ECONOMIC OUTLOOK No.85

Press Conference

Paris, 24th June 2009
10h30

Angel Gurría
Secretary General

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Acting Head of Economics Department

For a video link to the press conference and related material :
www.oecd.org/OECDEconomicOutlook

Summary of projections

	2008	2009	2010	2008		2009				2010					Q4 / Q4	
				Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009	2010
								Per cent								
Real GDP growth																
United States	1.1	-2.8	0.9	-0.5	-6.3	-5.7	-1.4	0.0	0.5	1.3	1.4	1.5	1.6	-0.8	-1.7	1.5
Japan	-0.7	-6.8	0.7	-2.8	-13.5	-14.2	-1.0	0.9	0.8	0.8	0.8	0.8	1.0	-4.4	-3.6	0.8
Euro area	0.5	-4.8	0.0	-1.5	-6.9	-9.5	-3.1	-1.1	-0.5	0.2	0.7	1.2	1.4	-1.7	-3.6	0.9
Total OECD	0.8	-4.1	0.7	-1.1	-7.8	-8.3	-1.7	-0.4	0.3	0.9	1.4	1.7	2.0	-1.7	-2.6	1.5
Inflation[1]								year-on-year								
United States	3.3	0.2	0.8	4.3	1.9	0.8	0.1	-0.8	0.7	1.1	0.9	0.7	0.5			
Japan	1.4	-1.4	-1.4	2.1	1.0	-0.1	-1.1	-2.3	-2.0	-1.5	-1.3	-1.2	-1.3			
Euro area	3.3	0.5	0.7	3.8	2.3	0.9	0.4	0.1	0.5	1.0	0.8	0.6	0.4			
Total OECD	3.2	0.6	0.8	3.8	2.4	1.2	0.6	0.0	0.7	1.1	0.9	0.7	0.6			
Unemployment rate[2]																
United States	5.8	9.3	10.1	6.0	6.9	8.1	9.3	9.8	10.0	10.1	10.1	10.1	10.1			
Japan	4.0	5.2	5.7	4.0	4.0	4.5	5.2	5.5	5.6	5.7	5.7	5.8	5.8			
Euro area	7.5	10.0	12.0	7.5	7.9	8.8	9.6	10.4	11.1	11.6	12.0	12.2	12.3			
Total OECD	5.9	8.5	9.8	6.0	6.4	7.4	8.3	8.9	9.4	9.6	9.8	9.9	9.9			
World trade growth	2.5	-16.0	2.1	1.5	-26.0	-32.1	-9.2	-3.9	1.1	3.7	4.8	6.2	7.4	-5.6	-12.0	5.5
Current account balance[3]																
United States	-4.7	-2.3	-2.4													
Japan	3.2	1.4	1.9													
Euro area	-0.4	-1.1	-1.0													
Total OECD	-1.4	-0.9	-0.9													
Fiscal balance[3]																
United States	-5.9	-10.2	-11.2													
Japan	-2.7	-7.8	-8.7													
Euro area	-1.9	-5.6	-7.0													
Total OECD	-3.2	-7.7	-8.8													
Short-term interest rate																
United States	3.2	1.0	0.5	3.2	3.4	1.5	0.9	0.8	0.8	0.7	0.6	0.4	0.4			
Japan	0.7	0.6	0.3	0.7	0.8	0.6	0.7	0.5	0.5	0.5	0.3	0.2	0.2			
Euro area	4.7	1.2	0.5	5.0	4.6	2.0	1.2	0.8	0.8	0.7	0.6	0.4	0.4			

Note: Real GDP growth, inflation (measured by the increase in the consumer price index or private consumption deflator for total OECD) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day (except inflation) adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate. The cut-off date for other information used in the compilation of the projections is 11 June 2009.

1. USA: price index for personal consumption expenditure, Japan: consumer price index and the euro area: harmonised index of consumer prices.

2. Per cent of the labour force.

3. Per cent of GDP.

Source : Base de données des Perspectives économiques de l'OCDE, n°85.

EDITORIAL

NEARING THE BOTTOM?

OECD activity now looks to be approaching its nadir, following the deepest decline in post-war history. The ensuing recovery is likely to be both weak and fragile for some time. And the negative economic and social consequences of the crisis will be long-lasting. Yet, it could have been worse. Thanks to a strong economic policy effort an even darker scenario seems to have been avoided. But this is no reason for complacency; the need for determined policy action remains across a wide field of policies.

The downturn has been global in scope, even though its financial epicentre was in the OECD area. Indeed, trade and financial linkages prompted a synchronised collapse in activity and trade after financial markets froze in the second half of 2008. De-coupling turned out to be a mirage on the way into the recession. But on the way out it looks as if recovery will take hold in a staggered manner across countries reflecting, not least, the extent of policy stimulus and the force of headwinds coming from the need for balance-sheet repair. More specifically:

- A recovery already appears to be in motion in most large non-OECD countries. This is particularly so in China, against the background of substantial monetary and especially fiscal stimuli. At the same time, these countries do not suffer from the kind of balance-sheet damage that afflicts many OECD countries.

- Signs have multiplied that US activity could bottom out in the course of the second half of this year. Such a recovery would reflect tremendous policy effort. However, as the growth impulse from fiscal stimulus fades and the need for balance-sheet repairs continues to hold back growth the recovery could be uncharacteristically weak and insufficient to bear down on unemployment at around 10% of the labour force.

- Japan's economy is also showing signs that the trade-induced contraction is close to the end, thanks not least to fiscal stimulus. Again, however, the recovery is likely to be slow and huge economic slack is likely to further entrench deflation.

- Signs of impending recovery in the euro area are not yet as clearly visible, reflecting country-specific combinations of bursting housing bubbles, export set-backs and damage to financial sectors. The eventual recovery may also be slow in this region, including because rising unemployment makes consumers more reluctant to spend.

Overall, this *Economic Outlook* is the first in two years to revise up the growth projections compared with the previous version -- most clearly for the non-OECD and the United States but also to some extent for Japan. But more significant than the upward revision to growth is the change in the distribution of risks around the projections. These are now more balanced than before. Indeed, the projections are built on the assumption that conditions in financial markets stay broadly unchanged for the remainder of this year before normalising in the course of 2010 and this assumption could prove too conservative. But new tremors in the financial area cannot be excluded either, and adverse bond market reactions to the sharp increase in government indebtedness also represent a downside risk.

The recession has already led to a substantial rise in unemployment, with more to come before recovery is sufficiently strong to reverse the trend. The weakness in product and labour markets is likely to put downward pressure on inflation over the projection. But, as in other periods of sustained large slack, its disinflationary impact may be limited and most countries are projected to stay clear of sustained deflation.

Concern has been expressed about potential inflationary impacts of central bank injections of liquidity. As long as slack is large, this risk is likely to be modest. Moreover, many of the instruments for liquidity injection are expected to be self-correcting as financial conditions improve. Nonetheless, discretionary action will at some point have to be taken to withdraw liquidity as financial markets normalise. The timing and calibration of such action will be tricky, requiring central banks not only to exercise good judgement but also to have at their disposal flexible instruments to perform these operations.

With a nascent recovery hopefully in sight it would be tempting to relax the extraordinary policy effort of the past nine months. Tempting, but wrong. Not only because post-crisis policy strategies need preparing but also because there is still more policy can do to ensure a faster and more robust recovery. Some countries have taken action to remove the uncertainty associated with impaired assets on bank balance sheets but others may have to follow. Likewise, and especially in conditions where the picture of bank balance sheets provided by existing accounting rules is hazy, stress testing has a role to play in providing confidence. Getting the full benefit out of stress testing requires that the tests be seen as challenging, be made public, and be associated with demands for recapitalisation where needed.

Eventually, however, the panoply of government interventions to stabilise the financial system should be rolled back. This will likely call for some degree of co-ordination across countries to avoid fear of competitive disadvantage blocking progress. Crucial for the future, regulatory and supervisory changes will have to be brought in to limit the risk of new financial crises. Some of these changes are likely to hurt profitability and be unpopular with regulated firms. And some may face resistance because they alter existing bureaucratic structures. Hence, such reforms need to be undertaken before the memory of the crisis has faded too much.

Government budgets also provide a very important cushion for economic activity in the downturn, principally through the workings of automatic stabilisers and discretionary fiscal easing. The result has been a dramatic, but unavoidable, run-up in government deficits. Indeed, with the incipient recovery likely to be weak, it is important that decided fiscal stimulus actually be implemented in a timely manner and that the fiscal impulse not be withdrawn at a pace that jeopardizes recovery.

But very substantial fiscal consolidation will eventually be required in many countries. Some governments have already announced medium-term consolidation plans and others will have to follow. Early announcement of such plans, even if their implementation is conditional on actual economic developments, will help to anchor medium-term expectations of savers and investors and thereby keep down the cost of financing much higher debt levels. Consolidation requirements clearly differ across countries, but analysis in the special chapter of this *Outlook* on "Beyond the crisis: Medium-term challenges relating to potential output, unemployment and fiscal positions" shows that even countries with large deficits in the near term can reach fiscal balance over the medium term, or at least get a good part of the way, provided that consolidation measures are taken which are strong but not without historical precedent.

Consolidation, when recovery is sufficiently firm, should aim to avoid collateral damage to economies' long-term growth prospects. That means relying as far as possible on rolling back public expenditure that is not growth-enhancing, and when tax hikes are necessary to concentrate on broad-based taxes that involve minimal distortion to economic decisions of producers, consumers and investors.

Avoiding negative impacts from consolidation on long-term prospects is particularly important because the crisis itself is likely to have such effects. Some of the increase in unemployment is likely to turn structural and the capital stock could be durably lower as a result of the crisis. It is to be hoped that past reforms in labour markets will limit the extent to which unemployment turns structural. But even so, further labour market reforms aimed at keeping the unemployed in contact with the labour market and prepared to take emerging new jobs will be crucial. At the same time, it is essential to guard against crisis-driven intervention in product and financial markets undermining the long-run health of the economy. And the pressures for protectionist measures, which can take many forms, must be withstood. Indeed, moves towards liberalisation such as through the Doha Development Agenda would not only benefit long-term growth but would also provide a very helpful boost to confidence in the current situation.

More generally, as the acute crisis abates, it may be time to reflect on the overall economic policy paradigm. One ingredient that will be crucial is structural reforms to foster long-term growth and make economies more resilient in the face of shocks. But the role of macroeconomic policies in the run-up to the crisis will also need to be analysed and appropriate changes to macroeconomic policy frameworks made. In particular, it will need to be understood whether and, if so, how monetary policy can contribute to avoiding the build-up of financial and asset price vulnerabilities; what role macro-prudential policies can play in this regard; and how fiscal policy can best be set in ways that allow margin for response when crisis hits.

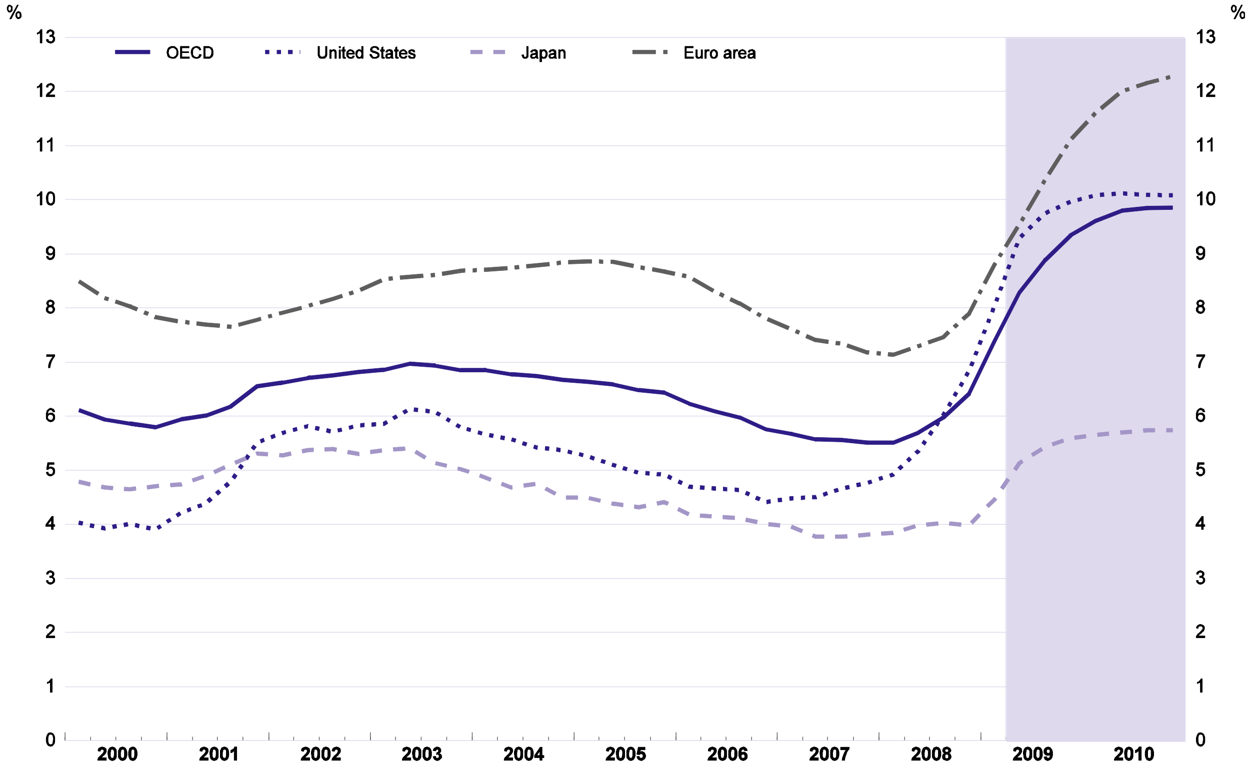
In summary, it looks as if the worst scenario has been avoided and that OECD economies are now nearing the bottom. Even if the subsequent recovery may be slow such an outcome is a major achievement of economic policy. But this is no time to relax -- ensuring that the recovery stays on track and leads towards a long-term sustainable growth path will call for major policy efforts going forward.

17 June 2009

Jorgen Elmeskov
Acting Head, Economics Department

The unemployment rate will rise substantially

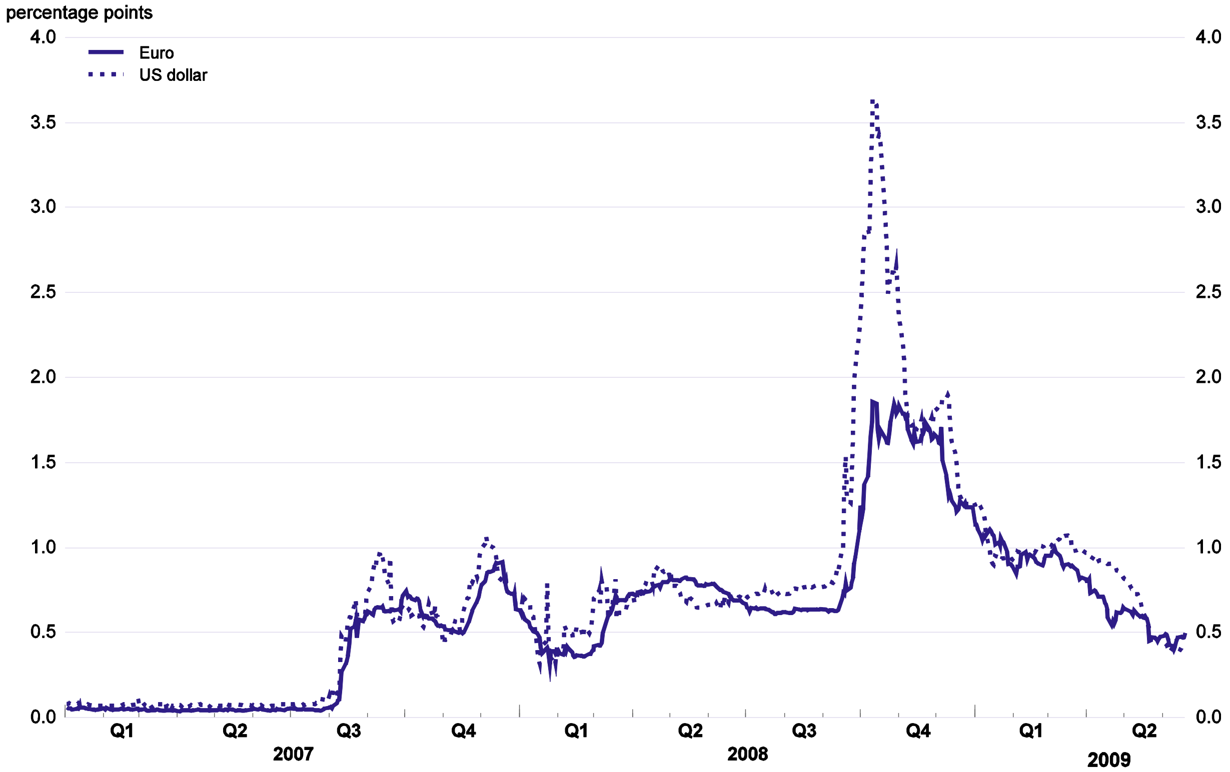
In percentage of labour force



Source: OECD Economic Outlook 85 database.

Money market spreads have eased considerably

Three-month spreads, last observation: 19 June 2009

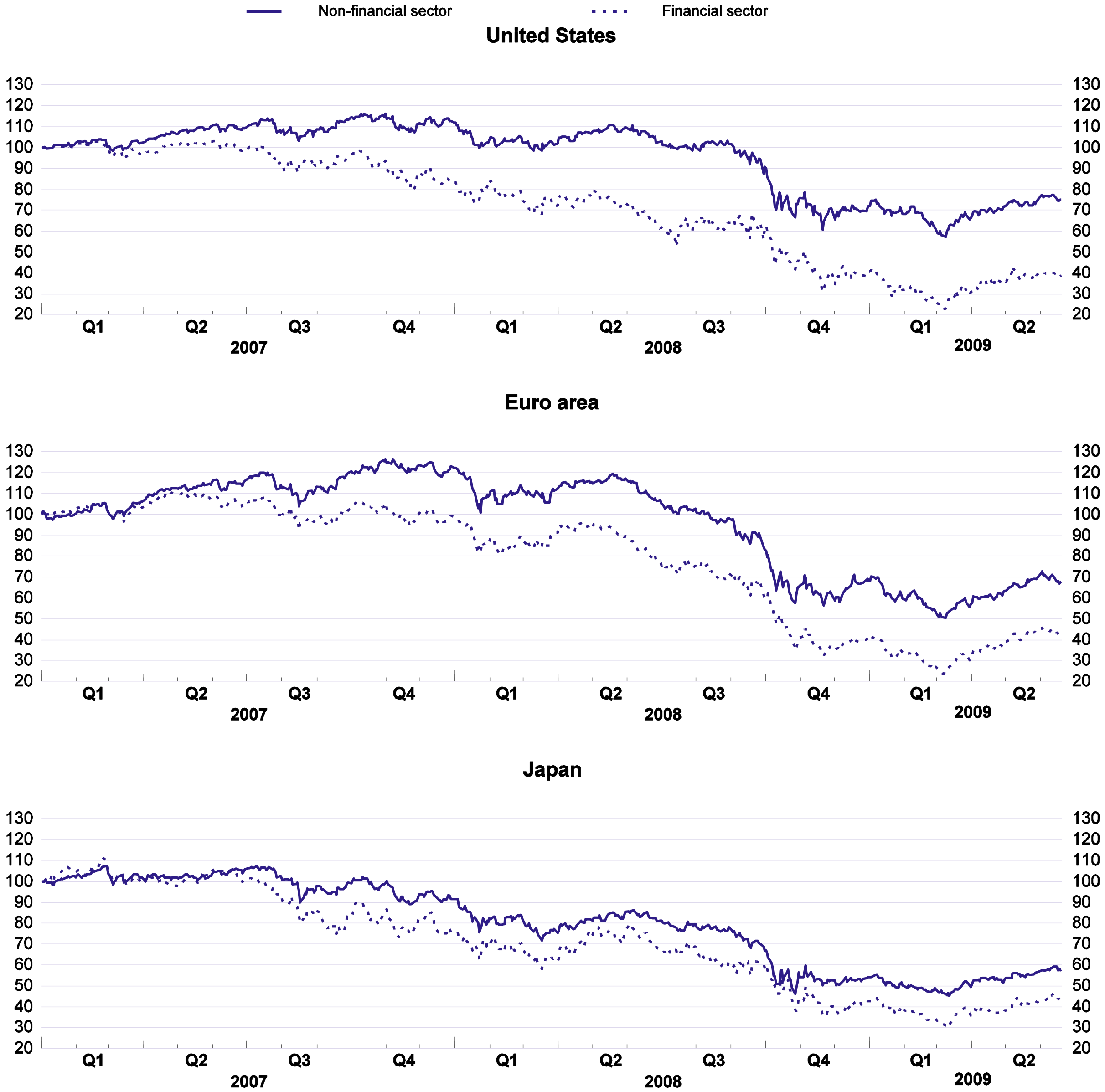


Note: Spread between three-month EURIBOR and EONIA swap index for euro area; spread between three-month LIBOR and overnight indexed swap for the United States.

Source: Datastream.

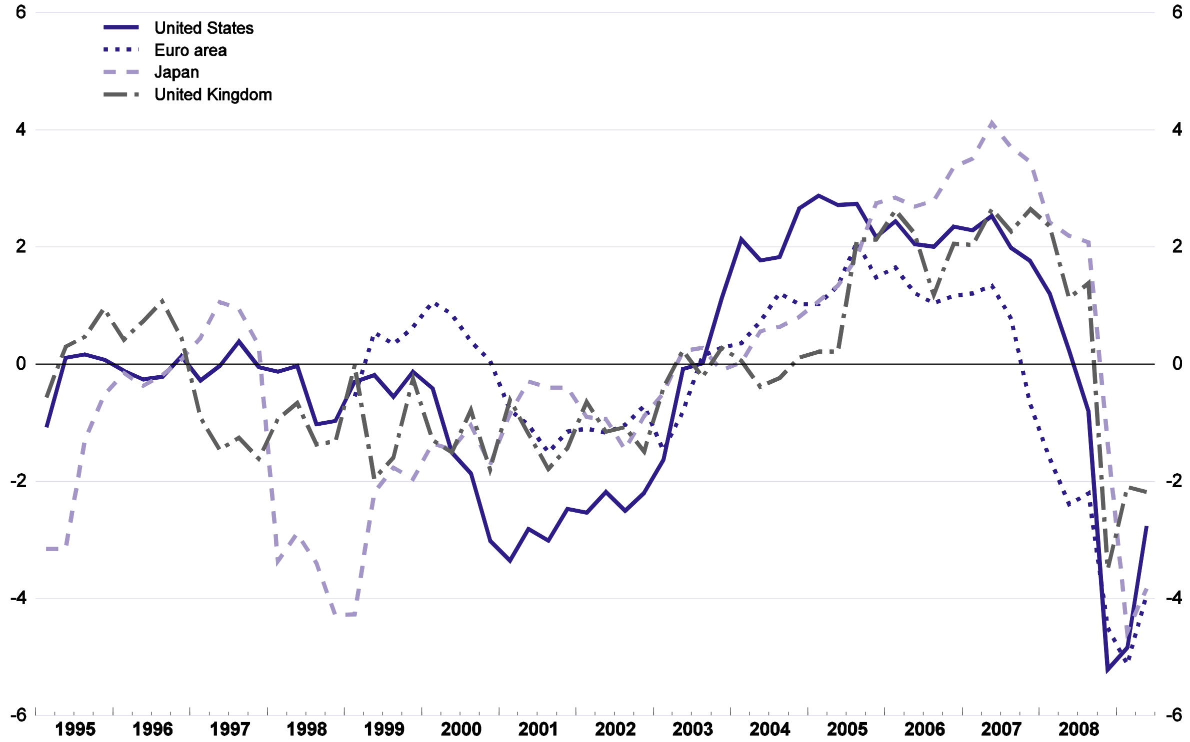
Share prices have rebounded to some extent

Indices, 1 January 2007 = 100



Source: Datastream.

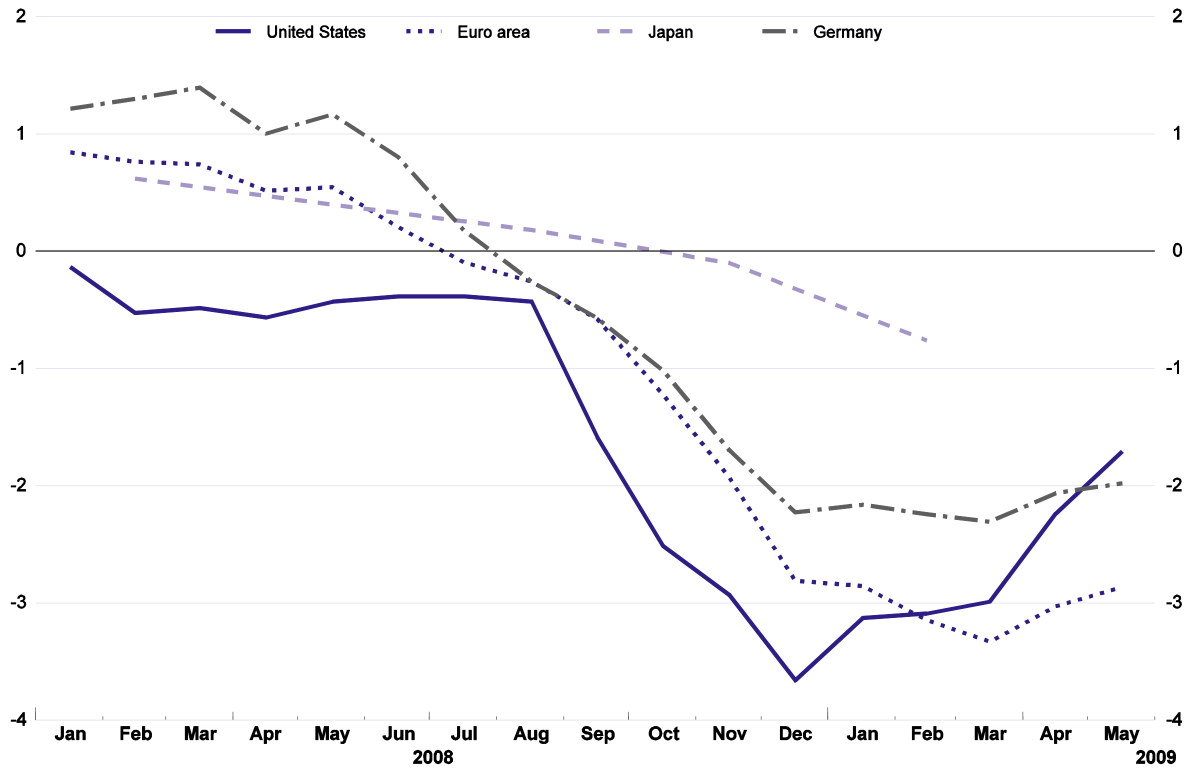
Synthetic indicators of financial conditions have turned up



Note: A unit decline in the index implies a tightening in financial conditions sufficient to produce an average reduction in the level of GDP by 1/2 to 1% after 4-6 quarters. See details in Guichard *et al.* (2009).

Source: Datastream; and OECD calculations.

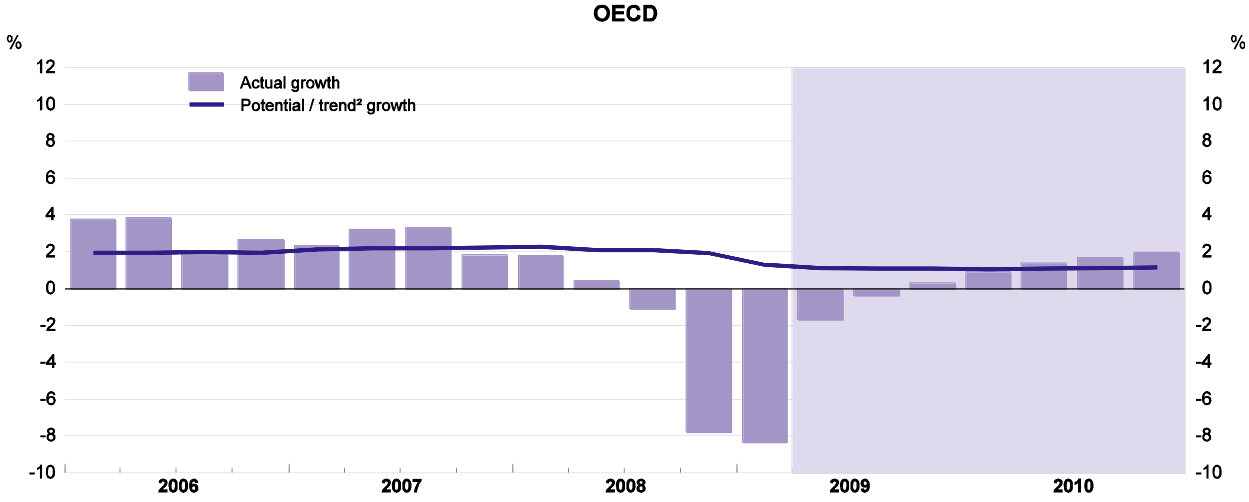
Business confidence shows signs of turning

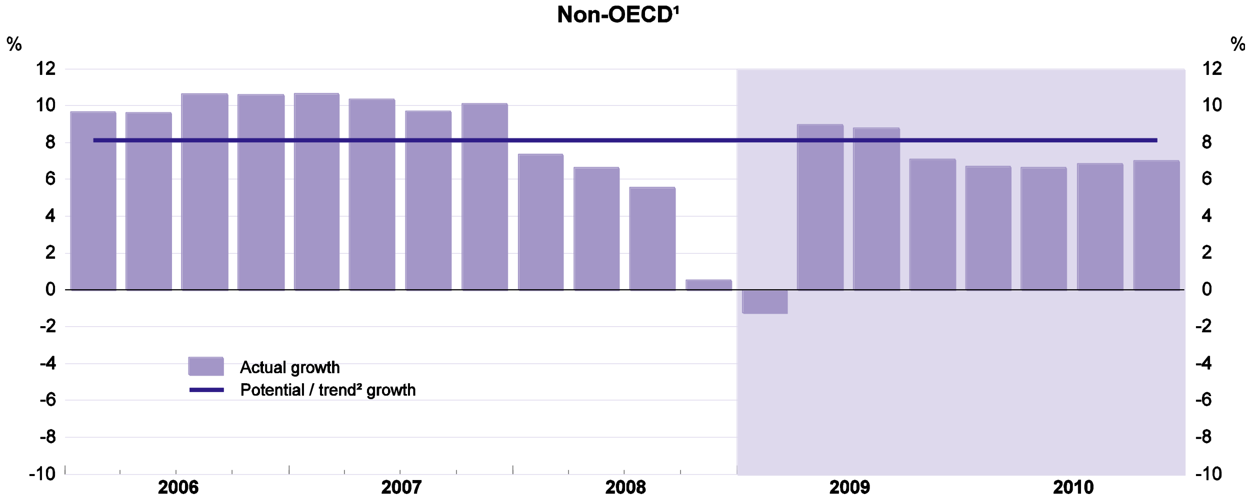


Note: Series have been normalised at the average for the period starting in 1985 and are presented in units of standard deviation. Monthly data for United States, euro area and Germany. Quarterly data for Japan.

Source: Datastream; and OECD, Main Economic Indicator database.

The recovery in the non-OECD region will be faster

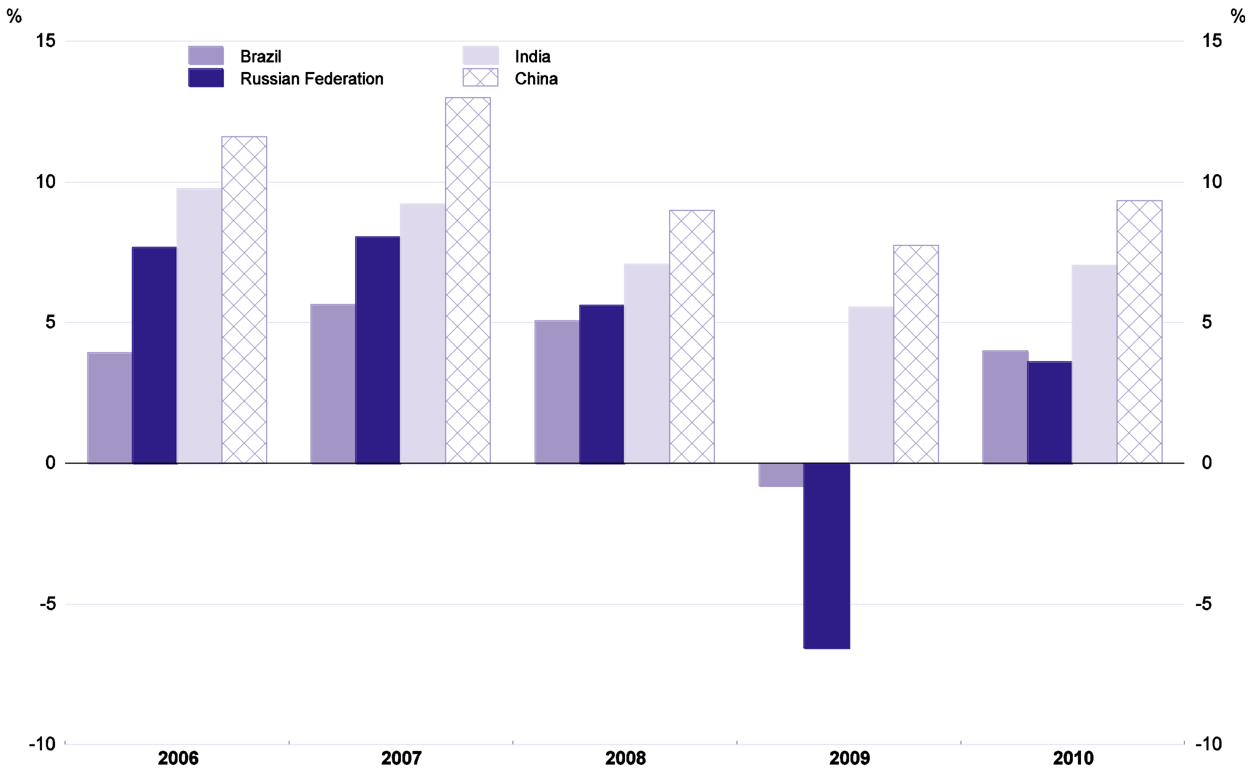




1. The non-OECD region is a weighted average, using 2005 GDP weights and PPPs, of Brazil, China, the Russian Federation and India which together accounted for more than half of non-OECD output in 2005.
2. Trend growth for the non-OECD is the average over the period 2000-07.

Source: OECD Economic Outlook 85 database.

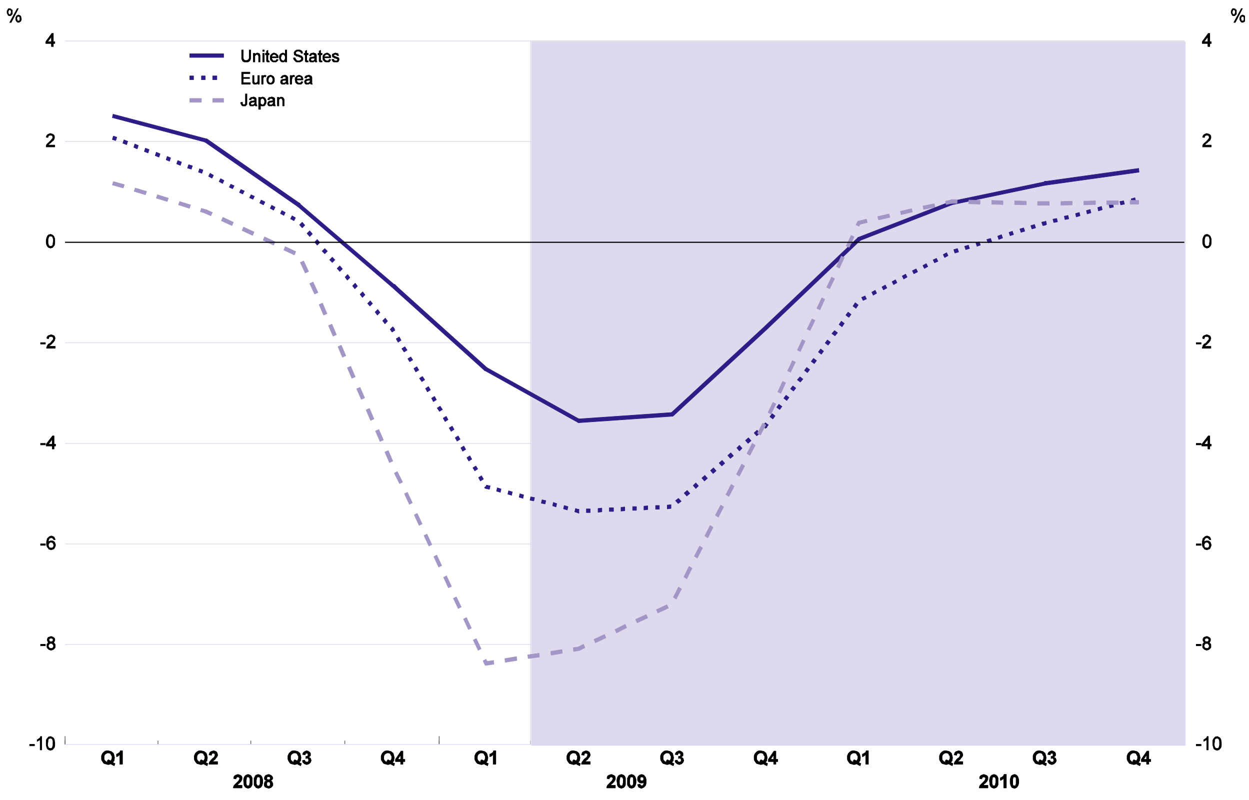
Real GDP Growth will resume in BRIC countries



Source: OECD Economic Outlook 85 database.

Real GDP in the OECD three main areas will rebound but grow at a slow pace

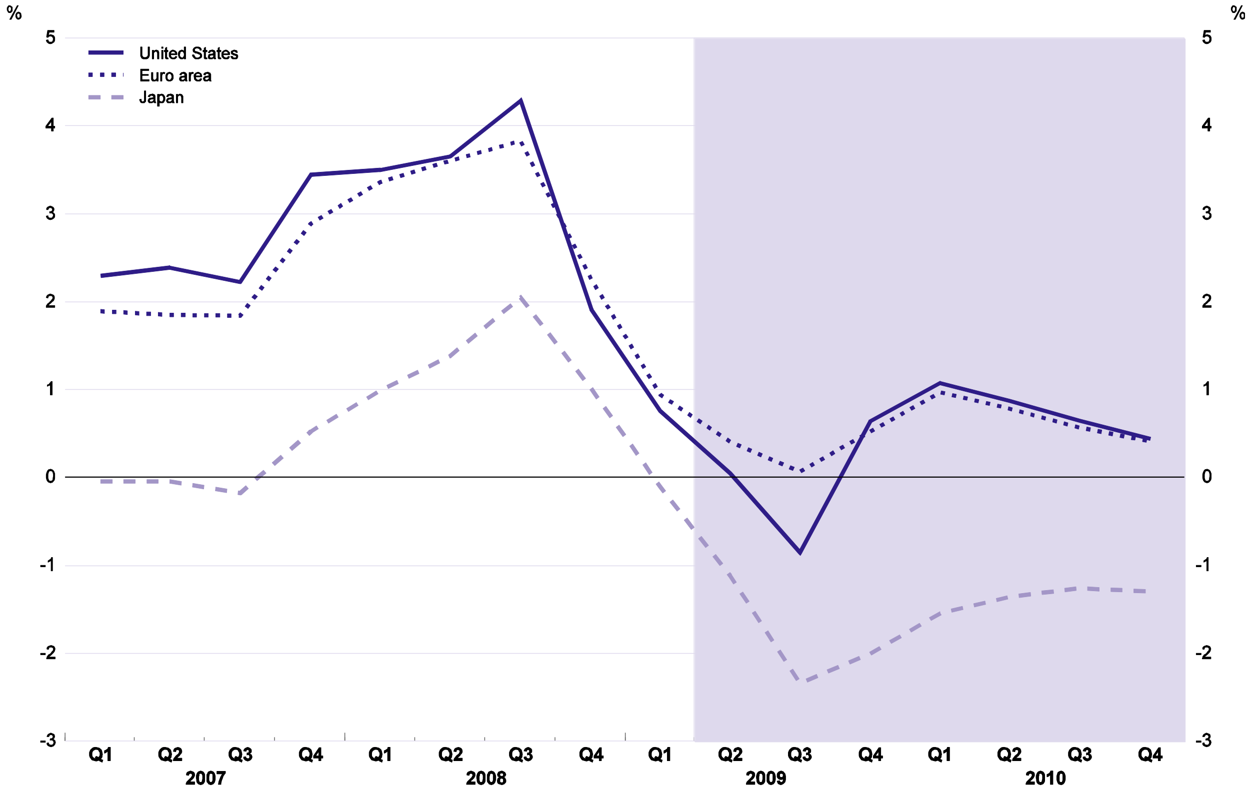
Year-on-year growth



Source: OECD Economic Outlook 85 database.

Inflation will fall to very low levels

Year-on-year growth rate

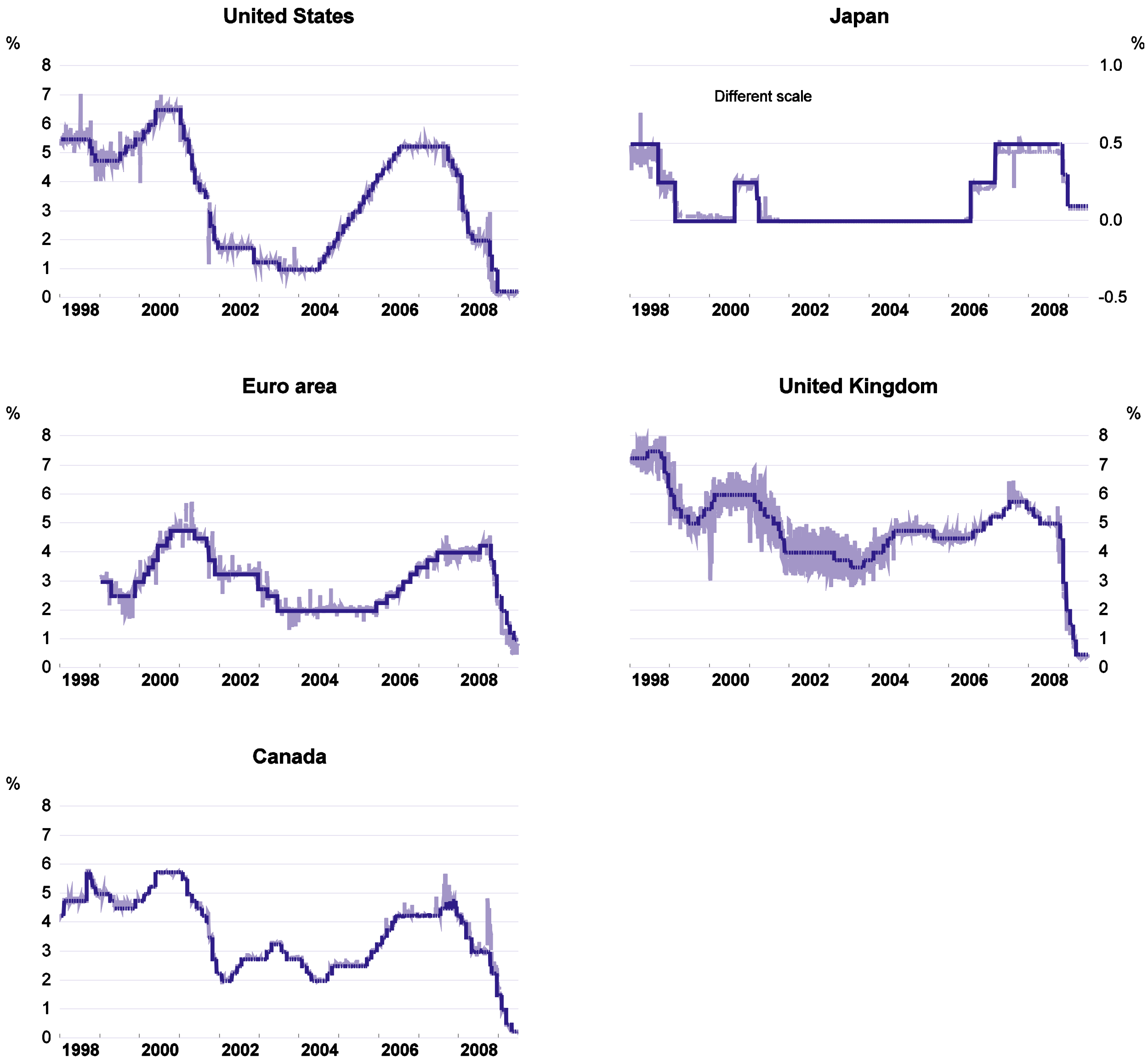


Note: Personal consumption expenditures deflator for the United States; Harmonised index of consumer prices for euro area; Consumer price index for Japan.

Source: OECD Economic Outlook 85 database.

Policy rates are very close to zero in most major OECD economies

Last observation: 19 June 2009



Note: The dark line represents the main policy rate of the central banks. The light line plots the effective overnight rate.

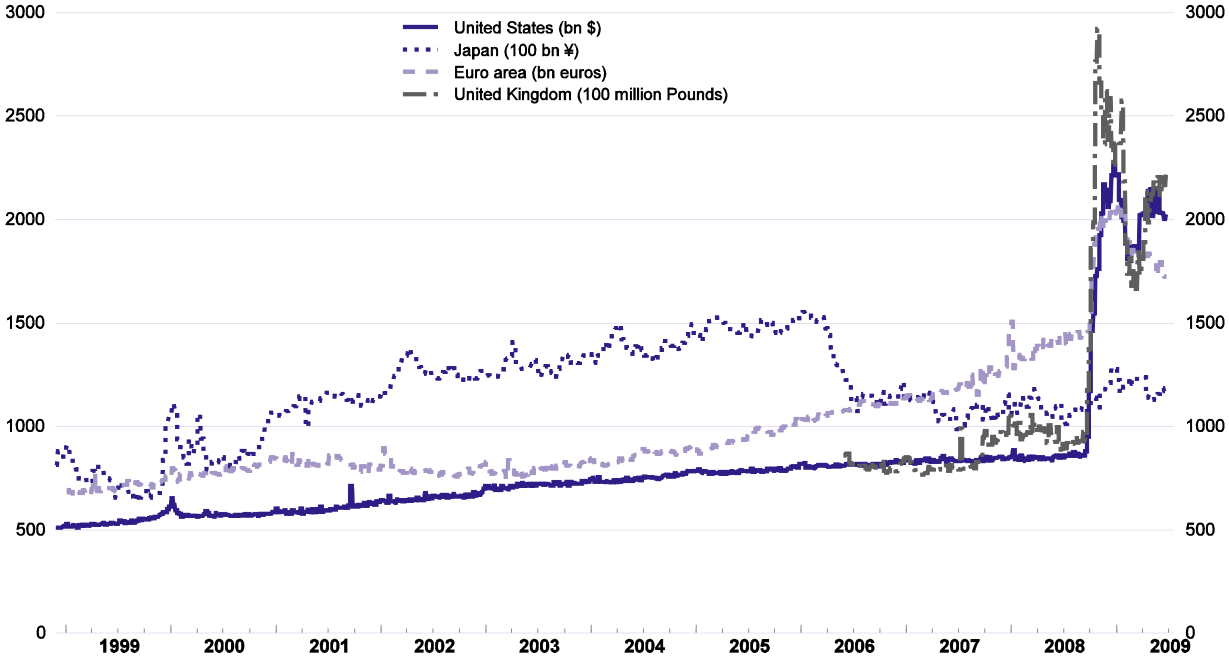
Source: Bloomberg, Bank of Japan, Datastream, ECB.

Bond yields have picked up

Source: OECD Economic Outlook 85 database.

Unconventional measures have led to expansion of central banks' balance sheets

Latest avalaible date: 19 June 2009



Source: Datastream.

Governments have introduced a wide array of financial relief measures since mid-2008

	Bank liabilities				Bank assets				
	Increase deposit insurance	Guarantee or buy bank debt	Inject capital[1]	Nationalise[2]	Ring-fence bad assets	Plan to purchase toxic assets	Fund commercial paper	Fund asset-backed securities	Ban or restrict short-selling
United States	x	x	x	x	x	x	x	x	x
Japan		x	x				x	x	x
Euro area	x								
Germany	x	x	x			x			x
France	already high	x	x						x
Italy	x		x						x
United Kingdom	x	x	x	x	x		x	x	x
Canada		x					x	x	x
Australia	x	x						x	x
Austria	x	x	x						x
Belgium	x	x	x						x
Czech Republic									
Denmark	x	x	x					x	x
Finland	x	x	x				x		x
Greece	x	x	x						
Hungary	x	x	x						
Iceland	x		x	x					x
Ireland	x	x	x	x		x			
Korea		x				x			
Luxembourg	x	x	x						
Netherlands	x	x	x	x					x
New Zealand	x	x							
Norway	already high	x	x						
Slovak Republic	x								
Poland	x		x						
Portugal	x	x	x						
Sweden	x	x	x					x	
Spain	x	x						x	x
Mexico		x							
Switzerland	x		x			x	x	x	
Turkey									

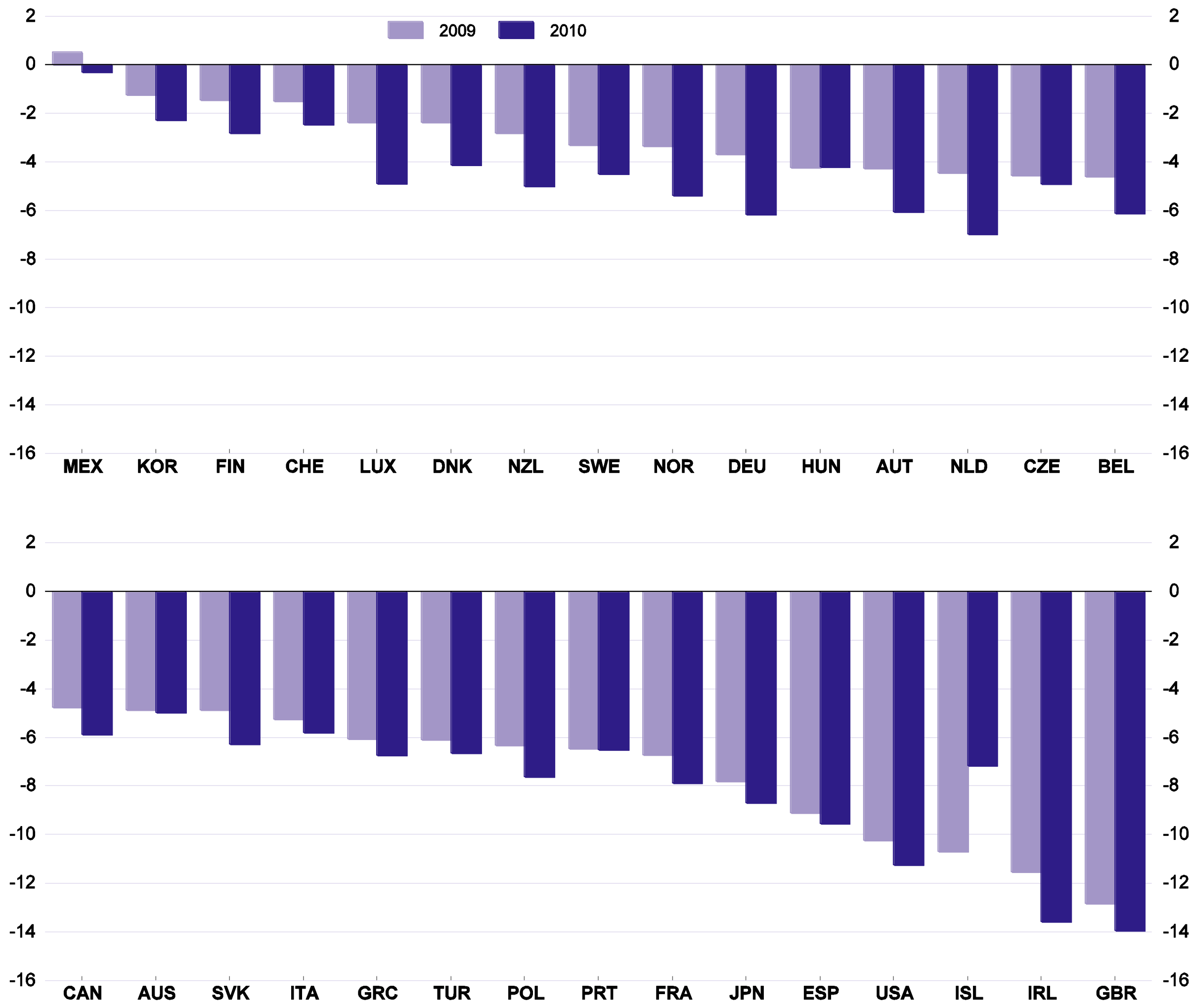
Note: the coverage of nationalisations and measures to ring-fence bad assets is incomplete.

1. Capital has already been injected in banks, or funds have been allocated for future capital injections. The law allows the Japanese government to inject capital into financial corporations, but so far this option has not been used.
2. Nationalisation is defined as the government taking control of a substantial share of banking activities (defined in a broad sense). The cell for the United States is ticked to acknowledge the actions taken by the authorities to take control of Fannie Mae and Freddie Mac and unwind Washington Mutual.

Source: OECD.

Budget balances will deteriorate

General government net lending, in percentage of actual output

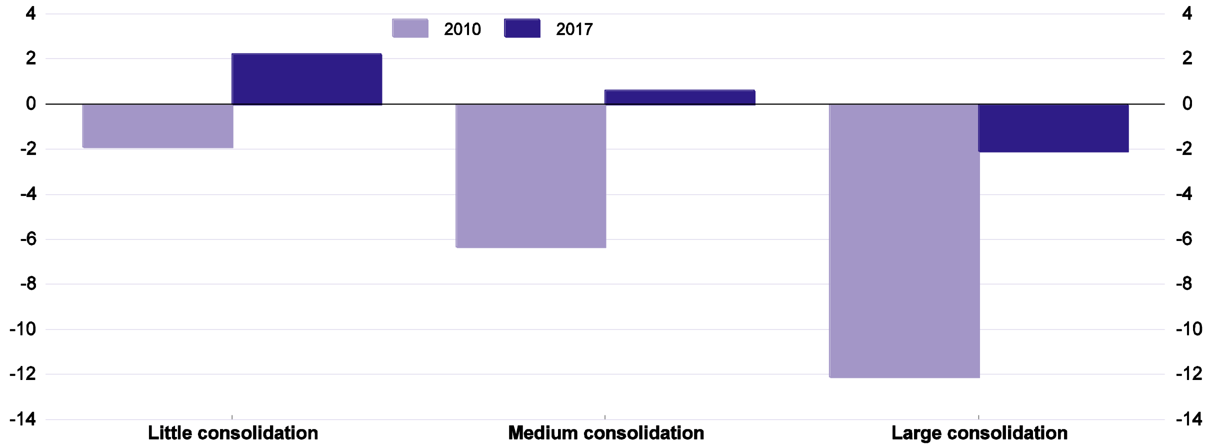


Source: OECD Economic Outlook 85 database.

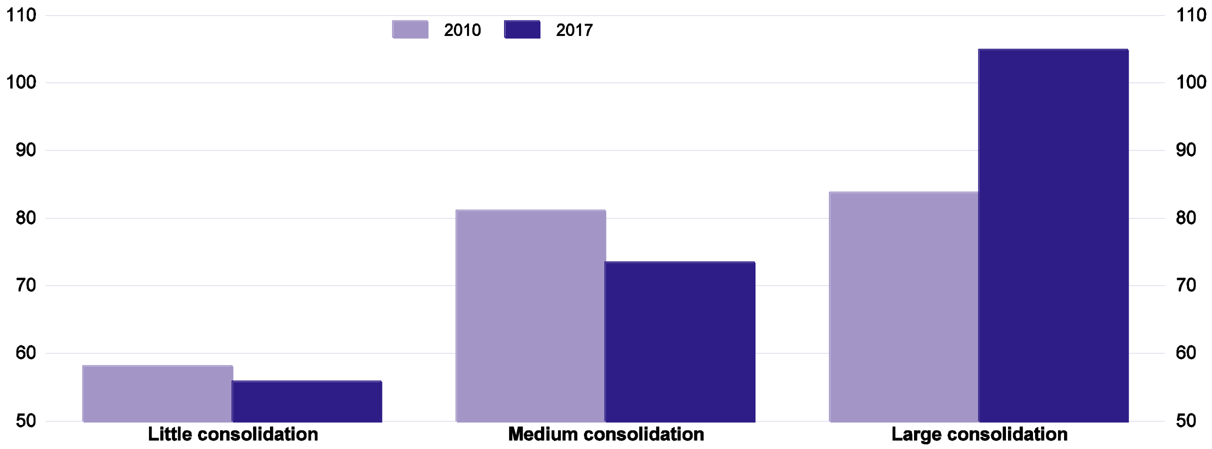
The need for fiscal consolidation varies across countries

In percentage of actual output

A. Budget balance



B. General government gross financial liabilities



Note:

Little consolidation*:* Countries with a fiscal deficit of less than 4 ½ per cent of GDP in 2010 and no assumed fiscal consolidation over and above the removal of temporary fiscal stimulus packages. The little consolidation group consists of Denmark, Finland, Hungary, Korea, Norway, Sweden and Switzerland.

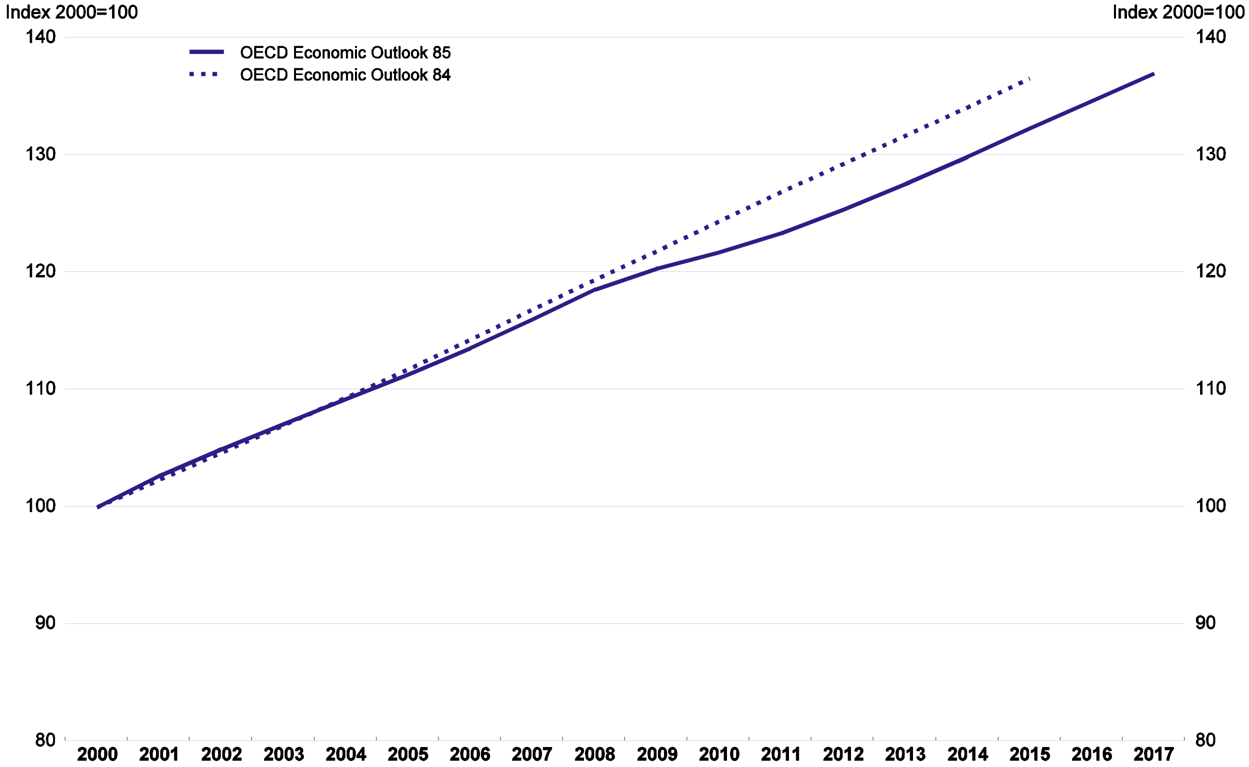
Medium consolidation: Countries with a fiscal deficit of between 4 ½ and 9 per cent of GDP in 2010 and fiscal consolidation assumed to be equivalent to 1 percentage point of GDP cumulatively for three years. The medium consolidation group consists of Australia, Austria, Belgium, Canada, Czech Republic, France, Germany, Greece, Iceland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Poland, Portugal and Slovak Republic.

Large consolidation: Countries with a fiscal deficit of more than 9 per cent of GDP in 2010 and assumed fiscal consolidation equivalent to 1 percentage point of GDP cumulatively for seven years. The large consolidation group consists of Ireland, Spain, United Kingdom and United States.

Data for groups are unweighted averages.

Source: OECD Economic Outlook 85 database.

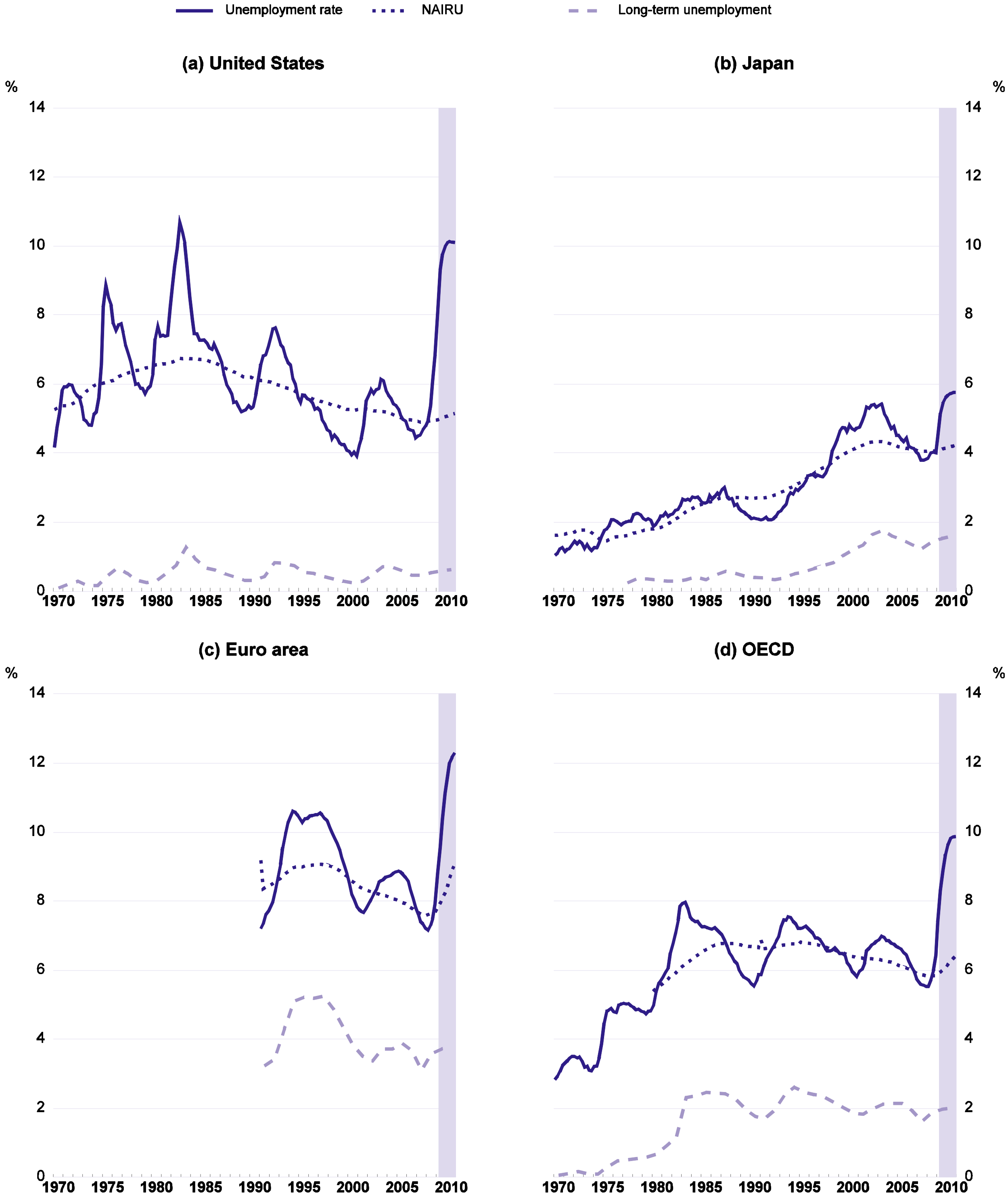
OECD potential output has been revised down



Source: OECD Economic Outlook 85 database.

Unemployment, long-term unemployment and NAIRUs are set to rise, especially in Europe

1970-2010 , percentage of labour force

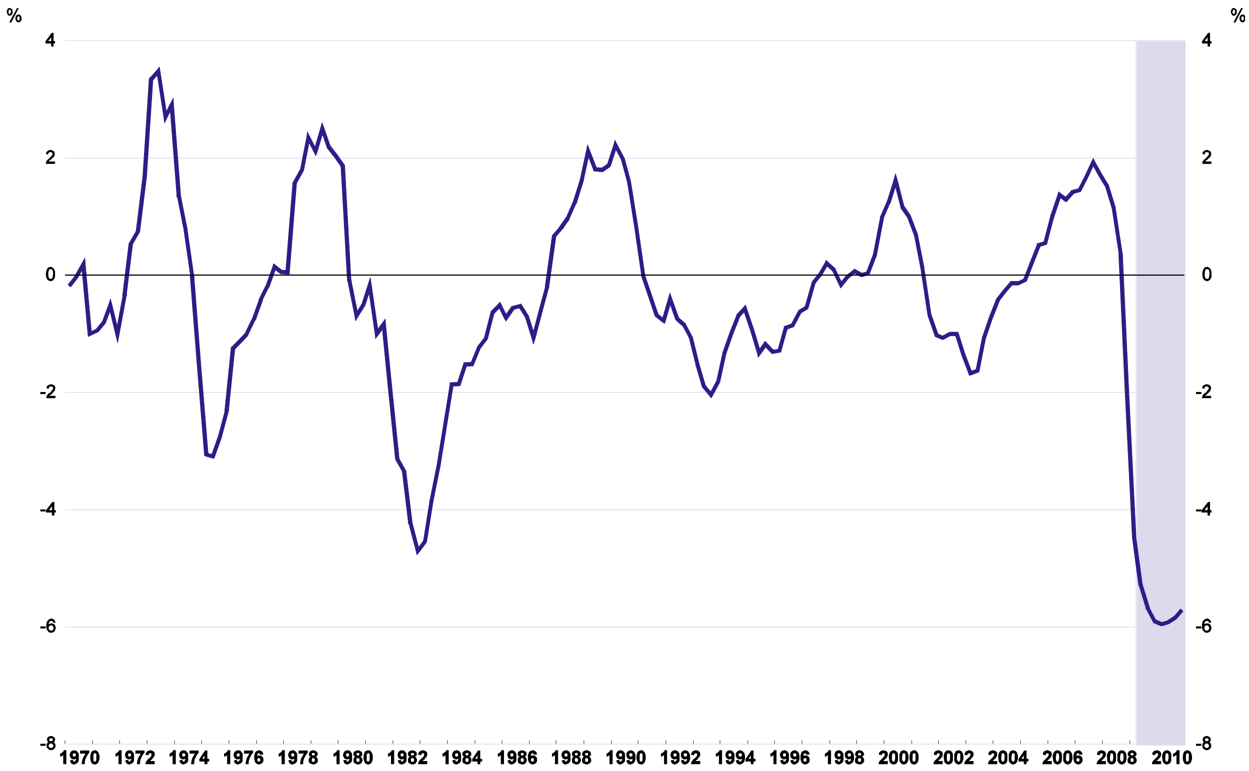


Source: OECD Economic Outlook 85 database; and OECD calculations.

ADDITIONAL FIGURES

The OECD output gap will be the largest in four decades

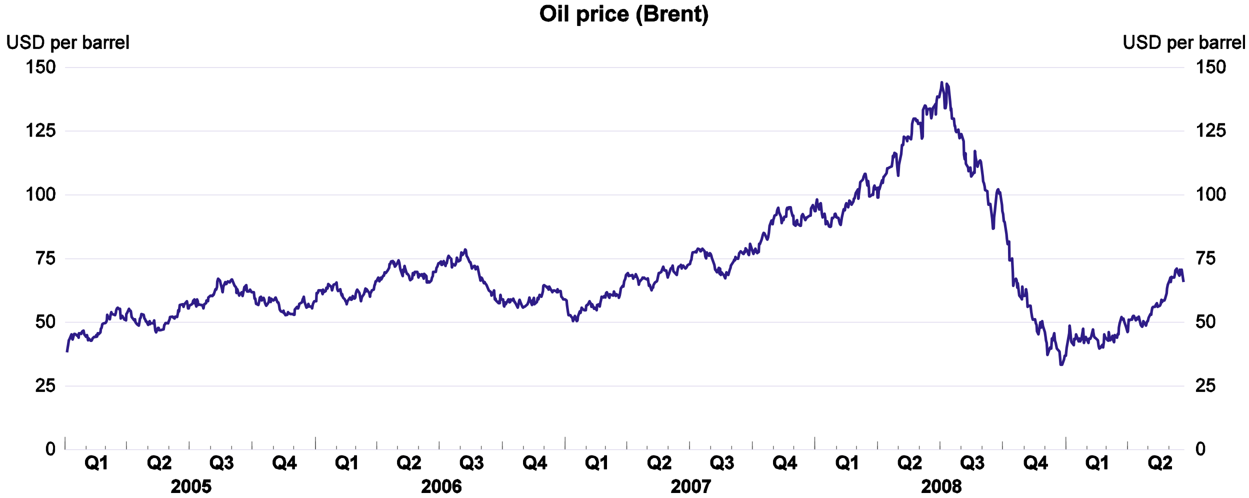
In percentage of potential output

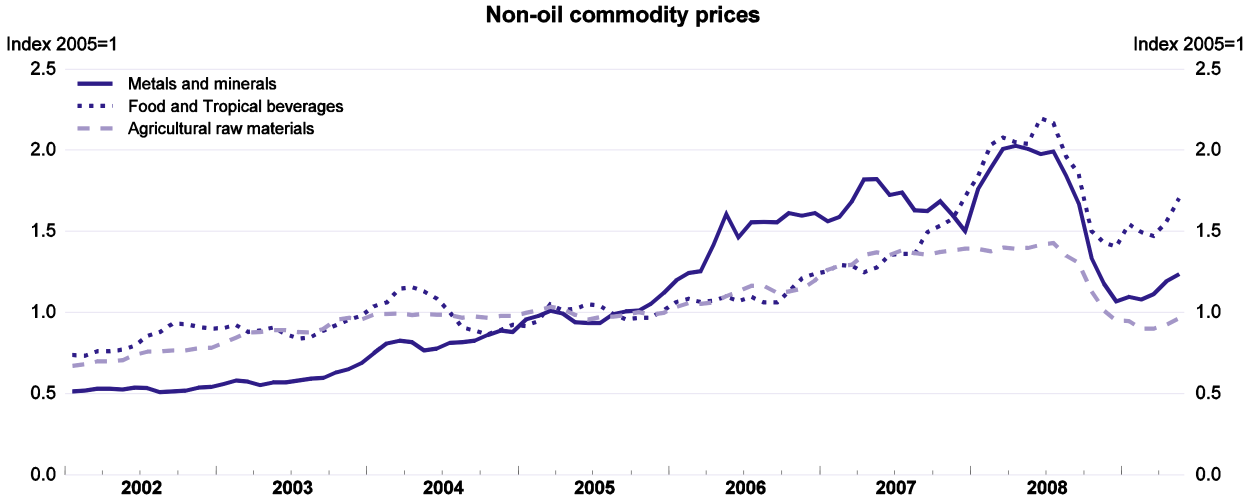


Note: The output gap is the difference between actual and potential output.

Source: OECD Economic Outlook 85 database.

Commodity prices have rebounded

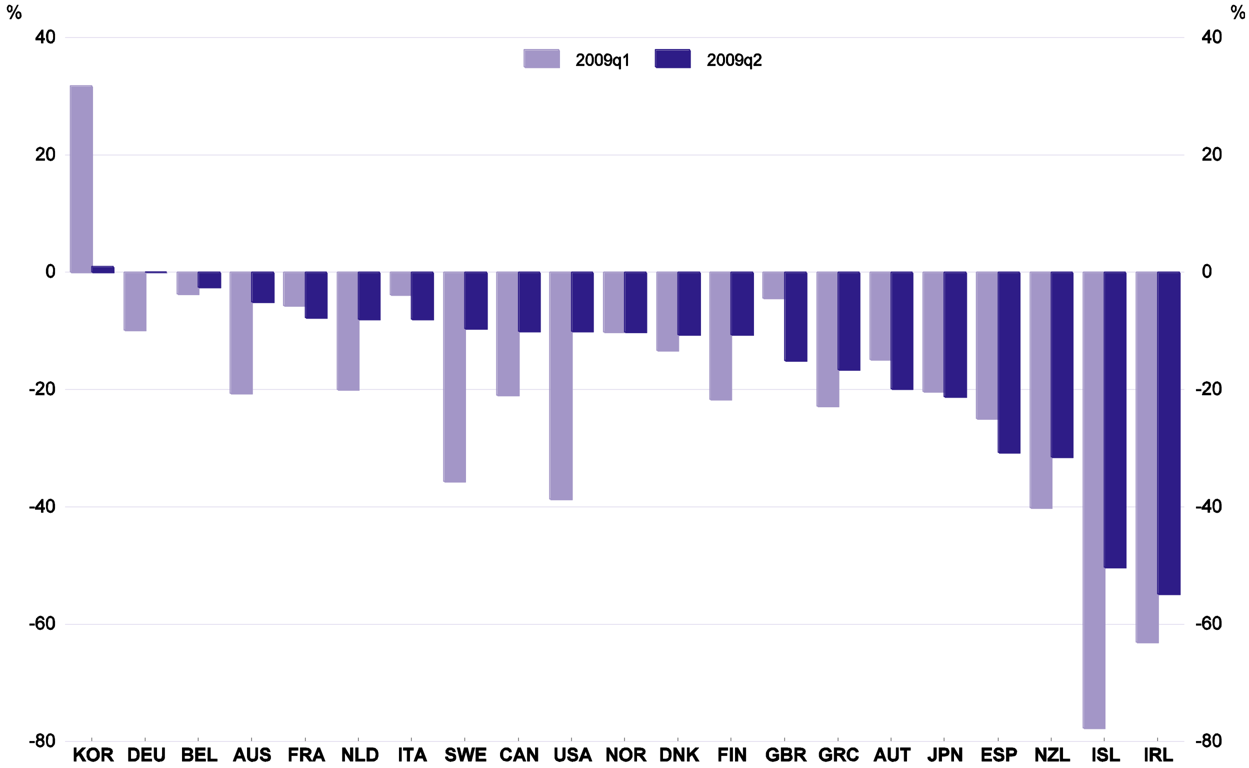




Source: OECD, Main Economic Indicators database; and Datastream.

Housing investment is falling in almost all countries

Quarter-on-quarter annualised growth rate, seasonally adjusted

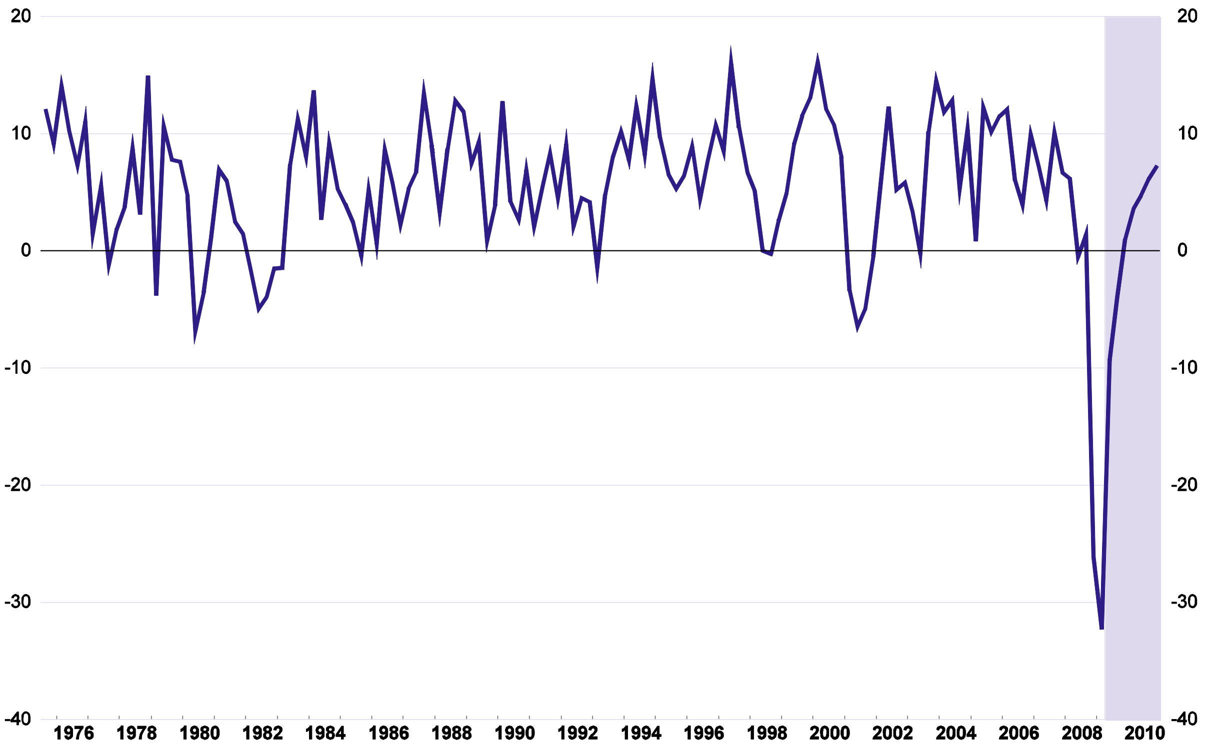


Note: 2009q1 and 2009q2 are forecasted for most countries.

Source: OECD Economic Outlook 85 database.

World trade growth has plummeted

Annualised quarter on quarter growth (%)



Source: OECD Economic Outlook 85 database.