CRC trillion	2016	2017	2018	2019	2020
		Percentage changes, volume (2012 prices)				
GDP at market prices	29.3	4.2	3.4	2.7	2.7	3.0
Private consumption	19.0	4.0	2.8	2.2	2.2	2.5
Government consumption	5.1	2.4	3.1	0.5	0.0	2.2
Gross fixed capital formation	5.5	4.6	-2.8	1.8	3.9	2.4
Final domestic demand	29.6	3.8	1.8	1.8	2.1	2.4
Stockbuilding[1]	0.0	0.4	1.0	-0.6	0.1	0.0
Total domestic demand	29.6	4.3	2.8	1.0	2.3	2.4
Exports of goods and services	9.0	9.4	5.1	4.1	4.0	4.6
Imports of goods and services	9.3	8.9	3.2	-0.5	3.0	3.0
Net exports[1]	- 0.3	-0.2	0.5	1.6	0.3	0.5
Memorandum items						
GDP deflator	_	2.0	2.5	2.3	3.8	2.8
Consumer price index	_	0.0	1.6	2.2	2.6	3.3
Core inflation index[2]	_	0.1	1.2	2.1	2.4	2.6
Unemployment rate (% of labour force)	_	9.5	9.1	10.3	10.1	10.0
Current account balance (% of GDP)	_	-2.3	-3.1	-3.1	-2.7	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935249

Additional measures to restore fiscal sustainability are needed

Spending restraint helped curb the public deficit in 2018 and a temporary tax amnesty has raised more than 0.6% of GDP in additional revenues. The implementation of the historic tax reform will improve fiscal sustainability and the progressivity of income tax. However, the implementation of the new fiscal rule will be key to put a halt to the rise in the debt-to-GDP ratio. Reforms to streamline the organisation of the public sector and in public sector employment would generate additional savings, improve effectiveness in the delivery of public services and decrease high inequalities. Reducing budget rigidities stemming from legally mandated spending and earmarking of government revenues would help to improve fiscal performance. Strengthening the budgetary process by implementing a multi-year expenditure framework and establishing a fiscal council would also help to control public expenditure and improve its quality.

Inflation expectations are converging towards the middle of the target range of the central bank and core inflation has remained stable, although a moderate rise is expected. The high level of dollarisation, which has recently increased, continues to impair the transmission of monetary policy, which highlights the necessity of continuing to allow the currency to float.

Growth is projected to rise moderately

Growth will increase as infrastructure investment is implemented in 2019. Rising business sentiment on the back of the approval of the fiscal reform bill will lift private investment. Improved terms of trade will raise disposable incomes but this effect will be mitigated by lower credit growth and higher taxes. Export growth will remain strong, especially in knowledge-intensive business services. Fiscal underperformance remains the main risk to the outlook, as high interest rates crowd out private investment. It could also lead to further bouts of sharp currency depreciation which would also affect confidence and domestic demand. An exacerbation of international trade tensions could also damp growth via lower exports. On the other hand, additional reforms to boost competitiveness and to put public finances on track would raise business confidence and investment.

Czech Republic

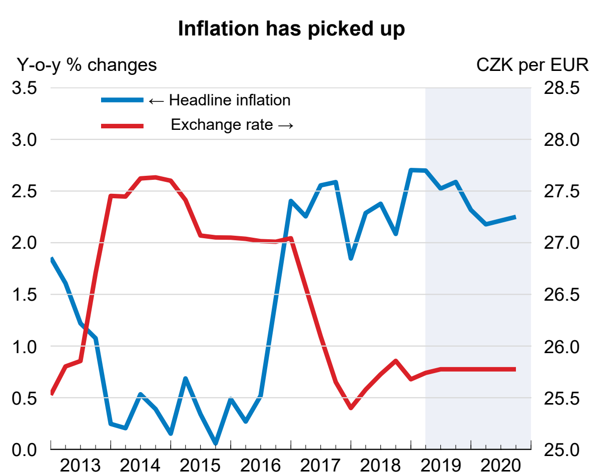
Economic growth will remain robust in 2019 and 2020, although slowing to around 2½ per cent. Household consumption will grow fast thanks to growing wages and social benefits. Government spending and private investment will also contribute to growth. Labour shortages and weaker demand from trading partners will restrain growth in 2020.

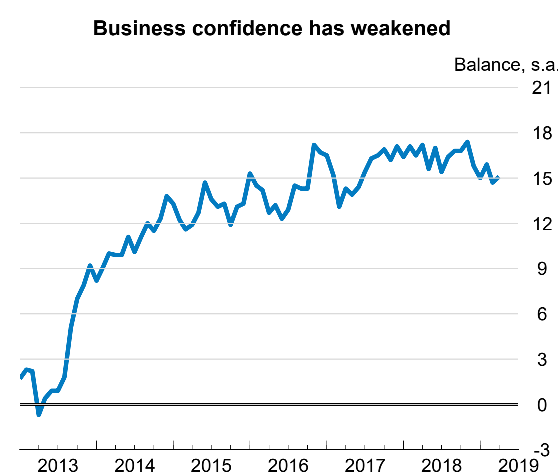
Monetary policy tightening is projected to continue in 2019 and 2020 to keep inflation close to the 2% target of the central bank. If inflation turns out to be higher than projected, monetary policy tightening would have to be stronger. The fiscal surplus is decreasing mildly on the back of fast spending growth, but public debt is set to decrease further to a record low. Improving transport infrastructure and regulations, lifting barriers to entry in professional services and increasing female participation in the labour market would help to boost potential growth.

Growth remains strong

The economy remains strong, supported by domestic demand. Although slowing somewhat, household consumption growth will remain robust, driven by high wage growth and employment. On the supply side, strong construction and manufacturing activity are driving production and investment, more specifically, in railway infrastructure. Exports of cars, an important segment of the economy, keep increasing, but overall export growth is slowing as external demand is weakening. This has led to a softening of business confidence, which is expected to slow investment. The labour market remains tight, constraining growth, in particular in sectors like construction. The number of job vacancies has stabilised but remains high, contributing to strong wage growth.

Czech Republic





Source: Czech Statistical Office; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934242

Czech Republic: Demand, output and prices

Czech Republic	2015	2016	2017	2018	2019	2020
	Current prices CZK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 597.8	2.4	4.5	2.9	2.6	2.5
Private consumption	2 152.8	3.6	4.4	3.2	3.0	3.3
Government consumption	883.1	2.7	1.3	3.7	2.0	2.3
Gross fixed capital formation	1 217.4	-3.3	4.1	10.4	3.8	3.3
Final domestic demand	4 253.4	1.4	3.6	5.2	3.0	3.1
Stockbuilding[1]	67.7	-0.3	0.0	-1.2	-0.1	0.0
Total domestic demand	4 321.0	1.1	3.6	3.9	2.9	3.1
Exports of goods and services	3 728.8	4.1	7.1	4.5	4.0	2.9
Imports of goods and services	3 452.0	2.6	6.3	6.0	4.6	3.6
Net exports[1]	276.8	1.4	1.2	-0.7	-0.2	-0.4
Memorandum items						
GDP deflator	_	1.3	1.4	2.1	3.0	2.4
Consumer price index	_	0.7	2.5	2.1	2.6	2.2
Core inflation index[2]	_	1.6	2.0	2.4	2.6	2.2
Unemployment rate (% of labour force)	_	3.9	2.9	2.2	2.1	2.1
Household saving ratio, net (% of disposable income)	_	6.5	4.4	6.1	6.9	6.5
General government financial balance (% of GDP)	_	0.7	1.6	0.9	0.7	0.5
General government gross debt (% of GDP)	_	47.7	43.8	40.2	38.7	37.4
General government debt, Maastricht definition (% of GDP)	_	36.8	34.6	32.7	31.1	29.8
Current account balance (% of GDP)	_	1.6	1.7	0.3	0.5	0.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935268

Investment in infrastructure and training is necessary

Inflation has picked up recently, but is projected to converge slowly toward the 2% target of the central bank. The Czech National Bank is expected to continue to increase interest rates progressively while limiting spreads with the euro area. Further appreciation of the koruna would offset domestic inflation pressures.

Although gradually declining due to strong public spending growth, the primary fiscal balance will remain in surplus and government debt will decrease further. The Czech Republic can use part of the fiscal space to increase potential growth. Investment in transport infrastructure is needed, in particular in roads and railways to better connect the country with important neighbouring trading partners. Developing more high-quality childcare and pre-school facilities would increase the participation of women with young children in the labour market. Moreover, increasing the flexibility of jobs through better enforcement of the right to part-time work, as well as promoting flexible teleworking arrangements and shared jobs, can facilitate the return to the labour market after family-related breaks.

The tight labour market, in the context of an ageing population, calls for bolder policies to increase labour supply. Increasing resources for education can help to reduce important skill mismatches. More specifically, vocational education should be further developed. Stronger involvement of employers in the design of curricula and internships would help to align training with labour market needs. Accelerating immigration procedures and facilitating immigrants' integration, including through language classes, would help ease labour market tensions in the short run.

Growth is projected to remain robust

GDP growth is projected to remain strong over the projection horizon, but to slow somewhat to 2½ per cent, due to weaker exports, business confidence and investment, as well as labour shortages. A tight labour market will continue to boost wage growth and consumption. Exports and economic growth could slow more sharply than projected should the abrupt growth deceleration in Germany, a major trading partner, be stronger and deeper than expected. The economy is highly integrated into European value chains and would be hit disproportionally, should trade disputes escalate. Moreover, higher-than-expected inflation is possible and would accelerate interest rate increases. On the other hand, structural reforms to ease labour market mismatches could sustain a stronger expansion for longer than expected.

Denmark

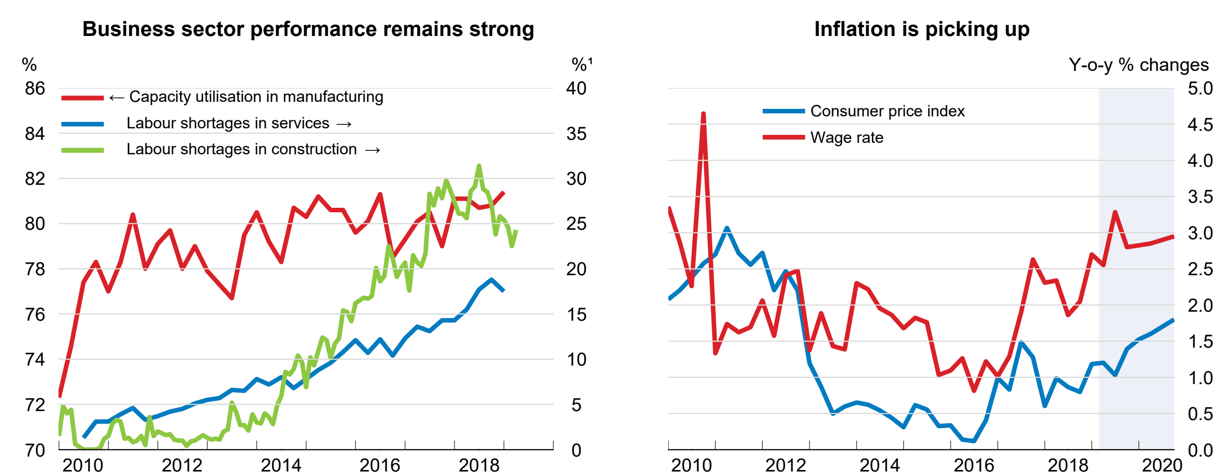
Economic growth is projected to remain strong in 2019 and moderate in 2020 to around 1¾ per cent, as weaker external demand constrains export growth. Rising employment and solid real wage gains will support domestic demand and help sustain the expansion. Inflation is set to pick up from a very low rate as the economy operates above its capacity constraints.

Expansionary monetary policy conditions, reflecting the peg of the krone to the euro, will continue to stimulate investment. Fiscal policy will also support growth in 2019, notably through ongoing public investment and measures decided in previous years. In 2020, fiscal policy is assumed to have a neutral impact on activity, which is appropriate given continued difficulties for firms to hire skilled workers. Structural reforms of competition and tax policies could help to accelerate weak productivity growth.

The long-lasting expansion continues

The economic expansion has been strong recently, underpinned by robust private consumption and accelerating exports. Industrial specialisation in goods that are less sensitive to business cycle fluctuations, such as pharmaceuticals and wind turbines, has helped to weather the global slowdown. Business investment has stabilised after peaking in mid-2018, driven by ship investments. High capacity utilisation and low interest rates are stimulating further investment.

Denmark



1. Percentage of firms reporting shortages of labour as the main factor limiting their business.
Source: OECD Economic Outlook 105 database; and Refinitiv.

StatLink https://doi.org/10.1787/888933934261

Denmark: Demand, output and prices

Denmark	2015	2016	2017	2018	2019	2020
	Current prices DKK billion	Percentage changes, volume (2010 prices)				
GDP at market prices	2 036.4	2.4	2.3	1.4	2.1	1.7
Private consumption	959.4	2.1	2.1	2.3	1.8	2.1
Government consumption	518.6	0.2	0.7	0.8	0.5	0.4
Gross fixed capital formation	404.2	7.6	4.6	5.1	-1.9	3.3
Final domestic demand	1 882.2	2.7	2.3	2.5	0.6	2.0
Stockbuilding[1]	15.9	-0.2	-0.1	0.0	0.0	0.0
Total domestic demand	1 898.1	2.5	2.2	2.6	0.6	1.9
Exports of goods and services	1 128.5	3.9	3.6	0.6	3.3	2.6
Imports of goods and services	990.3	4.2	3.6	2.7	0.5	3.2
Net exports[1]	138.2	0.1	0.2	-1.0	1.6	-0.1
Memorandum items						
GDP deflator	_	0.7	1.4	0.4	1.6	1.8
Consumer price index	_	0.3	1.1	0.8	1.2	1.7
Core inflation index[2]	_	0.7	0.9	0.6	1.1	1.7
Unemployment rate (% of labour force)	_	6.2	5.7	5.0	4.9	4.8
Household saving ratio, net (% of disposable income)	_	4.5	6.2	7.0	7.2	7.3
General government financial balance (% of GDP)	_	-0.1	1.4	0.5	0.3	0.2
General government gross debt (% of GDP)	_	51.4	48.8	47.4	46.9	46.6
General government debt, Maastricht definition (% of GDP)	_	37.2	35.5	34.1	33.6	33.4
Current account balance (% of GDP)	_	7.9	8.0	5.9	6.7	6.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935287

The labour market remains tight. Job creation was strong in early 2019 and employers report difficulties in filling more than a fifth of all vacancies. Labour shortages have started to ease in construction as residential investment moderates and house prices in Copenhagen stabilise. Wage increases are gaining pace, further boosting household real incomes, which have benefited from wages growing at a higher rate than prices for an extended period.

Structural reforms are needed to boost productivity growth

Monetary conditions remain very easy, as the central bank's deposit rate has been negative almost uninterruptedly since 2012 to maintain the peg to the euro. The expected continuation of accommodative euro area monetary policy warrants prudent fiscal policy. Fiscal developments have a slightly expansionary impact on aggregate demand in 2019, mainly reflecting changes in some volatile tax bases rather than policy changes. Ongoing public investment projects, including the construction of six large hospitals, will also give a boost to growth in 2019. A gradual tightening of fiscal policy to reflect the economic upturn and to reach the government's objective of structural balance after 2020 would be appropriate. At the same time, it would be suitable to plan for public infrastructure investment in the medium term, as envisaged by recent political agreements.

Productivity growth remains weak and would benefit from structural reforms. Competitive pressures could be bolstered by improving the competition framework, which tends to be comparatively complex and suffer from sometimes lengthy court procedures. Reducing high marginal taxes on labour and capital income would strengthen incentives to invest in innovation, education and entrepreneurship. For corporate income taxation, introducing an allowance for corporate equity would reduce incentives to finance investment by debt rather than equity and help to boost labour productivity and wages.

Growth is set to remain strong, amid high uncertainty

The economy is projected to grow by 2.1% in 2019 and 1.7% in 2020. Exports will give a boost to growth in the first half of 2019, but then weaken in line with the slowdown in the external environment. Rising household incomes and low unemployment will stimulate domestic demand and sustain growth above its long-run trend. Sizeable downside risks are present. Brexit continues to generate uncertainties for exporting firms and the fishery industry. A disorderly outcome of Brexit could have major negative effects on agricultural, food and manufacturing sectors in Denmark. Domestic risks mainly relate to intensifying labour shortages if the expected rise in the labour market participation of older workers does not materialise or the inflow of foreign workers tumbles.

Estonia

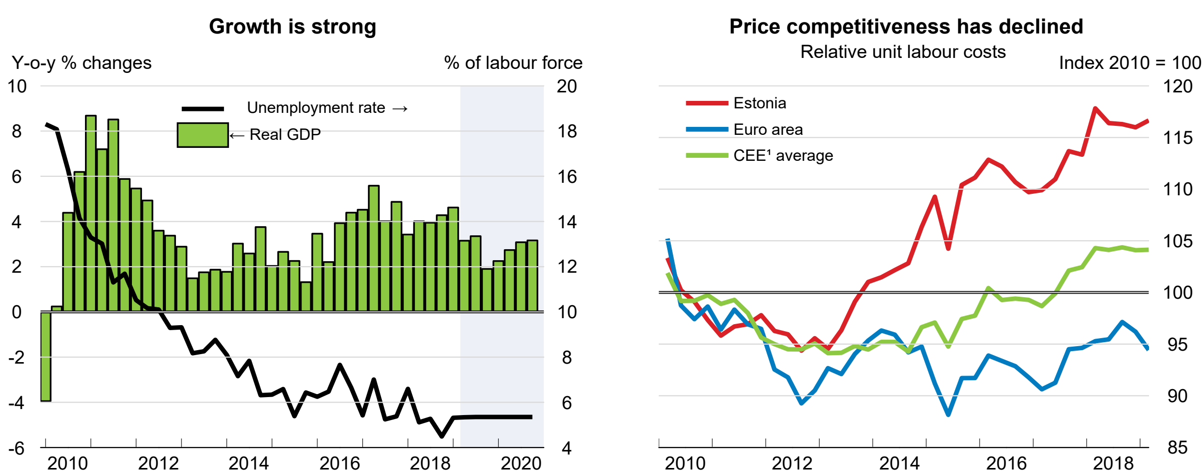
Growth is projected to slow to 3.2% in 2019 and 2.8% in 2020, as the global outlook softens and the domestic economy runs into capacity constraints. Strong growth of real wages and employment will support household consumption. Export growth will decelerate somewhat due to lower global demand and a loss of price competitiveness. Inflation will fall back as temporary factors wane.

Current budget plans include new spending on infrastructure, such as broadband Internet, as well as education, health and social welfare. A moderate fiscal consolidation in 2019 is expected, followed by a broadly neutral stance in 2020. Public debt is low, and macroprudential tools have been put in place to damp potential financial excesses. Cases of money-laundering pose risks to the banking system.

Growth is driven by domestic demand

The expansion continues, fuelled by domestic demand, as consumer confidence increases. Residential investment has picked up, after a housing downturn, and is now making a sizeable contribution to growth. Export growth has held up relatively well, despite a loss of price competitiveness, but imports have been growing faster due to a strong domestic economy and the weakening of the currencies of main trading partners. Employment has risen and unemployment fallen. Capacity constraints are increasingly becoming binding, resulting in labour shortages and strong nominal wage growth, at around 7% a year. Households have increased saving, and high wage growth has so far not been passed through to price inflation. Headline inflation has fallen back to slightly above 2%.

Estonia



1. Simple average of the Czech Republic, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934280

Estonia: Demand, output and prices

Estonia	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	20.6	3.5	4.7	3.9	3.2	2.8
Private consumption	10.6	4.1	2.7	4.7	4.1	3.4
Government consumption	4.1	2.1	0.6	0.3	1.2	1.0
Gross fixed capital formation	4.9	3.5	12.9	2.4	7.0	4.3
Final domestic demand	19.6	3.6	4.9	3.3	4.2	3.1
Stockbuilding[1]	0.2	1.0	-0.5	2.2	-0.4	0.0
Total domestic demand	19.8	4.7	4.3	5.4	3.6	3.1
Exports of goods and services	16.0	5.2	3.5	4.3	3.5	3.3
Imports of goods and services	15.2	5.4	3.6	6.1	3.8	3.7
Net exports[1]	0.8	0.0	0.1	-1.1	-0.1	-0.2
Memorandum items						
GDP deflator	_	1.4	4.0	4.5	3.6	3.3
Harmonised index of consumer prices	_	0.8	3.7	3.4	1.7	2.3
Harmonised index of core inflation[2]	_	1.2	2.0	1.7	1.8	2.5
Unemployment rate (% of labour force)	_	6.8	5.8	5.4	5.3	5.4
Household saving ratio, net (% of disposable income)	_	6.5	7.9	8.4	8.7	7.5
General government financial balance (% of GDP)	_	-0.3	-0.4	-0.6	-0.2	-0.2
General government gross debt (% of GDP)	_	12.7	13.0	12.9	15.4	17.5
General government debt, Maastricht definition (% of GDP)	_	9.2	9.2	8.4	10.9	13.0
Current account balance (% of GDP)	_	1.9	3.1	1.8	1.2	1.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935306

Productivity and skills need a boost to accelerate catch-up

Monetary policy in the euro area is expected to remain very accommodative. Further fiscal expansion in Estonia should be avoided to reduce risks of overheating, but there is fiscal space to finance productivity-enhancing investments, for example in infrastructure and skills. House prices are growing in line with incomes, and macroprudential tools have improved resilience. Subsidiaries of Nordic banks provide the bulk of banking services in the country. Several of them are being linked to on-going money-laundering investigations, calling for a strengthened legal framework with higher fines.

Export growth is still fairly solid, as rising unit labour costs are compensated by gains in non-price competitiveness and a compression of margins. Falling price competitiveness contributes to reductions in traditional manufacturing employment, with social costs that can be significant and geographically concentrated. Ensuring good access to unemployment insurance and activation policies can help to alleviate the social impact and help jobseekers return to work more rapidly. Structural policies to boost productivity and to encourage the adoption of digital technologies would help to sustain income growth.

Employment growth is strong and immigration helps to alleviate labour shortages. The work ability reform is bringing individuals with a partial ability to work out of disability insurance and into the labour force. However, some of these individuals, and workers displaced from traditional manufacturing, may struggle to find new employment, calling for renewed efforts to re-skill and up-skill. Further improving access to childcare, along with a more equal sharing of parental leave between parents, could give an additional boost to female employment and reduce the second-highest gender wage gap in the OECD.

Growth is projected to slow as the economy hits capacity constraints

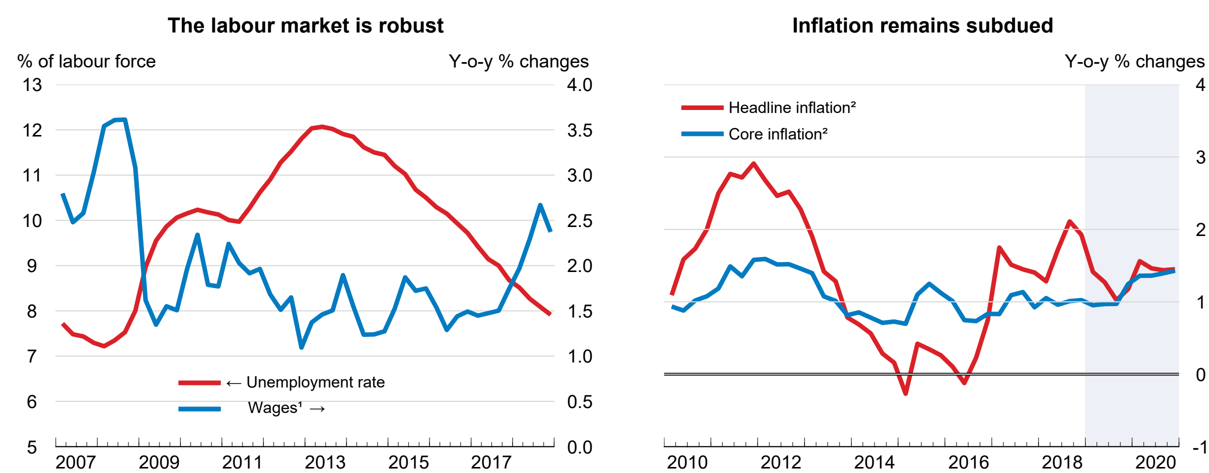
The economy will slow to a more sustainable pace over the projection period. Business investment is set to recover, partly with the assistance of EU structural funds, including the construction of Rail Baltica from 2020. As the economy slows and temporary inflationary effects from higher excise duties fade, inflation will stabilise. However, supply constraints are already affecting the economy, and there is a risk of overheating, resulting in higher-than-projected wage and price inflation and a further loss of price competitiveness. This could be particularly challenging to Estonia in an environment of weakening global demand. Money laundering revelations also hold the potential to cause some volatility in the banking sector.

Euro area

Economic growth is expected to remain subdued, due to weak external demand and low business confidence, which weighs on private investment. Moderate support to economic activity will come from private consumption, underpinned by a robust labour market, with unemployment declining slightly further and wage growth firming up modestly. Core inflation will pick up only gradually from low levels. Monetary policy is set to remain very accommodative and a slightly expansionary fiscal stance is expected. The large external surplus will decline very slightly.

Delaying monetary policy normalisation until the economy is on course to attain the inflation objective is appropriate. As investment and growth potential still display the scars from the crisis, a combined fiscal and structural policy effort is called for. Countries with low public debt should expand public investment, which would address infrastructure gaps and generate positive spillovers across the euro area. All countries should pursue structural reforms to make product markets more competitive, especially in services and network industries. Faster advances in completing the banking union and in developing common fiscal tools would reinforce the capacity of the euro area to resist the next crisis.

Euro area 1



1. Nominal wages per employee.
2. Harmonised consumer price indices, net of energy and food products for core inflation.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934299

Euro area: Demand, production and prices

Euro area	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	10 502.6	1.9	2.5	1.8	1.2	1.4
Private consumption	5 726.6	1.9	1.8	1.2	1.2	1.3
Government consumption	2 167.8	1.8	1.2	1.1	1.2	1.1
Gross fixed capital formation	2 103.2	3.9	2.9	3.3	2.6	2.2
Final domestic demand	9 997.6	2.3	1.9	1.7	1.5	1.5
Stockbuilding[1]	33.8	0.1	-0.1	0.1	-0.1	0.0
Total domestic demand	10 031.4	2.4	1.8	1.8	1.4	1.5
Net exports[1]	471.3	-0.4	0.8	0.2	-0.2	-0.1
Memorandum items						
GDP deflator	_	0.8	1.1	1.4	1.4	1.6
Harmonised index of consumer prices	_	0.2	1.5	1.8	1.2	1.5
Harmonised index of core inflation[2]	_	0.8	1.0	1.0	1.0	1.4
Unemployment rate (% of labour force)	_	10.0	9.1	8.2	7.9	7.7
Household saving ratio, net (% of disposable income)	_	6.1	5.7	6.0	6.4	6.5
General government financial balance (% of GDP)	_	-1.6	-1.0	-0.5	-0.9	-0.8
General government gross debt (% of GDP)	_	109.0	105.5	102.0	101.2	100.0
General government debt, Maastricht definition (% of GDP)	_	91.5	89.1	87.1	86.3	85.2
Current account balance (% of GDP)	_	3.4	3.9	3.6	3.6	3.5

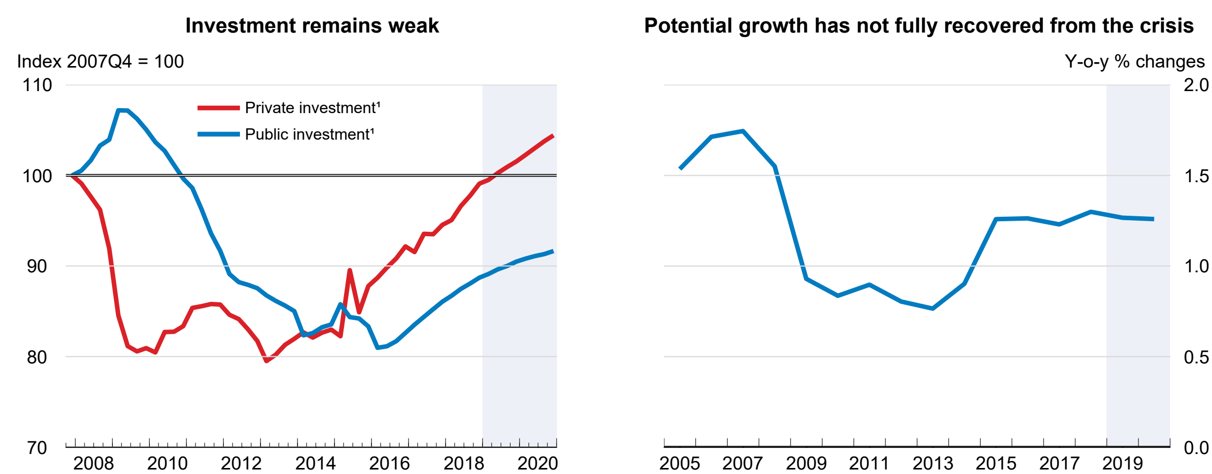
Note: Aggregation based on euro area countries that are members of the OECD, and on seasonally-adjusted and calendar-days-adjusted basis.

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935325

Euro area 2



1. Volume, deflated by the GDP deflator; private investment is obtained as gross fixed capital formation of the total economy minus public investment (government fixed capital formation, in the appropriation account).
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934318

Growth has slowed down substantially

The euro area economy has slowed down markedly since mid-2018. Weaker external demand, especially from some emerging-market economies, and persistent trade tensions have weighed on export growth. Investment has weakened as well, with substantial destocking in the final quarter of 2018, and in some countries activity was further hampered by one-off factors. A reversal of the one-off factors contributed to more vigorous growth in the first quarter of 2019, but underlying weakness persists. Indeed, recent indicators point to sharp declines in new export orders and investment goods production, and to weakening business confidence, especially in manufacturing. The whole euro area has been affected, with a sharp decline in intra-area trade, likely reflecting highly-integrated supply chains. However, impacts have been asymmetric across countries, with Germany and Italy hit hardest, in line with their strong reliance on manufacturing and, especially in the German case, high trade openness and exposure to the car industry, in which one-off events were felt strongly.

Against this backdrop, private consumption has displayed some resilience, as have confidence indicators in services. This largely reflects a robust labour market, with unemployment declining further in most countries and some mild acceleration in wages. Nonetheless, the pass-through to prices has so far been limited, with core inflation still hovering at around 1%.

Growth and resilience to future crises need to increase

Monetary conditions will remain very accommodative, which is appropriate, given the protracted weakness of core inflation and the need to support internal demand and minimise risks of instability in financial markets. Net asset purchases were brought to an end by the ECB in December, as planned, but continued reinvestment of proceeds from maturing assets will help to keep long-term interest rates at low levels. According to the ECB, policy rates are to remain unchanged at least through the end of 2019. A new series of quarterly targeted long-term refinancing operations (TLTRO) has been introduced, starting in September 2019, which is welcome. The first increase of the main refinancing rate is expected to only take place in the fourth quarter of 2020. Macroprudential, housing and tax policies should be used at national level to reduce the build-up of housing risks.

The aggregate euro area fiscal stance is expected to be slightly expansionary in 2019-20, by about ¼ percentage point of potential GDP in each year. Moderate fiscal loosening is observed across countries with very different budgetary room for manoeuvre, and often comprises measures to support households' disposable income. While this support is welcome, it does little to revive the area's subdued growth potential and still depressed investment levels. Taking advantage of historically low interest rates, there is a case for additional stimulus in the form of a combined increase in public investment by countries with low public debt and renewed structural reform efforts in all countries. Increased public investment would help to address national investment needs, generate positive spillovers for other euro area countries, and ease the introduction of structural reforms.

Combined policy efforts are also needed to complete the economic and monetary union. All countries need to further liberalise product markets, especially in services and network sectors, to deepen the single market and reap the ensuing productivity gains. Progress in establishing a banking union through common deposit insurance and a common fiscal backstop to the Single Resolution Fund would increase resilience to future crises, inter alia by fostering financial market integration. An acceleration of the resolution of remaining non-performing loans, which are still high in some countries, would also favour financial integration and boost credit and investment. Creating a common fiscal capacity for the euro area can help to smooth economic shocks and buttress the euro area when the next crisis hits. In parallel, adopting simpler fiscal rules focussing on expenditure growth anchored to a debt ratio target would improve fiscal credibility and effectiveness.

Growth is projected to remain subdued

Growth is projected to remain modest at below 1.5%. Policy uncertainty and trade tensions will continue to hamper exports and private investment, thus contributing to very modest productivity growth. Some support to activity, albeit on a limited scale, is expected from private consumption and public spending, and moderate employment growth will make joblessness decline slightly. In line with only moderate internal demand growth, core inflation is projected to pick up slowly and the euro area’s large current account surplus will fall only marginally.

Given strong participation of euro area companies in global value chains, additional escalation of global trade tensions would exert downward pressure on exports and investment. Pressure would also stem from a disorderly Brexit, with countries with the strongest trade links to the United Kingdom hit hardest. A stronger-than-expected slowdown in emerging-market economies would depress external demand and could induce financial instability. On the upside, combined actions to increase public investment and implement structural reforms in product markets would help the euro area to recover from long-standing anaemic productivity growth.

Finland

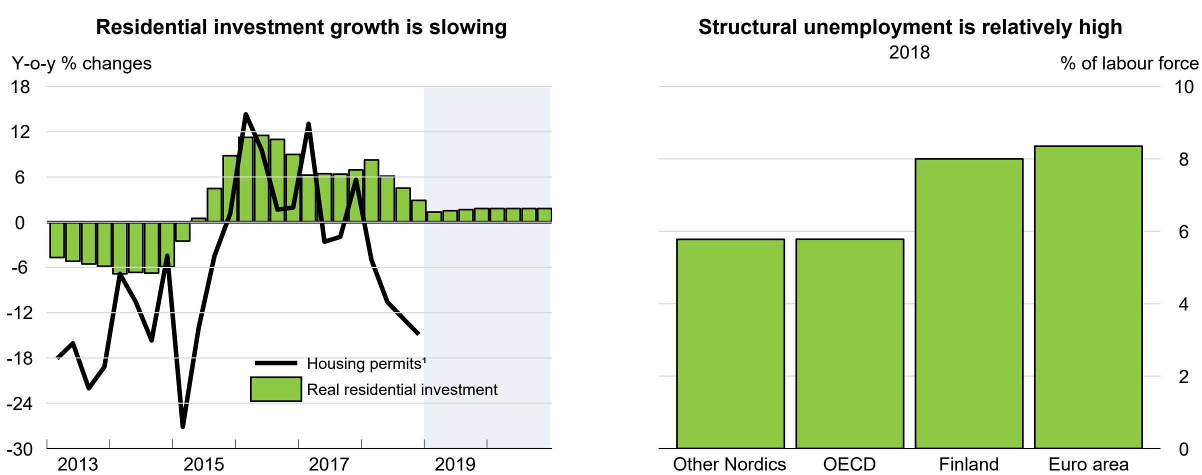
The economy is projected to expand at a slower pace of around 1½ per cent in 2019-20, as export growth will weaken due to lower foreign demand growth, especially for investment goods. Residential investment will remain weak. Earnings and employment growth will support private consumption, even though gradually rising inflation is set to erode household real incomes. Employment growth will slow, as labour market mismatch binds.

Strong growth, rising employment and fiscal consolidation measures have reduced government debt. However, population ageing will continue to weigh on public finances and potential growth. Raising the employment rate to the level of other Nordic countries through enhancing skills and strengthening active labour market policies is key to addressing long-term fiscal challenges.

GDP growth is slowing

Residential investment growth has declined considerably from record levels. Business and consumer confidence have fallen, but are still close to their long-term averages. Export growth is sluggish, as global trade tensions weigh on foreign demand, while strong domestic demand pushes up imports. The unemployment rate has fallen to its lowest level since 2011, thanks to robust output growth, wage moderation resulting from the Competitiveness Pact and activation measures. Nevertheless, structural unemployment remains relatively high due to labour market rigidities and skills mismatches. The tightening labour market is starting to push up wages, which should gradually lift inflation from its currently low level.

Finland



1. Year-on-year percentage changes of 3-month cumulated flows.
Source: OECD Economic Outlook 105 database; and Statistics Finland.

StatLink https://doi.org/10.1787/888933934337

Finland: Demand, output and prices

Finland	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	210.0	2.8	2.7	2.3	1.5	1.4
Private consumption	115.9	2.2	1.5	1.4	1.7	1.3
Government consumption	51.1	1.8	-0.4	1.4	0.3	0.8
Gross fixed capital formation	42.7	8.6	4.3	3.2	1.8	1.7
Final domestic demand	209.8	3.4	1.7	1.8	1.4	1.3
Stockbuilding[1,2]	1.1	-0.2	0.1	0.4	-0.5	0.0
Total domestic demand	210.9	3.3	1.8	2.3	0.9	1.2
Exports of goods and services	76.3	3.5	7.7	1.5	1.7	2.4
Imports of goods and services	77.3	5.4	3.8	4.2	1.3	1.9
Net exports[1]	- 1.0	-0.7	1.4	-1.0	0.2	0.2
Memorandum items						
GDP deflator	_	0.1	0.9	1.9	2.9	1.8
Harmonised index of consumer prices	_	0.4	0.8	1.2	1.2	1.7
Harmonised index of core inflation[3]	_	1.1	0.6	0.3	1.0	1.7
Unemployment rate (% of labour force)	_	8.8	8.6	7.4	6.7	6.5
Household saving ratio, net (% of disposable income)	_	-1.4	-1.7	0.1	-0.1	-0.3
General government financial balance (% of GDP)	_	-1.7	-0.8	-0.7	-0.4	0.1
General government gross debt (% of GDP)	_	75.4	73.8	71.8	71.7	70.9
General government debt, Maastricht definition (% of GDP)	_	63.0	61.3	58.9	57.5	56.8
Current account balance (% of GDP)	_	-0.7	-0.3	-1.9	-1.4	-1.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statiscal discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935344

Employment needs to be boosted further

The ECB's monetary policy continues to provide strong support to the economy. Fiscal policy is broadly neutral, with a small reduction in the government budget deficit over the projection period resulting mainly from higher employment. The fiscal position provides room to let the automatic stabilisers operate and for some discretionary fiscal stimulus in the case of a severe downturn.

Finland's employment rate, which remains well below that in other Nordic countries, will need to rise further, not least to finance growing age-related spending. The employment rate has reached the government's target of 72%, thanks to a strong economy and a range of policy reforms carried out over the past few years to boost employment. The duration of the earnings-related unemployment insurance benefit was shortened to increase work incentives. Early childhood education fees were lowered to increase work opportunities for women. Stricter conditions to receive unemployment benefits were set. Nevertheless, high tax rates upon return to work and complex benefit rules still weaken work incentives for many. Strengthened active labour market policies and welfare reform are required to tackle structural unemployment.

Growth will slow and is vulnerable to further global economic weakness

Growth is projected to weaken markedly, due to capacity constraints, notably skilled-labour shortages, and fading foreign demand. Private consumption growth will slow somewhat as gradually rising inflation limits household real income gains. Government investment will slow after the completion of several projects. Residential investment will decelerate, but non-residential investment will remain relatively strong due to several planned major projects, notably in the forest and shipping industries. Exports will grow only moderately, reflecting weak external demand from the euro area and Germany in particular. Inflation will rise due to high capacity utilisation. Employment will expand modestly as the working-age population continues to shrink and labour market mismatches persist. The main downside risk to the outlook is a further slowdown in global growth and investment, as equipment goods account for a large share of Finland's exports. Higher wages resulting from labour market tightness would support private consumption, but could erode competitiveness.

France

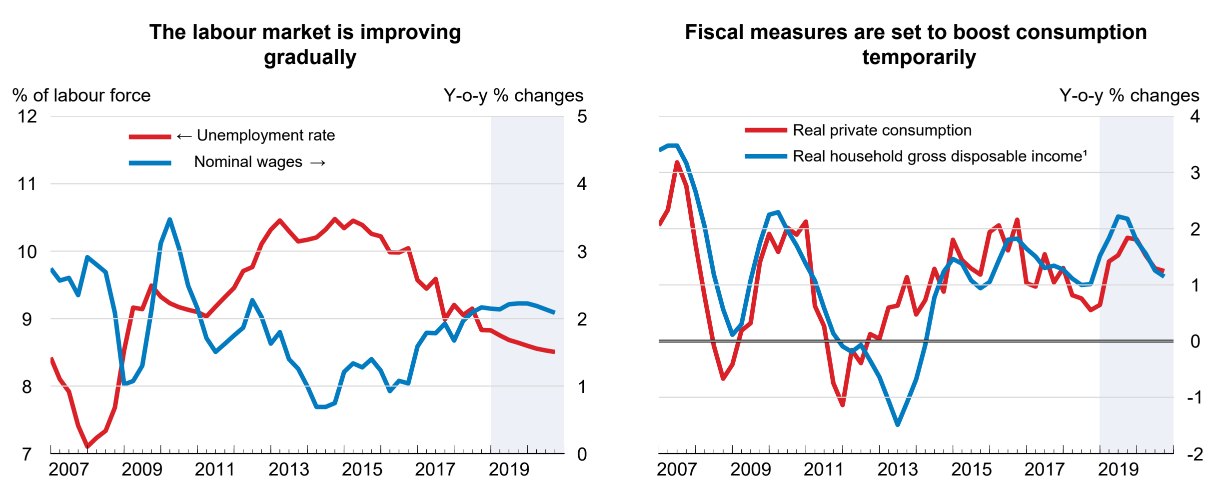
Economic growth is projected to be 1.3% in 2019-20. Global economic conditions will weigh on exports, but tax cuts and the impact of the social emergency measures are holding up disposable income and consumption. Supportive financing conditions and higher business profit margins will moderate a deceleration of investment. Ongoing labour market reforms will also help job creation and promote inclusiveness. The unemployment rate will decline towards 8.5% at the end of 2020, while core inflation will strengthen only slightly.

The budget deficit will progressively decline, despite a temporary increase due to a tax credit reform in 2019. Even so, consolidation efforts remain limited, and a further reduction in non-priority spending is needed to firmly reduce the public debt-to-GDP ratio and to lower taxes. In addition, continuing to strengthen early childhood education and up-skilling programmes, as well as reducing the excessive use of short-term contracts, would generate more inclusive growth. Further opening up regulated professions would also increase economic dynamism and employment.

Economic activity is resilient

Internal demand is supporting growth. Household purchasing power has risen sharply. Employment gains have remained strong and the lowering of the housing tax, higher in-work benefits and some cuts in social contributions have taken effect. Consumer price inflation has eased following the oil price decrease in late 2018. The unemployment rate has declined and dependence on subsidised jobs and short-term contracts has diminished. Wage growth has gathered pace and shortages for high-skilled jobs are increasing. After a weak end of 2018, durable goods consumption is increasing and household confidence is recovering, but the household saving rate remains high.

France 1



1. Four-quarter moving average.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934356

France: Demand, production and prices

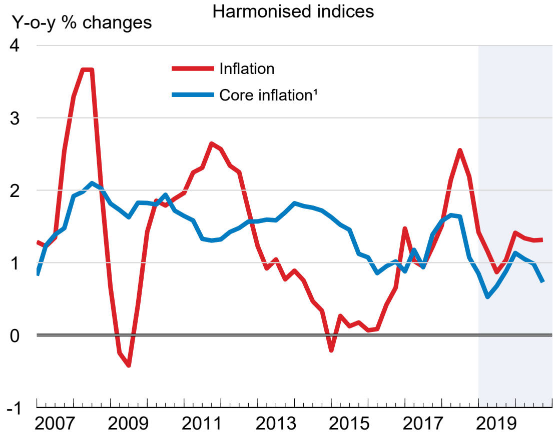
France	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2014 prices)				
GDP at market prices	2 198.3	1.1	2.3	1.6	1.3	1.3
Private consumption	1 188.5	1.9	1.1	0.9	1.4	1.5
Government consumption	523.4	1.4	1.4	1.0	0.8	0.4
Gross fixed capital formation	472.6	2.7	4.7	2.9	2.0	1.8
Final domestic demand	2 184.5	2.0	2.0	1.4	1.4	1.3
Stockbuilding[1]	26.4	-0.4	0.2	-0.4	0.0	0.0
Total domestic demand	2 210.9	1.6	2.2	0.9	1.3	1.3
Exports of goods and services	672.2	1.5	4.7	3.3	2.7	2.7
Imports of goods and services	684.8	3.1	4.1	1.2	2.7	2.7
Net exports[1]	- 12.6	-0.5	0.1	0.6	0.0	0.0
Memorandum items						
GDP deflator	_	0.2	0.7	0.9	1.2	1.2
Harmonised index of consumer prices	_	0.3	1.2	2.1	1.1	1.3
Harmonised index of core inflation[2]	_	0.6	0.5	0.9	0.7	1.1
Unemployment rate[3] (% of labour force)	_	10.1	9.4	9.1	8.7	8.5
Household saving ratio, gross (% of disposable income)	_	13.7	13.8	14.0	14.7	14.4
General government financial balance (% of GDP)	_	-3.6	-2.8	-2.5	-3.2	-2.3
General government gross debt (% of GDP)	_	124.5	123.3	122.7	124.1	124.5
General government debt, Maastricht definition (% of GDP)	_	98.3	98.5	98.5	99.8	100.3
Current account balance (% of GDP)	_	-0.8	-0.6	-0.3	0.0	0.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. National unemployment rate, includes overseas departments.
Source: OECD Economic Outlook 105 database.

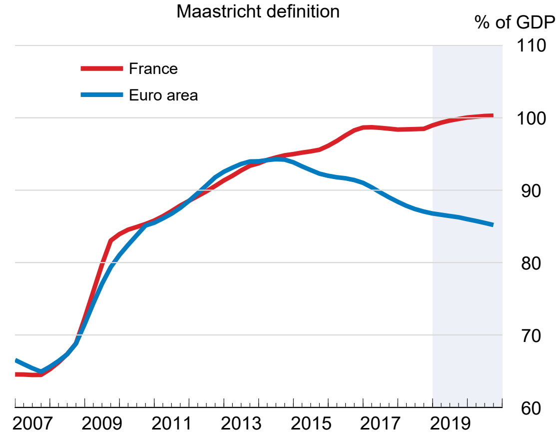
StatLink https://doi.org/10.1787/888933935363

France 2

Oil prices are a key driver of inflation
Harmonised indices



Public debt is set to remain at a high level
Maastricht definition



1. Index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934375

Public consumption has continued to grow at a moderate pace, and local governments' investment has rebounded. Housing starts have continued to weaken, and home sales have stabilised, albeit at a high level. Business investment, notably in intangible assets, has been robust, as the business climate and financing conditions remain supportive. Exports have been held up by substantial deliveries in the shipbuilding and aeronautical sectors, despite an overall deceleration of external demand.

Additional reforms would help make growth more inclusive

The fiscal deficit will increase due to a large one-off business tax reduction in 2019 but is then set to decline to 2.3% of GDP in 2020. Measures to reduce the tax burden for households and firms and higher in-work benefits will broadly compensate for lower current public expenditures, as well as increases in tobacco taxes. These measures will also enhance employment incentives and boost economic performance. However, public debt will remain historically high.

Additional efforts to cut inefficient and non-priority spending are key to make room for the ongoing tax reductions, rebuild fiscal buffers and put public debt on a firmly declining path. The effective use of targeted expenditure reviews will be particularly important to reduce overlap in sub-central governments' responsibilities and to identify areas where there is room to rationalise public administration. Systematically reviewing tax expenditures and low-revenue taxes, while taking into account their benefits for low-income households, would also promote economic activity and a more redistributive tax structure.

The recent reform agenda will help improve inclusiveness, skills and job quality. The implementation of the 2017 labour reforms will better align firm-level wage and productivity developments and encourage hiring on open-ended contracts. The additional financing for the training of low-skilled and unemployed workers, the overhaul of vocational training and the increased focus on apprenticeships will improve skills and ensure better job matches. Pro-business measures (the PACTE law) will also ease firm entry and growth. The rapid implementation of health care and pension reforms could also foster inclusiveness and long-term growth. Yet, social mobility remains weak and employment rates are low for many disadvantaged groups. Further efforts are needed to ease the labour market entry of low-skilled youth, reduce the excessive use of short-term contracts, and improve access to high-quality early education and social mobility, as well as to ensure better training and longer careers for older workers. Moreover, continuing to increase competition in some service sectors would strengthen employment and productivity growth.

Internal demand will drive growth

Economic growth is projected to remain at 1.3% in 2019-20. Lower household taxes, the impact of the emergency measures on low-wage earners and retirees, still favourable financing conditions and lower oil prices will all raise household purchasing power and private consumption. This will also support a slow recovery in housing investment. The labour market for skilled workers will remain tight, in line with declining employment gains. However, weaker trade momentum will weigh on exports and business investment. Ongoing labour market and fiscal reforms will sustain business investment and exports.

Consumption growth might turn out stronger or weaker than expected, as the impact of ongoing tax changes on saving behaviour is hard to predict. The effects of lower taxes and social charges on businesses, and the temporary improvement of their financial situation in 2019, could lead to stronger-than-expected investment which would raise economic activity. However, businesses may prefer to lower their debt instead, which would weaken growth. Renewed financial market turbulence, trade uncertainty and a disorderly Brexit could also reduce exports and investment, while the historically high level of private debt reduces margins of adjustment for households and firms.

Germany

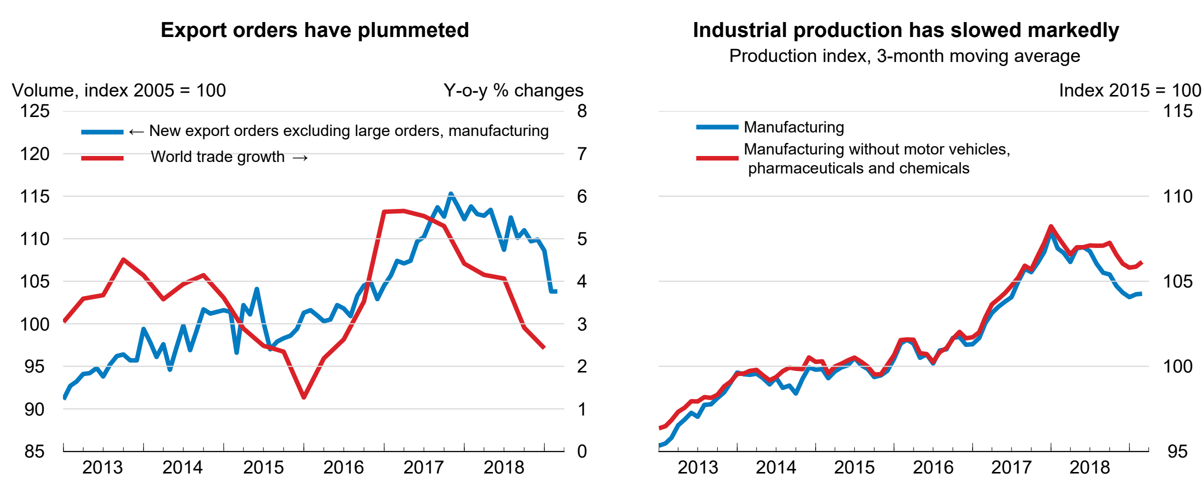
GDP growth slowed considerably in 2018 - as world trade lost pace and important export markets decelerated sharply, adding to temporary supply disruptions in the car and chemicals sectors towards the end of the year. GDP is projected to grow at 0.7% in 2019 and 1.2% in 2020. Mounting political uncertainties regarding trade disputes and Brexit are weighing on business confidence. Export growth and business investment are thus expected to slow. Yet, record low unemployment and strong wage growth should continue to buttress private consumption and the construction sector is booming.

Higher spending on pensions, long-term care and child benefits along with reductions in labour taxes will support domestic private demand. Accelerating the disbursal of funds set aside to upgrade digital, transport, energy and childcare infrastructure would strengthen economic growth in the long term, while providing a much needed fillip to aggregate demand now as the external outlook is weakening.

Economic growth has slowed considerably

The significant reduction of world trade growth led to a sharp slowdown of activity in Germany's highly export-oriented economy. This was reinforced by temporary supply disruptions in the automobile and chemicals sectors towards the end of 2018, owing to delays in the certification of new emission standards for cars and a drought. While these temporary factors have now abated, with GDP growth picking up in the first quarter of 2019, the slowdown of world trade, looming trade disputes and Brexit-related uncertainties have led to a sharp deterioration of business confidence. The weakening of the global economy is weighing on demand for investment goods, in which Germany specialises, and new export orders have fallen sharply. Industrial production has slowed down, although less so when one-off factors are excluded.

Germany 1



Source: Statistisches Bundesamt; OECD Economic Outlook 105 database and OECD calculations.

StatLink https://doi.org/10.1787/888933934394

Germany: Demand, output and prices

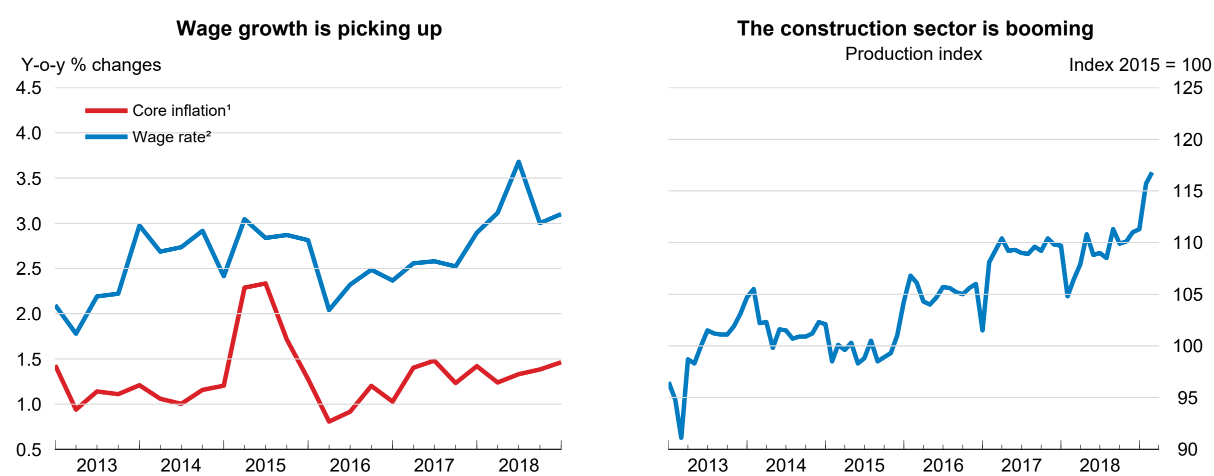
Germany	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	3 046.0	2.2	2.5	1.5	0.7	1.2
Private consumption	1 631.1	1.9	2.0	0.9	1.1	1.3
Government consumption	587.4	4.0	1.6	1.0	1.7	1.4
Gross fixed capital formation	604.1	3.4	3.6	2.7	2.7	1.9
Final domestic demand	2 822.6	2.6	2.3	1.3	1.6	1.5
Stockbuilding[1]	- 19.6	0.3	-0.1	0.5	0.0	0.0
Total domestic demand	2 803.0	2.9	2.2	1.9	1.6	1.5
Exports of goods and services	1 425.3	2.1	5.3	2.2	0.9	2.4
Imports of goods and services	1 182.3	4.0	5.3	3.4	3.0	3.3
Net exports[1]	243.0	-0.5	0.4	-0.3	-0.8	-0.2
Memorandum items						
GDP without working day adjustments	3048.8	2.2	2.2	1.4	0.7	1.6
GDP deflator	_	1.4	1.5	1.9	1.9	2.1
Harmonised index of consumer prices	_	0.4	1.7	1.9	1.5	1.7
Harmonised index of core inflation[2]	_	1.0	1.3	1.3	1.4	1.6
Unemployment rate (% of labour force)	_	4.2	3.8	3.4	3.1	2.8
Household saving ratio, net (% of disposable income)	_	9.8	9.9	10.4	10.6	10.5
General government financial balance (% of GDP)	_	0.9	1.0	1.7	0.9	0.8
General government gross debt (% of GDP)	_	76.9	72.3	68.2	66.5	64.7
General government debt, Maastricht definition (% of GDP)	_	68.7	64.5	60.8	59.1	57.3
Current account balance (% of GDP)	_	8.4	8.0	7.4	7.3	7.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935382

Germany 2



1. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
2. Average nominal wage per employee.

Source: Statistisches Bundesamt; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934413

The labour market remains strong, and wage growth accelerated considerably in 2018. This has started to feed slowly into core inflation. Both the quantity and the quality of employment continue to improve, as job growth mainly concerns regular jobs, while the number of low-hour mini jobs subject to limited social contributions and protection is declining. The construction sector continues to boom.

Stepping up public investment would support demand and long-term growth

Highly expansionary monetary policy in the euro area and a further loosening of credit standards continue to result in favourable financing conditions, fuelling the housing boom. Higher public spending on pensions, long-term care and child benefits along with some relief for R&D and income taxes will lower the fiscal surplus and support private consumption and investment.

The government budget foresees higher investment in childcare, transport and digital infrastructure, in particular at the regional and municipal levels, as well as additional funds for education, research and innovation. Yet, despite a significant investment backlog, planned spending on infrastructure remains below the 2018 average in other euro area countries relative to GDP. Stepping up investment ambitions would strengthen economic growth in the long term and support domestic demand in the current downturn.

To support effective implementation of planned investment, efforts are needed to bolster planning capacity, in particular at the local government level, and simplify administrative procedures. Plans to simplify and streamline procedures to expand the electricity transmission grid are welcome. This infrastructure is crucial to speed up the transition to cleaner electricity by ensuring that wind energy produced in the north of the country can be transmitted to the south, where industrial activity is concentrated. Similar ambition in other areas would promote a faster upgrade to higher-speed digital infrastructure in rural areas, promoting the adoption of digital technologies, economic growth and regional cohesion. Faster investment in high-quality childcare would promote equal opportunities in education and allow parents to align their working hours with their desires. This would also help to reduce significant gender gaps in career opportunities and wages.

Weaker global trade and capacity constraints will slow economic growth

Public and private consumption are projected to support growth, as wages and employment will continue to expand, albeit at a more subdued pace, as significant uncertainty about the external environment is likely to lead to more prudent private-sector wage agreements. Inflation is expected to remain well below 2%. While high capacity utilisation and favourable financing conditions support investment, its growth should slow down due to the weaker global outlook. Capacity constraints and labour shortages are expected to contribute to a slowdown in housing investment. As export growth is weakening, the current account surplus is expected to fall slightly, to 7% of GDP by 2020.

Several external risks could combine to lead to a sharper and more prolonged slowdown of the German economy. These include an intensification of global trade disputes, in particular if this were to involve tariffs on German cars, a sharper slowdown in China than expected or a disruptive Brexit. On the other hand, if domestic demand and imports were to be stronger than projected, the German economy could become the locomotive for faster growth in the euro area. A swift and flexible increase in public spending or steeper labour tax cuts would make such a scenario more likely.

Greece

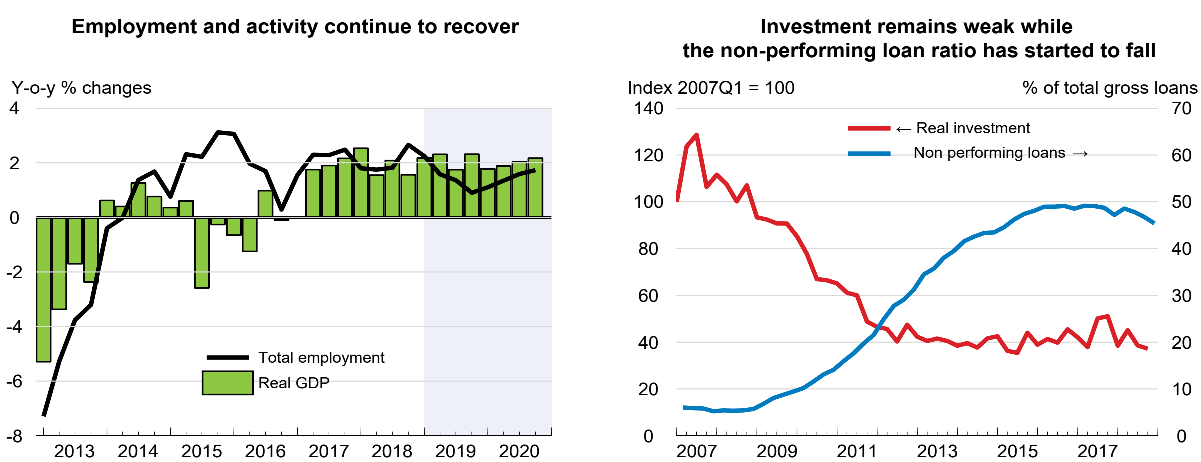
The economic recovery is projected to maintain its recent pace, with GDP growing at or slightly above 2% in both 2019 and 2020. Domestic demand will contribute more to growth than in the recent past, offsetting moderating export growth. Investment is expected to start to recover as financing conditions improve. Stronger household incomes due to the recent minimum wage increase and rising employment will support household consumption.

The primary budget surplus continues to exceed medium-term targets, access to international bond markets is improving and cash buffers are substantial. Safeguarding fiscal credibility requires continuing to meet medium-term fiscal targets. Continuing progress in reducing banks' high non-performing loan exposures will require deeper measures. Additional reforms are needed to bolster productivity and investment, improve the business environment and raise skills.

The recovery maintains its momentum

Greece's economy grew by 1.9% in 2018, its fastest rate since the crisis. Strong broad-based growth of exports and private consumption have driven the recovery. Some of the sectors that recorded the deepest downturns, such as construction and real estate, are finally recovering, as record tourist arrivals are leading to new accommodation developments.

Greece



Source: OECD Economic Outlook 105 database; and Bank of Greece.

StatLink https://doi.org/10.1787/888933934432

Greece: Demand, production and prices

Greece	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	177.0	-0.3	1.4	1.9	2.1	2.0
Private consumption	123.0	0.1	0.9	1.0	1.0	1.5
Government consumption	36.0	-0.7	-0.5	-2.5	2.3	1.2
Gross fixed capital formation	20.3	4.6	9.4	-12.0	1.2	8.4
Final domestic demand	179.3	0.5	1.7	-1.1	1.2	2.3
Stockbuilding[1,2]	- 2.5	0.1	0.0	1.7	0.0	0.0
Total domestic demand	176.9	0.4	2.0	0.4	1.1	2.2
Exports of goods and services	55.8	-1.9	6.9	8.8	5.3	3.1
Imports of goods and services	55.6	1.2	7.4	2.9	2.8	3.8
Net exports[1]	0.1	-1.0	-0.2	1.9	0.9	-0.2
Memorandum items						
GDP deflator	_	-0.1	0.5	0.5	0.6	1.2
Harmonised index of consumer prices	_	0.0	1.1	0.8	0.8	1.3
Harmonised index of core inflation[3]	_	0.6	0.3	0.3	0.8	1.2
Unemployment rate (% of labour force)	_	23.5	21.5	19.3	18.1	17.3
Household saving ratio, net (% of disposable income)	_	-17.0	-17.0	-14.9	-12.6	-12.8
General government financial balance[4] (% of GDP)	_	0.5	0.7	1.1	0.1	0.3
General government gross debt (% of GDP)	_	188.4	191.4	186.8	182.9	178.3
General government debt, Maastricht definition (% of GDP)	_	178.7	176.6	181.8	177.8	173.3
Current account balance[5] (% of GDP)	_	-1.7	-1.8	-2.9	-1.3	-1.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statiscal discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. National Accounts basis. Data also include Eurosystem profits on Greek government bonds remitted back to Greece. For 2015-2019, data include the estimated government support to financial institutions and privatisation proceeds.
5. On settlement basis.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935401

Investment remained stable, but at the low level of 11.6% of GDP, in 2018. Bank lending is increasing to some sectors and the demand for credit for large projects is growing, while lending rates of business loans are declining. Banks' liquidity is improving as deposits keep rising and banks have fully repaid the central bank's emergency funding. Foreign investors have announced some larger projects but investment inflows are yet to rise. Sales of state-owned assets, which can attract new financing, are progressing more slowly than anticipated.

Reducing non-performing loans and improving job creation are priorities

Banks are making inroads into their high levels of non-performing loans, which fell to 44.7% of outstanding loans in December 2018. E-auctions of collateral in default are becoming more common, but foreclosures have also increased. The government is introducing streamlined measures to resolve non-performing household and small business loans secured against a primary residence where income, asset, loan and property values are below somewhat generous thresholds.

The statutory minimum wage was raised by 11% to EUR 650 per month and the youth sub-minimum wage was abolished in February 2019. The increases take Greece's minimum wage relative to the median wage to near the middle of OECD countries. The increase will reduce in-work poverty, but it risks abetting informal work and slowing gains in the number of jobs, given weak productivity.

The primary budget surplus continued to exceed medium-term targets, reaching 4.2% of GDP in 2018. Revenue strength, such as the boost to VAT receipts from tourists' spending, and investment under spending contributed to the outperformance. The 2019 budget maintains the 3.5% primary budget surplus target. Nonetheless, there are risks to expenditure management due to payment arrears and public payroll pressures arising mainly from court rulings. Recent policy announcements will reduce tax revenues, mainly by lowering selected VAT rates, and raise spending, mostly on pensions, from 2019. Following these measures, the government announced its desire to discuss with the European partners the opportunity of lowering the primary surplus target from 3.5% of GDP to 2.5% of GDP in 2020 and using the large accumulated cash buffers to fund the difference. Future fiscal measures should prioritise investing in infrastructure and skills, fighting poverty, and improving public spending effectiveness and controls. These measures along with greater progress in reforms to strengthen public sector administration, to develop out-of-court mediation and to privatise state-owned energy assets would improve competitiveness and reduce barriers to firms' growth, while supporting medium-term budget targets.

Reviving investment is essential to sustain the recovery

GDP growth is projected to remain at around 2% in 2019-20. Export growth is projected to moderate with softer external demand and renewed competition from other tourist markets. The anticipated pick up in investment follows expected progress in cutting non-performing loan exposure levels, privatising state owned assets, and realising foreign investment projects. The continued large output and employment gaps should limit wage rises and the pass-through to prices.

Deviations from the current medium-term fiscal strategy would undermine gains in fiscal credibility. Delays in reforms to improve the business environment, competitiveness and banks' health would create downside risks to the projected recovery in investment. A fall in tourism related to a disorderly Brexit could lead to a sharper slowdown in exports. Recent measures undertaken to resolve non performing exposures could produce results faster than expected, boosting confidence and further improving the investment outlook.

Hungary

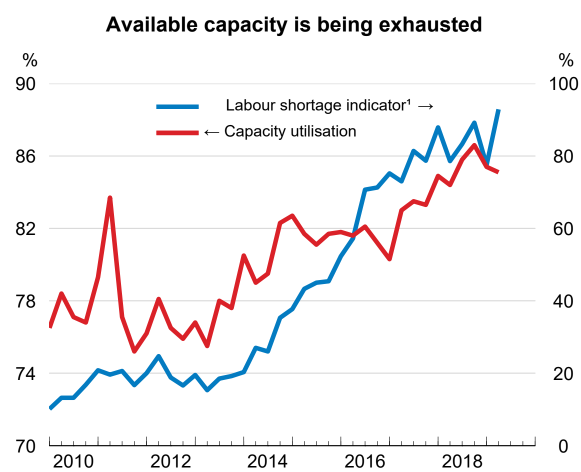
The economic expansion is projected to slow, but GDP will still grow at 3.9% in 2019 and 3% in 2020. Private consumption will be underpinned by income gains from strong real wage and employment growth. Investment will be supported by the business sector's need to expand capacity, government housing support and disbursements of EU structural funds. A tight labour market is pushing up inflation and increasingly tight capacity constraints are reducing GDP growth, with expanding demand being increasingly satisfied via higher imports.

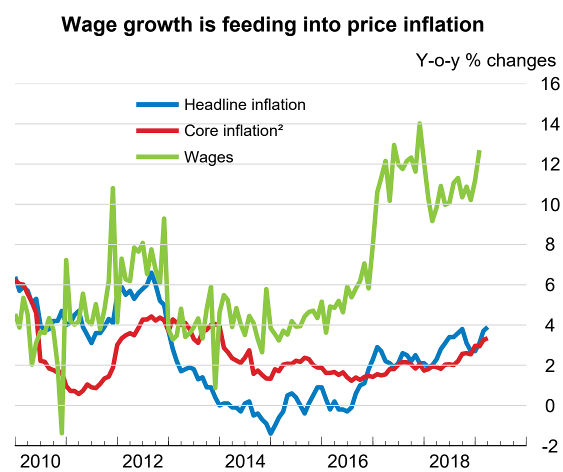
Fiscal policy remains expansionary as further cuts in social security contributions are combined with higher spending, particularly on public sector wages. Tighter fiscal policies are required to counter signs of economic overheating. Higher monetary policy rates are needed to limit rises in inflation expectations and contain inflation within the central bank's 3+/-1% inflation target band. Measures to expand labour resources, including faster reduction of public work schemes and greater supply of early childhood care, would prolong the recovery.

Domestic demand is driving strong growth

Strong private consumption is driven by rising real incomes, high consumer confidence, and supportive macroeconomic policies. Buoyant investment growth reflects disbursements of EU structural funds, generous housing support schemes and the need to expand production capacity, including foreign direct investment in the export-oriented automotive industry. Solid export growth dipped in the second half of 2018 in line with external demand. Rising imports are lowering the current account surplus.

Hungary





1. Percentage of manufacturing firms pointing to labour shortages as a factor limiting production.
2. Core inflation excludes food products and fuels.
Source: Eurostat Industry database; and OECD Main Economic Indicators database.

StatLink https://doi.org/10.1787/888933934451

Hungary: Demand, output and prices

Hungary	2015	2016	2017	2018	2019	2020
	Current prices HUF billion	Percentage changes, volume (2005 prices)				
GDP at market prices	34 378.6	2.2	4.4	5.0	3.9	3.0
Private consumption	17 012.7	4.0	4.8	5.4	4.6	4.0
Government consumption	6 822.6	0.7	1.3	-0.5	1.1	1.8
Gross fixed capital formation	7 743.5	-11.7	18.2	16.5	10.2	4.3
Final domestic demand	31 578.8	-0.6	7.0	6.8	5.4	3.6
Stockbuilding[1]	15.3	1.4	-0.2	0.2	-0.3	0.0
Total domestic demand	31 594.1	0.8	6.7	7.0	5.0	3.6
Exports of goods and services	30 586.2	5.1	4.7	4.7	5.8	5.4
Imports of goods and services	27 801.8	3.9	7.7	7.1	6.4	6.4
Net exports[1]	2 784.5	1.4	-1.9	-1.5	-0.2	-0.5
Memorandum items						
GDP deflator	_	1.0	3.6	4.5	4.2	4.2
Consumer price index	_	0.4	2.3	2.9	3.0	3.8
Core inflation index[2]	_	1.5	1.8	2.1	3.4	3.9
Unemployment rate (% of labour force)	_	5.1	4.1	3.7	3.4	3.1
Household saving ratio, net (% of disposable income)	_	8.1	7.3	8.4	8.4	8.5
General government financial balance (% of GDP)	_	-1.6	-2.2	-2.2	-2.0	-2.1
General government gross debt (% of GDP)	_	99.6	94.2	87.9	85.5	83.9
General government debt, Maastricht definition (% of GDP)	_	76.0	73.4	70.8	68.5	66.8
Current account balance (% of GDP)	_	6.2	2.8	0.5	0.0	-0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935420

A historically low unemployment rate of 3.6% has been achieved, and firms are reporting a severe lack of qualified workers. The tight labour market, strong public sector wage growth and a third consecutive yearly hike in minimum wages have maintained double-digit wage growth into 2019. The pressures on total labour costs have been offset to some extent by the lowering of employer social security contributions. However, the pressures are likely to continue as industrial action in the important automotive industry in early 2019 led to wage increases of nearly 20% in the sector. Higher prices of services, food, alcohol and tobacco – the latter two linked to excise tax hikes -- induced an increase in core and headline inflation from end-2018 onwards, with the latter approaching 4 per cent in early 2019.

Tighter macroeconomic policies are required to prevent overheating

Stimulatory macroeconomic policies are increasing the risk of overheating and should gradually be reversed. In early 2019, the central bank increased the overnight deposit rate by 10 basis points to -0.05%. This normalisation should be continued, as higher rates are needed to contain inflation expectations. Expansionary fiscal measures in 2019 include lower social security contributions for businesses, higher public sector wages and subsidies for house purchases, leading to an unchanged public deficit despite the strong economy.

The strong recovery is an opportunity to introduce measures to improve fiscal sustainability, reduce old-age poverty and address access challenges in the pension and health system. Also, the expansion of employment opportunities in the primary labour market allows for an acceleration of the ongoing reduction in public work schemes. This should be combined with investing in childcare, at least at the announced pace, to allow parents with young children to combine work with family life. Bolstering domestic SMEs should focus on improving business regulation, facilitating their integration into regional and national supply chains, and upgrading skills.

Growth is projected to slow amidst rising inflationary tensions

Economic growth is projected to slow, but will remain robust. Private consumption will benefit from continued strong growth in real incomes, while business investment will expand in reaction to increasing capacity pressures. Exports are supported by the installation of new export-oriented industrial capacity, although rising unit labour costs will reduce market-share gains amidst slowly expanding export markets. Imports will remain vibrant, reflecting increasing production capacity constraints. Downside risks include higher-than-expected wage increases that could de-anchor inflation expectations, requiring an abrupt monetary policy reaction. This may also be necessary in the event of negative spillovers from renewed financial turmoil in emerging market economies. In contrast, a faster reduction in public work schemes could ease wage pressures, sustaining the recovery for longer. Likewise, larger-than-projected reductions in import price growth would mitigate domestic price developments.

Iceland

The economy will slow significantly as exports, in particular tourism, decline because of the insolvency of a major domestic airline. Household consumption growth will ease on the back of moderate wage growth. Business investment will gradually recover from the current trough, but housing investment will ease further following a wave of new construction. Unemployment will edge up as the economy slows, and the current account surplus will narrow.

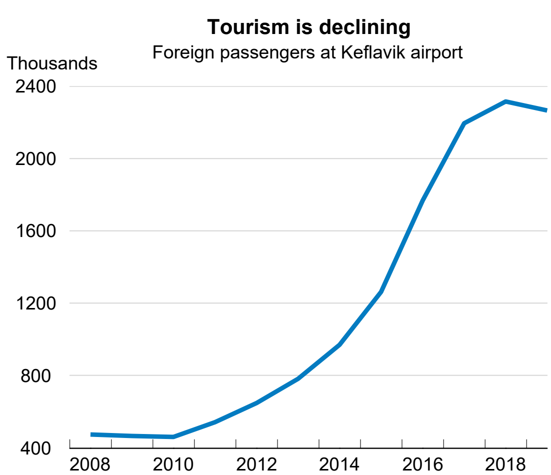
Inflation and inflation expectations are rebounding as the króna is depreciating and wages are rising above productivity. The central bank should act to keep inflation within the target band if price pressures persist. Fiscal policy is expansionary and should be less so, although higher infrastructure spending could help boost productivity. Comprehensive regulatory reform is needed to maintain competitiveness and high wages.

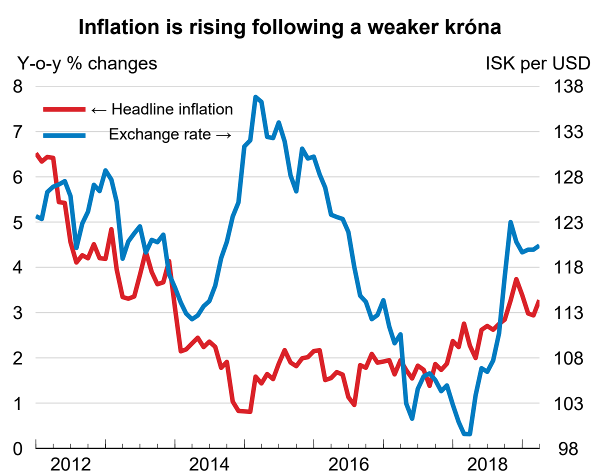
Growth is slowing

The economy is slowing rapidly, mainly due to several temporary export shocks. Tourist arrivals are declining after a low-cost Icelandic airline has gone insolvent, cutting the number of flights to the country. A bad start to the fishing season and a partial shutdown in the aluminium industry add to the shock. The global economic slowdown has further weakened the demand for goods and service exports.

Household demand, including for imports, is easing on the back of the recently concluded wage agreements. Business investment remains weak after the termination of large construction projects and because business confidence is low. The labour market is easing and unemployment has started to rise, especially after the airline's demise. With external demand weakening, the current account balance is narrowing. Capital flows remain inconspicuous despite further liberalisation of capital controls.

Iceland





Source: OECD Economic Outlook 105 database; and Statistics Iceland.

StatLink https://doi.org/10.1787/888933934470

Iceland: Demand, output and prices

Iceland	2015	2016	2017	2018	2019	2020
	Current prices ISK billion	Percentage changes, volume (2005 prices)				
GDP at market prices	2 293.9	6.6	4.6	4.6	1.0	2.4
Private consumption	1 146.6	7.2	8.1	4.8	1.9	2.4
Government consumption	535.3	1.9	3.6	3.3	2.7	2.3
Gross fixed capital formation	445.0	17.8	11.6	2.1	0.9	4.3
Final domestic demand	2 126.8	8.0	7.7	3.7	1.8	2.8
Stockbuilding[1]	3.5	-0.6	-0.5	0.4	0.3	0.0
Total domestic demand	2 130.3	7.4	7.4	4.3	2.1	2.8
Exports of goods and services	1 188.4	10.9	5.4	1.6	-3.8	1.3
Imports of goods and services	1 024.7	14.5	12.5	0.1	-2.4	1.6
Net exports[1]	163.6	-0.8	-2.6	0.7	-0.7	-0.2
Memorandum items						
GDP deflator	_	1.8	0.4	2.4	2.2	3.4
Consumer price index	_	1.7	1.8	2.7	3.8	3.3
Core inflation index[2]	_	2.2	2.4	2.5	3.5	3.2
Unemployment rate (% of labour force)	_	3.0	2.8	2.7	3.2	3.4
General government financial balance (% of GDP)	_	12.4	0.5	1.1	0.0	-0.2
General government gross debt[3]	_	64.4	63.4	61.8	61.5	61.4
Current account balance (% of GDP)	_	7.5	3.6	2.9	0.3	0.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. Includes unfunded liabilities of government employee pension plans.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935439

Policy is accommodative

Inflation is overshooting the central bank's target mainly because of wage drift and rising import prices due to a weakening of the króna, although the upward trend has recently slowed following the interest rate hike in November 2018. The policy rate is projected to rise again over the projection period. The central bank should stand ready to increase rates even further if inflationary pressures persist, which will also help stabilise the króna and reduce the risk of sudden capital flow reversals. Financial markets remain inconspicuous, and house prices have eased further.

The fiscal stance is expansionary. The projection includes spending increases, in particular for infrastructure, which will help boost potential growth. Cuts in income taxes and social contributions for low-income earners will strengthen work incentives and help reduce income inequality but the budget will turn from a surplus to a small deficit. Fiscal policy should be less expansionary, mainly through a smaller increase in public consumption, to help reduce debt and build fiscal space. On current policies, public debt will decline only gradually.

Competitiveness is on a long-term decline as wages are rising faster than productivity. The competitive edge gained after the 2008 crisis, when the króna devalued sharply and real wages were cut, is exhausted. To boost productivity and ensure continuing high salaries, Iceland should further open its economy and dismantle excessive regulatory barriers in domestic services and on foreign investment. The education system should better respond to labour market demands and prepare for rapid technological change.

Growth will continue to slow

Growth is projected to slow to 1% in 2019, mainly because of weaker revenues from foreign tourism on the back of the global slowdown and the airline's insolvency. Growth will rise to 2.4% in 2020 as temporary factors affecting exports of goods and services fade. Business investment will recover gradually as capacity constraints will bite again, and household consumption will grow more strongly. Government spending, in particular on infrastructure and social services, will be supportive. Inflation is projected to remain under control. The small size of the economy makes it volatile and vulnerable, and continuing bad fishing seasons, falling aluminium prices or collapsing tourism can quickly translate into stalling growth.

India

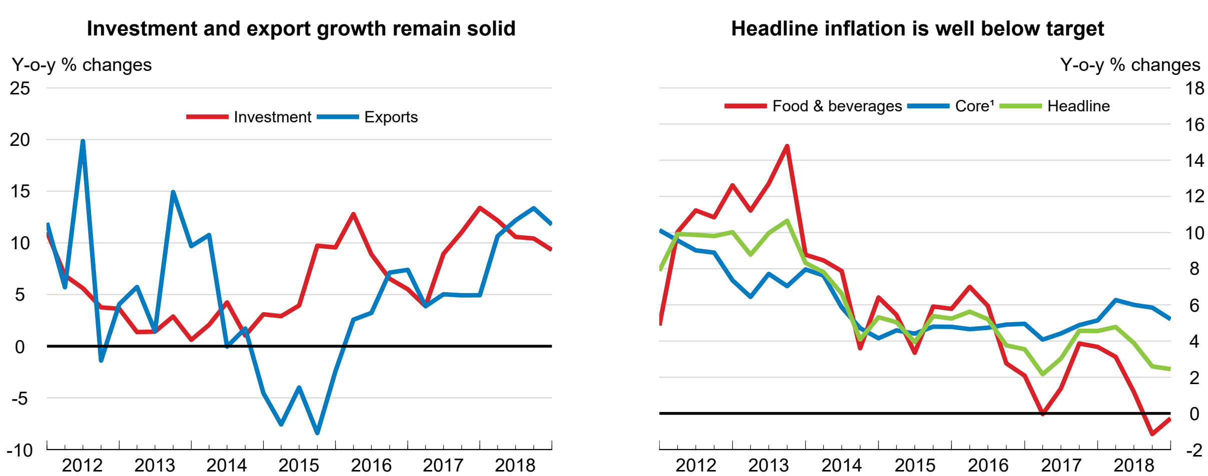
Economic growth will regain strength and approach 7½ per cent by 2020. The new income scheme for small farmers will support rural consumption. Investment growth will accelerate as capacity utilisation rises, interest rates decline, and geopolitical tensions and political uncertainty are assumed to wane. Lower oil prices and the recent appreciation of the rupee will reduce pressures on inflation and the current account.

Monetary policy could be loosened somewhat as headline inflation remains well below target and inflation expectations are adjusting down. Rising public sector borrowing requirements reflect the implementation of new welfare schemes, sluggish tax revenue, and growing financial needs of public enterprises and banks. Reducing the high public debt-to-GDP ratio would require improving the collection of the Goods and Services Tax and broadening the personal income tax base. Ensuring a swift resolution of bankruptcy processes would help contain non-performing loans and boost productivity by promoting the reallocation of resources to more productive firms and sectors. Improving the quality and timeliness of economic data, in particular on employment and public finances, would help in designing better policies.

Private activity weakens as spending plans are postponed

India has the fastest growth among G20 economies. Export growth has held up well, with export orders growing steadily. The Goods and Services Tax (GST) administration has continued to improve, enabling exporters to get faster tax refunds, and ongoing efforts to improve trade infrastructure, logistics and processes are starting to pay off. Investment has continued to grow robustly, supported by hefty public sector projects. In contrast, private investment, in particular in manufacturing, has been affected by uncertainty ahead of the parliamentary elections, combined with persistent difficulties in financing projects, acquiring land and getting all the necessary clearances. Rural consumption, two-wheeler and tractor sales have slowed, driven by subdued agricultural prices and wages.

India 1



1. Core inflation excludes food, beverages and fuel.
Source: OECD Economic Outlook 105 database; and Central Statistics Office.

StatLink https://doi.org/10.1787/888933934489

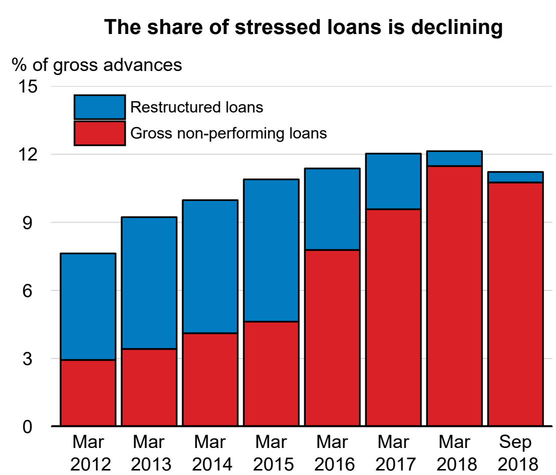
India: Demand, output and prices

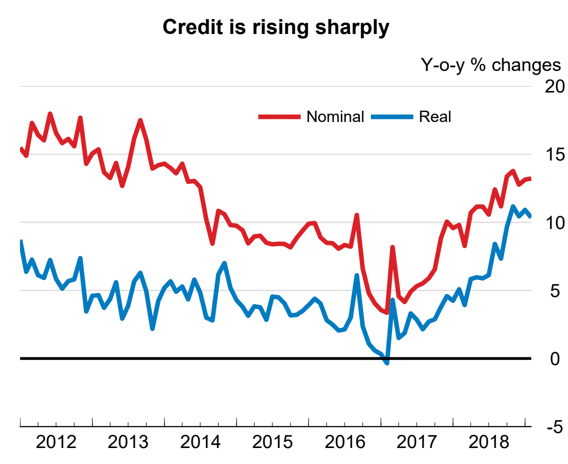
India	2015	2016	2017	2018	2019	2020
	Current prices INR trillion	Percentage changes, volume (2012/2013 prices)				
GDP at market prices	137.7	8.2	7.2	7.0	7.2	7.4
Private consumption	81.3	8.2	7.4	8.0	8.2	7.5
Government consumption	14.4	5.8	15.0	8.2	9.6	6.2
Gross fixed capital formation	39.6	8.3	9.3	10.5	7.7	9.9
Final domestic demand	135.2	8.0	8.8	8.8	8.2	8.0
Stockbuilding[1]	5.7	-1.0	0.2	0.1	0.0	0.0
Total domestic demand	140.9	8.0	9.9	8.5	7.3	8.0
Exports of goods and services	27.3	5.1	4.7	11.9	6.2	6.3
Imports of goods and services	30.4	4.4	17.6	17.5	6.8	9.0
Net exports[1]	- 3.2	0.1	-2.8	-1.7	-0.5	-1.0
Memorandum items						
GDP deflator	_	3.1	3.8	4.2	4.1	4.3
Consumer price index	_	4.5	3.6	3.4	3.2	4.2
Wholesale price index[2]	_	1.7	2.9	4.3	3.1	4.3
General government financial balance[3] (% of GDP)	_	-6.9	-6.4	-6.3	-6.2	-6.0
Current account balance (% of GDP)	_	-0.6	-1.8	-2.4	-2.4	-2.7

Note: Data refer to fiscal years starting in April.
1. Contributions to changes in real GDP, actual amount in the first column.
2. WPI, all commodities index.
3. Gross fiscal balance for central and state governments.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935458

India 2





Source: Reserve Bank of India.

StatLink https://doi.org/10.1787/888933934508

Structural reforms are needed to sustain job creation and incomes

Fiscal policy is supporting consumption demand. While revenue from the corporate income tax is buoyant, thanks to measures to improve compliance, revenue from the GST and the personal income tax is below target. Adding to temporary spending pressures ahead of the elections, various welfare schemes targeting the poor are being implemented. These include a new hospital insurance scheme, the creation of primary health care centres, retirement pensions for workers of the unorganised/informal sector, and an income support scheme for small land-holding farmers. These measures will contribute to reducing poverty and improving access to quality public services. Fiscal space for most states is limited. Given the relatively high public debt and to avoid crowding-out private investment, additional spending should be partly financed by winding down ineffective spending programmes, such as fertiliser subsidies which benefit more large farms and contribute to soil and water degradation. Additional tax revenue could also be raised by limiting the use of exemptions and reduced rates for the GST and by removing tax rebates in the personal income tax system that mostly benefit the rich.

With inflation well below the mid-band point target, inflation expectations adjusting down, and existing slack, there is room for a cut in policy rates. With banks' health gradually improving, as evidenced by the recent decline in stressed assets, lending rates should adjust more swiftly, and support the revival of business investment. To avoid a new build-up of non-performing loans, public banks' governance should be improved to ensure sound portfolio decisions. Implementing strict norms for defaulting borrowers and time-bound resolution of insolvency procedures are also key to promoting sound debtors' behaviour.

Removing structural bottlenecks to the manufacturing sector is key to promoting job creation in more productive and better-paid activities. Infrastructure has improved, in particular in energy supply and roads. Replacing the plethora of state and cascading sales taxes by the GST has made India a single market and exports more competitive on foreign markets, as taxes on inputs can be deducted. To help firms grow and become more productive, product and labour market regulations, together with administrative processes, should be streamlined and modernised further. Experiences in some states look promising. However, the lack of comprehensive and timely data, including on employment, makes it difficult to assess the benefits of reforms. Manufacturing output, exports and jobs would also benefit from a reduction in tariff and non-tariff barriers to trade. The process of land acquisition and administrative clearances should be made easier and predictable to facilitate greenfield investment.

Growth is projected to rise

Accommodative monetary policy and additional fiscal support will boost economic growth, despite subdued demand from partner countries. Rural consumption will revive, as the new income support scheme for small farmers is being fully implemented. Subdued inflation is also contributing to boost households' purchasing power. Private investment will accelerate once uncertainty related to the election wanes, capacity utilisation rises, and financing conditions improve. Exports would suffer only marginally from the planned withdrawal of US preferential duties, as the products concerned account for only a small share of India's export basket. Conditional on a good monsoon, food inflation will remain moderate, thanks to better supply and distribution networks. However, rising oil prices are a risk to inflation. Preserving the Reserve Bank's credibility in targeting inflation remains key to anchor inflation expectations. The exacerbation of geopolitical tensions and rising oil prices would weigh on economic activity.

Indonesia

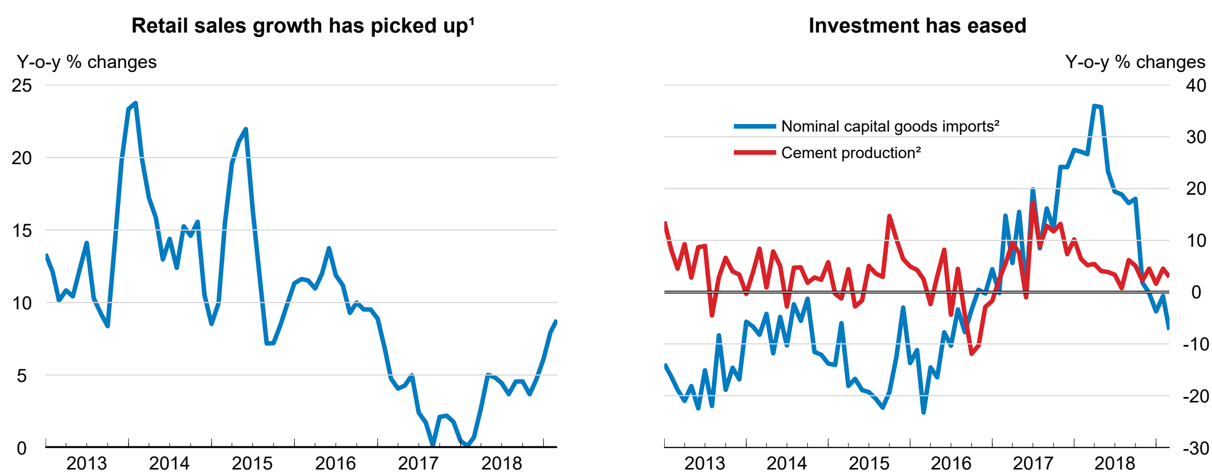
GDP growth has held up well thanks to robust domestic demand, and is projected to remain above 5% in 2019 and 2020. Rising household incomes and low inflation will support household spending. Investment has slowed but will remain solid. The completion of large infrastructure projects in 2018 and 2019 should improve logistics considerably. Nonetheless, weaker trade growth, especially in Asia, will weigh on exports in 2019.

Low inflation and a more accommodative monetary stance in the advanced economies should allow Bank Indonesia to keep interest rates at their current levels. The easing in financial market tensions is an opportunity to build buffers in the financial system and reduce foreign currency exposures. Fiscal policy is expected to be broadly neutral, with the budget deficit well below the 3%-of-GDP limit. With low inflation, energy subsidies could be reduced to fund better-targeted social assistance to reduce poverty.

Growth has been resilient

Domestic demand has retained strong momentum. Ongoing job creation, the expansion of social assistance programmes and subdued inflation are all supporting household spending. Spending associated with the parliamentary and presidential elections held in April added to economic activity in the first half of 2019. However, investment has slowed from its rapid pace a year ago. Financial conditions have improved since October 2018, with portfolio capital returning and the rupiah appreciating, which has eased liquidity for firms and banks. Credit growth remains in double digits.

Indonesia 1



1. Year-on-year percentage change in the 3-month moving average.
2. Based on seasonally adjusted data.
Source: Refinitiv; CEIC; and OECD calculations.

StatLink https://doi.org/10.1787/888933934527

Indonesia: Demand, output and prices

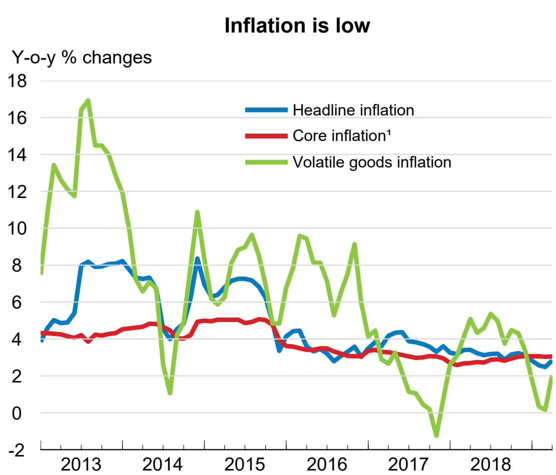
Indonesia	2015	2016	2017	2018	2019	2020
	Current prices IDR trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	11 526.3	5.0	5.1	5.2	5.1	5.1
Private consumption	6 621.9	5.0	5.0	5.1	5.3	5.3
Government consumption	1 123.7	-0.1	2.1	4.8	4.6	4.0
Gross fixed capital formation	3 782.0	4.5	6.2	6.7	5.3	5.5
Final domestic demand	11 527.6	4.4	5.1	5.6	5.3	5.3
Stockbuilding[1]	- 45.4	0.7	-0.2	0.8	-0.5	0.0
Total domestic demand	11 482.2	5.0	4.8	6.3	4.6	5.2
Exports of goods and services	2 439.0	-1.7	8.9	6.5	-1.4	4.8
Imports of goods and services	2 394.9	-2.4	8.1	12.0	-3.8	5.3
Net exports[1]	44.1	0.1	0.3	-1.0	0.5	0.0
Memorandum items						
GDP deflator	_	2.4	4.3	3.8	1.9	3.5
Consumer price index	_	3.5	3.8	3.2	3.0	3.6
Private consumption deflator	_	3.1	3.4	3.2	2.6	3.2
General government financial balance (% of GDP)	_	-2.4	-2.5	-1.9	-2.0	-1.8
Current account balance (% of GDP)	_	-1.8	-1.6	-3.0	-2.4	-2.3

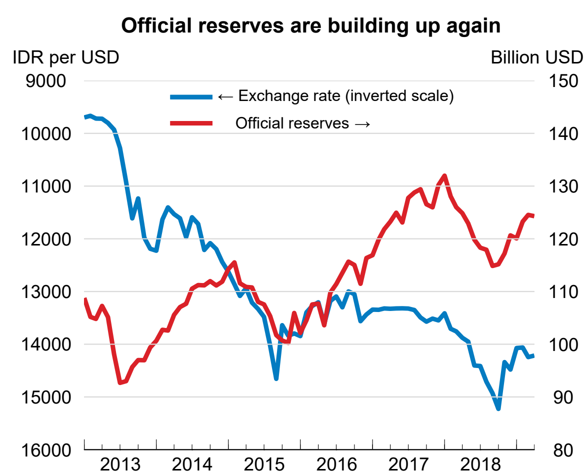
1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935477

Exports and imports have fallen over the past year. In value terms, goods exports to China and Japan have been hit hardest, while exports to the United States have held up better. Imports have declined by more, particularly oil and gas imports. Overall, the trade balance has improved, thereby narrowing the current account deficit, which had widened to 3% of GDP in 2018. Consumer price inflation has eased to low levels reflecting muted administered and volatile goods prices.

Indonesia 2





1. Excludes administered and volatile goods prices.
Source: Refinitiv; CEIC; and OECD calculations.

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Reviving the structural reform agenda is key to higher growth

Fiscal and monetary policies are focussed on stability. The smaller-than-expected fiscal deficit in 2018 contained the widening of the current account deficit and provided an important signal to investors. During 2019-20, fiscal policy is expected to be broadly neutral. There is ample scope to make the composition of spending more effective and inclusive. Shifting from fuel subsidies, which have increased, to targeted social assistance would benefit poor households. Raising more tax revenue remains a priority to enable higher spending on education, health and social assistance, which would reduce inequality and raise medium-term growth. Higher revenues would also allow a renewed infrastructure drive. Improvements in tax administration are ongoing and are part of the necessary efforts to raise compliance.

Bank Indonesia raised interest rates during 2018 to maintain macroeconomic stability amid escalating risks in global financial markets. It sought to offset the drag on growth through accommodative macroprudential policies, such as relaxing macroprudential liquidity buffers and lifting loan-to-valuation ratios. Non-performing loans are low but credit quality should be monitored carefully for signs that standards have deteriorated. Monetary policy is likely to remain on hold, which is prudent given current exposures to renewed financial market turmoil. Interest rates could be lowered if vulnerabilities ease significantly.

The authorities have been taking measures to bolster financial system resilience and continue to co-ordinate policy amongst the responsible authorities. Bank Indonesia is working towards local currency settlement systems with regional trading partners, which will reduce the need for US dollars. It also issued regulations to help enforce hedging requirements for foreign currency exposures. The authorities could encourage borrowers to reduce foreign currency exposures, for instance by borrowing in rupiah. Bank supervisors should remain vigilant against risks in the banking sector. Foreign exchange reserves have risen anew but should be used sparingly to ensure that they are available when needed.

A bold structural reform agenda would raise medium-term growth prospects, improving incomes, and provide a strong signal to financial markets. The government's recently published "Low Carbon Development Path" highlights the risk to economic and social prospects without action to reduce environmental degradation and pollution. This agenda needs private investment, which in turn requires greater regulatory certainty and lower costs of doing business. Ongoing improvements to the online single submission system are needed, including by incorporating sub-national governments. Administrative price controls are used extensively to contain inflation but have knock-on effects. Low inflation rates offer an opportunity to relax these. The launch of the "One Map Policy", which created a unified map of land use, was an important step towards improving legal certainty, including for rural households. It should be further developed to improve its accuracy. Easing the process for hiring foreign skilled workers and relaxing the negative investment list would boost foreign investment.

Growth is projected to remain robust

Growth will remain just above 5% during 2019-20. Rising incomes and falling poverty rates will support brisk consumption growth. However, investment growth is likely to remain more subdued than in earlier years as the boost from the government's infrastructure drive fades. Trade will be soft in 2019 but will benefit from a pick-up in regional trade in 2020. Throughout the projection period, better logistics, including toll roads and ports, will pay economic dividends. Inflation is projected to increase but remain within Bank Indonesia's target range, which will be lowered to 3 +/-1% next year.

A key downside risk is another bout of capital outflows, which could cause instability and higher interest rates. Continued weakness in trade, especially with China, would slow Indonesia's exports further. However, if external vulnerabilities were to decline, monetary policy could be eased, strengthening private demand. Likewise, higher confidence could reinvigorate private investment growth. Faster completion of large infrastructure projects would boost near-term growth as well as medium-term prospects.

Ireland

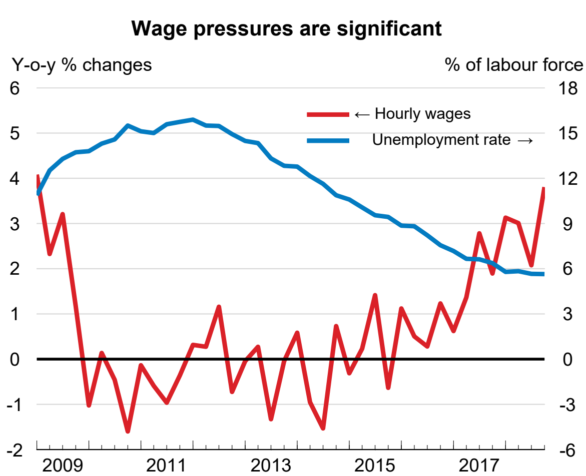
Economic growth is projected to remain robust, but to ease gradually to 3.9% in 2019 and 3.3% in 2020. Abstracting from the volatile activities of multinational enterprises (MNEs), underlying domestic demand growth will remain solid, supported by strong construction investment. Equipment investment growth will moderate somewhat amid ongoing uncertainty around the Irish economy, notably that related to the Brexit process. As the unemployment rate has fallen to historically low levels, job growth will moderate but wage pressures will remain strong, feeding into higher inflation.

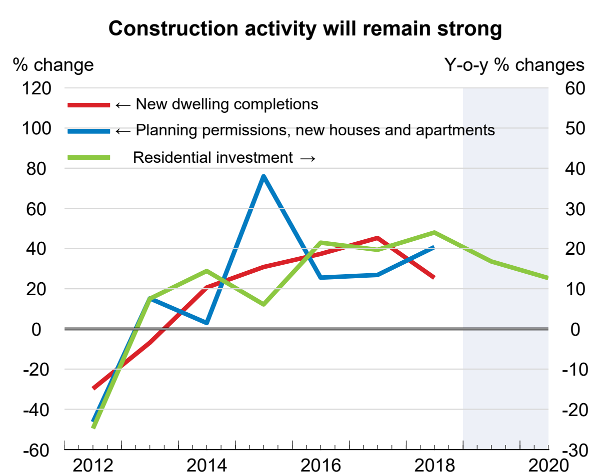
The improvement in the fiscal position is expected to slow in the near term. The government should remain committed to improving the public finances, but it should stand ready to mitigate disruptive consequences if significant risks materialise, such as a disorderly conclusion of the Brexit negotiations. As property prices have recovered strongly over the past years, the property tax yield should be raised through more regular revaluations of the base, which would also help rationalise property purchase demand.

The strong expansion continues

Underlying domestic demand grew by around 4.5% in 2018. Solid consumption has been driven by strong gains in employment and income. With the unemployment rate having declined rapidly, wage growth has already become strong. However, inflation remains muted, pulled down by lower import costs. Both consumption and equipment investment have weakened over the past few quarters, while consumer confidence and business sentiment declined since early 2019, on the back of high external uncertainty. In contrast, construction activity has kept momentum, reflected in strong growth in planning permissions and completions. Although new housing completions have been catching up with demand, there will continue to be shortages in the dwelling stock for some time.

Ireland





Source: Central Statistics Office Ireland; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934565

Ireland: Demand, output and prices

Ireland	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2016 prices)				
GDP at market prices	262.1	4.9	7.2	6.8	3.9	3.3
Private consumption	86.9	3.8	1.8	3.0	2.3	1.8
Government consumption	32.3	3.4	3.7	5.8	3.9	2.7
Gross fixed capital formation	62.3	53.0	-30.1	7.8	7.0	5.5
Final domestic demand	181.5	20.4	-12.2	5.4	4.2	3.4
Stockbuilding[1]	5.5	2.2	-1.3	-0.4	-0.1	0.0
Total domestic demand	187.0	21.7	-15.6	5.7	3.4	3.3
Exports of goods and services[2]	320.1	4.4	7.7	8.9	4.7	4.8
Imports of goods and services	244.9	18.5	-9.3	7.1	4.7	5.3
Net exports[1]	75.1	-11.8	19.0	4.2	1.5	1.0
Memorandum items						
GVA[3], excluding sectors dominated by foreign-owned multinational enterprises	_	4.9	7.2	4.5	4.1	3.6
GDP deflator	_	-0.8	0.4	1.4	1.4	2.3
Harmonised index of consumer prices	_	-0.2	0.3	0.7	1.3	2.3
Harmonised index of core inflation[4]	_	0.7	0.2	0.3	1.5	2.2
Unemployment rate (% of labour force)	_	8.4	6.7	5.7	5.5	5.4
Household saving ratio, net (% of disposable income)	_	3.8	6.6	7.5	7.6	7.6
General government financial balance[5] (% of GDP)	_	-0.7	-0.3	0.0	0.2	0.4
General government gross debt (% of GDP)	_	85.3	78.2	74.3	70.8	65.7
General government debt, Maastricht definition (% of GDP)	_	73.5	68.6	64.8	61.4	56.2
Current account balance (% of GDP)	_	-4.2	8.5	9.1	8.8	8.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. So called "contract manufacturing" (exports of goods produced abroad under contract from an Irish-based entity) by multinational enterprises is assumed to remain at the 2018 level in 2019 and 2020.
3. Gross value added. Data for 2016-2020 are OECD 's estimates.
4. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
5. Includes the one-off impact of recapitalisations in the banking sector.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935496

Policies should aim at ensuring sustainability

The improvement in the structural fiscal position is likely to weaken over the next two years. The authorities are planning to increase public investment by EUR 116 billion (36.4% of 2018 GDP) over the next ten years as part of the National Development Plan, with a focus on public transport, housing, education and skills. By addressing business constraints, including skills shortages, the plan will raise growth potential and living standards over the medium-term. Public debt as a share of measured underlying economic activity remains still very high and the plan should be implemented conditional on pursuing the target of further reducing public debt and focus exclusively on projects with the highest social returns. The government is planning to reduce income tax for low-income households and has recently abolished regressive VAT rate exemptions for the hospitality sector. These measures will improve social inclusiveness and are positive, in net terms, for government revenues. To further improve the fiscal position, the government should eliminate expenditure overruns, which have been significant in some sectors, notably in health, over the past years.

Property prices remain high, despite having moderated recently, both in the housing and commercial property sectors. The authorities strengthened macroprudential measures last year, tightening the application of loan-to-income ratios and announcing the imposition of an extra capital buffer from July 2019, which is appropriate. Foreign investors account for more than half of commercial property investment in Ireland. They often obtain funding from outside the Irish banking sector, but they still leave the Irish property market vulnerable to rapid changes in prices, and open up new channels for the transmission of external shocks.

The economy faces capacity constraints and uncertainties

Output will expand at a more moderate pace over the next two years due to increasing capacity constraints, especially in the construction sector, and weaker external conditions, especially for manufacturers. The unemployment rate will continue to fall to historically very low levels, albeit at a more moderate pace. As a result, wage pressures will remain significant, translating into higher prices given weak productivity growth.

Uncertainties to the outlook are significant. The most immediate one is a disorderly conclusion of Brexit negotiations, which could plunge the Irish economy into a recession. Changes in the international tax regime could affect FDI decisions by multinational firms, posing a significant risk for Ireland. Property prices may strongly surge again, which would further boost construction activity in the near term but may lay the foundation for another boom-and-bust cycle if associated with another surge in credit growth.

Israel

Economic growth is projected to ease slightly, but will remain strong at around 3% in 2019 and 2020. While the global slowdown is weakening export market expansion in the near term, the still strong labour market, low interest rates and expansionary fiscal policy will support domestic demand. Inflation will rise but remain within the lower half of the Bank of Israel's target range.

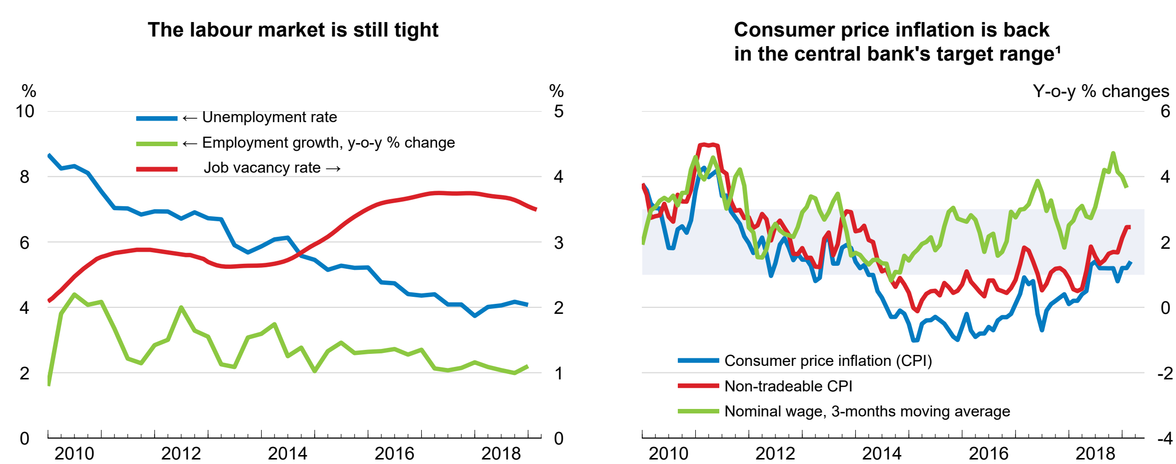
Some macroeconomic policy tightening will be needed to meet fiscal and longer-term inflation targets, and to ensure room for manoeuvre should downside risks materialise. To be able to respond to investment needs in infrastructure and education and foster more inclusive growth, the government should renew its efforts to enhance efficiency in the public sector and improve the tax structure to increase revenues.

The economy is growing close to its potential rate

Growth has remained strong, driven by robust non-residential investment and private consumption. Industrial production rebounded and business confidence improved at the beginning of the year. The labour market is close to full employment but shows some signs of cooling. Job creation in the business sector is slowing, and the job vacancy rate is falling slightly from high levels.

On the back of strong wage growth, non-tradables prices have jumped, and headline inflation has picked up, surpassing the lower bound of the central bank's 1-3% inflation target in the second half of 2018. Services exports continue to grow solidly, and the weakness in goods exports has eased somewhat thus far in 2019, narrowing the trade deficit.

Israel



1. Shaded area is the Bank of Israel's inflation target range.
Source: OECD Economic Outlook 105 database; Bank of Israel; and CBS Israel.

StatLink https://doi.org/10.1787/888933934584

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the west Bank under the terms of international law.

Israel: Demand, production and prices

Israel	2015	2016	2017	2018	2019	2020
	Current prices NIS billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 167.9	4.0	3.4	3.3	3.1	3.2
Private consumption	637.2	6.4	3.3	3.9	3.7	3.4
Government consumption	261.5	4.2	3.4	3.7	3.7	3.0
Gross fixed capital formation	221.6	12.8	2.9	3.3	3.3	1.9
Final domestic demand	1 120.3	7.1	3.2	3.7	3.6	3.0
Stockbuilding[1]	10.1	-0.4	0.2	0.0	-0.1	0.0
Total domestic demand	1 130.4	6.6	3.4	3.7	3.4	3.0
Exports of goods and services	365.6	1.4	5.1	4.9	2.6	4.5
Imports of goods and services	328.1	10.2	5.0	6.6	4.1	3.8
Net exports[1]	37.5	-2.4	0.1	-0.4	-0.4	0.2
Memorandum items						
GDP deflator	_	1.0	0.2	1.0	1.9	1.4
Consumer price index	_	-0.5	0.2	0.8	1.3	1.5
Core inflation index[2]	_	0.0	0.0	0.6	1.1	1.4
Unemployment rate (% of labour force)	_	4.8	4.2	4.0	4.1	4.2
General government financial balance[3] (% of GDP)	_	-1.4	-1.0	-3.0	-3.5	-3.4
General government gross debt (% of GDP)	_	62.0	60.5	61.0	61.7	62.5
Current account balance (% of GDP)	_	3.7	2.7	3.1	1.9	2.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. Excluding Bank of Israel profits and the implicit costs of CPI-indexed government bonds.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935515

Prudent fiscal policy must be maintained, while promoting more inclusive growth

Government expenditure commitments, which include higher spending on infrastructure, welfare and housing, will boost growth in 2019. Unless additional consolidation measures are taken, which are not factored into the projection, the budget deficit will increase markedly to well beyond the government's targets for 2019 and 2020, set at 2.9% and 2.5% of GDP respectively. With the economy close to full employment, the new government should focus on preserving fiscal margins and meeting the budget deficit targets. This will require restraining spending, including by promoting efficiency, and increasing tax revenues, preferably by reducing tax expenditures, such as VAT exemptions on fruits and vegetables and tourism. The Bank of Israel raised its policy rate for the first time in almost four years from 0.1% to 0.25% in November 2018. With inflation back in the Bank's target range, still low unemployment and a positive output gap, a further gradual increase in the interest rate would be appropriate.

Structural reforms are needed to boost productivity and reduce Israel's still wide socio-economic inequalities. This entails pursuing product market reforms to foster competition in lagging sectors and promoting more business-friendly regulations as well as improving the skills, educational attainment and incentives to work of disadvantaged groups whose population shares will continue to increase. Policies to narrow the relatively large regional disparities between municipalities should also be pursued, for example by modifying the inter-governmental and inter-municipal fiscal framework and shifting central budget allocations to support schools and services in disadvantaged municipalities.

Growth is projected to ease slightly

Domestic demand growth will gradually ease as labour market tightness stabilises and higher interest rates weigh on consumption and investment growth. A moderate recovery in export markets over the projection horizon, the development of the offshore gas fields, and new production facilities in the high-tech sector will improve the trade balance and support the economy. A rise in regional geopolitical tensions and prolonged political uncertainty following the recent elections are downside risks to activity. Growth could be stronger if a faster-than-assumed development of the gas fields accelerates the recovery of exports.

Italy

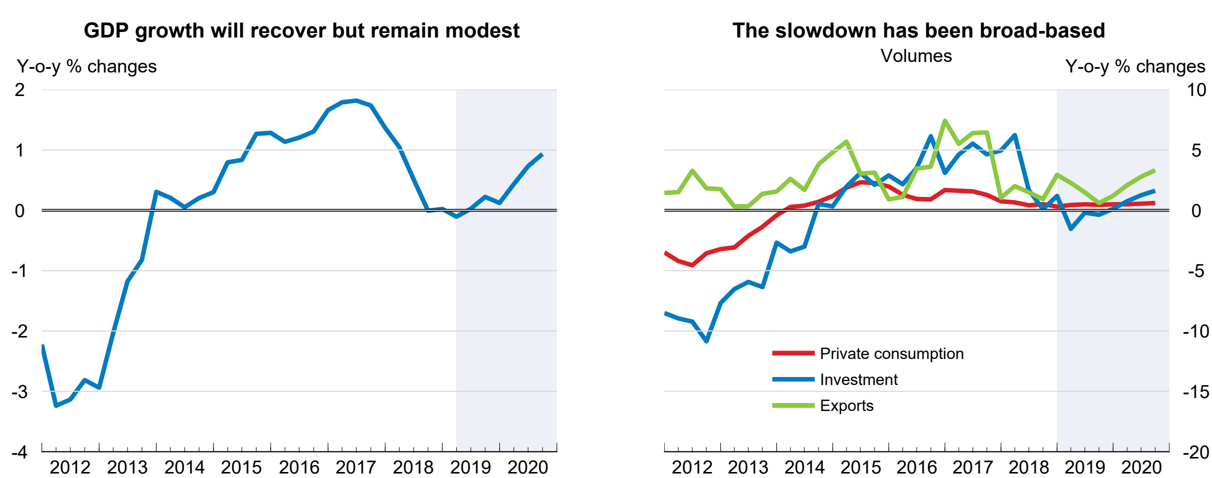
GDP is projected to stagnate in 2019 and expand by 0.6% in 2020. Sluggish employment growth and a rising household saving rate are holding back private consumption, while weak external demand and global trade tensions are hurting exports. Lower business confidence and weak demand are depressing private investment, while project planning and execution delays continue to hinder public investment. Consumer price inflation has moderated markedly as energy price pressures have abated and private-sector wage growth remains modest.

Fiscal expansion and low growth are projected to widen the budget deficit to 2.4% of GDP in 2019 and 2.9% of GDP in 2020. The planned large increase in social spending will help to reduce poverty. Social spending should be inter-generationally fair while also promoting employment growth, especially among women and the young. Streamlining administrative procedures and strengthening capacity at central and local levels are necessary to revive public investment. Enhancing competition in markets that are still protected, raising public administration efficiency and removing obstacles to firms' growth would foster productivity growth.

The economic slowdown has been broad-based

Sluggish external and domestic demand and falling business confidence have led to a drop in investment growth and a large decline in inventories, contributing to the technical recession in the latter half of 2018. In addition, weak activity in major trading partners, especially Germany, and uncertainties relating to Brexit and global trade arrangements have hurt key export sectors, such as the automotive and mechanical industries. Consumer confidence has weakened, though it remains high, and the household saving rate has risen, contributing to more sluggish household consumption. Unemployment has stopped falling and remains high, especially among the young and women. Ample slack in the labour market and stagnant productivity are damping private-sector wage growth.

Italy 1



Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934603

Italy: Demand, production and prices

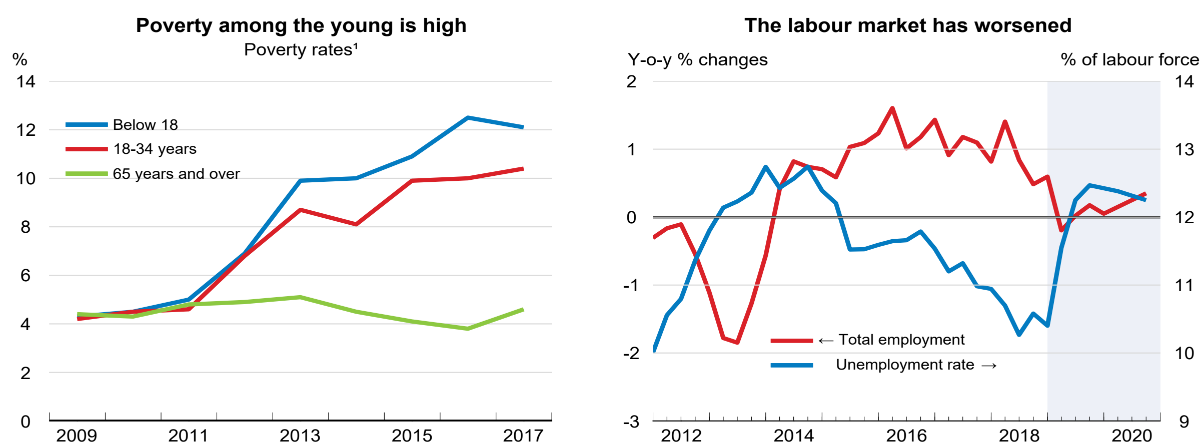
Italy	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 650.9	1.2	1.8	0.7	0.0	0.6
Private consumption	1 006.7	1.3	1.5	0.6	0.4	0.5
Government consumption	311.8	0.1	0.3	0.2	-0.2	0.4
Gross fixed capital formation	279.4	3.7	4.5	3.2	-0.2	0.9
Final domestic demand	1 597.9	1.5	1.8	1.0	0.2	0.6
Stockbuilding[1]	5.5	0.2	-0.4	-0.1	-0.4	0.0
Total domestic demand	1 603.4	1.6	1.4	0.9	-0.2	0.6
Exports of goods and services	493.1	2.3	6.4	1.4	1.8	2.3
Imports of goods and services	445.5	3.8	5.8	1.8	1.1	2.6
Net exports[1]	47.6	-0.4	0.4	-0.1	0.3	0.0
Memorandum items						
GDP deflator	_	1.2	0.5	0.8	0.5	1.1
Harmonised index of consumer prices	_	-0.1	1.3	1.2	0.6	1.0
Harmonised index of core inflation[2]	_	0.5	0.8	0.6	0.4	1.0
Unemployment rate (% of labour force)	_	11.7	11.3	10.6	11.7	12.3
Household saving ratio, net (% of disposable income)	_	3.2	2.4	2.6	3.7	4.1
General government financial balance (% of GDP)	_	-2.5	-2.4	-2.1	-2.4	-2.9
General government gross debt (% of GDP)	_	156.7	154.1	149.3	151.0	151.9
General government debt, Maastricht definition (% of GDP)	_	131.3	131.2	132.2	134.1	135.0
Current account balance (% of GDP)	_	2.5	2.8	2.6	2.6	2.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935534

Italy 2



1. The ISTAT absolute poverty measure reports the share of individuals belonging to households with overall consumption expenditure below a socially necessary minimum, adjusting for the number and age of household members and price levels in the household's location.

Source: OECD Economic Outlook 105 database; and ISTAT.

StatLink https://doi.org/10.1787/888933934622

Banks' non-performing loans continue to decline, reaching 4.5% of total outstanding loans (net of loan loss provisions). Loan quality has improved and the ratio of new non-performing loans to outstanding loans has dropped to pre-crisis levels, below 2%. Credit standards for new loans remain favourable and lending rates – along with banks' funding costs – are low. Despite these supportive credit conditions, bank lending to businesses fell in early 2019 as demand for credit diminished. Surveys report that firms are cutting back their investment plans.

Low growth and expansionary fiscal policy will increase the budget deficit from 2.1% of GDP in 2018 to 2.4% in 2019. The 2019 budget involves net new measures amounting to 0.6% of GDP, mostly consisting of higher social spending through a new early retirement scheme (for a three-year period) and a new and more generous guaranteed minimum income scheme (the Citizen's Income). These expansionary policies will be offset only partly by spending cuts, by at least EUR 2 billion as agreed with the European Commission, and higher business income taxes. These projections assume that the government will implement only about half of the planned VAT hikes in 2020, amounting to about 1.3% of GDP in total. For this reason, and assuming no other major policy change, the budget deficit is projected to rise further, to 2.9% of GDP in 2020. Given low nominal growth, gradually rising interest costs and a larger deficit, the public debt ratio (on a Maastricht basis) is projected to increase to 135% of GDP in 2020.

Broad-ranging reforms are needed to revive growth and broaden its benefits

The high debt-to-GDP ratio leaves Italy vulnerable to changes in interest rates, limiting policy choices to boost growth and pursue social goals. A clear and credible medium-term reform plan to boost growth and reduce the debt-to-GDP ratio is a prerequisite to improving fiscal credibility and reducing the risk premium on government borrowing. Public spending needs to become more efficient and better targeted with a fairer and progressive personal income tax system. Designing thorough spending reviews during the preparation of the yearly budget and effectively implementing them would promote priority-setting and spending re-allocation, contributing to free up resources for effective public programmes and public investment. Improving voluntary tax compliance and vigorously fighting tax evasion would lead to higher tax revenues and allow for a reduction in tax rates.

Increasing productivity growth is key to raising living standards and to offsetting the large negative effect of demographics and a shrinking labour force. In addition to enhancing competition in markets that are still protected, such as professional services and local public services, increasing productivity will require removal of obstacles hampering the growth of SMEs. This in turn will require revising the aspects of the tax system that discourage firms to grow, and enhancing the efficiency of public administration and the justice system, by raising accountability and transparency and pursuing the digitalisation of the public sector. Raising the employment rate, which is still one of the lowest among OECD countries, is also crucial to boost growth and social inclusion. Raising the employment rate will hinge on reducing employer social security contributions; improving the effectiveness of public employment services; and strengthening work incentives, by recalibrating the Citizen's Income and introducing an in-work benefit system for low-wage workers. A national minimum wage, whose introduction is being discussed, will need to be set at a level not to harm employment in the formal labour market.

Growth will resume at a modest pace

GDP growth is projected to resume at a modest pace in 2019 and to strengthen slightly in 2020. Uncertainty will curb the propensity of households and firms to consume and invest, offsetting the effects of the fiscal expansion on activity in 2019. Weak external demand will continue to hinder export growth while moderate domestic demand growth will result in low import growth. The current account surplus will remain high, at about 2.5% of GDP. Limited wage growth and gradually rising consumer price inflation will reduce real wage gains. This, along with sluggish employment growth, will check real household income and private consumption growth.

Renewed financial market turmoil is an important downside risk. Political uncertainty and a new standoff with the European Commission on the next budget would result in persistent large increases in sovereign bond spreads, raising banks' funding costs and hurting banks' balance sheets and capital ratios, thus reducing bank credit and investment. A disorderly Brexit would harm trade, depressing exports and leading firms to further reduce investment. On the other hand, if the planned boost to public investment and the recovery of the construction sector materialised faster than expected, investment growth would accelerate. Rapid progress on the planned reform of public employment services would support employment growth, buttressing incomes and private consumption.

Japan

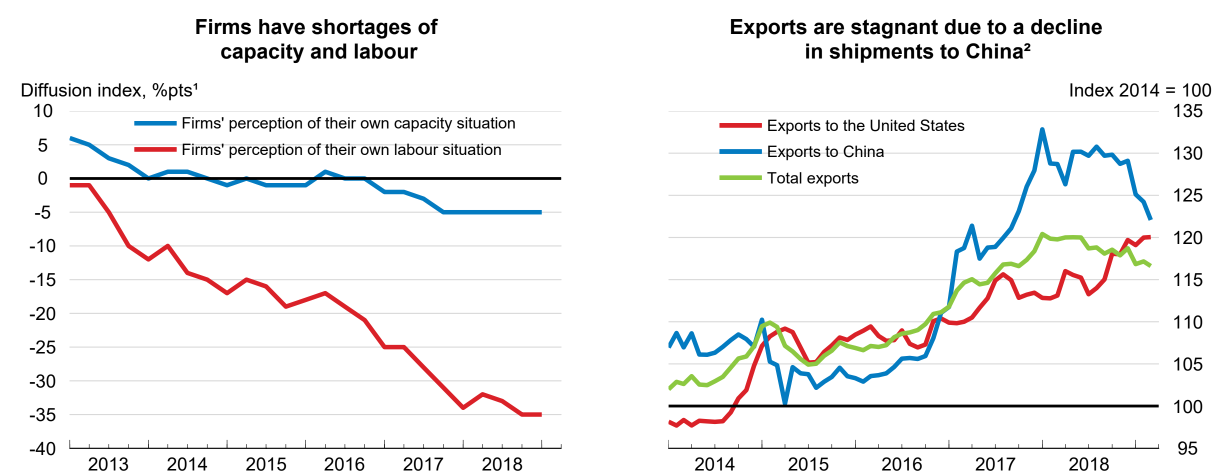
Economic growth is projected to remain close to only 0.7% in 2019-20, with wage and investment growth sustained by labour and capacity shortages. The temporary effect of the October 2019 consumption tax increase will be mitigated by fiscal measures. Sustained growth is projected to gradually push up headline inflation to 1% (excluding the impact of the tax increase) by 2020.

Government debt relative to GDP is the highest ever recorded in the OECD area, posing serious risks. Achieving fiscal sustainability requires a detailed consolidation programme that includes gradual increases in the consumption tax rate beyond the 2019 increase, and measures to control spending in the face of rapid population ageing. With a declining working-age population, structural reforms to boost productivity and employment are key to achieve fiscal sustainability and improve well-being. The Bank of Japan should maintain its expansionary monetary policy until the 2% inflation target is achieved.

Labour and capacity shortages sustain wages and business investment

After peaking at 1.9% in 2017, economic growth slowed to 0.8% in 2018, reflecting weaker export momentum as world trade decelerated. Nevertheless, the current expansion, which began in late 2012, is now the longest in Japan's post-war history, supported by a moderate recovery of consumption and robust business investment. The expansion faltered in early 2019, with declines in industrial production and exports, though labour market conditions remain tight.

Japan 1



1. The diffusion indices show the number of firms responding they had an excess number of workers minus those reporting a shortage and the number responding that they had excess capacity minus those with a capacity shortage. A negative number thus indicates an overall shortage of labour and capacity.
2. Seasonally-adjusted data (three-month moving average).
Source: Bank of Japan.

StatLink https://doi.org/10.1787/888933934641

Japan: Demand, output and prices

Japan	2015	2016	2017	2018	2019	2020
	Current prices YEN trillion	Percentage changes, volume (2011 prices)				
GDP at market prices	531.3	0.6	1.9	0.8	0.7	0.6
Private consumption	300.6	-0.1	1.1	0.4	0.5	-0.1
Government consumption	105.3	1.4	0.3	0.8	0.8	1.5
Gross fixed capital formation	126.4	-0.3	3.0	1.1	2.0	-0.3
Final domestic demand	532.3	0.1	1.4	0.6	0.9	0.2
Stockbuilding[1]	1.2	-0.1	0.0	0.2	0.1	0.0
Total domestic demand	533.5	0.0	1.4	0.8	1.0	0.2
Exports of goods and services	93.6	1.7	6.8	3.1	0.2	3.7
Imports of goods and services	95.8	-1.6	3.4	3.3	2.5	1.8
Net exports[1]	- 2.2	0.6	0.6	0.0	-0.4	0.3
Memorandum items						
GDP deflator	_	0.3	-0.2	-0.1	0.2	1.0
Consumer price index[2]	_	-0.1	0.5	1.0	0.8	1.5
Core consumer price index[3]	_	0.4	-0.1	0.2	0.9	1.5
Unemployment rate (% of labour force)	_	3.1	2.8	2.4	2.4	2.4
Household saving ratio, net (% of disposable income)	_	2.9	2.5	4.3	4.3	4.3
General government financial balance (% of GDP)	_	-3.5	-3.0	-2.5	-2.5	-2.0
General government gross debt (% of GDP)	_	222.8	222.5	224.2	225.6	225.7
Current account balance (% of GDP)	_	3.9	4.2	3.5	3.0	3.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Calculated as the sum of the seasonally adjusted quarterly indices for each year.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935553

The accelerating decline in the working-age population has exacerbated labour shortages. The unemployment rate hovers around 2½ per cent, while the ratio of job openings-to-applicants has risen to around 1.6, its highest level since 1974. Real wages were supported in 2018 by large bonus payments underpinned by record high corporate profits. This year's spring wage negotiations imply a 2.1% annual wage rise, in line with 2018. Combined with capacity shortages and high profits, labour shortages are also sustaining business investment. While consumer price inflation remains well below the Bank of Japan's 2% target, the 2.2% increase in unit labour costs in 2018, the highest since the early 1990s, is expected to feed into the prices of goods and services.

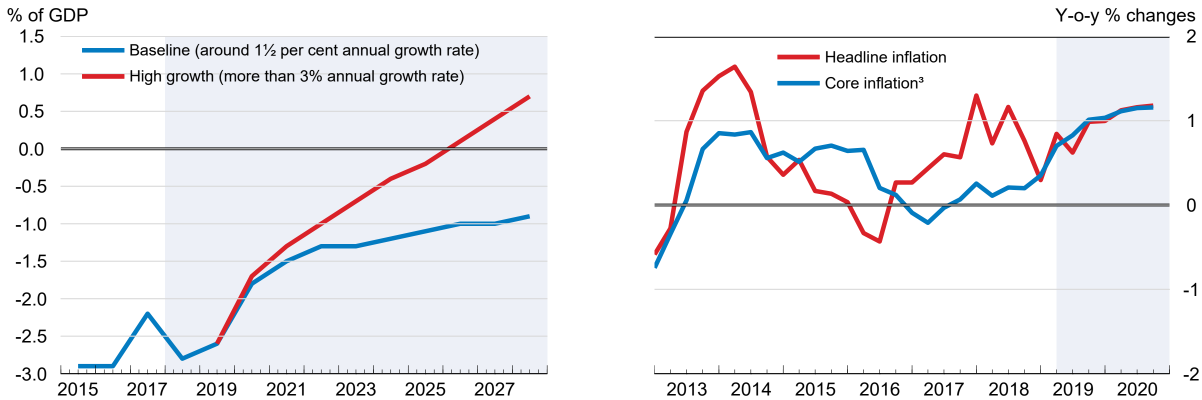
Meeting the intertwined challenges of population ageing and government debt

Japan's gross government debt has risen to 226% of GDP. The planned rise in the consumption tax rate will generate revenue of about 1% of GDP. To mitigate the short-term economic impact, the FY 2018 second supplementary budget and the FY 2019 budget jointly added public investment of 0.4% of GDP. The government is also planning exceptional measures over FY 2019-20, such as a cut in taxes on cars and housing. In addition, the government's decision to use half of the additional revenue for new spending programmes will offset the impact of the tax rise. Ensuring confidence in fiscal sustainability requires a detailed and concrete consolidation plan beyond the FY 2025 primary surplus target to put the government debt ratio on a downward path. Measures to raise revenues should rely primarily on less-distortive taxes, notably the consumption tax. The 2019 consumption tax increase should be followed by gradual further increases that raise it towards the 19% OECD average. On the spending side, containing social spending, notably by making better use of healthcare resources, is a priority.

Japan 2

The primary budget deficit is projected to continue through FY 2025 under current policies[1]

Consumer price inflation remains below the 2% target[2]



1. Government projections in January 2019. It assumes that the rise in the consumption tax rate from 8% to 10% is implemented as planned in 2019. The primary balance is central and local governments, as a percentage of GDP on a fiscal year basis.
2. Excluding the effects of the April 2014 consumption tax rise, which added 2 percentage points to inflation in FY 2014 according to a government estimate. It also excludes the scheduled October 2019 consumption tax increase, which would add 1 percentage point to inflation in the fourth quarter of 2019, and the impact of free childcare for children aged three to five, which would reduce it by 0.5 percentage points, according to an OECD estimate.
3. OECD measure, which excludes food and energy.
Source: Cabinet Office; OECD Economic Outlook 105 database; and Bank of Japan.

StatLink https://doi.org/10.1787/888933934660

Large-scale government bond purchases by the Bank of Japan, which now amount to 85% of GDP, have mitigated the impact of high government debt. Under its "yield curve control" policy, the central bank is currently keeping the yield on 10-year government bonds close to zero. The Bank of Japan is committed to continue expanding the monetary base until CPI inflation (excluding fresh food) exceeds the 2% target and stays above it in a stable manner. The projection assumes that the supportive monetary stance continues through 2020.

Japan's shrinking and ageing population makes it important to remove obstacles to employment for older persons through labour market reform, including abolishing the right of firms to set mandatory retirement, which is at age 60 at most firms. This would also help reduce the importance of seniority in setting wages. Breaking down labour market dualism would promote female employment and reduce Japan's large gender wage gap. The government plans to accept 345 000 foreign workers over 2019-24 under a new law that allows those who have completed training programmes in Japan to remain for up to five additional years to work in sectors facing severe labour shortages. The New Economic Policy Package sets an ambitious target of doubling labour productivity growth to 2% by 2020 through a range of measures, including corporate governance reforms, financial support for investment in ICT by SMEs and tax incentives for wage and investment increases. Increased openness to trade will also help. With Japan's leadership, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership entered into force in December 2018, followed by the Japan-EU Economic Partnership Agreement in February 2019.

Growth is projected to continue in line with potential

With the measures mitigating the impact of the consumption tax increase, output growth over 2019-20 is projected to remain around 0.7%, in line with Japan's estimated potential growth rate. The 2019 wage agreements imply moderate wage gains that will support private consumption. Continued wage increases are needed to sustain the expansion in 2020. While the new free trade agreements and the 2020 Olympic Games in Tokyo are expected to boost exports of goods and services, Japan is vulnerable to a further slowdown in China's domestic demand. Protectionism also remains a risk, though no new trade restrictions against Japan are to be introduced during the consultations based on the September 2018 Japan-US Joint Statement. Japan's unprecedentedly high level of public debt is a key risk. A loss of confidence in Japan's fiscal sustainability could destabilise the financial sector and the real economy, with large negative spillovers to the world economy.

Korea

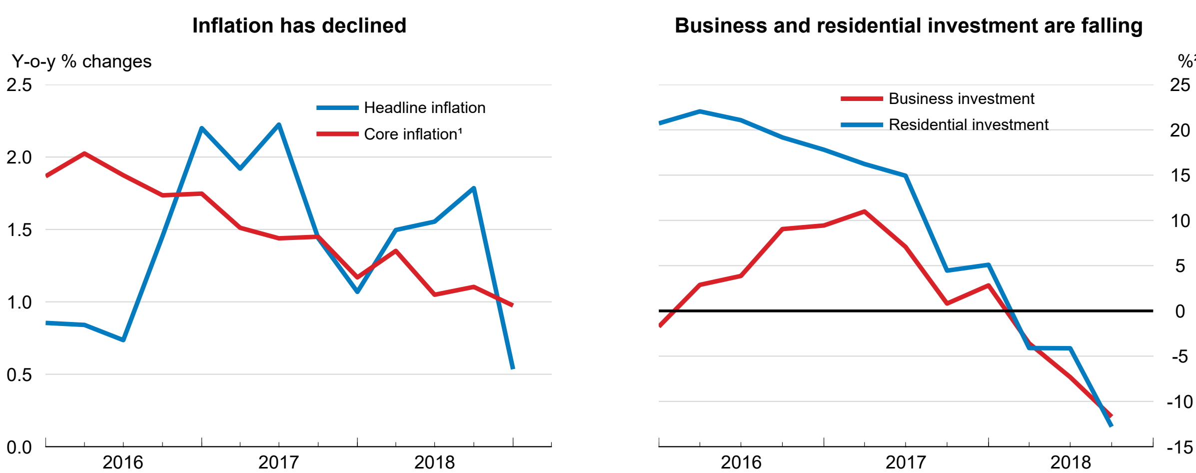
Economic growth is projected to slow to around 2½ per cent in 2019-20, reflecting weakness in domestic demand and international trade. Restructuring in the manufacturing sector, notably in some industries facing weak overseas demand, and double-digit increases in the minimum wage are holding back job creation. Fiscal stimulus is projected to support growth, while core inflation will pick up to around 1½ per cent in 2020.

Fiscal stimulus should continue in 2020, accompanied by an easing of monetary policy, as headline inflation is well below the 2% target. Minimum wage increases should be moderated, while focusing more on reforms to boost productivity, particularly in the service sector and in small and medium-sized enterprises. Measures to reduce air pollution are a priority to improve well-being and productivity.

Domestic and overseas demand has slowed

Weaker economic growth is due in part to a decline in fixed investment and weak job creation, reflecting restructuring in manufacturing. In addition, the 29% increase in the minimum wage over 2018-19 has held back job gains, particularly for low-skilled workers. Employment growth in 2018 dropped to 0.4%, the lowest since 2009. The job market improved in early 2019, but most new jobs in the first quarter were in social services and healthcare. Exports have been declining since late 2018 as global trade and demand from China lost momentum. The downturn in the semiconductor market, which peaked in mid-2018, also had a negative impact, as Korea accounted for more than 60% of the world memory market in 2018. Headline inflation dropped to 0.5% in early 2019, well below the 2% target, in part due to government measures to reduce prices of healthcare and telecommunications and a temporary tax cut on oil.

Korea



1. Excludes food and energy. The central bank's target is for CPI inflation.
2. Annualised change of three-quarter moving average.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934679

Korea: Demand, output and prices

Korea	2015	2016	2017	2018	2019	2020
	Current prices KRW trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 564.1	2.9	3.1	2.7	2.4	2.5
Private consumption	771.2	2.5	2.6	2.8	2.5	2.7
Government consumption	234.8	4.5	3.4	5.6	6.9	5.0
Gross fixed capital formation	458.4	5.6	8.6	-2.1	-2.4	1.6
Final domestic demand	1 464.4	3.8	4.7	1.7	1.7	2.8
Stockbuilding[1,2]	- 9.2	0.0	0.4	0.2	0.5	0.0
Total domestic demand	1 455.2	3.8	5.1	1.9	2.2	2.7
Exports of goods and services	709.1	2.6	1.9	4.1	-0.5	3.4
Imports of goods and services	600.2	4.7	7.0	1.7	-1.4	3.8
Net exports[1]	108.9	-0.7	-1.7	1.1	0.4	0.0
Memorandum items						
GDP deflator	_	2.0	2.3	0.3	0.4	2.2
Consumer price index	_	1.0	1.9	1.5	0.8	1.5
Core inflation index[3]	_	1.9	1.5	1.2	1.2	1.4
Unemployment rate (% of labour force)	_	3.7	3.7	3.9	3.9	3.9
Household saving ratio, net (% of disposable income)	_	8.7	8.8	8.8	8.9	8.6
General government financial balance (% of GDP)	_	2.4	2.8	2.5	1.1	0.6
General government gross debt (% of GDP)	_	45.1	44.5	43.3	43.4	44.9
Current account balance (% of GDP)	_	6.9	4.9	4.7	4.3	4.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. The actual amount for 2015 includes statistical discrepancy equal to KRW -3.1 trillion.
3. Consumer price index excluding food and energy.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935572

Expansionary fiscal policy should be accompanied by structural reform

The government responded to weaker growth with fiscal stimulus. Spending is set to increase more than 9% in 2019, focusing on social welfare and job creation, which is to rise by 22%. In addition, the government aims to boost public employment by 0.8 million, a 34% increase, over 2017-22. Nevertheless, the general government fiscal balance is projected to remain in surplus at around ½ per cent of GDP in 2020, while gross government debt stays below 45% of GDP. The 2019 supplementary budget, which includes outlays to address fine dust pollution, will boost the economy.

The Bank of Korea raised its policy interest rate in late 2018, partly due to concerns about high and rising household debt. Household debt rose less than 6% in 2018, the lowest in five years, reflecting the tightening of regulations on mortgage lending, but still outpaced household income.

Korea’s key challenge is to raise labour productivity, which is only about half of that in the top half of OECD countries. Robust labour supply that has offset low productivity is shrinking with the cut in maximum weekly working time from 68 to 52 hours and the decline in the working-age population since 2017. With the fertility rate falling below one in 2018, Korea faces the fastest population ageing in the OECD area. The scope for productivity gains is largest in the service sector, where output per employed person is only about half of that in manufacturing. Priorities are regulatory reform and policies to promote greater dynamism in small and medium-sized enterprises, which are dominant in services.

Growth of 2½ per cent is projected in 2019-20

Growth will be supported by fiscal easing and a rebound in fixed investment in 2020, leading to GDP growth near Korea's potential rate. If such an upturn fails to materialise, additional fiscal support will be necessary. Further large minimum wage increases would reduce job gains and the competitiveness of Korean firms if not accompanied by higher productivity. Korea is also exposed to a sharper-than-projected slowdown in China, which accounts for a quarter of its exports, and to the US-China trade dispute.

Latvia

Economic growth is projected to decline as export market conditions worsen and the disbursement of EU funds slows. Robust household consumption will continue to support growth. High wage growth will gradually translate into rising inflation.

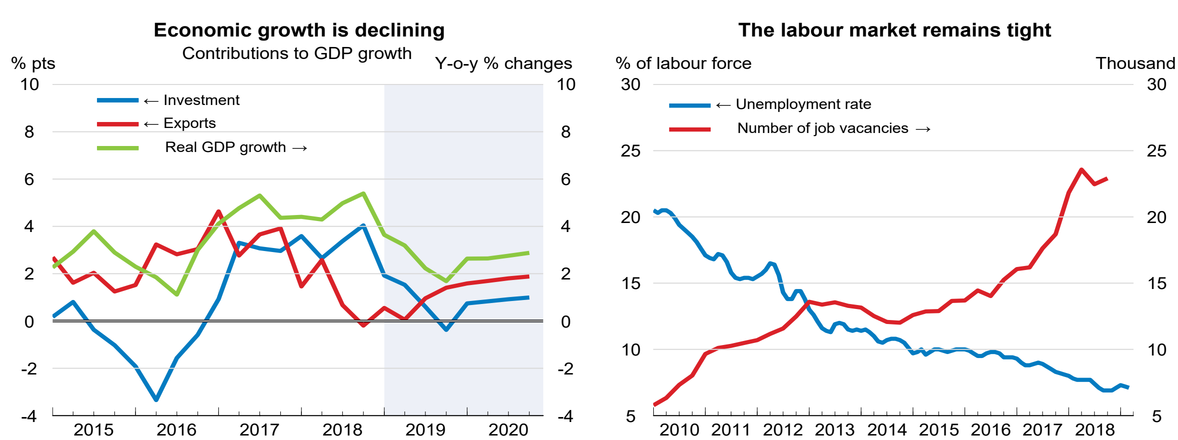
Fiscal policy will be broadly neutral. More efficient tax collection is essential for financing higher spending on healthcare and better access to housing, education and training. The new government's commitment to bolster efforts to reduce informality and fight economic crimes, including money laundering, is welcome.

Economic growth is led by domestic demand

Latvia enjoyed strong economic growth in 2018, supported by double-digit investment growth due to some large investment projects in the trade and logistic sectors and an exceptional surge in the disbursement of EU funds. Labour tax cuts and strong wage growth, driven by higher minimum wages, labour shortages and productivity advances, supported robust household consumption. However, the weakening in global trade has weighed recently on business confidence, industrial production and exports. Rising labour costs have not resulted in significant inflationary pressures so far.

The labour market remains tight and the number of job vacancies is elevated. The unemployment rate has declined but remains above 7%, as labour mismatches across skills and regions hold back faster employment growth. There are also many involuntary part-time and discouraged workers and individuals that are ready to work but not actively searching for jobs. This is a serious challenge for economic growth, not least because the labour force is decreasing due to continuous emigration and population aging. The average wage grew by 8% in 2018, resulting in a rise in unit labour costs relative to Latvia's trade partners.

Latvia



Source: Central Statistical Bureau of Latvia; Eurostat; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934698

Latvia: Demand, production and prices

Latvia	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	24.3	2.1	4.6	4.8	2.7	2.7
Private consumption	14.7	1.4	4.1	4.5	3.8	3.6
Government consumption	4.4	3.9	4.1	4.0	2.6	2.0
Gross fixed capital formation	5.4	-8.4	13.1	16.4	3.9	3.9
Final domestic demand	24.4	-0.3	5.9	6.9	3.6	3.4
Stockbuilding[1]	0.0	2.3	0.5	0.2	-0.3	0.0
Total domestic demand	24.4	2.1	6.3	6.8	3.1	3.3
Exports of goods and services	14.7	4.4	6.2	1.8	1.3	3.0
Imports of goods and services	14.8	4.4	8.9	5.1	2.0	4.1
Net exports[1]	- 0.1	0.0	-1.5	-2.0	-0.4	-0.6
Memorandum items						
GDP deflator	_	0.9	3.2	4.2	4.1	3.7
Harmonised index of consumer prices	_	0.1	2.9	2.6	2.6	2.5
Harmonised index of core inflation[2]	_	1.2	1.7	1.9	2.2	2.4
Unemployment rate (% of labour force)	_	9.6	8.7	7.4	7.0	6.8
Household saving ratio, net (% of disposable income)	_	-5.3	-6.0	-3.8	-2.1	-0.7
General government financial balance (% of GDP)	_	0.1	-0.6	-1.0	-0.8	-0.8
General government gross debt (% of GDP)	_	50.3	48.0	44.6	44.3	44.1
General government debt, Maastricht definition (% of GDP)	_	40.3	40.0	35.9	35.6	35.4
Current account balance (% of GDP)	_	1.6	0.7	-1.0	-1.5	-1.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935591

Policy measures should be mobilised to make growth more inclusive

The fiscal stance will be broadly neutral, as the personal and corporate income tax reforms phased in since 2018 are compensated by higher excise taxes and spending restraint. The government also raised social contributions to finance a part of the increase in health spending. The fiscal stance is adequate given limited inflationary pressures and the need for more spending, in particular on healthcare, education and training to address skills shortages and inequalities in access to social services. However, the government should monitor the impact of higher wages on prices and stand ready to react with some more fiscal tightening should inflationary pressures rise more than expected, in particular towards the end of the projection horizon.

Strong productivity growth is needed to ensure robust economic growth against demographic headwinds stemming from ageing and emigration. Aligning vocational and tertiary education better with labour market needs and increasing the participation in adult learning are essential for addressing skills shortages that constrain innovation and the adoption of digital technologies. Developing a rental housing market would help strengthen labour mobility and address regional job mismatches. The capacity of the judiciary, law enforcing agencies and supervisors must be strengthened to fight economic crimes, such as money laundering and tax evasion, to address informality and reputational risks as well as inefficiencies in insolvency procedures that hold back more efficient resource allocation. Improving access to healthcare and strengthening social protection would contribute to both higher and more inclusive growth.

Economic growth is projected to remain robust

Economic growth will slow down somewhat, as investment will moderate to a more sustainable pace on the back of a deceleration of the disbursement of EU funds. Export growth is projected to recover only gradually. A disorderly exit of the United Kingdom, Latvia’s sixth largest export destination, from the European Union could delay the recovery of exports further. Wage growth will remain high as skills shortages and labour mismatches are expected to persist in the short term. This will support consumption via higher household incomes, but risks undermining the price competitiveness of Latvian firms, if not matched by sufficiently high productivity growth. On the other hand, recent structural reforms to foster innovation and training may take effect faster than expected, allowing Latvian firms to strengthen their non-price competitiveness. This would contribute to stronger growth and employment.

Lithuania

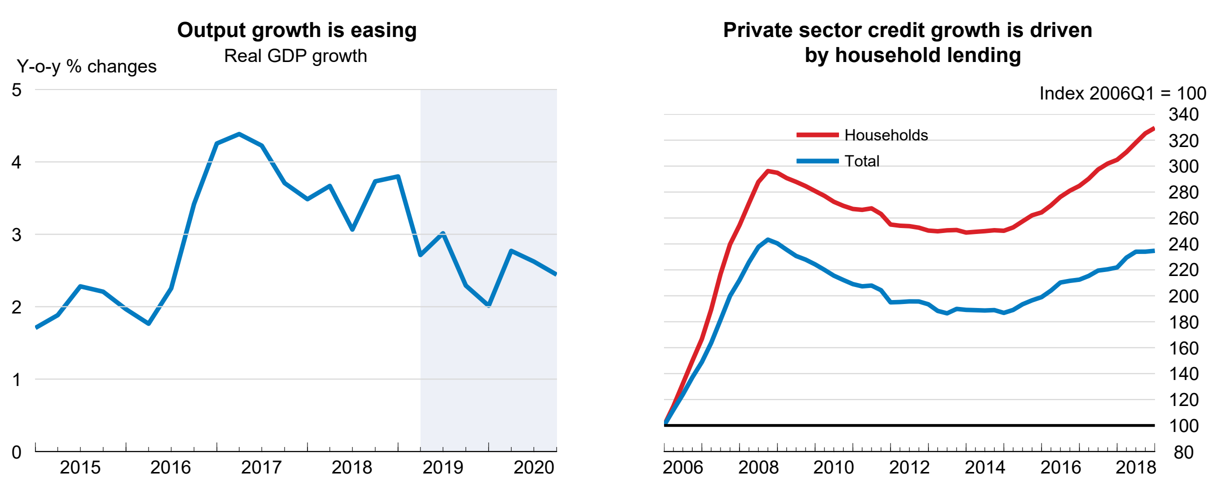
GDP growth is projected to slow gradually as investment eases towards more sustainable levels and the external sector remains weak. Labour supply constraints also limit growth. Tight labour market conditions and robust domestic demand will continue to put pressures on underlying inflation. Wage increases above productivity growth will sustain consumption and reduce income inequalities, but might negatively affect competitiveness.

The government budget will remain in a small surplus in 2019-20, safeguarding the healthy fiscal position. Reforms to enhance productivity and make growth more inclusive should aim to further improve the business environment, including by lowering administrative burdens, and helping individuals to attain their productive potential by equipping them with relevant skills. Stronger work-based training at the vocational education level and effective up-skilling and re-skilling programmes for adults are essential.

Economic growth is driven by domestic demand

The economy is growing at a solid pace, albeit below recent highs. Private consumption continues to be supported by rapidly rising wages in excess of productivity growth and expanding credit. Income-boosting measures, such as increases in the non-taxable income threshold and social benefits, have fuelled consumption. Consumer confidence strengthened in early 2019. Investment growth remains firm, even if business confidence has somewhat weakened, amid high capacity utilisation and a faster implementation of EU-funded projects. Buoyant domestic demand has offset partly the drag on growth from external weakness. Headline inflation has edged down, helped by lower oil prices. However, skills shortages and falling unemployment, along with robust domestic demand, continue to put pressures on underlying inflation, especially in services sectors.

Lithuania



Source: OECD Economic Outlook 105 database; and European Central Bank.

StatLink https://doi.org/10.1787/888933934717

Lithuania: Demand, output and prices

Lithuania	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	37.4	2.4	4.1	3.5	2.9	2.5
Private consumption	23.5	5.0	3.3	3.9	3.7	3.6
Government consumption	6.4	-0.1	-0.4	0.8	0.9	0.6
Gross fixed capital formation	7.3	0.3	6.8	6.5	5.1	4.3
Final domestic demand	37.2	3.2	3.4	3.9	3.5	3.2
Stockbuilding[1]	0.4	-1.0	-0.6	-1.1	0.5	-0.2
Total domestic demand	37.6	2.1	2.9	2.9	4.0	3.0
Exports of goods and services	28.4	4.0	13.6	5.1	3.6	3.5
Imports of goods and services	28.6	3.8	12.0	4.3	4.9	4.1
Net exports[1]	- 0.2	0.1	1.3	0.7	-0.9	-0.5
Memorandum items						
GDP deflator	_	1.4	4.3	3.3	2.7	2.4
Harmonised index of consumer prices	_	0.7	3.7	2.5	2.2	2.2
Harmonised index of core inflation[2]	_	1.7	2.6	1.9	2.1	2.2
Unemployment rate (% of labour force)	_	7.9	7.1	6.2	5.9	5.8
Household saving ratio, net (% of disposable income)	_	-3.6	-5.2	-3.7	-3.5	-3.4
General government financial balance (% of GDP)	_	0.2	0.5	0.7	0.4	0.2
General government gross debt (% of GDP)	_	51.7	47.8	42.1	40.9	40.0
General government debt, Maastricht definition (% of GDP)	_	40.0	39.4	34.2	33.0	32.1
Current account balance (% of GDP)	_	-1.3	1.2	1.7	0.4	0.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935610

Efforts to raise productivity and equality need to continue

The ECB monetary policy stance remains accommodative and credit to the private sector is growing, driven by strong lending to households. House price growth has moderated somewhat but wide regional differences remain, with prices outside the capital region still growing at a robust pace. Private sector indebtedness and house prices are still below their historical peaks, mitigating financial stability risks. The authorities need to continue using prudential rules in a pro-active manner to avert the emergence of financial imbalances.

After a mildly expansionary fiscal stance in the past two years aimed at boosting productivity and fighting income inequality, a broadly neutral fiscal stance is assumed over the period 2019-2020. The budgetary cost of additional measures to reduce poverty is to be partly offset by revenue-enhancing improvements in tax administration as well as rises in some taxes, including an increase in excise duties on tobacco products.

Fostering higher productivity and inclusiveness requires additional reforms to ensure that the education system provides the right skills to meet evolving labour market demands and reduce large skills mismatches. Enhancing the attractiveness and labour-market relevance of vocational education, including through more work-based learning, is vital in this regard, as are up-skilling and re-skilling programmes for adults that ensure strong and transferable skills and competencies. Low-skilled workers would further benefit from a reduction in the high labour tax burden, making them more attractive to employers. Reforms should also promote firm dynamism by simplifying bankruptcy procedures and reduce informality by lowering the administrative burden on business.

Growth is projected to ease

Output growth is set to slow to 2½ per cent by 2020. Investment growth should moderate, after the surge in 2017-18, as the flows of EU funds return to more normal levels and global uncertainty impacts business decisions. Domestic demand will further be influenced by a shrinking labour force, constraining consumption growth. Weak external demand will continue to hold back exports. The unemployment rate is set to hover at around 6% in 2019-20. Underlying inflation will drift up as labour market conditions remain tight. A weaker than anticipated growth in Lithuania's main EU trade partners could dent investment and exports. Labour shortages are another important downside risk as they could limit employment growth more than anticipated and may lead to faster wage increases that could harm export performance. On the other hand, structural reforms could result in stronger productivity and output growth.

Luxembourg

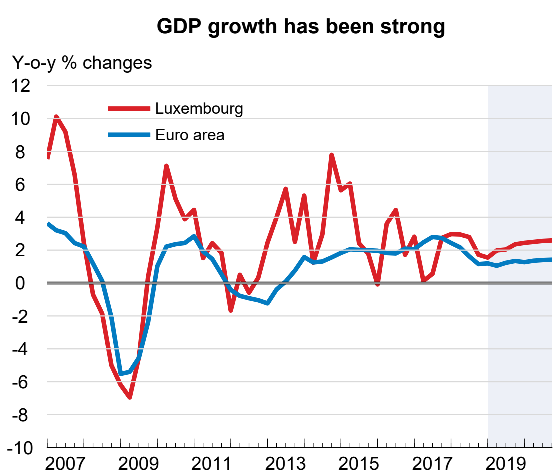
Economic growth is projected to decline to 2% in 2019, but to recover to 2.5% in 2020. Domestic demand will support economic activity, notably private consumption, which will be held up by a resilient labour market and continuing effects of the tax reform. Slow growth in the euro area will weigh on exports of financial and non-financial services. Continued job creation will primarily benefit cross-border workers, but also help to reduce the unemployment rate to just above 5%.

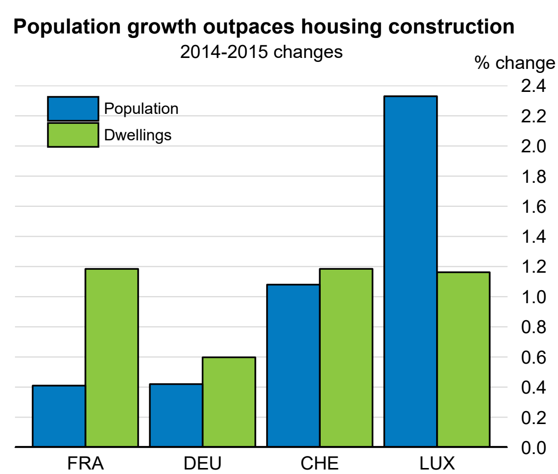
Fiscal policy is sound and ample fiscal space could be used to step up infrastructure investment and implement other growth-enhancing measures, such as housing construction. Reliance on the financial sector exposes Luxembourg to high financial volatility transmitted by international investment funds, which warrants ongoing monitoring and diversification of the economy. Constraints on the supply of housing need to be addressed as housing prices continue to increase and household indebtedness is high.

Domestic demand underpins growth

Consumer confidence has rebounded, pointing to continued robust household consumption supporting economic growth. In contrast, business confidence deteriorated in the first quarter of 2019, suggesting a possible weakening in exports of both financial and non-financial services. A decline in the unemployment rate, by more than half a percentage point from a year earlier, and a high vacancy rate, indicate tight labour markets. There is growing evidence of skills mismatches and shortages, signalling potential capacity constraints. Luxembourg's position as a global financial hub translates into further growth of assets under the management of investment funds, driven by a search for yield and positive valuation effects from accommodative monetary policy. The contribution to growth by the financial sector was positive in 2018.

Luxembourg





Source: OECD Economic Outlook 105 database; OECD (2018), International Migration Outlook; and OECD Affordable Housing Database.

StatLink https://doi.org/10.1787/888933934736

Luxembourg: Demand, output and prices

Luxembourg	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	51.6	2.4	1.6	2.6	2.0	2.5
Private consumption	15.9	1.7	3.0	4.2	2.8	3.6
Government consumption	8.7	2.5	3.5	4.0	4.3	3.2
Gross fixed capital formation	9.4	10.1	3.9	-2.8	5.5	4.5
Final domestic demand	33.9	4.1	3.4	2.2	3.9	3.7
Stockbuilding[1]	0.5	-0.4	-0.5	0.6	-0.6	0.0
Total domestic demand	34.4	3.5	2.6	3.3	3.0	3.6
Exports of goods and services	115.9	3.8	-1.9	4.6	3.8	4.1
Imports of goods and services	98.8	4.5	-2.2	5.1	4.4	4.8
Net exports[1]	17.1	0.1	-0.1	0.5	0.1	0.1
Memorandum items						
GDP deflator	_	0.9	2.1	3.8	2.8	2.2
Harmonised index of consumer prices	_	0.0	2.1	2.0	1.7	1.9
Harmonised index of core inflation[2]	_	1.0	1.4	0.9	1.8	1.9
Unemployment rate (% of labour force)	_	6.3	5.9	5.5	5.2	5.1
Household saving ratio, net (% of disposable income)	_	13.7	16.5	16.5	18.0	18.1
General government financial balance (% of GDP)	_	1.9	1.4	2.4	1.9	1.8
General government gross debt (% of GDP)	_	28.9	30.7	28.8	29.1	29.5
General government debt, Maastricht definition (% of GDP)	_	20.7	23.0	21.4	21.7	22.1
Current account balance (% of GDP)	_	5.1	5.0	4.8	4.0	4.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935629

Policies are needed to revive productivity and increase the housing supply

Gross public debt, at 21.4% of GDP in 2018, is among the lowest in the OECD. Indeed, net public debt is negative due to significant assets held by the social security administration. The general government budget is in surplus, which is projected to decrease in 2019, mainly reflecting slowing GDP growth. The fiscal policy stance is projected to remain broadly neutral. The 2019 budget projects falling revenues due to a corporate income tax reduction, the introduction of a minimum social salary tax credit, and a further loss of e-commerce VAT, offset in part by higher taxes and excise duties on transport fuel. Introducing a system of congestion charges in Luxembourg City would further promote green growth. An important structural challenge facing fiscal policy is work disincentives in the tax-benefit system, which are an obstacle to a further reduction in unemployment and inactivity traps.

The high exposure of the Luxembourg economy to financial sector developments warrants a close monitoring of related risks. This is particularly the case given high household indebtedness. Supply constraints in the housing sector, such as the limited use of available land, have held down new housing construction and led to strong increases in real estate prices, eroding housing affordability. Immigration, mainly driven by the buoyant labour market, has bolstered demand, while the supply of housing remains constrained by unused land zoned for construction and weak co-ordination between the central government and municipalities.

Despite strong digital skills and substantial public investment into connectivity and high speed Internet, the take-up of digital technologies by companies, for example in the area of e-commerce, and by the public administration needs to be improved. Skills mismatches and shortages of high skilled labour are already apparent and further improvements in the education system should focus on lifelong learning and aligning the supply of skills with labour market needs.

Growth is projected to slow down

Growth is projected to decelerate to 2% in 2019, mainly due to the slowdown in the euro area, before recovering to 2.5% in 2020 on the back of resilient domestic demand and improving export performance. Fiscal policy is projected to remain broadly neutral. Heightened financial volatility represents a key downside risk in the medium term. On the upside, financial companies have announced the reallocation of some of their activities to Luxembourg after Brexit, possibly increasing the output of the financial sector.

Mexico

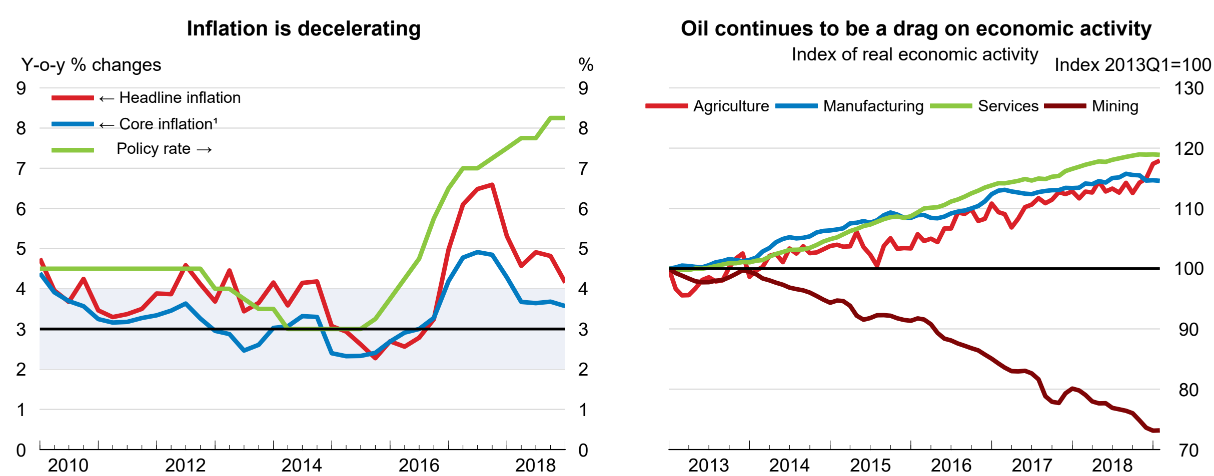
Economic activity will pick up modestly, supported by domestic demand. Consumption is set to strengthen on the back of robust remittances, lower inflation and higher social transfers. Announced infrastructure investment plans will also add to growth, but restraints on current spending will partly offset these effects. Policy uncertainty will continue to restrain private investment. The decline in oil activity will remain a drag on growth. Overall, growth will be too modest to allow for a reduction in high informality rates.

Monetary policy is appropriately tight to contain high inflation and keep expectations anchored. Inflation is projected to gradually return to target in the absence of additional shocks due to increased slack. Fiscal prudence will continue to keep public debt at a constant level. A renewed strategy to boost productivity and low potential growth is needed and should include stepping up efforts to improve the rule of law and competition. Raising education outcomes for all would also help make growth more inclusive. Increasing low female labour market participation by expanding good quality early childhood education and care would boost growth and inclusion. Overall, greater inclusion will require creating equality of opportunities for all, with a focus on under-privileged groups, such as the indigenous population and people with disabilities.

Economic activity has decelerated

Growth has fallen recently, owing to weak investment and lower export growth, as US imports have slowed. Trade tensions and policy uncertainty have also dented business confidence. Disruptions in gasoline supply, strikes and railroad blockades affected supply chains at the beginning of 2019. Energy and food prices keep putting pressure on headline inflation, which is still above target. However, inflation expectations and core inflation, the central bank's preferred measures, are already within the bank's variability interval, although the latter is falling only slowly.

Mexico



1. Core inflation excludes food and energy prices.
Source: OECD Economic Outlook 105 database; and INEGI.

StatLink https://doi.org/10.1787/888933934755

Mexico: Demand, output and prices

Mexico	2015	2016	2017	2018	2019	2020
	Current prices MXN billion	Percentage changes, volume (2013 prices)				
GDP at market prices	18 562.7	2.7	2.3	2.0	1.6	2.0
Private consumption	12 167.5	3.5	3.4	2.2	1.4	2.2
Government consumption	2 288.3	2.6	1.0	1.4	-0.6	0.3
Gross fixed capital formation	4 179.4	1.1	-1.6	0.6	-1.8	2.2
Final domestic demand	18 635.2	2.8	2.0	1.7	0.4	2.0
Stockbuilding[1]	308.7	0.1	0.0	0.1	0.0	0.0
Total domestic demand	18 943.9	2.9	1.9	1.8	0.4	1.9
Exports of goods and services	6 410.3	3.7	4.0	5.7	3.0	4.9
Imports of goods and services	6 791.5	2.4	6.7	6.2	4.2	4.5
Net exports[1]	- 381.2	0.4	-1.1	-0.3	-0.5	0.1
Memorandum items						
GDP deflator	_	5.5	6.7	5.3	4.0	3.8
Consumer price index	_	2.8	6.0	4.9	3.8	3.5
Core inflation index[2]	_	3.0	4.7	3.8	3.5	3.3
Unemployment rate[3] (% of labour force)	_	3.9	3.4	3.3	3.5	3.4
Public sector borrowing requirement[4]	_	-0.5	-1.1	-2.5	-2.4	-2.5
Current account balance (% of GDP)	_	-2.2	-1.7	-1.8	-1.9	-1.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding volatile items: agricultural, energy and tariffs approved by various levels of government.
3. Based on National Employment Survey.
4. Central government and public enterprises. In 2016 and 2017, the public sector borrowing requirement includes the operating surplus of the central bank.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935648

Containing public spending would stabilise debt and preserve confidence

A strong macroeconomic policy framework has supported the resilience of the economy amid several headwinds. The policy interest rate, which is at its highest level since the financial crisis, has prevented inflation from rising fast and helped to anchor inflation expectations. Inflation is projected to return progressively to target in the absence of further shocks as economic slack increases. The monetary authorities should remain vigilant to the evolution of core inflation, expectations and the balance of risks, and adjust the policy rate to a level consistent with reaching the inflation target.

Fiscal prudence is being maintained, and the government is committed to keeping the public debt-to-GDP ratio constant. As GDP growth has fallen and non-tax revenues are declining, spending adjustments will be necessary. Spending is shifting towards infrastructure, as the government plans to promote development in the southern regions and boost energy production. While private investment is being sought to upgrade ports and expand railroads, planned public investment in the energy sector is likely to be incompatible with a stable debt-to-GDP ratio, in the context of a rigid budget and no increase in taxation. Social spending has increased on the back of higher pension outlays and scholarships, but more investment is needed in schools in underprivileged areas, which would attenuate existing high inequalities in education services. Expanding good quality affordable early-childhood education and care is a priority to boost education outcomes and increase equity, as well as to facilitate the inclusion of women in the labour market. Efforts to continue improving the efficiency of tax collection, and reduce tax expenditures and exemptions should be pursued. Increasing the progressivity of personal income tax would enhance low tax collection and equity.

Growth is projected to increase modestly

Growth is set to rise modestly, supported by infrastructure investment and domestic consumption. Export growth will continue to support the economy, albeit at lower rates, consistent with a gradual slowdown in growth in the United States. Raising private investment is necessary to boost productivity and formal job growth. Improving the business environment is therefore a priority. Policy uncertainty, rising protectionism and the non-ratification of the trade agreement with the United States and Canada (USMCA) remain negative risks to the outlook, as they would dent exports and damp investment even further. On the other hand, more policy certainty, an improvement in the rule of law and competition, and a reduction in violence would support the business environment and lift well-being.

Netherlands

Economic growth is projected to slow considerably, to 1.6% in 2019 and 1.5% in 2020. A weakening external economic environment and increased international trade uncertainties are weighing on trade and investment growth. Deteriorating domestic conditions are contributing to projected labour market weakness, slow disposable income growth and tepid consumption.

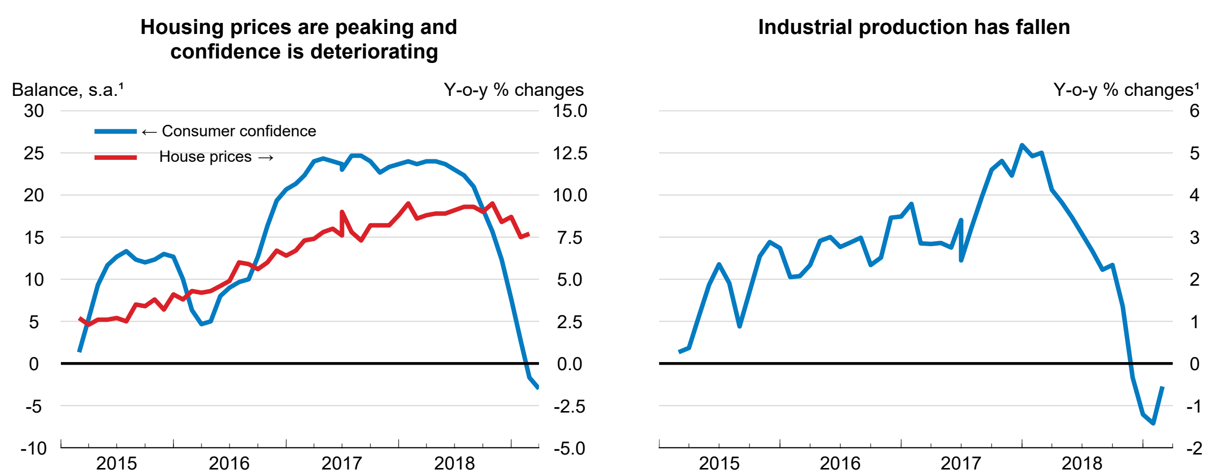
Fiscal space should be utilised to stimulate growth, which will also help reduce internal euro area imbalances. Labour market reforms, such as expanding supplementary social security coverage for the self-employed and improving the fairness of the tax system, would improve inclusiveness and protect the job security of vulnerable workers.

Heightened uncertainty and weak external demand are weighing on growth

Economic growth has weakened significantly. A sharp reversal in external demand throughout the second half of 2018 is having a large negative impact on trade growth and industrial production. Business confidence remains subdued and consumer confidence has been falling rapidly. Business investment slowed throughout the second half of 2018 and remains volatile. Slowing investment and a shrinking net trade balance pushed the current account surplus to nearly 12% of GDP in end-2018.

Private consumption has been robust, largely reflecting current labour market strength. Low unemployment and diminishing labour market slack are putting upward pressure on wages. Headline inflation has risen sharply reflecting the increased VAT rate, but core inflation is slowing somewhat. Housing price growth has moderated, following the increase in recent years.

Netherlands



1. Three-month moving average.
Source: Statistics Netherlands (CBS).

StatLink https://doi.org/10.1787/888933934774

Netherlands: Demand, production and prices

Netherlands	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	690.1	2.1	3.0	2.6	1.6	1.5
Private consumption	310.8	1.1	1.9	2.5	1.1	1.1
Government consumption	172.4	1.3	1.1	1.5	1.6	2.0
Gross fixed capital formation	152.7	-7.3	6.2	4.2	4.6	1.4
Final domestic demand	635.9	-0.9	2.6	2.6	2.1	1.4
Stockbuilding[1]	2.5	0.1	-0.3	0.1	0.2	0.0
Total domestic demand	638.3	-0.8	2.3	2.6	2.3	1.4
Exports of goods and services	570.4	1.5	5.6	2.6	1.1	2.0
Imports of goods and services	518.6	-2.1	5.2	2.7	1.8	2.0
Net exports[1]	51.8	2.8	0.9	0.3	-0.4	0.2
Memorandum items						
GDP deflator	_	0.5	1.2	2.2	2.4	1.4
Harmonised index of consumer prices	_	0.1	1.3	1.6	2.2	1.4
Harmonised index of core inflation[2]	_	0.6	0.8	1.0	1.5	1.4
Unemployment rate (% of labour force)	_	6.0	4.9	3.8	3.6	3.9
Household saving ratio, net[3] (% of disposable income)	_	9.9	9.0	9.1	9.2	9.9
General government financial balance (% of GDP)	_	0.0	1.2	1.5	1.2	0.8
General government gross debt (% of GDP)	_	76.6	69.8	64.5	61.9	60.2
General government debt, Maastricht definition (% of GDP)	_	61.9	56.9	52.4	49.8	48.1
Current account balance (% of GDP)	_	8.1	10.5	10.8	11.1	10.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Including savings in life insurance and pension schemes.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935667

Policy measures should reduce imbalances and improve inclusiveness

The current expansionary fiscal stance remains broadly appropriate given the deteriorating growth outlook, the large positive headline budget surplus and the favourable debt trajectory. Increased fiscal spending has provided some support to growth, although the level of spending in 2018 was much lower than was previously budgeted. The strong fiscal position could be further utilised to boost potential output through targeted investments in R&D and innovation and to mitigate the projected slowdown in growth, which would help to reduce the largest current account surplus as a share of GDP in the OECD.

A further slowing of, or negative, housing price growth could contribute to vulnerabilities in the financial system, reflecting the currently high levels of household debt and the high exposure of domestic banks to mortgage lending. The accelerated phase-out of mortgage interest rate deductibility should be complemented with a further decrease in the loan-to-value ratio for new mortgages to reduce these vulnerabilities. Measures to increase the number of rental properties in the private residential market would help to alleviate supply issues in that segment.

To improve the fairness of taxation and income security across different employment types, tax deductions for self-employment should be reduced and minimum sickness and disability insurance coverage for the self-employed should be introduced. To improve labour market inclusiveness, employment support should be targeted at vulnerable groups and a more coordinated approach to implementing activation policies would improve inter-regional labour mobility. Paid paternity leave should be further expanded and provisions to keep childcare affordable for two-earner households should be strengthened to address the large gender disparity in part-time work.

Growth is projected to slow sharply

Growth is projected to slow in 2019 and remain subdued in 2020, reflecting modest economic growth in Europe and a rapid deterioration in consumer confidence. Private consumption will weaken and unemployment will rise gradually. Business investment is projected to soften, reflecting the worsening trade environment. Residential investment is expected to slow down sharply. Uncertainties related to Brexit represent sizeable negative risks to the projection. A sharper-than-expected deceleration in house price growth poses a significant risk to financial stability given high household indebtedness.

New Zealand

Economic growth is projected to remain around 2½ per cent. Consumption is set to slow as net migration falls and the effect of increased financial support for families fades. Exports will pick up gradually, but less so than imports, as global growth eases. Business investment is expected to recover in the face of capacity constraints, while strong housing investment continues to meet shortages.

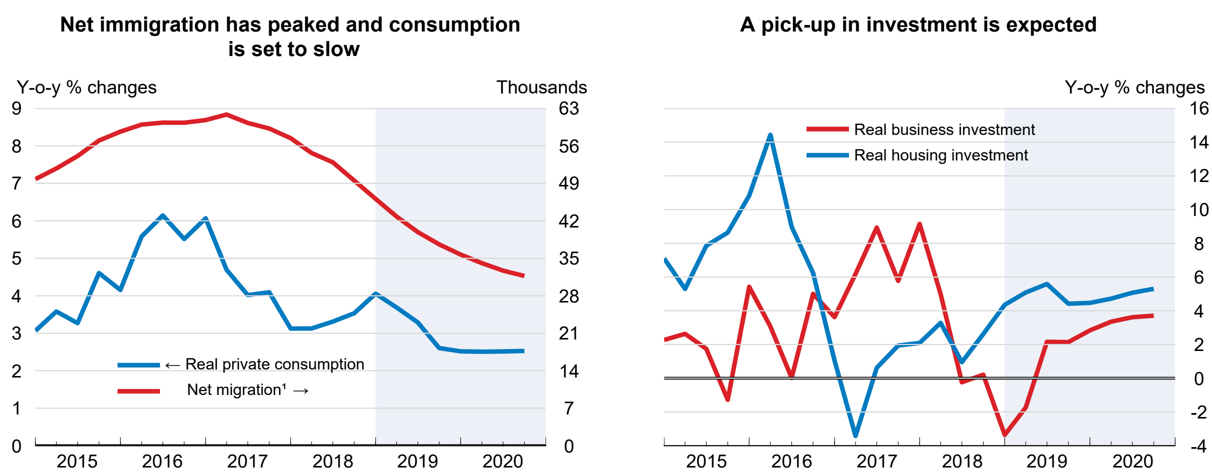
Fiscal policy is broadly neutral in 2019 and moderately contractionary in 2020, which is appropriate given the lack of domestic slack. Despite capacity pressures and core inflation close to its target midpoint, the central bank cut the policy rate in May, reflecting recent weaker domestic spending and the risk that the outlook for trading partner economies could deteriorate further.

Growth has stabilised and capacity is tight

Economic growth stabilised at around 2½ per cent (year-on-year) in late 2018. Increased transfer payments through the Families Package have temporarily boosted private consumption, as have historically high net immigration flows. Immigration has also contributed to a pick-up in housing investment to meet accumulated shortages. Poor business confidence has held back business investment despite capacity pressures, contributing to subdued imports. Export growth has remained steady despite softening global growth, with prices for New Zealand's commodity exports remaining strong.

The labour market is tight. Unemployment is just below the estimated structural rate, while nominal wage growth picked up during 2018 but remains moderate. Consumer price inflation is close to the midpoint of the Reserve Bank's target band, with some near-term softness expected from oil price declines.

New Zealand



1. RBNZ projections. Net migration data are for the working-age population.
Source: Reserve Bank of New Zealand (2019), Monetary Policy Statement, February; and OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934793

New Zealand: Demand, output and prices

New Zealand	2015 Current prices NZD billion	2016	2017	2018	2019	2020
		Percentage changes, volume (2009/2010 prices)				
GDP at market prices	250.5	4.2	2.7	2.8	2.6	2.5
Private consumption	144.3	5.4	4.7	3.3	3.4	2.5
Government consumption	46.4	2.0	2.9	2.2	2.1	1.4
Gross fixed capital formation	57.1	4.3	3.5	3.8	2.0	3.2
Final domestic demand	247.9	4.5	4.1	3.2	2.8	2.5
Stockbuilding[1]	0.6	0.1	-0.1	0.4	-0.7	0.0
Total domestic demand	248.4	4.6	4.0	3.6	2.1	2.5
Exports of goods and services	70.3	2.1	1.8	3.0	2.4	2.9
Imports of goods and services	68.3	3.4	6.9	5.5	0.0	3.1
Net exports[1]	2.0	-0.3	-1.3	-0.6	0.7	0.0
Memorandum items						
GDP deflator	_	1.8	3.5	1.1	1.4	2.1
Consumer price index	_	0.6	1.9	1.6	1.5	2.1
Core inflation index[2]	_	1.4	1.4	1.2	1.6	2.0
Unemployment rate (% of labour force)	_	5.1	4.7	4.3	4.2	4.3
Household saving ratio, net (% of disposable income)	_	0.1	-1.4	-1.0	-1.0	-0.9
General government financial balance (% of GDP)	_	1.2	1.1	0.1	-0.4	0.1
General government gross debt (% of GDP)	_	37.7	36.1	36.2	36.6	36.5
Current account balance (% of GDP)	_	-2.2	-2.9	-3.7	-2.9	-2.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935686

Fiscal support will ease as the minimum wage is ramped up

Fiscal policy was expansionary in 2018 due to a pick-up in spending. The fiscal stance is projected to become moderately contractionary by 2020 as spending slows absent substantial further discretionary measures, allowing tax receipts to catch up as economic growth continues. Residential construction will be supported by the government's KiwiBuild programme, but a lack of construction industry capacity means that some crowding out of private activity is inevitable. The government will release the country's first Well-Being Budget in late May 2019, with selection of priorities and spending proposals informed by well-being analysis.

Monetary policy has become more expansionary, with the policy interest rate recently cut by a further 25 basis points. Market expectations include another rate cut in 2019. However, the case for a further cut is not strong unless there is further deterioration in global economic conditions, as inflation, unemployment and the gap between potential and actual output are projected to remain steady at levels consistent with Reserve Bank targets. The government raised the minimum hourly wage by 7% in April 2019 and plans a similar hike in April 2020. This will push up overall wage growth (increasingly so as a greater share of the workforce is affected) and slow employment growth. To sustain higher wages, productivity growth needs to be revived through structural reforms such as reducing barriers to foreign direct investment, facilitating competition and increasing support for business innovation.

Growth is projected to remain steady

The main drivers of growth are set to shift from private consumption and government spending toward business and housing investment. Private consumption is projected to slow despite solid wage growth, as reduced employment creation weighs on disposable income growth. Higher-than-anticipated immigration is an upward risk that would support stronger consumption and housing investment, especially if it contributed to a resumption of strong house price growth. Growth would be lower if poor business confidence resulted in sustained weakness in business investment, or if a greater-than-anticipated slowing in global growth led to a fall in demand for New Zealand's commodity exports. Further house price falls in Australia have the potential to negatively affect the New Zealand economy via the countries' close financial and trade links.

Norway

Mainland GDP growth will ease slightly as capacity constraints bind further. GDP growth will remain above trend and the narrowing of spare capacity will transmit into higher wage growth and continued reductions in unemployment.

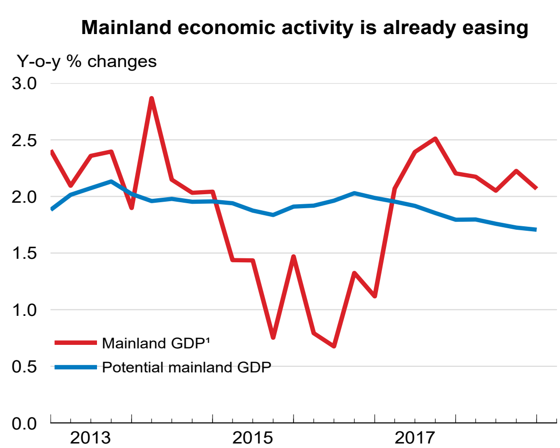
Given above-trend growth, Norges Bank's gradual tightening of monetary conditions and the neutral stance of fiscal policy are appropriate. However, the authorities must remain vigilant given the risks surrounding the housing market and mortgage borrowing, along with elevated oil-price uncertainties amid the weakening global outlook. Structural policy should focus on improving the employment prospects of vulnerable groups and public-sector spending efficiency.

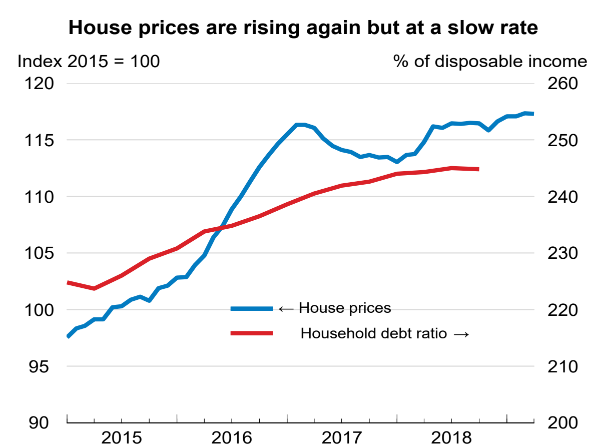
Economic growth has eased somewhat

Mainland output growth (i.e. abstracting from oil and gas production) has eased a little in recent quarters but remains above potential. Labour and product markets continue to tighten. The rate of unemployment is falling, wage growth is picking up and headline inflation has moved above the 2% target, partly due to exchange-rate depreciation. Rising oil prices following the end-2018 low point are reviving oil-related activity. Solid household consumption growth and a bottoming out of housing construction have supported overall activity. In addition, import growth has been comparatively weak. Recent non-oil export data show a mixed picture, pointing to weakness in services but strength in goods.

House-price increases have resumed following some downward adjustment, but at a moderate pace. However, the stock of unsold houses remains high and properties are taking longer to sell, which may foreshadow a further downward correction. The debt-to-income ratio among households remains elevated.

Norway





1. Estimates for 2019Q1.

Source: OECD Economic Outlook 105 database; Statistics Norway; and Real Estate Norway (Eiendom Norge).

StatLink https://doi.org/10.1787/888933934812

Norway: Demand, production and prices

Norway	2015	2016	2017	2018	2019	2020
	Current prices NOK billion	Percentage changes, volume (2016 prices)				
Mainland GDP at market prices[1]	2 621.0	1.1	2.0	2.2	2.0	1.9
Total GDP at market prices	3 118.1	1.2	2.0	1.4	1.8	2.1
Private consumption	1 353.7	1.3	2.2	2.0	1.6	1.9
Government consumption	729.3	2.1	2.5	1.5	1.4	2.0
Gross fixed capital formation	741.4	5.2	3.6	0.9	2.7	2.3
Final domestic demand	2 824.4	2.5	2.6	1.6	1.8	2.0
Stockbuilding[2]	118.3	-0.5	0.1	0.5	0.2	0.0
Total domestic demand	2 942.7	2.0	2.6	2.0	2.0	2.0
Exports of goods and services	1 176.1	1.1	-0.2	-0.8	0.7	2.3
Imports of goods and services	1 000.7	3.3	1.6	0.9	1.4	2.0
Net exports[2]	175.4	-0.7	-0.6	-0.6	-0.2	0.2
Memorandum items						
GDP deflator	_	-1.1	3.9	5.6	1.9	2.2
Consumer price index	_	3.5	1.9	2.8	2.5	2.1
Core inflation index[3]	_	3.3	1.7	1.2	2.3	2.1
Unemployment rate (% of labour force)	_	4.7	4.2	3.8	3.6	3.5
Household saving ratio, net (% of disposable income)	_	7.3	6.7	6.5	6.3	5.8
General government financial balance (% of GDP)	_	4.0	4.9	7.2	7.8	7.8
General government gross debt (% of GDP)	_	42.5	43.0	45.7	..	..
Current account balance (% of GDP)	_	4.0	5.6	8.1	7.9	8.1

1. GDP excluding oil and shipping.
2. Contributions to changes in real GDP, actual amount in the first column.
3. Consumer price index excluding food and energy.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935705

Fiscal and monetary support has been reduced

Central government fiscal budget outcomes for 2018 confirm the successful switch to a neutral fiscal stance to reflect the upswing in output growth and to ensure adherence to the fiscal rule -- that the structural deficit over time should equal 3% of the value of the oil fund (the Government Pension Fund Global). The structural deficit has in recent years been kept below the 3% reference line and the government is expected to continue its neutral stance, provided above-trend growth continues. Norges Bank is expected to follow up on the two rate increases since September 2018 (the latest, a policy-rate increase from 0.75% to 1% in March) with some further tightening.

Tightening labour market conditions are laying bare labour supply and skills issues. A government-appointed commission has made wide-ranging recommendations, many aimed at resolving the policy-design issues that have resulted in elevated numbers of sick-leave and disability-benefit claimants — many of them from vulnerable segments of society. Greater attention to public-spending efficiency will be needed as budget challenges intensify over the longer term due to the prospect of a steady decline in the value of the oil fund relative to GDP, public-spending pressures from population ageing and tax-base shrinkage, notably in vehicle (and related fuel) taxation.

Mainland output growth will ease amidst substantial downside risks

Mainland output growth is projected to remain above potential but will ease to around 2% in 2019 and 2020. Capacity constraints will intensify further, including additional falls in the rate of unemployment. Consumer-price inflation will decline in the near term as price pressures from exchange-rate depreciation wear off, but then rise again gradually.

Risks to the outlook are weighed on the downside. Weaker global economic prospects may lower oil prices, feeding through to incomes and output, although the petroleum sector's substantial cost reductions have increased resilience to this type of shock. A more extensive downturn in Europe could further dent non-oil exports. Also, substantial adjustment of the housing market and the potential for a negative fall-out from the large amount of household credit remain sizeable risks, particularly for household consumption. Meanwhile, wage growth may be stronger than expected, boosting overall demand and cushioning any negative feedback from the housing market.

Poland

Economic growth will decline to a still robust pace of 4.2% in 2019 and 3.5% in 2020, in part due to the wider slowdown in Europe. The decline in world trade growth will weigh on exports. However, an increase in social transfers and tax cuts will bolster private consumption. Accelerating wages will underpin a pick-up in inflation.

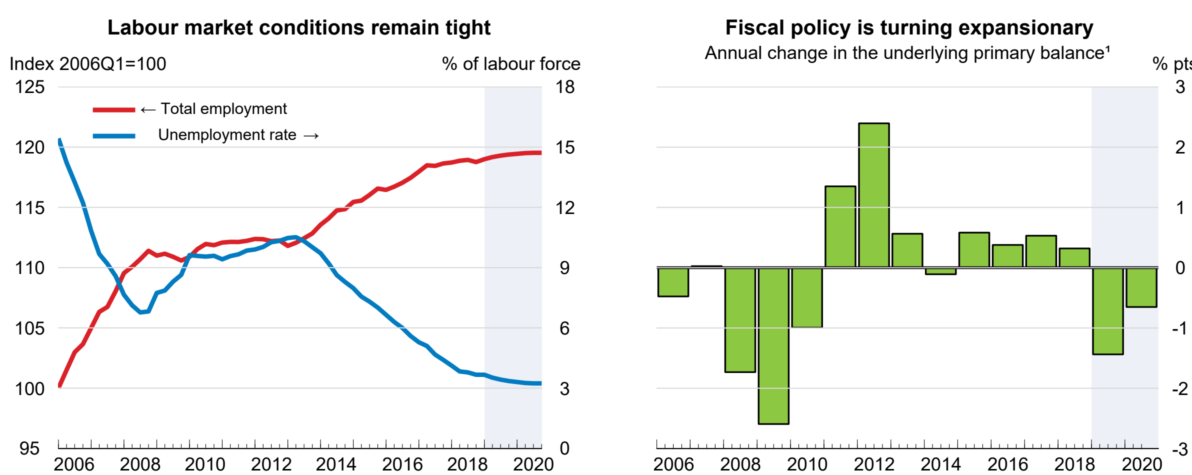
Fiscal policy is turning expansionary in 2019-20, widening the budget deficit despite strong economic growth. A tighter fiscal stance would be desirable to confront demographic challenges and strengthen the fiscal position to tackle a potential downturn. The central bank is projected to gradually increase interest rates to counter rising inflationary pressures. Policies will need to bolster seniors' and female employment, while favouring skilled immigration.

Domestic demand is driving growth

GDP growth peaked at 5.1% in 2018, the strongest annual growth since 2007. Domestic demand remains strong, with private consumption growing firmly thanks to a booming labour market, and investment being supported by fast disbursements of EU funds and accommodative monetary policy. However, the slowdown in the euro area has reduced export growth.

The labour market remains tight, as gains in employment and a shrinking labour force have led to record-low levels of unemployment. Firms increasingly report labour shortages as a factor limiting production in the manufacturing sector. Underlying inflation remains low, even though it has picked up of late.

Poland



1. Measured in percentage points of potential GDP.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934831

Poland: Demand, production and prices

Poland	2015	2016	2017	2018	2019	2020
	Current prices PLN billion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 800.2	3.1	4.8	5.1	4.2	3.5
Private consumption	1 051.5	3.9	4.9	4.5	4.7	4.2
Government consumption	324.7	1.9	3.5	3.6	5.3	4.8
Gross fixed capital formation	361.5	-8.2	3.9	7.3	5.8	5.6
Final domestic demand	1 737.7	1.0	4.4	4.9	5.0	4.6
Stockbuilding[1]	6.8	1.2	0.5	0.7	0.0	0.0
Total domestic demand	1 744.5	2.3	4.9	5.5	4.9	4.5
Exports of goods and services	891.1	8.8	9.5	6.2	6.3	4.9
Imports of goods and services	835.4	7.6	10.0	7.0	6.9	6.8
Net exports[1]	55.7	0.8	0.1	-0.1	-0.1	-0.9
Memorandum items						
GDP deflator	_	0.3	2.0	1.3	2.2	3.2
Consumer price index	_	-0.7	2.1	1.8	1.9	3.0
Core inflation index[2]	_	-0.2	0.7	0.8	1.7	2.9
Unemployment rate (% of labour force)	_	6.1	4.9	3.9	3.5	3.3
Household saving ratio, net (% of disposable income)	_	1.5	-0.9	-0.4	0.9	1.3
General government financial balance (% of GDP)	_	-2.2	-1.5	-0.4	-1.4	-1.0
General government debt, Maastricht definition (% of GDP)	_	54.2	50.6	48.9	47.9	46.6
Current account balance (% of GDP)	_	-0.5	0.1	-0.7	-1.2	-1.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935724

Structural reforms would help to raise long-term growth

Fiscal policy is turning strongly expansionary, as the authorities have unveiled a major fiscal stimulus package. The 500+ programme will no longer be means-tested for the first child from July 2019, pensioners will receive a one-off bonus in 2019, and there will be cuts to personal income taxes from 2020. However, one-off revenues, notably due to changes in the pension system, will reduce the budget deficit by about one percentage point of GDP in 2020, and an increase in social security contributions will also limit the budget deficit in 2020. Even so, a tighter fiscal stance would be appropriate. Eliminating some of the reduced VAT rates that do not benefit low-income households and ending the preferential tax treatment for the self-employed would raise revenues. Implementing broad-based spending reviews and reviewing energy subsidies would help achieve budget savings. Monetary policy has been appropriately accommodative given subdued inflationary pressures. Yet, wages are projected to accelerate further, reflecting binding capacity constraints and public-sector pay rises. The central bank is assumed to initiate a tightening cycle from the summer of 2019 to counter rising inflationary pressures.

To address the decline in the working-age population, the authorities will need to increase women's labour force participation, raise the effective retirement age and put in place policies in favour of high-skilled immigrants. Increasing access to high-quality early childcare will facilitate combining work with family life and improve opportunities for under-privileged children. Strong immigration from neighbours in Eastern Europe is alleviating labour shortages, but putting in place comprehensive monitoring and integration policies would help Poland attract and retain skilled migrants. Stepping up efforts to inform the public about the impact of working longer on pension income would contribute to increasing the effective retirement age. Making corrections to the pension system, such as aligning male and female retirement ages and indexing them to life expectancy, would also help address demographic challenges. Participation in adult training is limited, and there is a need to boost digital skills, notably among older workers. Raising skills by promoting lifelong learning would create more learning opportunities in line with labour market needs and enhance long-term employment prospects.

Growth is projected to moderate

Output growth is projected to gradually ease. Private consumption will continue to grow strongly thanks to the tight labour market and rising social transfers. However, investment growth will moderate on the back of lower absorption of EU funds and less supportive export prospects. Import growth is projected to outpace increases in exports, widening the current account deficit. Downside risks include a possible decline in the inflow of foreign workers, which could spur labour shortages and be a drag on growth. On the other hand, a faster growth in private consumption is a key upside risk as wage pressures could accelerate more than projected on the back of a booming labour market.

Portugal

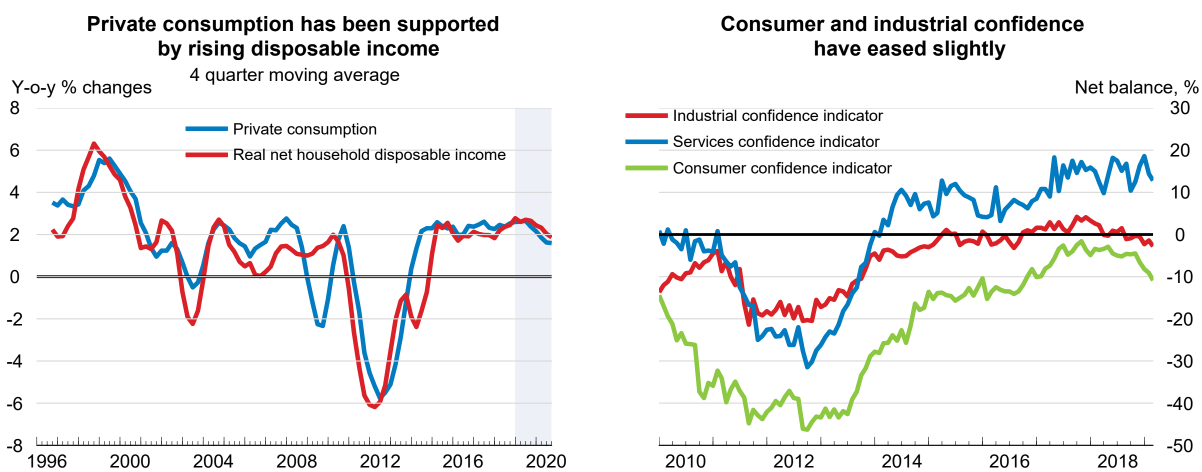
Economic growth is projected to remain stable, at 1.8-1.9% in 2019 and 2020. Private consumption will continue to rise in response to persistent employment growth and, more recently, wage increases. Business investment growth should remain robust, on the back of strong corporate profits and accommodative financial conditions. Nonetheless, export growth will slow amid weakening economic activity in Portugal's major trading partners.

Fiscal policy will modestly support economic growth in 2019 and 2020. Nevertheless, public debt reduction should continue to be prioritised, partly through introducing new productivity-enhancing policy changes. Existing regulations in some sectors, including professional services and transport, should be reformed to reduce the cost of intermediate inputs used by businesses. At the same time, reforms to the judiciary and the vocational education and training system should be further pursued.

Consumer spending has been driven by improved labour market conditions

The economy continues to expand rapidly, with employment growth and rising real disposable incomes supporting private consumption. While export growth softened in late 2018, this partly reflected industrial action at the Port of Setúbal in November and December that temporarily restricted automobile exports. Imports have been rising strongly, especially of machinery and equipment. Industrial and consumer confidence remain at high levels relative to the 2014-16 period, but have eased slightly since mid-2018.

Portugal



Source: OECD Economic Outlook 105 database; and European Commission, Economic Sentiment Indicator.

StatLink https://doi.org/10.1787/888933934850

Portugal: Demand, production and prices

Portugal	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2011 prices)				
GDP at market prices	179.8	1.9	2.8	2.1	1.8	1.9
Private consumption	117.7	2.4	2.3	2.5	2.4	1.6
Government consumption	32.6	0.8	0.2	0.8	0.2	0.6
Gross fixed capital formation	27.8	2.3	9.2	4.4	6.0	5.5
Final domestic demand	178.2	2.1	3.0	2.6	2.6	2.1
Stockbuilding[1]	0.6	-0.1	0.0	0.2	0.1	0.0
Total domestic demand	178.8	2.0	3.0	2.8	2.7	2.1
Exports of goods and services	72.6	4.4	7.8	3.6	2.4	4.0
Imports of goods and services	71.6	4.7	8.1	4.9	4.1	4.4
Net exports[1]	1.0	-0.1	0.0	-0.5	-0.8	-0.2
Memorandum items						
GDP deflator	_	1.8	1.5	1.4	1.1	1.6
Harmonised index of consumer prices	_	0.6	1.6	1.2	0.7	1.3
Harmonised index of core inflation[2]	_	0.9	1.2	0.8	0.8	1.3
Unemployment rate (% of labour force)	_	11.1	8.9	7.0	6.3	5.9
Household saving ratio, net (% of disposable income)	_	-3.7	-4.1	-4.2	-3.9	-3.6
General government financial balance[3] (% of GDP)	_	-2.0	-3.0	-0.5	-0.5	-0.2
General government gross debt (% of GDP)	_	146.7	146.9	140.8	138.2	135.0
General government debt, Maastricht definition (% of GDP)	_	129.2	124.8	121.5	118.9	115.7
Current account balance (% of GDP)	_	0.6	0.5	-0.6	-1.1	-0.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Based on national accounts definition.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935743

Domestic factors are supporting growth

Fiscal policy is expected to support economic growth in 2019 and 2020. The deep temporary cuts to public sector wages at the height of the crisis have now been reversed, public employment is rising again and new changes to tax and benefits policies will support disposable income growth. Investment activity will be bolstered by increased absorption of EU funds over the next few years. Reviving public investment projects with high economic returns is key given Portugal's rapidly ageing population and sluggish productivity growth.

Financial conditions in the business sector have improved: return on equity has increased over the past few years, especially for small and medium enterprises, and borrowing costs continue to decline. Following a sustained period of corporate deleveraging, businesses are now in a good financial position to undertake new investment projects.

New productivity-enhancing reforms could further reduce costs for businesses. Various professional services are both strictly regulated and represented by the same professional association. Independent supervisory bodies should be established that approve any new regulations that they propose. At ports, concession contracts can be awarded that give exclusive rights to private contractors of port services. However, these are often excessive in their duration, reducing the potential for market entrants that can provide higher quality services to Portuguese enterprises.

Economic growth is projected to remain solid

GDP growth is projected to be 1.8% in 2019 and 1.9% in 2020, with continued improvements in labour market conditions supporting private consumption. A gradual further reduction in economic slack will prompt a slight increase in inflation over the coming years. Economic growth in export markets such as Spain, Germany and the United Kingdom is expected to slow, providing a headwind to export growth.

Risks to the outlook include a tightening of financial conditions. In particular, an increase in market interest rates may dent business and household spending and lead to an increase in the stock of non-performing loans on bank balance sheets. On the upside, further improvements in the competitiveness of Portuguese exports could result in larger gains in export market share.

Slovak Republic

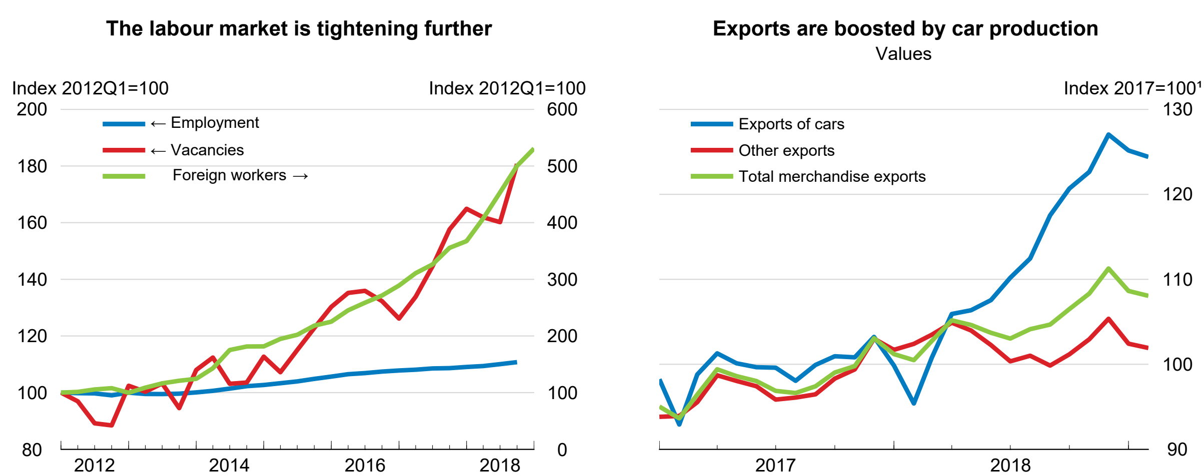
Growth is projected to remain strong over the next two years, driven mainly by domestic demand. Low unemployment and rising wages will support household consumption. Investment growth will remain solid, underpinned by favorable financial conditions and by the disbursement of EU structural funds. External demand is weakening, but the launch of a new production line in the automotive sector will support gains in export market shares. Consumer price inflation will remain above 2% as the labour market tightens further.

The government should reach budget balance by 2019 as planned, given the absence of spare capacity and medium-term challenges posed by population ageing. However, if downside risks were to materialise, fiscal policy should stand ready to mitigate the downturn. The government also needs to enhance public-sector efficiency. In particular, education reform and measures to enhance Roma integration are important to make growth more inclusive.

Growth is moderating but still robust

Economic growth slowed at the end of 2018 due to a weaker external environment, but domestic demand remains strong. Investment activity has increased, fuelled by a faster absorption of EU funds, favourable financial conditions and continuous investment in car manufacturing. Household consumption continues to expand on the back of a buoyant labour market. Employment growth has slowed somewhat, reflecting persistent labour shortages. New production capacity in the automotive sector has boosted exports despite a weaker external environment. Imports have been growing faster than exports, reflecting import-intensive investment and strong household consumption. Inflation moderated at the end of 2018, mainly as a result of a decline in food price inflation, but it remains above 2%.

Slovak Republic



1. Six-month moving average.

Source: OECD Economic Outlook 105 database; Eurostat; Central Office of Labour, Social Affairs and Family; and Statistical office of the Slovak Republic.

StatLink https://doi.org/10.1787/888933934869

Slovak Republic: Demand, production and prices

Slovak Republic	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	79.1	3.1	3.2	4.1	3.5	3.4
Private consumption	43.2	2.9	3.5	3.0	3.4	3.6
Government consumption	15.3	1.6	1.7	1.9	2.1	2.0
Gross fixed capital formation	19.2	-9.4	3.4	6.8	3.9	4.0
Final domestic demand	77.7	-0.4	3.1	3.6	3.2	3.3
Stockbuilding[1]	0.2	1.5	-0.5	0.5	0.2	0.0
Total domestic demand	78.0	1.2	2.6	4.2	3.4	3.3
Exports of goods and services	73.1	5.5	5.9	4.8	5.7	5.0
Imports of goods and services	71.9	3.4	5.3	5.3	6.0	4.9
Net exports[1]	1.2	2.0	0.7	-0.3	-0.2	0.2
Memorandum items						
GDP deflator	_	-0.5	1.2	2.1	2.4	3.0
Harmonised index of consumer prices	_	-0.5	1.4	2.5	2.6	2.7
Harmonised index of core inflation[2]	_	0.9	1.4	2.0	1.8	2.7
Unemployment rate (% of labour force)	_	9.6	8.1	6.5	5.8	5.5
Household saving ratio, net (% of disposable income)	_	3.0	2.4	2.9	2.9	2.8
General government financial balance (% of GDP)	_	-2.2	-0.8	-0.7	0.0	0.0
General government gross debt (% of GDP)	_	59.8	58.2	56.3	54.4	52.4
General government debt, Maastricht definition (% of GDP)	_	51.8	50.9	48.9	47.1	45.1
Current account balance (% of GDP)	_	-2.2	-2.0	-2.5	-1.9	-2.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935762

Fiscal policy should remain prudent

The government's fiscal policy objective is to reach a balanced budget by 2019, but the risk of slippage has increased. The government should maintain its objective, given robust economic growth and the medium-term challenges posed by rapid population ageing. The Slovak Republic has one of the fastest ageing populations in the OECD, which will significantly increase ageing-related spending in the future. The recent change to the constitution, which prevents increasing the pension age above the age of 64, will add to these fiscal pressures. A prudent fiscal stance would also make more room for manoeuvre in the event of shocks, as Slovakia's open economy is very much exposed to international trade tensions and volatility. If downside risks materialised and growth slowed significantly, fiscal policy should stand ready to limit the downturn.

Priority spending should be financed by a combination of expenditure switching and improved efficiency. The government should also persist in its efforts to improve tax collection. Structural reforms are needed particularly in the area of education and more needs to be done to improve the well-being of Roma, who suffer from significant social exclusion. Early-childhood education and better-trained teachers are necessary parts of such reforms.

Growth is projected to remain robust

Growth will remain robust, but slow somewhat as the effects of new production capacity in the car industry will fade. Export growth is expected to decelerate in 2020. Private consumption will continue to grow strongly thanks to strong employment and wage growth, supported by the substantial increase in public sector wages in 2019 and 2020. Investment activity will benefit from the rising absorption of EU funds and from the increase in defence expenditure. Narrowing spare capacity will gradually push consumer price inflation towards 3%. The main risk is on the external side, as the Slovak economy is particularly exposed to any disruption in trade, given its inclusion in global value chains and significant reliance on the automotive sector. On the upside, supportive financial conditions and rising wages could strengthen private domestic demand even more than projected.

Slovenia

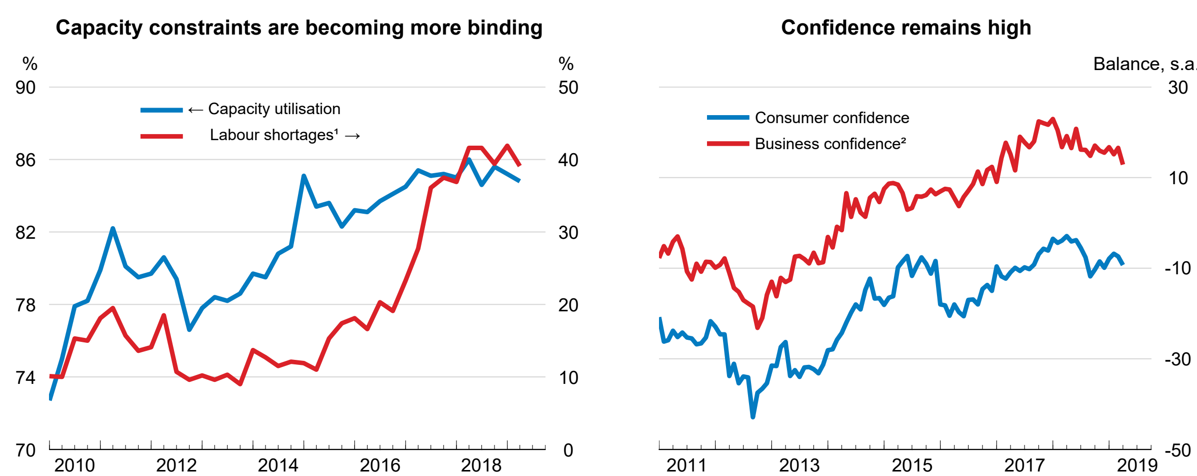
Economic growth is projected to slow to around 3½ per cent this year and just over 3% in 2020. Private consumption will be supported by continued income gains from real wage and employment growth, while private investments will be underpinned by the business sector's need to expand capacity and favourable financing conditions. The maturing of the recovery is reflected in increasing labour shortages and tightening capacity constraints, leading demand to be increasingly satisfied through higher imports.

The fiscal stance is expansionary in 2019 and neutral the following year. As monetary conditions remain extremely accommodative, a tighter of the fiscal stance is needed to contain inflationary pressures and secure fiscal sustainability. Measures, such as restricting pathways to early retirement and accelerating the privatisation process, would contribute to mobilising under-utilised labour resources and free up workers to faster growing industries.

The recovery is maturing

Economic growth remains strong, underpinned by solid domestic demand. Private consumption is supported by improving labour market conditions, higher real wage growth and upbeat consumer confidence. Strong investment growth is sustained by EU structural funds, the need to expand production capacity, and favourable financing conditions. Export growth is moderating along with slower foreign demand. Until now, wage growth has picked up only moderately. Consumer price inflation dipped to 1.6% in early 2019, under the influence of lower energy prices, and core inflation has remained stable.

Slovenia



1. Percentage of manufacturing firms pointing to labour shortages as a factor limiting production.
2. Unweighted average of sentiment in construction, retail trade, services and manufacturing sector.
Source: Eurostat Industry database; and OECD Main Economic Indicators.

StatLink https://doi.org/10.1787/888933934888

Slovenia: Demand, output and prices

Slovenia	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	38.9	3.1	4.9	4.5	3.4	3.1
Private consumption	20.8	3.9	1.9	2.2	3.0	3.1
Government consumption	7.2	2.7	0.5	2.6	2.2	1.9
Gross fixed capital formation	7.3	-3.7	10.7	10.6	8.0	7.2
Final domestic demand	35.3	2.1	3.3	4.1	4.0	3.8
Stockbuilding[1]	0.2	0.7	0.6	0.6	0.3	0.0
Total domestic demand	35.5	2.9	3.9	4.6	4.2	3.7
Exports of goods and services	29.9	6.4	10.7	7.2	5.2	5.9
Imports of goods and services	26.6	6.6	10.3	7.7	5.8	7.0
Net exports[1]	3.3	0.5	1.3	0.3	0.1	-0.3
Memorandum items						
GDP deflator	_	0.8	1.6	2.3	2.4	2.7
Harmonised index of consumer prices	_	-0.2	1.6	1.9	1.4	2.1
Harmonised index of core inflation[2]	_	0.7	0.7	1.0	1.7	2.0
Unemployment rate (% of labour force)	_	8.0	6.6	5.1	4.2	3.7
Household saving ratio, net (% of disposable income)	_	5.1	6.2	7.8	7.2	7.3
General government financial balance (% of GDP)	_	-1.9	0.0	0.7	0.7	1.0
General government gross debt (% of GDP)	_	97.7	89.2	83.3	81.2	79.0
General government debt, Maastricht definition (% of GDP)	_	78.7	74.1	70.1	66.3	62.0
Current account balance (% of GDP)	_	5.5	7.2	7.3	7.3	6.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935781

Employment continues to rise and unemployment is falling further, inducing higher labour force participation and the hiring of foreign nationals. Nonetheless, labour shortages and capacity utilisation remain at their highest level in a decade. Despite that, confidence remains high. Wage growth is set to rise, as the government and social partners agreed to increase minimum wages by 10% by end-2020 and public sector wages by about 4% in 2019.

Fiscal tightening would limit the risk of overheating

Financing conditions remain favourable with the highly accommodative ECB monetary policy, and long-term interest rates continue to fluctuate slightly below 1%. At the same time, the quality of banks' assets is improving, contributing to stronger financial resilience. Fiscal policy continues to be expansionary with increases in social transfers and public sector wages. A tighter stance is required to limit the risks of overheating and to improve fiscal sustainability.

To address increasing labour shortages, better training and activation policies are needed to mobilise under-utilised labour resources, such as low-skilled workers and the long-term unemployed. Restricting pathways to early retirement for older workers and strengthening re-training opportunities could also help relieve skill shortages. Further privatisation efforts are required to free up resources for sectors with high growth potential. This should be combined with measures to improve the functioning of the housing rental market to enable workers to move to locations with strong job growth.

Growth will slow

GDP growth is projected to slow over the forecast period. Due to domestic capacity constraints, robust private consumption and investment growth will increasingly be satisfied through higher imports. Export growth will ease in the face of weaker global demand growth and rising unit labour costs. The unemployment rate will fall further below its natural rate, leading to accelerating wage growth over the projection period, feeding into price inflation. The main upside risk is a lower-than-expected household saving rate, which would lead to stronger private consumption growth. Downside risks stem primarily from lower-than-expected productivity gains from the expansion of the capital stock, leading to a deterioration in external competitiveness and export performance. As house prices have increased substantially in the last year, an abrupt correction in the real estate market could also have negative repercussions on demand and growth.

South Africa

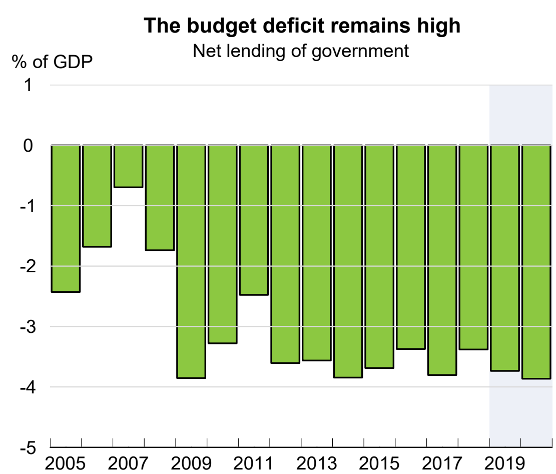
Economic growth will remain sluggish throughout 2019 and 2020. Private consumption will expand on the back of moderate increases in real wages and disposable household income. Policy uncertainty around the land reform is assumed to fade with a clarification of the reform agenda following the general election, and investment is projected to pick up as confidence recovers. Exports will improve, benefitting from the recovery in international commodity prices. Inflation will pick up moderately due to rising food and electricity prices.

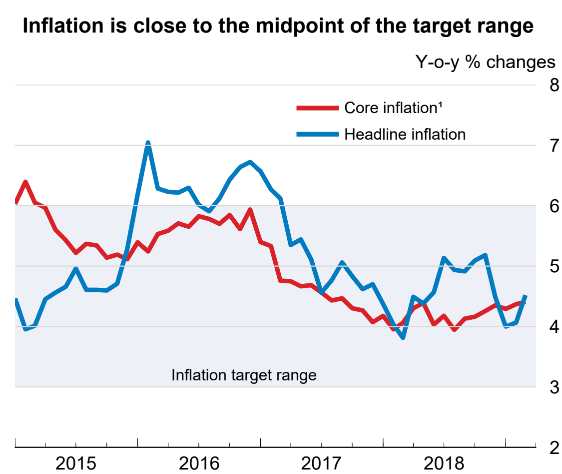
Despite the recent slowdown in inflation and only moderate upward risks, the Reserve Bank has left the policy rate unchanged to anchor inflation closer to the midpoint of the inflation target range (3-6%). If inflation expectations continue to be anchored, the Reserve Bank could consider adjusting monetary policy. The government budget remains constrained due to relatively high public debt, limiting fiscal policy room to manoeuver. Structural policy reforms that reduce barriers to competition and boost job creation are key to support growth.

Weak investment hampers growth

The economy slowed down in 2018. Investment declined on the back of policy uncertainty around the land reform and unstable electricity supply. Business confidence continued to deteriorate at the beginning of 2019 but is expected to improve following the recent election. Investment will pick up modestly throughout the year and should accelerate in 2020. Exports and household consumption are the main drivers of growth. An increase in commodity prices boosted exports during the second half of 2018 and should further contribute to growth in 2019. However, constrained electricity supply, if continued, will weaken production in 2019. Wage growth should remain modest as inflation expectations are anchored and unemployment continues to be high.

South Africa





1. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database; and Statistics South Africa.

StatLink https://doi.org/10.1787/888933934907

South Africa: Demand, output and prices

South Africa	2015	2016	2017	2018	2019	2020
	Current prices ZAR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 042.6	0.4	1.4	0.8	1.2	1.7
Private consumption	2 420.1	0.6	2.1	1.8	1.6	1.9
Government consumption	828.4	2.2	0.2	1.9	0.8	1.0
Gross fixed capital formation	822.6	-3.5	1.0	-1.4	0.0	3.0
Final domestic demand	4 071.1	0.1	1.5	1.2	1.1	1.9
Stockbuilding[1]	24.6	-1.0	0.4	-0.2	-1.4	0.0
Total domestic demand	4 095.7	-0.9	1.9	1.0	-0.3	1.9
Exports of goods and services	1 221.2	0.4	-0.7	2.6	5.8	3.0
Imports of goods and services	1 274.3	-3.9	1.0	3.3	0.7	3.6
Net exports[1]	- 53.1	1.3	-0.5	-0.2	1.5	-0.2
Memorandum items						
GDP deflator	_	7.1	5.6	3.3	4.3	4.5
Consumer price index	_	6.3	5.3	4.6	4.8	4.9
Core inflation index[2]	_	5.7	4.6	4.2	4.3	4.5
General government financial balance (% of GDP)	_	-3.4	-3.8	-3.4	-3.7	-3.9
Current account balance (% of GDP)	_	-2.9	-2.5	-3.6	-3.4	-3.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935800

The tight fiscal space calls for structural reforms

Inflation has trended down since 2016. The Reserve Bank is committed to anchoring inflation at the mid-point of the 3-6% target range and has therefore maintained rates. Rising food and electricity prices put moderate upward pressure on inflation. If inflation expectations continue to be moderate, the Reserve Bank could consider slightly increasing the degree of monetary accommodation to support growth.

The government's fiscal deficit is set to increase slightly from its 2018 level. Despite important efforts to prevent a deterioration of the primary balance, increasing interest payments are weighing on debt and fiscal space. Fiscal policy has to focus on increasing spending efficiency to reduce high government debt. The government should strengthen its efforts to contain the wage bill. High government exposure to underperforming state owned enterprises (SOEs) is threatening debt sustainability. Reforms have been launched to improve the governance of key SOEs. These have to continue focussing on implementing an effective governance framework that clearly sets company-specific objectives in terms of profitability, capital structure and non-financial results.

A strategy is needed to increase job creation and growth. It should focus on investment in infrastructure and implementation of structural reforms such as strengthening and broadening competition. Developing labour intensive sectors like tourism can further support job creation. Providing employment opportunities for young people is critical, as they are especially vulnerable to unemployment. Income and economic opportunities remain highly unequal. Building a comprehensive social system that protects against risks and shocks can provide more confidence, boost saving and strengthen productivity. While the creation of such a system involves substantial fiscal costs, it is crucial for creating a more inclusive society.

Growth is projected to remain fragile

Growth is projected to pick up slowly but will remain vulnerable to policy uncertainty and external shocks. Household consumption continues to be an important driver of growth, despite low employment growth. Investment is projected to pick up progressively, albeit from historically low levels, as a clarification of the reform agenda following the recent general election is expected to support confidence. On the external side, the economy will remain vulnerable to increasing oil prices, escalating global protectionism, global financial tightening and negative investor sentiment towards emerging market economies.

Spain

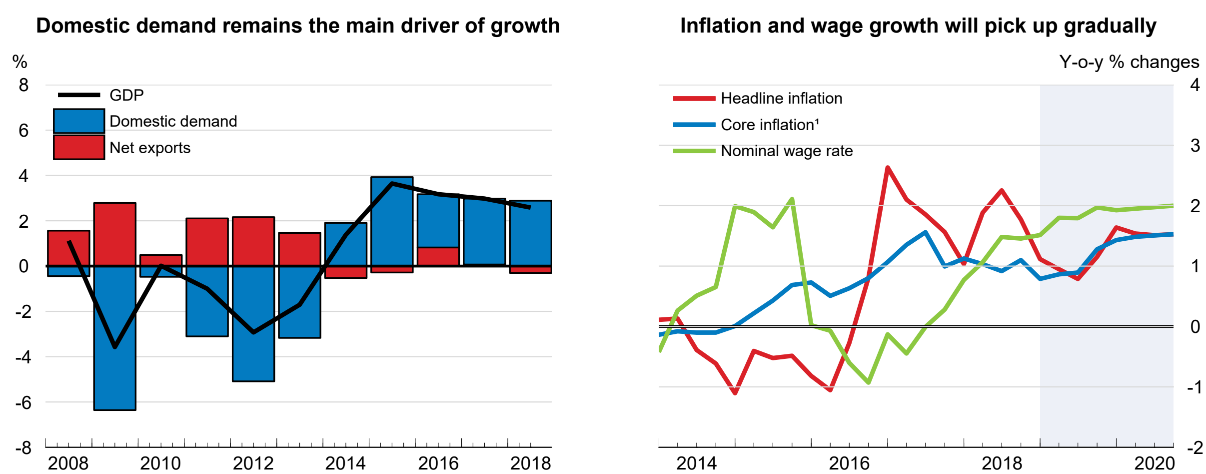
The economy is projected to grow at a robust, but more moderate, pace in 2019 and 2020. Favourable financial conditions and continued solid employment growth will support domestic demand, which will remain the main driver of growth. The contribution of the external sector is projected to remain broadly neutral in the projection period.

The government should stick to its medium-term fiscal targets to ensure a durable reduction of public debt, which remains high. If growth surprises on the upside, all windfall revenues should be used to reduce the debt ratio faster. More effective labour market policies and re-skilling are needed to reduce further unemployment and inequalities. Towards that end, increasing the share of active labour market spending on training and improving co-ordination of social and employment services are key.

Growth remains resilient

Driven by domestic demand, economic growth remains robust. Strong job creation, moderate inflation and some recent measures, such as increases in public sector wages, pensions and minimum wages, have boosted real disposable incomes and supported private consumption. Business investment continues to grow, supported by low financing costs and improved profit margins. Export growth has moderated in line with export markets. Labour market conditions continue to improve, with the unemployment rate having now fallen close to 14%.

Spain



1. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933934926

Spain: Demand, production and prices

Spain	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 081.2	3.2	3.0	2.6	2.2	1.9
Private consumption	626.0	2.9	2.5	2.3	1.7	1.6
Government consumption	208.9	1.0	1.9	2.1	1.9	1.6
Gross fixed capital formation	214.7	2.9	4.8	5.3	3.8	3.9
Final domestic demand	1 049.7	2.5	2.9	2.9	2.2	2.1
Stockbuilding[1]	6.3	-0.1	0.1	0.1	0.0	0.0
Total domestic demand	1 055.9	2.4	3.0	3.0	2.2	2.1
Exports of goods and services	356.1	5.2	5.2	2.3	0.8	3.7
Imports of goods and services	330.9	2.9	5.6	3.5	0.6	4.3
Net exports[1]	25.2	0.8	0.1	-0.3	0.1	-0.1
Memorandum items						
GDP deflator	_	0.3	1.2	1.0	0.9	1.5
Harmonised index of consumer prices	_	-0.3	2.0	1.7	1.0	1.6
Harmonised index of core inflation[2]	_	0.7	1.2	1.0	1.0	1.5
Unemployment rate (% of labour force)	_	19.6	17.2	15.3	13.8	12.7
Household saving ratio, net (% of disposable income)	_	1.8	-0.8	-1.5	-1.4	-1.4
General government financial balance (% of GDP)	_	-4.5	-3.1	-2.5	-2.0	-1.3
General government gross debt (% of GDP)	_	116.5	114.6	113.5	113.0	111.7
General government debt, Maastricht definition (% of GDP)	_	99.0	98.1	97.1	96.5	95.7
Current account balance (% of GDP)	_	2.3	1.8	0.9	0.8	0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935819

Reforms to boost productivity growth and skills should continue

While the 2019 budget did not pass the legislative assembly, some of the proposed measures were approved and the fiscal stance will be slightly expansionary in 2019. This will provide support to domestic demand, but there is a need to strengthen structural public finances further, given high levels of public debt. The fiscal deficit is projected to decline to 2% of GDP in 2019, mainly due to favourable macroeconomic conditions.

There is potential for changes in the tax mix that would boost growth and reduce inequalities. Taxation remains tilted towards labour income, which penalises growth and employment. There is room for environmental taxes to address market failures and less distortive value-added taxes. Policies to improve competition and innovation are needed to boost productivity growth and exports. Ensuring the effective implementation of prior structural reforms and addressing the internal fragmentation of product markets requires enhanced co-operation and co-ordination across different levels of government. Innovation support can be made more effective through more widespread ex-post evaluation of programmes and moving towards performance based funding.

Improving lifelong learning policies and better targeting participation on low-qualified adults would increase the adaptability of workers to future skill needs. Providing individualised support to students at risk of failing at an early stage could further lower early school leaving rates and would benefit especially disadvantaged students. Enhancing incentives for the mobility of well-qualified teachers across schools and regions is another way to increase equality of opportunities.

The pace of the recovery will moderate

Growth is projected to moderate to 2.2% in 2019 and 1.9% in 2020. Job creation will ease, but remain robust, further reducing unemployment. Employment gains and rising real wages will underpin consumption growth. Continued accommodative monetary policy in the euro area should keep boosting private investment. Exports will decelerate in 2019 in line with the growth slowdown in Spain’s main trading partners, but will pick up again in 2020. The contribution of the external sector to growth is projected to remain broadly neutral in the projection period. Inflation will slowly increase as slack dissipates, but remain subdued.

Risks to the outlook include lower-than-projected growth in Europe, Spain's main export destination, which would undermine exports. Private consumption growth could be lower if the pace of job creation slows more than projected or political uncertainty persists, reducing consumer confidence. Conversely, stronger demand from Europe would boost growth more than projected.

Sweden

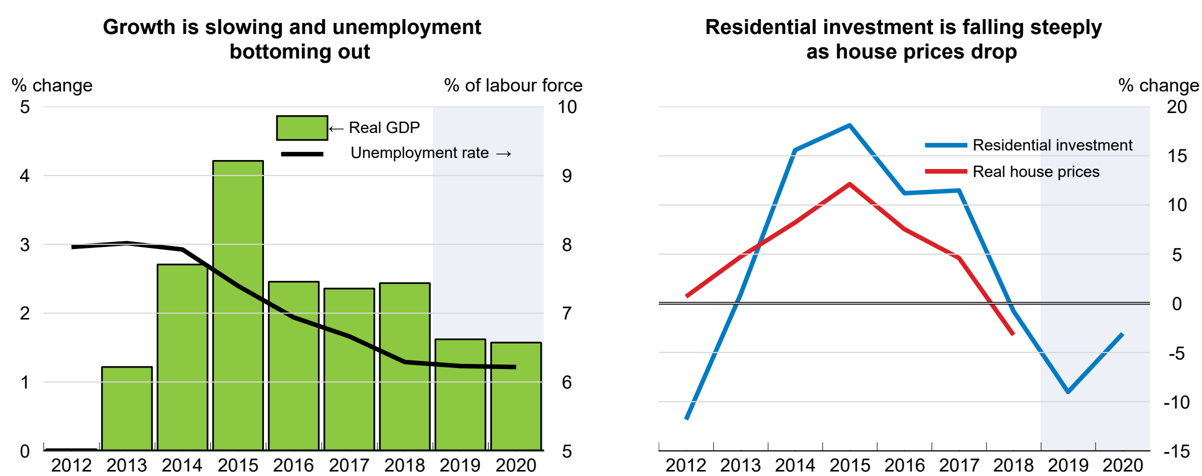
The economy remains robust, but growth is set to slow to 1.6% as the construction boom is over. Modest wage growth and lower house prices will continue to hold back private consumption, and global uncertainties will weigh on business investment. The unemployment rate is set to stop falling, as skill mismatches hamper hiring. Inflation is close to the 2% target.

The Riksbank has started raising its policy rate, which is appropriate, but further moves should depend on inflation and output developments. Fiscal policy is appropriately prudent, but space for easing is available, should the economy deteriorate further than projected. The government is planning housing and labour market reforms, which are welcome steps to strengthen growth and inclusiveness.

Economic growth is slowing

Private consumption slowed sharply in 2018 with consumer confidence falling. Modest wage increases, sagging house prices and global uncertainties are encouraging households to save. The construction boom is now over and following house price declines, residential investment is falling steeply. Declining business confidence and global uncertainties hold back corporate investment. Exports have remained relatively strong so far, with support from a weak krona, while sluggish domestic demand is damping imports. Skill mismatches hamper further reductions in unemployment. Inflation is close to target, albeit partly due to rising energy prices.

Sweden



Source: OECD Economic Outlook 105 database; and OECD Analytical House Prices database.

StatLink https://doi.org/10.1787/888933934945

Sweden: Demand, output and prices

Sweden	2015	2016	2017	2018	2019	2020
	Current prices SEK trillion	Percentage changes, volume (2017 prices)				
GDP at market prices	4 200.7	2.5	2.4	2.4	1.6	1.6
Private consumption	1 889.3	2.8	2.3	1.2	1.8	2.1
Government consumption	1 085.7	3.2	0.4	1.1	1.0	0.4
Gross fixed capital formation	990.3	3.9	6.5	3.5	-0.5	1.5
Final domestic demand	3 965.4	3.2	2.8	1.8	1.0	1.5
Stockbuilding[1]	31.3	-0.1	0.1	0.4	0.1	0.0
Total domestic demand	3 996.7	3.0	2.9	2.1	1.0	1.5
Exports of goods and services	1 912.5	2.6	3.7	3.7	3.2	3.2
Imports of goods and services	1 708.6	3.9	5.2	3.1	2.2	3.1
Net exports[1]	204.0	-0.4	-0.4	0.4	0.5	0.2
Memorandum items						
GDP deflator	_	1.7	2.2	2.2	2.1	2.1
Consumer price index[2]	_	1.0	1.8	2.0	1.7	2.0
Core inflation index[3]	_	1.4	2.0	2.1	1.6	1.9
Unemployment rate[4] (% of labour force)	_	6.9	6.7	6.3	6.2	6.2
Household saving ratio, net (% of disposable income)	_	16.0	15.1	17.1	17.3	17.0
General government financial balance (% of GDP)	_	1.0	1.4	0.9	0.8	1.0
General government debt, Maastricht definition (% of GDP)	_	42.4	40.8	38.8	36.5	34.7
Current account balance (% of GDP)	_	3.8	2.8	2.0	3.4	3.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. The consumer price index includes mortgage interest costs.
3. Consumer price index with fixed interest rates.
4. Historical data and projections are based on the definition of unemployment which covers 15 to 74 year olds and classifies job-seeking full-time students as unemployed.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935838

Labour and housing market reforms could strengthen growth and inclusiveness

The Riksbank raised its policy rate to -0.25% in December 2018, with actual and expected inflation close to the 2% target. Monetary policy remains very supportive and a gradual normalisation of interest rates is welcome given high capacity utilisation and the potential impact of a long period of very low interest rates on indebtedness, asset prices and resource allocation. Still, delaying further policy moves until inflation and growth prospects become clearer is appropriate.

Fiscal policy is expected to remain prudent over the projection period, with surpluses in excess of the target of ⅓ per cent of GDP over the business cycle. This stance is appropriate, given cyclical conditions, the need for budget buffers in an economy highly exposed to external shocks and where low policy rates limit room for monetary policy manoeuvre.

The economy is suffering from some structural weaknesses. The government is considering easing labour market regulations to increase flexibility and facilitate the hiring of low-skilled workers. The introduction of entry agreements, negotiated with the social partners and combining subsidised employment and education, should help better integrate immigrants and long-term unemployed in the labour market. Housing market inefficiencies affect affordability, macroeconomic and financial stability, and labour mobility. The government has taken measures to release land for development and speed up planning processes. It also plans to remove rent controls for new dwellings and to amend property taxation, but restoring affordability may require further and deeper reforms in the housing market.

The economy will remain solid but global uncertainty shrouds the outlook

Growth will moderate, as bottlenecks appear after years of strong growth and global uncertainties weigh on confidence. Private consumption is expected to remain fairly weak despite tax cuts, as real wages will grow only modestly and households remain cautious in uncertain times. The contribution from foreign trade to growth will gradually shrink as export growth weakens and imports recover as domestic demand picks up. The large proportion of the low-skilled and recent immigrants among the unemployed limits the scope for further reductions in unemployment. Inflation is projected to remain close to the 2% target, as capacity utilisation remains high. Further decreases in house prices constitute a key risk to the outlook, as they could depress residential investment and private consumption. However, a reduction in global uncertainty would be conducive to stronger growth.

Switzerland

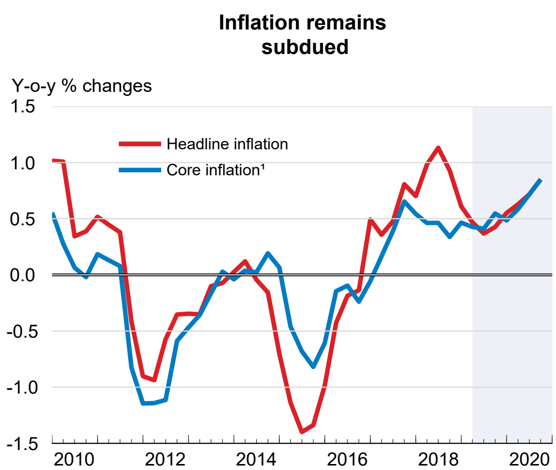
After a strong 2018 outturn, GDP growth is projected to be more subdued in 2019 and 2020. Slower external demand growth will weigh on exports and investment. Household consumption will strengthen as job creation and real wage growth pick up. Inflation is projected to edge up, but will remain low.

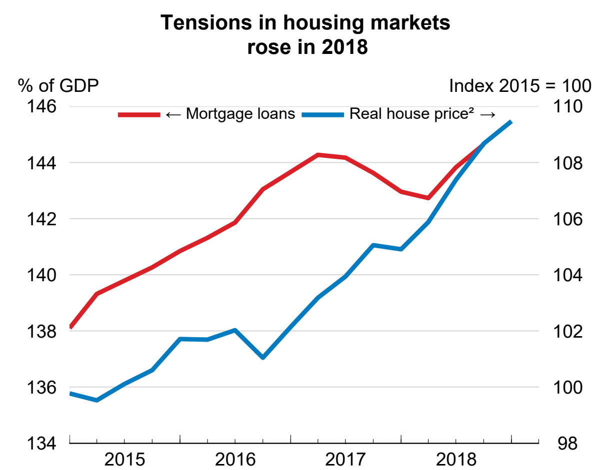
Monetary policy is accommodative. Interest rates are set to remain at current negative levels until end-2020, when tightening is expected to start. A stricter bank-lending framework would help mitigate financial stability risks. Fiscal policy is currently neutral and on course to become expansionary in 2020. The budget balance, in surplus since 2015, is projected to remain so through 2020. Allowing more immigration and encouraging more women to study scientific fields could ease rising skills shortages.

Growth slowed in the course of 2018

Growth is heading towards a modest pace after a marked slowdown in the second half of 2018. Fixed investment seems to be picking up from its end-2018 trough. Goods exports have been buoyant recently, especially in early 2019. Consumer confidence is around its long-run average. Business sentiment has bottomed out, but at relatively low levels.

Switzerland





1. Core inflation excludes fresh and seasonal food products, energy and fuels.
2. The real house price series is deflated using the private consumption deflator from the national account statistics.
Source: OECD Economic Outlook 105 database; Swiss National Bank; and OECD Analytical House Price database.

StatLink https://doi.org/10.1787/888933934964

Switzerland: Demand, output and prices

Switzerland	2015	2016	2017	2018	2019	2020
	Current prices CHF billion	Percentage changes, volume (2010 prices)				
GDP at market prices	654.2	1.6	1.7	2.5	1.0	1.5
Private consumption	348.7	1.5	1.2	1.0	1.2	1.5
Government consumption	78.1	1.2	0.9	1.0	0.8	1.2
Gross fixed capital formation	155.6	3.4	3.4	1.7	0.7	2.2
Final domestic demand	582.4	2.0	1.7	1.2	1.0	1.7
Stockbuilding[1]	- 4.8	-1.4	-0.1	-0.9	-0.1	0.0
Total domestic demand	577.7	0.3	1.5	0.2	0.9	1.7
Exports of goods and services	406.9	6.7	-0.1	2.0	0.0	3.4
Imports of goods and services	330.4	5.9	-0.7	-1.8	-0.4	4.2
Net exports[1]	76.5	1.2	0.3	2.3	0.2	0.0
Memorandum items						
GDP deflator	_	-0.6	-0.4	0.7	0.2	0.8
Consumer price index	_	-0.4	0.5	0.9	0.5	0.7
Core inflation index[2]	_	-0.3	0.3	0.5	0.5	0.7
Unemployment rate (% of labour force)	_	4.9	4.8	4.7	4.7	4.5
Household saving ratio, net (% of disposable income)	_	18.7	17.8	17.7	17.7	17.5
General government financial balance (% of GDP)	_	0.4	1.3	1.6	1.4	1.1
General government gross debt (% of GDP)	_	42.1	42.9	41.6	40.3	39.5
Current account balance (% of GDP)	_	9.4	6.7	10.2	9.6	9.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935857

Both underlying and headline inflation remain subdued. Real wages have remained flat, weighing on household consumption and saving. Imbalances in the housing market worsened in 2018 as mortgage lending reached new highs and house prices rose while rents stagnated and vacancies increased. Weakening domestic demand in 2018 compressed imports, lifting the current account surplus to over 10% of GDP.

Measures are needed to address labour shortages and rising house prices

Inflation is low, but consistent with the central bank's target of between 0% and 2%. Monetary policy is expansionary and still-negative rates add to financial stability risks. The first increase in the policy rate, from -0.75%, is expected in late 2020. A proposal by the authorities that is currently under public consultation aims to increase the risk weights for investment property loans with high loan-to-value ratios. Banks are also considering whether to tighten self-regulation, using loan-to-value ratios. To reduce financial stability risks, a proper framework setting lending limits should be enforced on a comply-or-explain basis.

The government's fiscal stance is set to become expansionary in 2020, lowering the surplus, as monetary policy starts to normalise. Tax revenues will decline, reflecting a corporate tax reform with lower cantonal tax rates. A personal income tax reduction, planned for 2021, would lower work disincentives for second earners. Accompanying these reforms with higher value-added tax, as proposed, and increasing environmentally related taxes would improve the efficiency of taxation and reduce environmental damage. Boosting public investment from its relatively low levels could help meet long-term challenges, notably population ageing and climate change.

Skills shortages are growing, especially in technical, scientific and information technology occupations. Job vacancies continue to rise, while immigration – a long-standing source of skilled workers in Switzerland – is slowing and population ageing is starting to bite. In the medium term, shortages could be alleviated by encouraging more women to study science, technology, engineering and mathematics. Allowing more non-EU immigration would also help in the shorter run.

Growth is projected to recover to trend in 2020

In 2019, subdued investment and exports will hold back GDP growth. Both are projected to improve in 2020 as global trade recovers. Household consumption will gradually gain momentum on the back of faster job creation and wage growth. Switzerland's future relationship with the European Union depends on negotiations on an institutional framework that are currently stalled and failure to reach an agreement may hamper export-oriented sectors. The prospect of prolonged negotiations could hurt business confidence and investment. An escalation of global tensions could push up the safe-haven Swiss franc and damp exports. In contrast, past wage moderation may turn out to provide a stronger-than-foreseen boost to exports.

Turkey

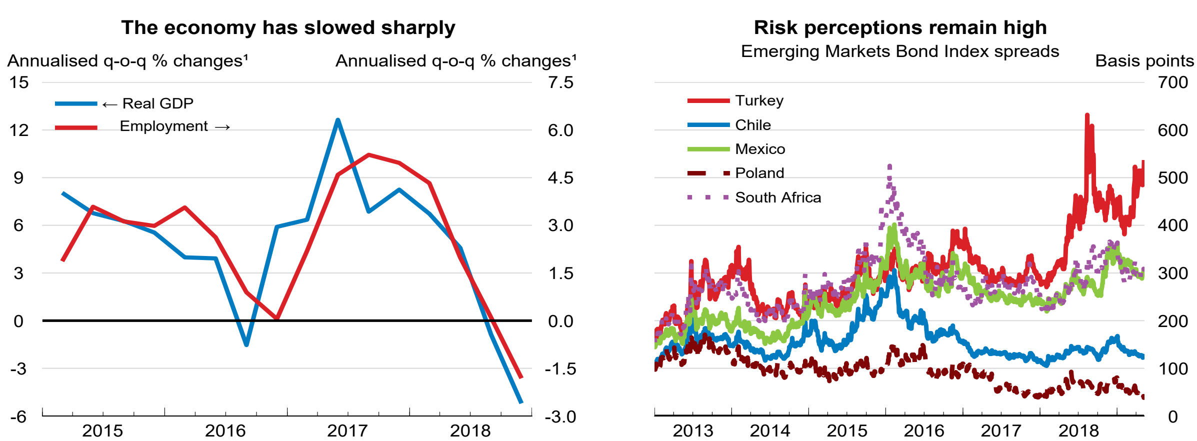
After the severe financial shock in August 2018, which triggered a recession in the second half of the year, strong fiscal and quasi-fiscal stimulus have moderated the contraction in early 2019. However, investor uncertainty remains high after the recent municipal elections. Business and household sentiment are affected by increased uncertainty. Absent any new shocks to international and domestic confidence, a measured recovery is projected from the second half of 2019 onwards, although the level of GDP in 2019 and 2020 is projected to remain below the 2018 level. Substantial risks remain around the projected recovery of growth.

Regaining the confidence of households, businesses, and domestic and international investors in the quality and predictability of economic policies and the credibility of market institutions is crucial. The central bank should aim to enhance its credibility and to re-build its net international reserve position. Fiscal policy should be made much more transparent. Countercyclical measures would be more effective if implemented in a transparent and predictable way. Structural reforms would boost growth, notably the enforcement of a level playing field in product and labour markets.

Domestic demand has contracted sharply and trade adjustment is underway

Household consumption, the central driver of the macroeconomic cycle, stayed weak in the first quarter of 2019 despite very strong fiscal stimulus, due to increased unemployment and low household confidence. Households have also faced real income losses due to high inflation, despite a significant increase in the official minimum wage at the beginning of the year. In particular, low-income households suffer from higher food costs. Private investment remained very weak, but public infrastructure investment, including by state-owned companies in the commercial sector, appears to have strengthened. On the back of strong labour force growth despite the recession, the rate of unemployment soared to 14.7% in the December-February period and the youth unemployment rate has reached almost 27%.

Turkey



1. Three-quarter moving average.
Source: OECD Economic Outlook 105 database; and Refinitiv.

StatLink https://doi.org/10.1787/888933934983

Turkey: Demand, production and prices

Turkey	2015	2016	2017	2018	2019	2020
	Current prices TRY billion	Percentage changes, volume (2009 prices)				
GDP at market prices	2 338.6	3.2	7.4	2.6	-2.6	1.6
Private consumption	1 411.8	3.6	6.1	1.2	-6.1	2.2
Government consumption	324.6	9.7	4.6	4.0	1.4	0.6
Gross fixed capital formation	694.8	2.2	7.8	-1.7	-6.8	1.9
Final domestic demand	2 431.1	4.1	6.4	0.7	-5.2	1.9
Stockbuilding[1]	- 31.5	0.0	-0.8	-0.4	0.5	0.0
Total domestic demand	2 399.6	4.1	5.8	0.3	-4.6	2.0
Exports of goods and services	546.0	-1.9	11.9	7.5	5.9	3.5
Imports of goods and services	607.0	3.7	10.3	-7.9	-7.7	5.0
Net exports[1]	- 61.0	-1.4	0.1	4.2	4.1	-0.4
Memorandum items						
GDP deflator	_	8.1	10.8	16.2	16.5	11.4
Consumer price index[2]	_	7.8	11.1	16.3	17.3	12.6
Core inflation index[3]	_	8.5	10.1	16.5	16.6	12.5
Unemployment rate (% of labour force)	_	10.9	10.9	11.0	13.3	14.0
Current account balance (% of GDP)	_	-3.8	-5.6	-3.1	0.3	-0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Based on yearly averages.
3. Consumer price index excluding food and energy.

Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935876

Manufacturing and service exports, including tourism exports, are being boosted by the substantial real exchange rate depreciation which followed the August financial shock and further depreciation episodes in March and May. With the sharp contraction of imports, reflecting the decline of domestic demand and real depreciation, external adjustment has accelerated and the current account balance has significantly improved. However, the slowdown of demand from Turkey's main export markets in Europe, notably from Germany-centered value chains, has moderated this positive support in the first half of 2019.

The policy framework should be made more predictable

The authorities introduced a large number of fiscal and quasi-fiscal stimulus measures in late 2018 and early 2019. These included major consumption tax cuts, administrative price reductions, subsidised foodstuff sales, loan restructuring for firms and households by public banks, and generous job subsidies. However, the relatively unpredictable implementation of these measures, and uncertainty about their sustainability may have reduced their impact. Publishing a regular fiscal policy report based on standard government accounts according to international norms would help implement countercyclical policies in a transparent way, provided that all quasi-fiscal activities are also covered.

Monetary conditions were tightened in 2018, and policy interest rates have been kept high to support the Turkish Lira and to contain the increased dollarisation of the economy. The central bank should restore credibility by putting inflation on a convergence path to its 5% target. The transparency of its policy instruments and accounts should be improved and tightening measures, when needed, should be implemented more directly. Explicit rather than indirect tightening measures would be more effective. Financial conditions for long-term business and household borrowers are very restrictive, due to Turkey's high sovereign risk premia and banks' and blue-chip firms' very high international borrowing costs. The loan restructuring vehicles envisaged for the highly strained energy and real estate sectors (that the Turkish

Banking Association is expected to put in place with domestic and foreign private investors, without direct government participation), if implemented successfully, would reduce pressures on creditor banks, offset financial contagion risks, and help improve confidence.

A slow recovery is projected, but risks are substantial

Turkey's post-shock recovery experiences suggest that under an adequate policy framework household consumption and business investment tend to rebound relatively rapidly. However, the high debt stock, high debt roll-over costs (with 25% of GDP of foreign debt maturing in the next 12 months), which will be particularly challenging for non-financial firms carrying high foreign and foreign-currency domestic debt, and substantial uncertainties in political conditions and economic policies weigh heavily on the recovery. A gradual upturn is foreseen from the second half of 2019, on the assumption that Turkey will face no further confidence shocks. If domestic and international confidence is restored more rapidly, risk premia and investment costs will likely start to normalise and the economy could recover faster. However, if current uncertainties continue to prevail and confidence remains fragile, Turkey would remain vulnerable to turbulences and headwinds, and GDP growth would be weaker. The phasing-in of the structural reforms needed to enhance the rule of law in, and the level-playing operation of, product and labour markets would improve confidence and help increase the potential growth rate.

United Kingdom

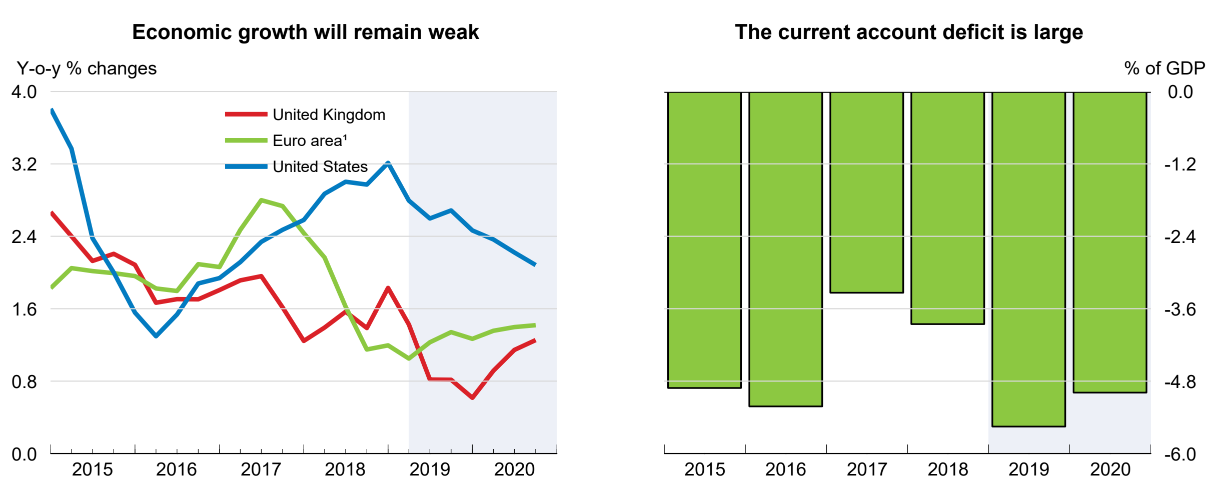
Economic activity is expected to grow slightly above 1% this year and next under the assumption that there is a smooth transition and exit from the European Union after 2020. Brexit-related uncertainties will keep holding back investment until there is clarity about future trading arrangements. Consumption will decelerate in line with slower employment gains. The economy should nonetheless benefit from a supportive fiscal stance this year and the modest recovery in global growth in 2020. Inflation should converge to 2% by the end of 2020.

With inflation close to target but with large uncertainties remaining, the policy interest rate should be kept constant until there are clear signs of accelerating prices. The fiscal authorities should stand ready to respond, should growth weaken significantly as a result of Brexit. To lower economic uncertainties and reassure investors the government should clarify its preferred option for the future trade relationship with the European Union, which should ensure the closest possible trading relationship and high access for financial services to overseas markets.

Economic uncertainty has held back business investment

Brexit-related uncertainties have risen in the past few months, further deteriorating business confidence and holding back investment. Firms have been meeting demand by hiring rather than investing. Tight labour markets and receding inflation have supported household consumption. The saving rate has been volatile, increasing on average in the most recent period. Growth has slowed in major trading partners. The current account deficit has been widening, nearing 4½ per cent of GDP, reflecting worsening trade, particularly in the car sector, and deteriorating income balances. There has been massive stockpiling in the first quarter of 2019, which is likely to be mostly imported goods.

United Kingdom 1



1. Covers 17 countries that are both euro area and OECD members.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935002

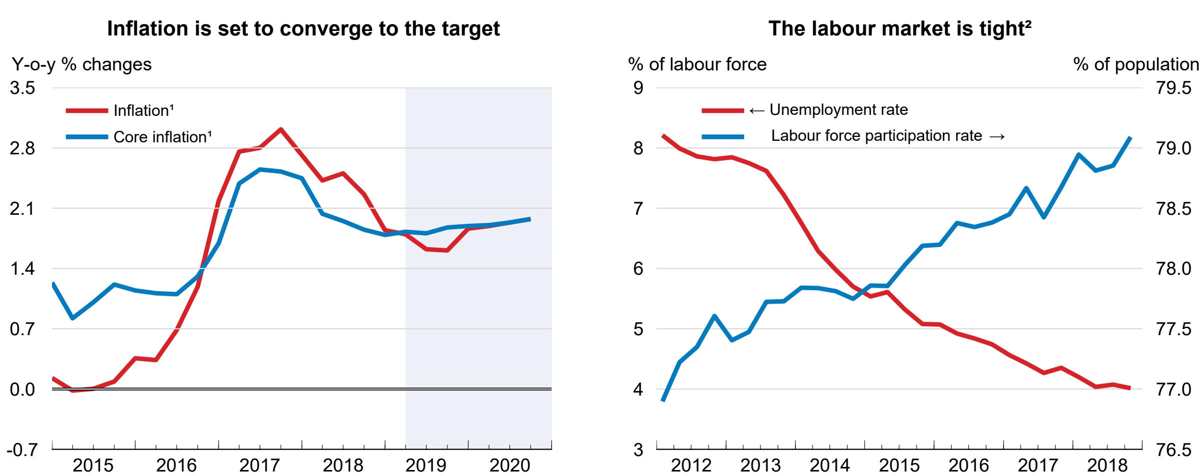
United Kingdom: Demand, production and prices

United Kingdom	2015	2016	2017	2018	2019	2020
	Current prices GBP billion	Percentage changes, volume (2016 prices)				
GDP at market prices	1 895.8	1.8	1.8	1.4	1.2	1.0
Private consumption	1 235.5	3.1	2.1	1.7	1.6	0.8
Government consumption	361.0	0.8	-0.2	0.4	2.8	1.8
Gross fixed capital formation	319.4	2.3	3.5	0.2	1.0	0.3
Final domestic demand	1 915.9	2.5	1.9	1.2	1.7	0.9
Stockbuilding[1]	6.9	-0.2	-0.5	0.4	1.9	0.0
Total domestic demand	1 922.8	2.4	1.4	1.6	3.6	0.9
Exports of goods and services	519.6	1.0	5.6	0.1	1.8	1.6
Imports of goods and services	546.6	3.3	3.5	0.7	9.7	1.3
Net exports[1]	- 27.0	-0.7	0.5	-0.2	-2.5	0.1
Memorandum items						
GDP deflator	_	2.1	2.2	1.9	2.1	2.1
Harmonised index of consumer prices	_	0.6	2.7	2.5	1.7	1.9
Harmonised index of core inflation[2]	_	1.2	2.3	2.1	1.8	1.9
Unemployment rate (% of labour force)	_	4.9	4.4	4.1	3.9	3.9
Household saving ratio, gross (% of disposable income)	_	6.7	4.2	4.5	4.7	4.7
General government financial balance (% of GDP)	_	-2.9	-1.8	-1.6	-2.1	-2.0
General government gross debt (% of GDP)	_	119.5	116.4	113.0	112.4	112.0
General government debt, Maastricht definition (% of GDP)	_	87.9	87.1	86.8	85.2	84.5
Current account balance (% of GDP)	_	-5.2	-3.3	-3.9	-5.6	-5.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935895

United Kingdom 2



1. Harmonised consumer price index (HICP). Core HICP excludes energy, food, alcohol and tobacco.
2. Data for the unemployment rate refer to the population aged 16 and over. Data for the labour force participation rate refer to the population aged between 16 and 64.
Source: OECD Economic Outlook 105 database; and Office for National Statistics.

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Policy measures will be needed to smooth the exit from the European Union

The projections assume that the extension of the Article 50 period to October 2019 will allow the United Kingdom to smoothly leave the European Union after 2020 following a transition period. The nature of the future relationship with the European Union and its implications for trade, investment and labour mobility still needs to be defined. To lower economic uncertainties, the UK authorities should clarify their position, both in terms of exit date and of the nature of the relationship as soon as possible. The government should strive to forge an agreement that will ensure the closest possible trading relationship with the European Union and high access for financial services to overseas markets.

The Monetary Policy Committee has appropriately paused the normalisation process in the context of large uncertainties. It has indicated that gradual and limited increases in the policy interest rate may be warranted, if the UK economy grows broadly in line with its latest economic projections. Monetary policy conditions should remain accommodative until there are clear signals of strengthening price pressures. In the OECD projections, interest rates are assumed to start rising in 2020.

After several years of consolidation, fiscal policy has become accommodative. Higher projected income tax receipts and lower interest payments have increased fiscal space. Increases in health spending, infrastructure and defence, together with cuts in household income tax and other taxes, are expected to support the economy this year, adding some 0.3 percentage point to growth. The government should be ready to react should the economy markedly decelerate due to Brexit. In addition to letting the fiscal automatic stabilisers fully operate, they should focus on measures that foster productivity and inclusive growth in the long term, such as increasing spending on digital infrastructure and providing good ICT training to low-skilled workers. Government policies should seek to support workers, not particular sectors or jobs, should trade and production shift as a result of Brexit.

Growth is projected to remain weak

Activity is expected to pick up but to grow below trend in both 2019 and 2020. Investment growth should recover slowly as uncertainties regarding the nature of Brexit gradually diminish. Consumption growth is expected to weaken as employment-related incomes slow and monetary policy starts to normalise. Inflation will move up gradually to the 2% target. With high economic uncertainty and fragile consumer confidence, housing activity and prices are likely to remain subdued in the short term. The unemployment rate is anticipated to remain broadly stable. The public debt-to-GDP ratio is projected to decline marginally from its peak. The current account deficit should narrow but remain large.

An exit without a deal and associated financial disruptions remains a tail risk. Political uncertainty and its impact on investment could also damp growth more strongly or for longer than projected. Investment prospects could recover faster should the United Kingdom and the European Union agree on a closer economic relationship than currently envisaged. Stockpiling observed at the eve of Brexit is also likely to unwind at some point.

United States

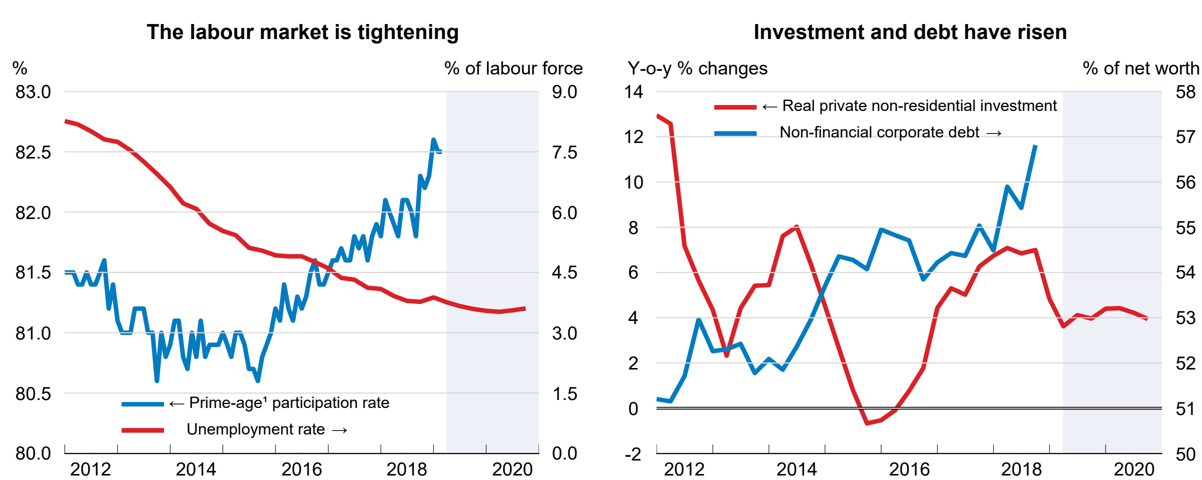
Economic growth is slowing as fiscal policy becomes less supportive, and headwinds from a weaker global outlook, as well as trade and political uncertainties, weigh on activity. The labour market remains strong and, while job growth will slow, wages are picking up, which will underpin continued consumption growth. Uncertainty about trade policy and the consequences of past trade measures, coupled with the current weakness in global demand, are damping exports and investment.

Fiscal policy will be broadly neutral over the projection period, with the spending ceilings assumed to be raised to prevent a contraction in 2020. The government recent shutdown imposed costs on households and while the economy will recover, it is important to avoid further manifestations of brinksmanship. Monetary policy is assumed to remain unchanged due to concerns about the outlook and persistent undershooting of the inflation target, which is to keep annual price increases at around 2%. In this low interest rate environment, prudential regulators and supervisors need to ensure that loan standards do not deteriorate further. Removing barriers to labour force participation would help offset the impact of population ageing.

The expansion continues

After the unexpectedly strong upturn at the start of 2019, economic growth will slow gradually as the fiscal boost dissipates. Consumer and business confidence remain at high levels and financial conditions are supportive. The labour market continues to add substantial numbers of jobs, supporting higher labour force participation while keeping the unemployment rate low. Labour market tightness is beginning to spur more sustained wage increases, although this has not translated into stronger price inflation. Consumer spending and business investment remain solid. On the other hand, weaker external demand and retaliatory measures introduced in trade disputes continue to damp export growth.

United States 1



1. Defined as 25-54 year olds.

Source: OECD Economic Outlook 105 database; US Bureau of Labor Statistics; and Federal Reserve Economic Data.

StatLink https://doi.org/10.1787/888933935040

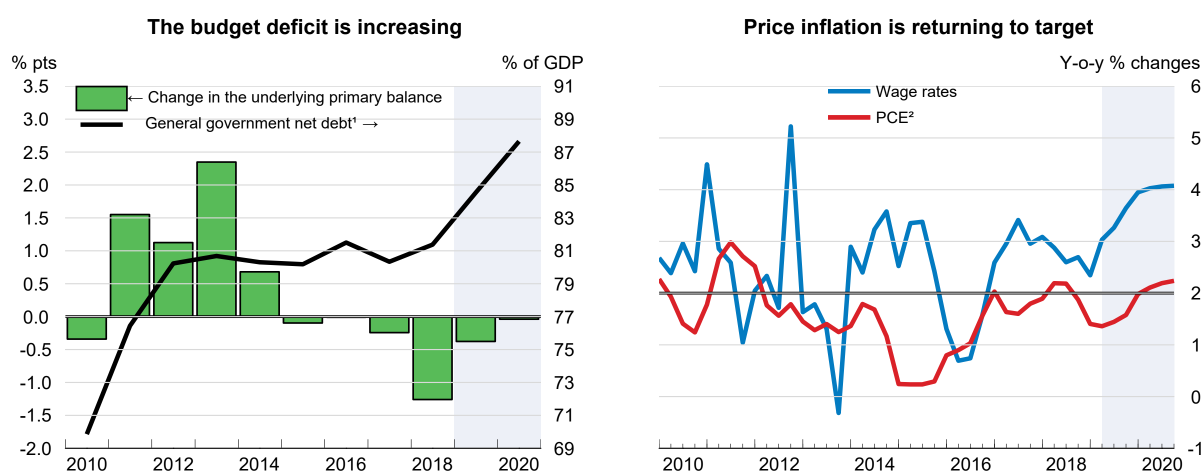
United States: Demand, output and prices

United States	2015	2016	2017	2018	2019	2020
	Current prices USD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	18 219.3	1.6	2.2	2.9	2.8	2.3
Private consumption	12 294.5	2.7	2.5	2.6	2.4	2.1
Government consumption	2 612.7	1.5	-0.1	1.2	1.6	2.4
Gross fixed capital formation	3 704.8	1.7	4.0	4.8	3.2	3.8
Final domestic demand	18 612.0	2.3	2.5	2.9	2.5	2.5
Stockbuilding[1]	128.7	-0.5	0.0	0.1	0.3	-0.1
Total domestic demand	18 740.7	1.8	2.5	3.0	2.7	2.4
Exports of goods and services	2 265.0	-0.1	3.0	4.0	1.7	2.4
Imports of goods and services	2 786.5	1.9	4.6	4.5	1.2	3.4
Net exports[1]	- 521.4	-0.3	-0.3	-0.2	0.0	-0.2
Memorandum items						
GDP deflator	_	1.1	1.9	2.3	1.6	2.1
Personal consumption expenditures deflator	_	1.1	1.8	2.0	1.4	2.1
Core personal consumption expenditures deflator[2]	_	1.7	1.6	1.9	1.7	2.2
Unemployment rate (% of labour force)	_	4.9	4.4	3.9	3.7	3.6
Household saving ratio, net (% of disposable income)	_	6.7	6.7	6.7	6.7	6.9
General government financial balance (% of GDP)	_	-5.4	-4.3	-6.6	-6.6	-6.7
General government gross debt (% of GDP)	_	106.7	106.0	107.1	110.3	113.4
Current account balance (% of GDP)	_	-2.3	-2.3	-2.4	-2.4	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Deflator for private consumption excluding food and energy.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935914

United States 2



1. General government shows the consolidated (i.e. with intra-government amounts netted out) accounts for all levels of government (central plus State/local) based on OECD national accounts. This measure differs from the federal debt held by the public, which was 77.8% of GDP for the 2018 fiscal year.
2. Personal Consumption Expenditures price index.
Source: OECD Economic Outlook 105 database.

StatLink https://doi.org/10.1787/888933935059

Policy measures will be needed to support employment and productivity growth

After the longest government shutdown in December and January dented GDP growth, fiscal policy is set to remain broadly neutral with the spending ceilings from the Budget Control Act assumed to be raised to avoid a sharp contractionary impulse. Developing policy to support infrastructure investment would lay the foundation for a targeted spending boost should the economy falter. At the same time, easing regulatory barriers would help sustain stronger growth of private investment.

The Federal Reserve is unlikely to raise interest rates further over the projection as growth is moderating and inflation expectations remain well anchored, albeit towards the lower end of their normal range. A further reason for caution is that inflation has risen only very gradually towards target, questioning the extent to which the inflation target is viewed as symmetrical. The Federal Reserve has announced that quantitative tightening, or reducing the size of its balance sheet, will end later in 2019, leaving the federal funds rate as the principal monetary policy instrument. In this low-interest rate environment, prudential regulators need to ensure robust lending standards. In particular, regulators need to ensure that high levels of non-financial corporate debt do not pose systemic risks.

Labour force participation has recovered from the crisis, which is particularly notable amongst prime-age workers, but there is scope for further increases. The impact of labour market tightness has induced greater participation of older workers and groups that have remained on the margins of the labour force. For example, disability rolls have begun to decline after a long period of steady increases. In recent years, these developments have lifted household income and reduced poverty rates. However, demographic pressures dictate that labour force growth will slow. This puts a priority on easing remaining barriers to participation and spatial mobility, such as reducing occupational licensing, increasing training of needed skills, or facilitating job search.

Reducing policy uncertainty about international trade would also support growth. Current uncertainty is likely depressing investment in companies reliant on global supply chains. Exporters, notably agriculture, are suffering the consequences of retaliatory measures, while importers of affected goods have faced higher prices and largely passed these on to consumers. Relaxing these barriers to trade would benefit both exporters and consumers. The projections assume trade measures remain unchanged from late April, with neither new barriers (including the increase in tariffs on imports from China announced in mid-May) nor relaxation of existing ones.

Growth is projected to slow gradually

In the absence of further shocks, the economy is on track to continue its solid expansion and grow somewhat faster than the rest of the OECD on average. Strong growth will support higher household incomes and reduce poverty rates further. However, as the fiscal impulse diminishes and labour force growth begins to slow, economic growth will gradually moderate. Growth and labour market tightness will nonetheless help to keep inflation around the Federal Reserve's target. Fiscal deficits will remain sizeable and debt levels continue to mount (with net debt exceeding 87% of GDP in 2020) and will eventually need corrective action.

In the context of moderating growth and a weaker external environment, policy needs to avoid inflicting further economic self-harm, notably by avoiding the debt ceiling, inducing another government shutdown, or ratcheting up trade tensions and provoking retaliatory measures. Failure risks aggravating current account imbalances and increasing government debt. In addition, financial risks from high levels of corporate debt could disrupt financial markets and weaker global growth could provide additional headwinds. On the other hand, a stronger pick-up in productivity growth, a brighter international outlook and a diminishment of trade tensions could support stronger growth and inflation rising somewhat above target, dispelling the concerns of persistent undershooting. In these conditions, the expansion would be on track to become the longest on record.

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Consult this publication on line at ***https://doi.org/10.1787/b2e897b0-en***.

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