



ECONOMIC OUTLOOK No.83

Press Conference

**Paris, 4th June 2008
11h**

Jørgen Elmeskov
Acting Head of Economics Department

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

Summary of projections

	2007	2008	2009	2008			2009				Fourth quarter		
				Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008	2009
Per cent													
Real GDP growth													
United States	2.2	1.2	1.1	-0.5	0.7	0.2	1.0	1.4	2.2	3.0	2.5	0.3	1.9
Japan	2.1	1.7	1.5	1.1	1.0	1.3	1.6	1.6	1.7	1.7	1.5	1.7	1.6
Euro area	2.6	1.7	1.4	0.2	1.1	1.2	1.4	1.7	1.8	1.9	2.1	1.4	1.7
Total OECD	2.7	1.8	1.7	0.5	1.2	1.2	1.7	2.0	2.4	2.7	2.6	1.3	2.2
Inflation¹													
United States	2.5	3.2	2.0	3.6	2.4	2.0	1.8	1.7	1.6	1.6	3.4	2.9	1.6
Japan	0.1	0.9	0.4	0.6	0.3	0.3	0.3	0.4	0.5	0.6	0.5	0.6	0.5
Euro area	2.1	3.4	2.4	3.3	2.6	2.4	2.3	2.2	2.1	2.0	2.9	3.1	2.1
Total OECD	2.2	3.0	2.1	3.2	2.5	2.3	2.0	1.9	1.8	1.8	2.8	2.8	1.9
Unemployment rate²													
United States	4.6	5.4	6.1	5.2	5.5	5.8	6.0	6.2	6.2	6.1	4.8	5.8	6.1
Japan	3.9	3.8	3.8	3.8	3.8	3.9	3.9	3.8	3.7	3.7	3.9	3.9	3.7
Euro area	7.4	7.2	7.4	7.2	7.2	7.3	7.4	7.4	7.5	7.5	7.1	7.3	7.5
Total OECD	5.6	5.7	6.0	5.7	5.7	5.9	6.0	6.0	6.0	6.0	5.5	5.9	6.0
World trade growth													
	7.1	6.3	6.6	6.1	6.1	6.3	6.6	6.9	7.0	7.1	7.2	6.2	6.9
Current account balance³													
United States	-5.3	-5.0	-4.4										
Japan	4.8	4.4	4.4										
Euro area	0.2	0.1	0.0										
Total OECD	-1.4	-1.3	-1.1										
Cyclically-adjusted fiscal balance⁴													
United States	-3.2	-5.2	-4.4										
Japan	-2.6	-1.6	-2.5										
Euro area	-0.7	-1.0	-0.8										
Total OECD	-2.0	-2.8	-2.5										
Short-term interest rate													
United States	5.3	2.7	3.1	2.6	2.6	2.5	2.3	2.6	3.4	4.0	5.0	2.5	4.0
Japan	0.7	0.8	0.7	0.9	0.9	0.8	0.7	0.7	0.8	0.8	0.8	0.8	0.8
Euro area	4.3	4.5	4.1	4.5	4.5	4.4	4.2	4.1	4.1	4.1	4.7	4.4	4.1

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-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.

Assumptions underlying the projections include:

- no change in actual and announced fiscal policies;
- unchanged exchange rates as from 13 May 2008; in particular 1\$ = 104.44 yen and 0.64 €;

The cut-off date for other information used in the compilation of the projections is 23 May 2008.

1. USA : Price index for personal consumption expenditure, Japan : Consumer price index, Euro area : Harmonised index of consumer prices
2. Per cent of the labour force.
3. Per cent of GDP.
4. Per cent of potential GDP.

Source: OECD Economic Outlook 83 database.

EDITORIAL

AFTER THE STORM?

Several quarters of weak growth lie ahead for most OECD economies. At the same time, headline inflation could remain high for some time to come. This scenario is the combined outcome of financial market turmoil, cooling housing markets and sharply higher commodity prices. The projections in this *OECD Economic Outlook* carry both upside and downside risks and embody the following main features:

- US activity is essentially flat through 2008 and then picks up thereafter as housing adjustment ends, credit conditions normalise and the effects of past monetary ease are felt. With substantial capacity slack and under the assumption of unchanged commodity prices, inflation moderates significantly. Robust export growth, on the back of recent dollar depreciation, helps to narrow the external deficit to around 4½ per cent of GDP next year.
- Euro area activity is restrained through the current year by tighter credit, squeezed real incomes, lower export market growth and market share losses. Growth gradually recovers as these factors fade, though falling housing investment remains a drag throughout. Despite currency appreciation inflationary pressures are strong and, with capacity use moving just slightly below its normal level, it is only towards the end of the projection period that inflation reverts to 2%.
- Japan has been less directly affected by financial turmoil but growth is held back in the near term by slower export growth, weak household incomes and some hesitancy on the part of firms to invest. As growth regains momentum, inflation also gradually moves up to reach a rate around ½ per cent.

The current economic situation is particularly unsettled and the distribution of risk around the projections is wide. In this environment, economic policy in OECD countries needs to take into account the growing importance of developments in non-OECD economies; the influences of higher energy and credit costs on the supply side of OECD economies; the possibility of upward drift in inflation expectations; and the uncertainty as to the effects of financial market developments on growth and inflation.

Globalisation was an important driver of the economic cycle on the way up as non-OECD economies exported both cheap manufactured products and surplus saving, helping to keep OECD interest rates low and thereby boosting asset demand and prices. Currently, robust non-OECD growth is an important factor behind high commodity prices. And, going forward, continued rapid import growth in non-OECD countries will help to cushion activity in the OECD area. At the same time, buoyant non-OECD demand is leading to inflationary pressure in these countries and sustains tensions in commodity markets.

Macroeconomic policy setting, and in particular monetary policy, in OECD countries needs to take into account that non-OECD countries are likely to be an important source of demand at the same time as they are likely to be a less important source of disinflation than previously.

Macroeconomic policy is also faced with a more hazy picture of OECD economies' supply capacity than previously. Both globalisation and structural reform have boosted potential growth rates in the past and will hopefully continue to do so. But sharply higher energy prices and higher costs of capital as a result of financial market developments could sap potential growth. The chapter on supply side uncertainties in this *Economic Outlook* provides some illustrative calculations of these effects. While such quantifications are inherently uncertain, macroeconomic policy needs to be alert to the possibility that capacity limits could be tighter than posited.

Signs that inflation expectations could be drifting up also call for caution. Well-anchored inflation expectations are a crucial policy asset earned, in many cases, through painful disinflation in past decades. Confidence in price stability can be enhanced through various institutional arrangements coupled with careful communication but the ultimate confidence-enhancing measure is to actually deliver.

Financial market influences on growth remain hard to gauge. The odds have improved that financial market dislocation has passed its peak, but this is far from a foregone conclusion. And even if true, the effects on growth are likely to linger. Uncertainty is compounded by the likely feed-back from a weaker growth environment on financial markets and by the fact that problems at financial institutions can be resolved in different ways. In this regard, it is desirable for capital deficiency to be addressed through the injection of new capital and asset disposal rather than through credit compression. While a slower than projected normalisation of financial markets cannot be excluded, nor can a more rapid restoration, especially if improved confidence were to create a positive feed-back between financial asset prices and institutions' balance sheets. Central banks need to stand ready to deal with both eventualities.

Apart from dealing with the fall-out on demand from current financial market distress, it will be necessary to re-visit the prudential and supervisory framework for financial markets. The Financial Stability Forum has recently provided directions for change in these areas and efforts towards implementation are in some cases already underway. It will be important to carry through with the required reforms, also when the memory of recent turmoil becomes more distant and those subject to tighter regulation more likely to resist. At the same time, regulatory overkill needs to be avoided. Many recent innovations in financial markets have the capacity to improve welfare, when appropriately harnessed.

It also needs to be considered whether and how the tendency for financial markets to generate cycles can best be addressed. This may involve both regulatory initiatives to attempt to damp inherent cyclicality as well as a reconsideration of monetary policy conduct. Dynamic provisioning and reserve requirements are some of the instruments that may help smooth credit cycles and increase resilience of the financial sector but they are not without drawbacks. Concerning monetary policy, it may not be desirable nor feasible to prick bubbles, but greater symmetry in the response to credit booms and busts may be useful.

As regards fiscal policy, the United States has introduced temporary tax rebates that seem to be appropriately timed and targeted and therefore stand a good chance of providing needed support to activity. The issue of fiscal stimulus has also been broached for other OECD regions but, in general, the case for such initiatives is weak. Inflation pressures in the euro area are such that any stimulus might have to be offset by monetary policy and, in any case, automatic fiscal stabilisers are much stronger than in the United States. In Japan, the fiscal situation does not allow fiscal expansion and the economy is anyway less directly affected by financial turmoil than other OECD countries.

Much higher food and energy prices are leading to demands for offsetting policy action. Such demands ought to be resisted. Only by allowing the right price signals to affect demand and supply can better balance be established in these markets. Concerns for living standards among those on low incomes are better addressed through an appropriately designed tax and social transfer system.

Overall, OECD economies have been hit by strong gales over the recent past and it will take time and well-judged policies to get back on course. Nonetheless, it is a tribute to the effects of past structural reform and well-honed macro-policy frameworks that the effects of this near-perfect storm have not been worse. This underlines the need to persevere with such policies.

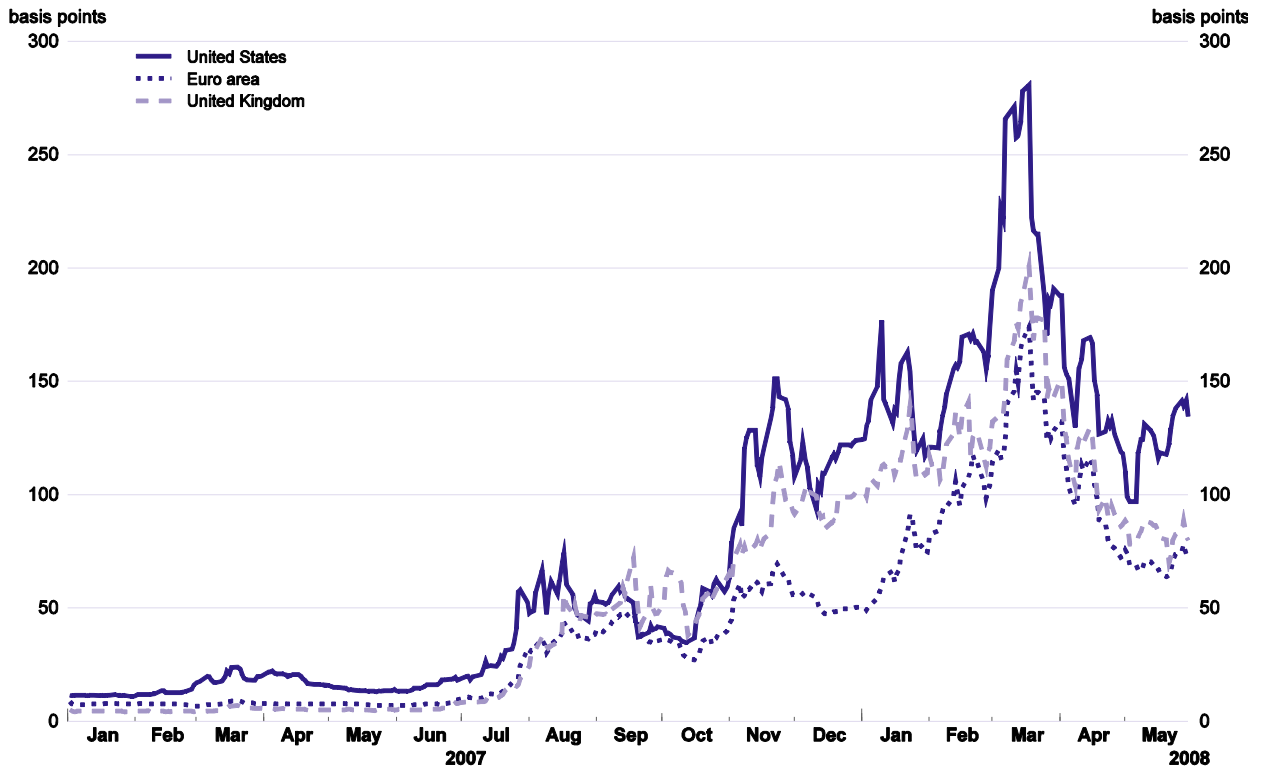
28 May 2008

A handwritten signature in black ink, appearing to read 'Jørgen Elmeskov', written in a cursive style.

Jørgen Elmeskov

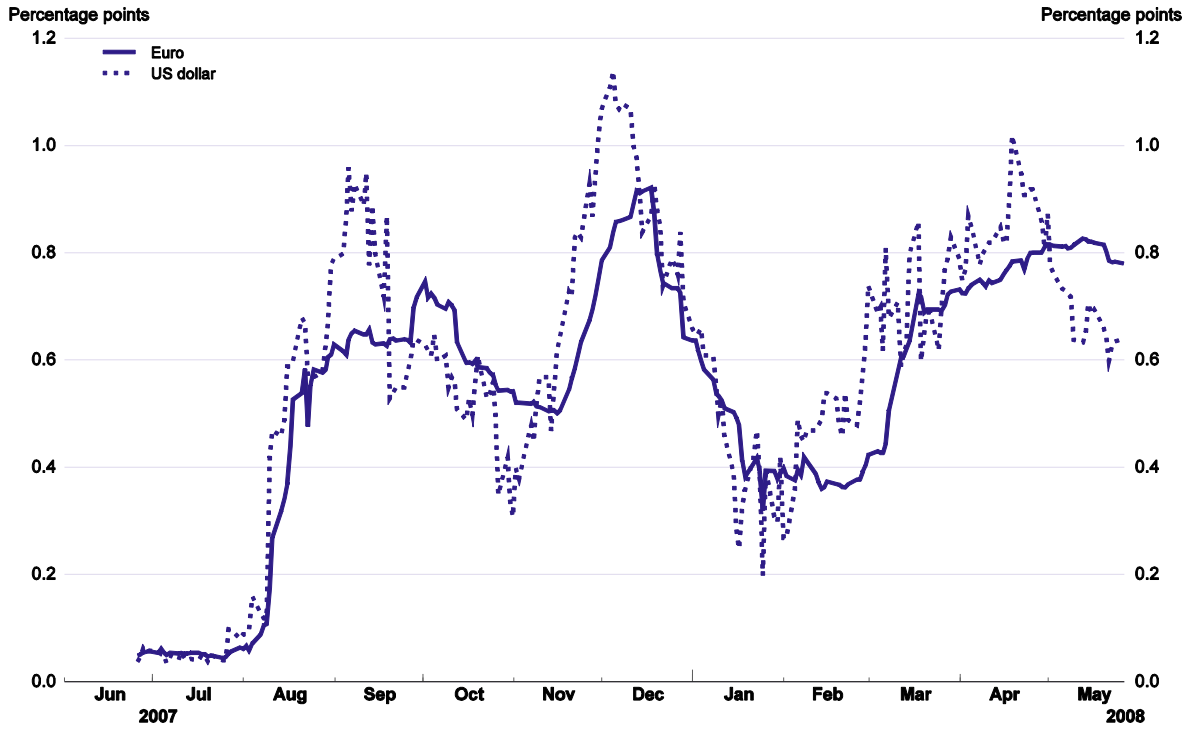
Acting Head, Economics Department

Credit default swaps in the banking sector have come down somewhat



Source: Datastream.

Money market spreads remain wide



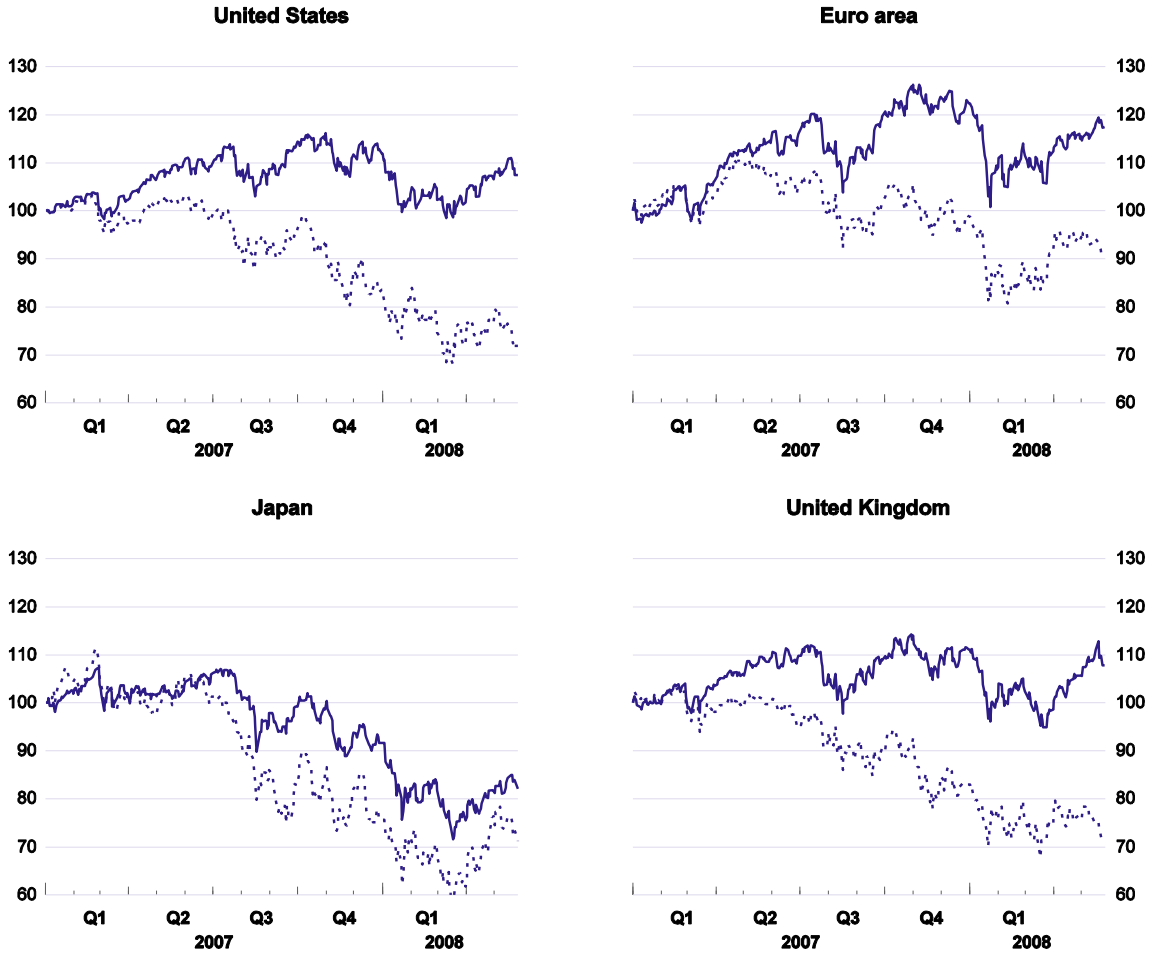
Note: Spread between three-month EURIBOR and EONIA three-month swap index for euro area; spread between three-month LIBOR and three-month overnight index swap for the United States.

Source: Datastream; and Bloomberg.

Share prices of financial institutions have fallen

Share price indices, 1 January 2007 = 100

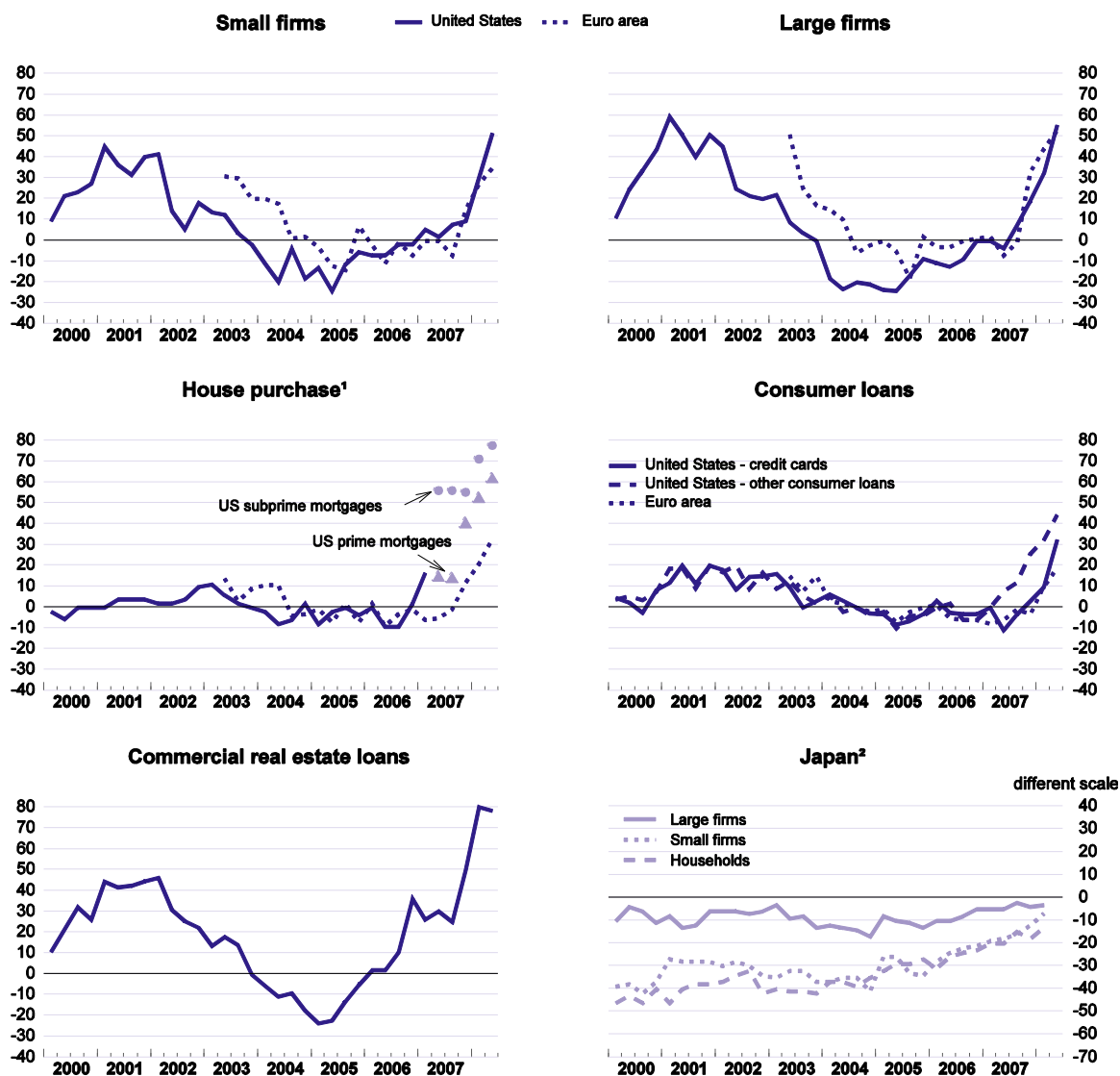
— Non-financial sector - - - Financial sector



Source: Datastream.

Banks are tightening lending standards

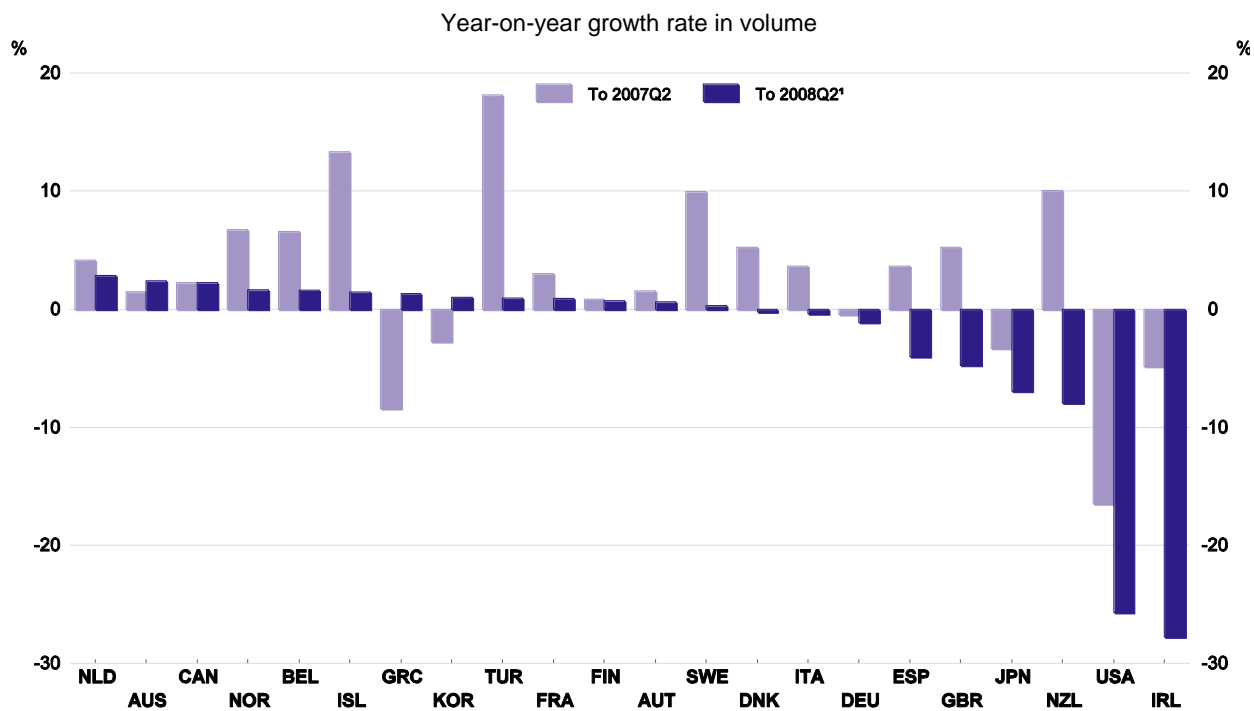
Net percentage of banks tightening credit



1. In the United States, starting in 2007Q2 changes in standards for prime, non conventional (not displayed on this figure) and subprime mortgage loans are reported separately.
2. The Bank of Japan publishes a diffusion index of 'accommodative' minus 'severe'. The data have then been transformed to show the net percentage of banks tightening credit, as for the United States and the euro area.

Source: US Federal Reserve, Senior Loan Officer Survey; ECB, The euro area bank lending survey; and Bank of Japan, Senior Loan Officer Opinion Survey.

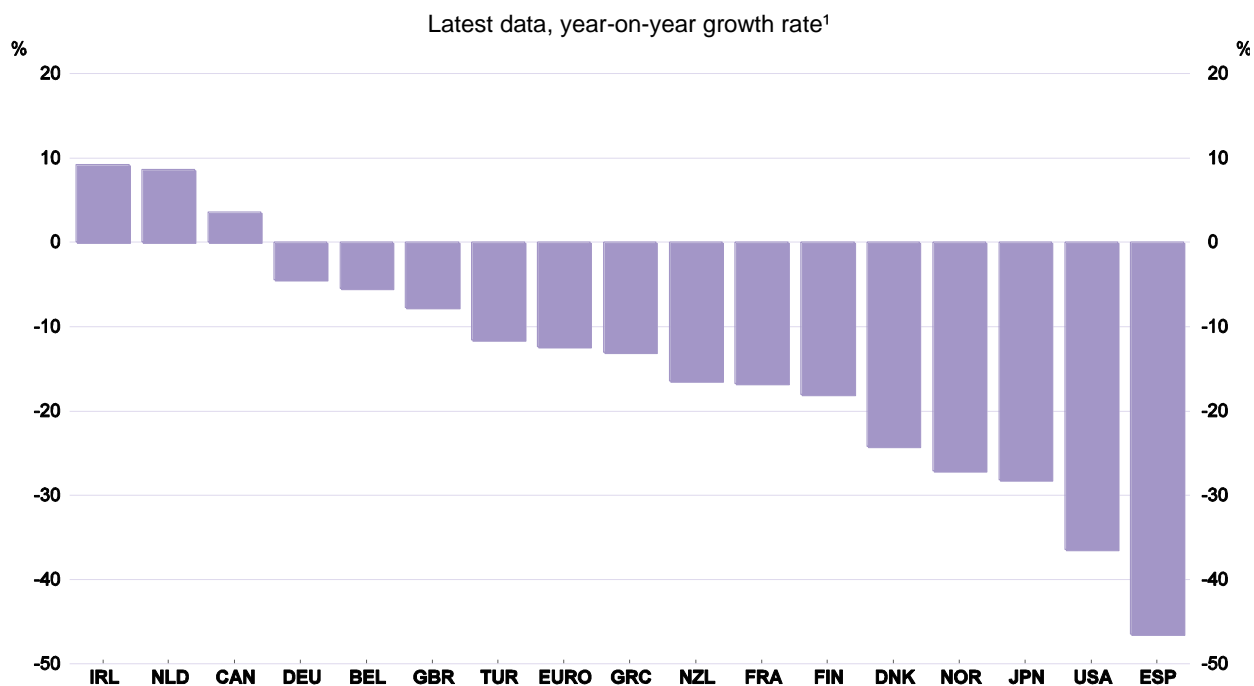
Housing investment is decelerating in most countries



1. Change in second quarter in 2008 is projected.

Source: OECD Economic Outlook 83 database.

Residential permits are falling sharply in most countries



1. Monthly data mostly ending between December 2007 and March 2008; three-month average over the same three-month average in the previous year.

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

Real house prices are slowing or falling

Per cent annual rate of change

	2000-2005	2006	2007 ¹	Latest quarter ²	Lastest available quarter
United States	5.6	4.6	-0.1	-4.0	2008 Q1
Japan	-4.6	-3.3	-0.8	-0.5	2007 Q3
Germany	-3.1	-1.8	-2.2	-3.0	2007 Q4
France	9.4	10.0	4.9	3.1	2007 Q4
Italy	6.5	4.1	2.9	3.3	2007 Q3
United Kingdom	9.8	3.9	8.4	4.0	2008 Q1
Canada	6.2	9.1	8.7	9.8	2007 Q4
Australia	7.8	4.1	8.7	9.1	2008 Q1
Denmark	5.7	19.4	2.7	-1.9	2007 Q4
Finland	4.0	8.4	5.5	0.7	2008 Q1
Ireland	7.9	10.5	-1.8	-5.4	2007 Q4
Netherlands	2.9	2.9	2.6	2.2	2008 Q1
Norway	4.5	10.7	11.5	-0.6	2008 Q1
New Zealand	9.7	6.9	8.3	4.3	2007 Q4
Spain	12.2	6.3	2.6	-1.1	2008 Q1
Sweden	6.0	10.5	8.4	8.8	2007 Q4
Switzerland	1.7	1.4	1.3	-2.0	2008 Q1
Euro area ^{3,4}	4.6	4.0	1.6	0.4	
Total of above countries ⁴	4.2	3.6	1.6	-0.7	

Note: House prices deflated by the Consumer Price Index.

1. Average of available quarters where full year is not yet complete.

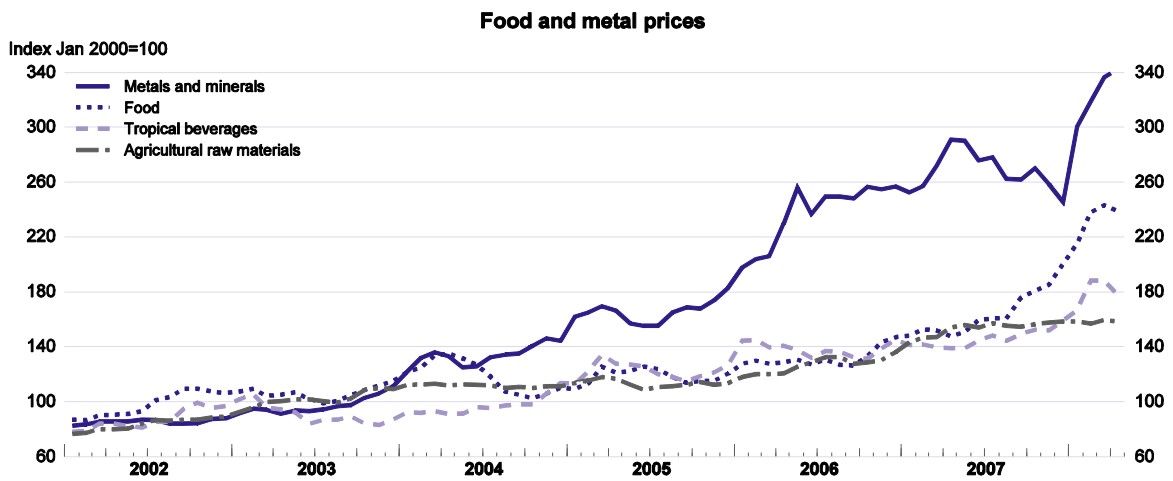
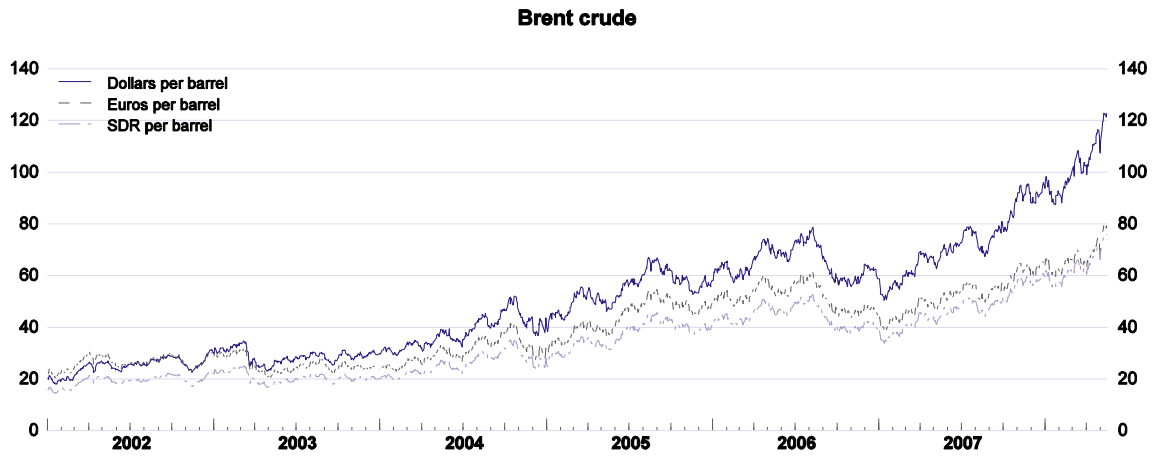
2. Increase over a year earlier to the latest available quarter.

3. Germany, France, Italy, Spain, Finland, Ireland and the Netherlands.

4. Using 2000 GDP weights.

Source: OECD calculations.

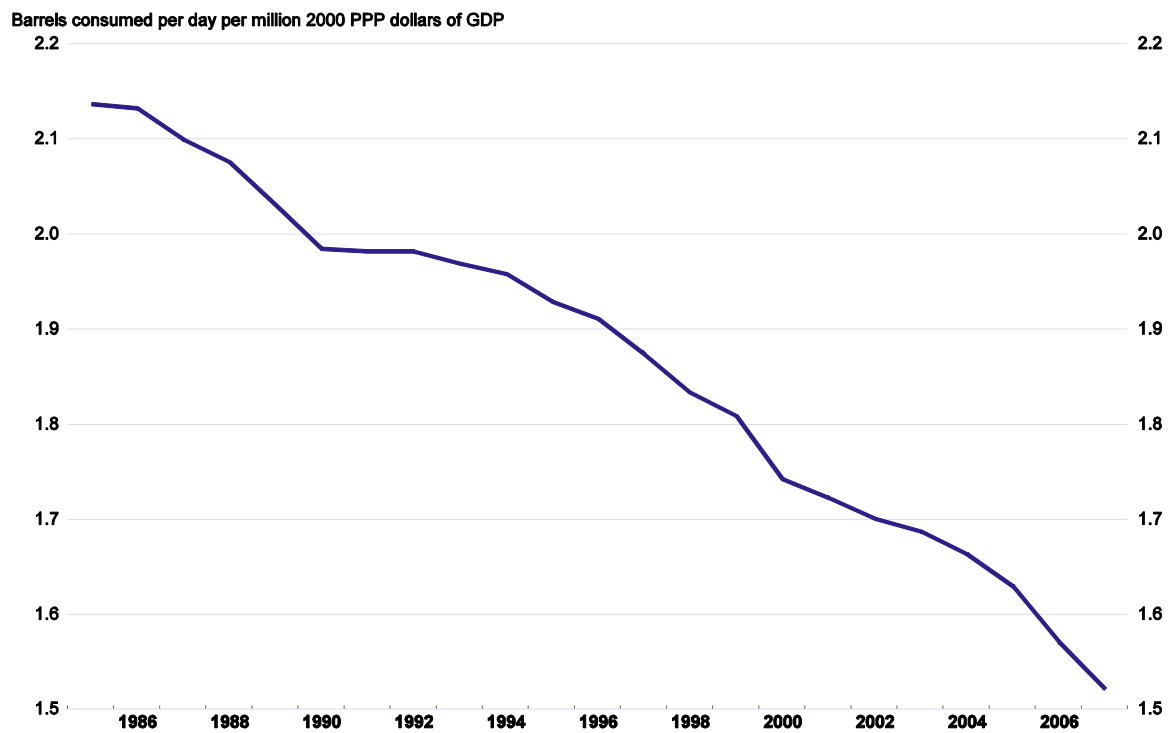
Commodity prices hover at new heights



Source: Datastream; HWWI; IMF, Exchange Rates data; OECD Economic Outlook 83 database.

Oil intensity in the OECD area is falling

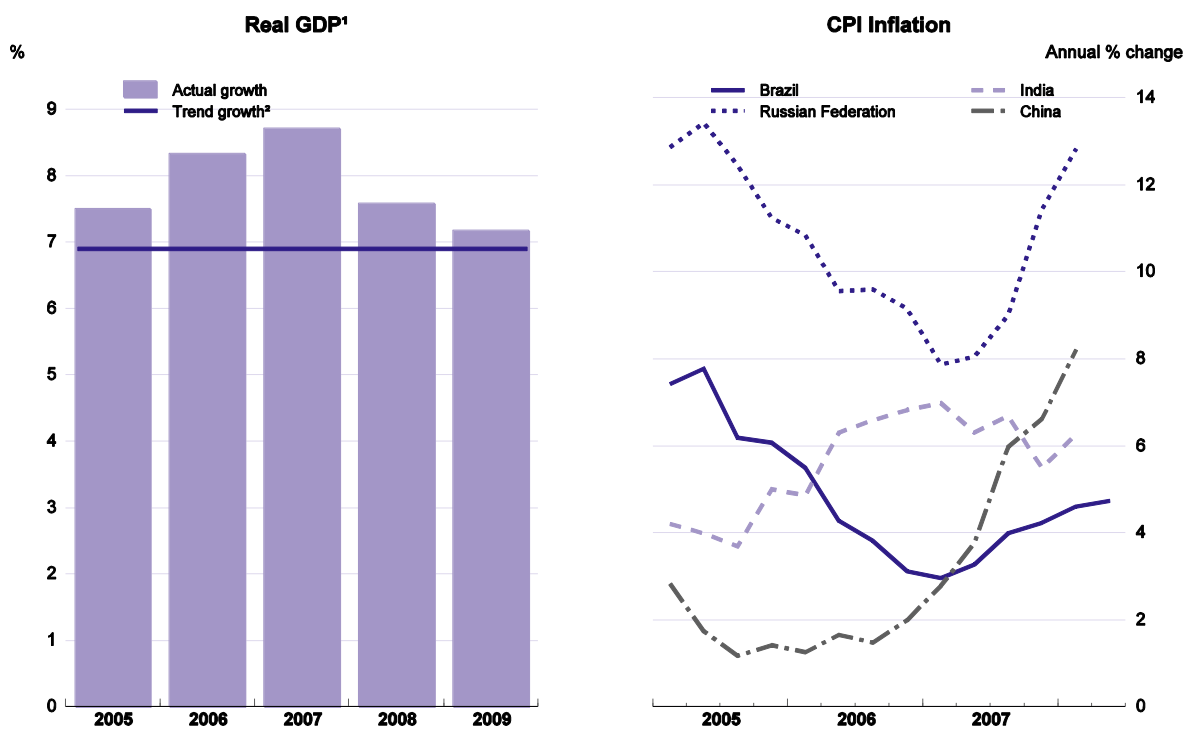
Oil demand¹ relative to GDP volume



1. Oil demand: deliveries from refineries and primary stocks.

Source: IEA; and OECD Economic Outlook 83 database.

Only a modest slowdown in non-OECD growth is expected, but inflation has risen sharply



1. Weighted average, using 2000 GDP weights and PPP's, of Brazil, Russian Federation, India, China and Dynamic Asia which together accounted for about two-thirds of non-OECD output in 2000.
2. Trend growth is the average GDP growth over the period 2000-06.

Source: OECD calculations.

China: domestic demand offsets weaker net exports



Source: CEIC.

Estimated impacts if risks materialise

Difference from OECD Economic Outlook No. 83 projection, percentage points

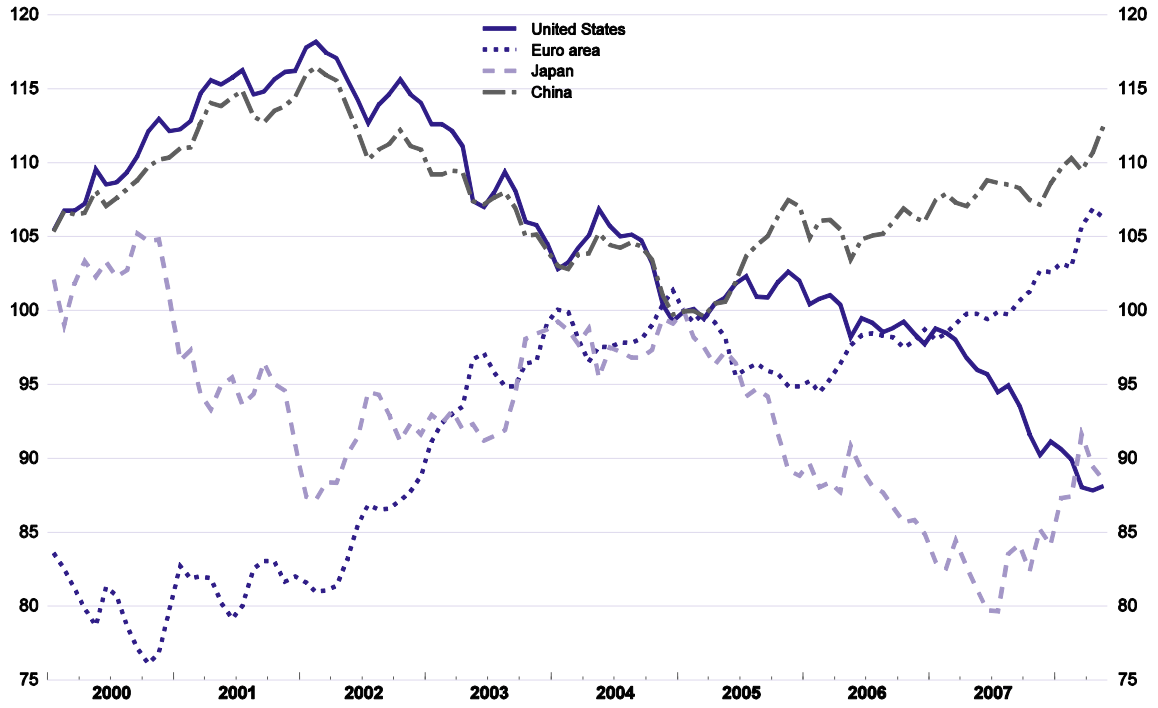
	Weaker US house prices ¹		Lower emerging market demand ²		Continued financial turmoil ³		Depreciation of the dollar ⁴		Further oil price shock ⁵	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
United States										
Output growth	-0.2	-0.3	-0.1	-0.1	-0.3	-0.4	0.4	0.3	-0.1	-0.2
Inflation	0.0	-0.1	0.0	0.0	0.0	-0.1	0.2	0.3	0.2	0.1
Japan										
Output growth	0.0	0.0	-0.1	-0.3	-0.2	-0.3	0.0	-0.2	-0.1	-0.2
Inflation	0.0	0.0	-0.1	-0.1	-0.1	-0.1	0.0	-0.2	0.2	0.1
Euro area										
Output growth	0.0	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1
Inflation	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.2	0.1

1. US house prices fall by 10%.
2. Domestic demand in emerging markets falls by 1%.
3. Risk premiums rise by 50 basis points in all countries.
4. The US dollar falls by 10% against all currencies.
5. The reported effects are for a 10% shock to oil prices relative to baseline; in the present case this is equivalent to an increase of \$12 per barrel relative to the baseline assumption of \$120 per barrel. These ready reckoner effects are approximately linear in percentage terms, although significantly larger shocks need to be re-evaluated on a specific basis."

Source: OECD calculations.

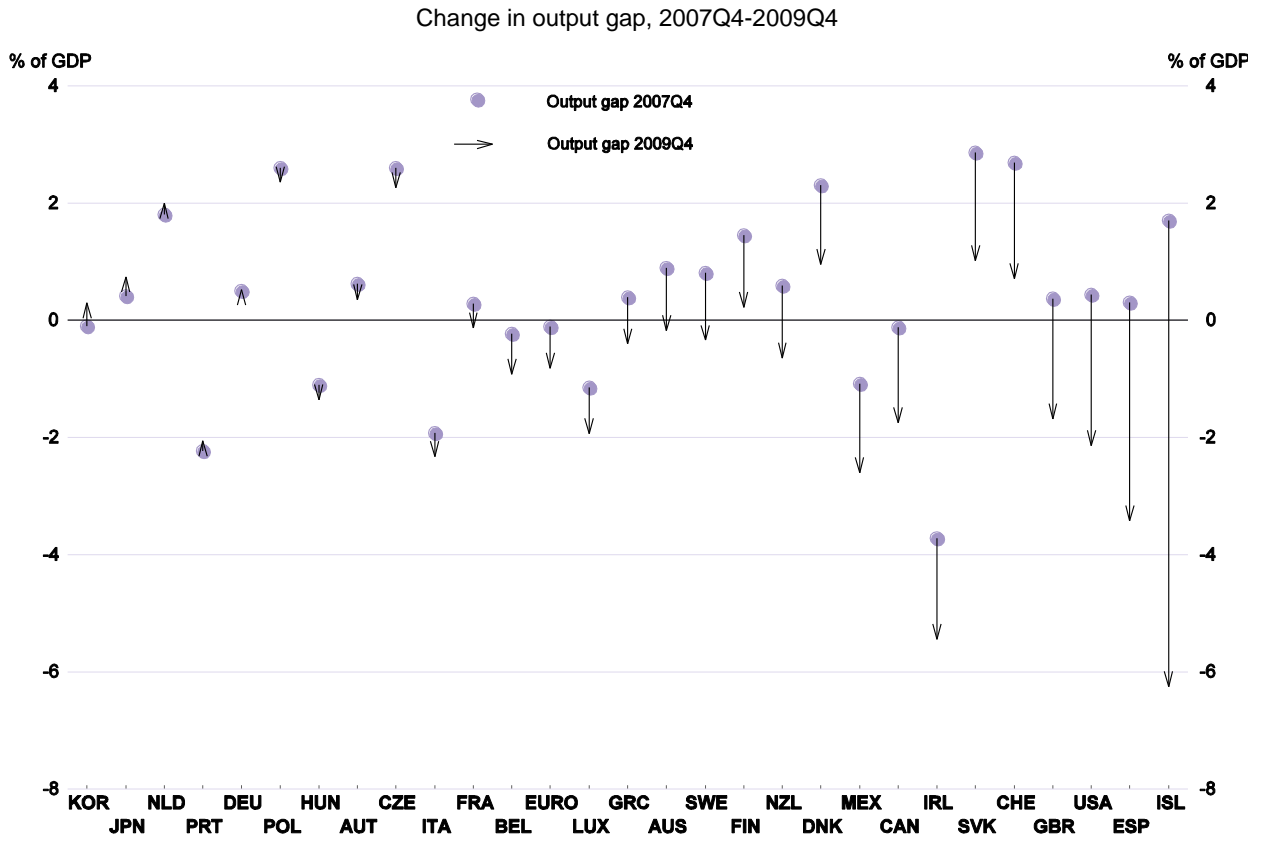
Effective exchange rates have moved

January 2005 = 100



Source: OECD, Main Economic Indicators database.

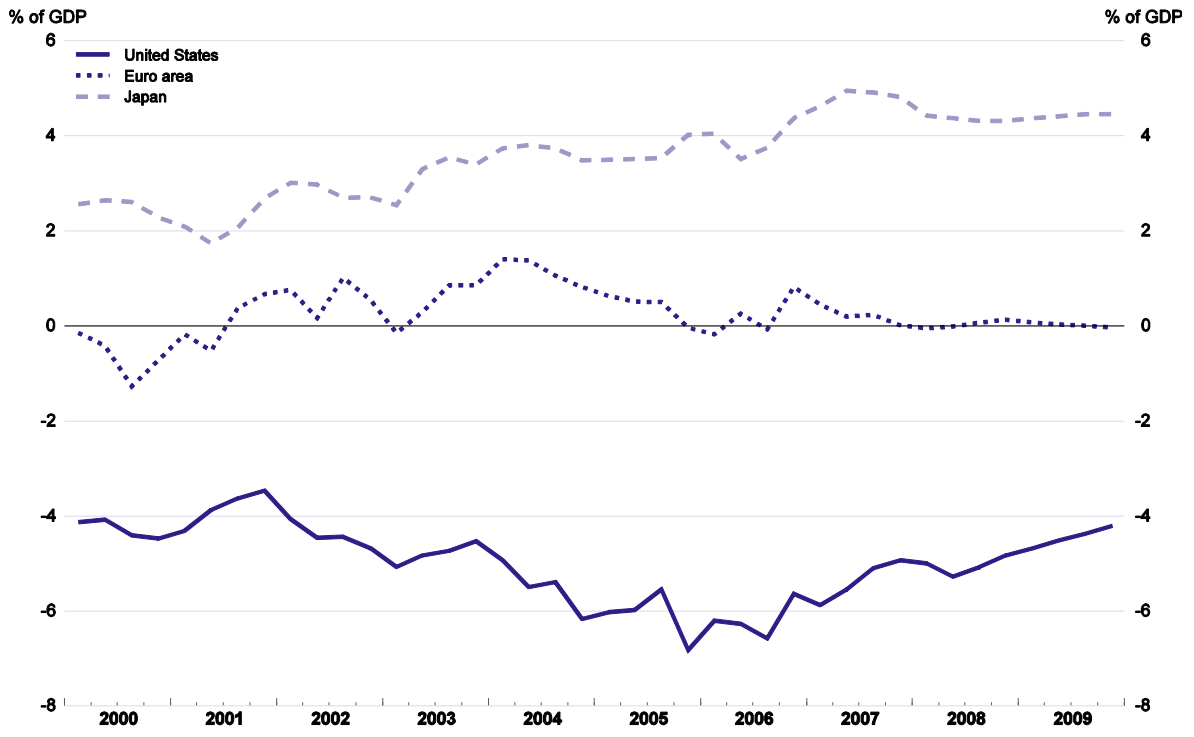
Vulnerability to headwinds differs across countries



Note: Countries are ranked according to the change in the output gap over the period 2007Q4-2009Q4.

Source: OECD Economic Outlook 83 database.

Current account imbalances are projected to improve



Source: OECD Economic Outlook 83 database.

Fiscal positions are worsening

Per cent of GDP / Potential GDP

	2006	2007	2008	2009
United States				
Actual balance	-2.6	-3.0	-5.5	-5.2
Cyclically-adjusted balance	-2.9	-3.2	-5.2	-4.4
Japan				
Actual balance	-1.4	-2.4	-1.4	-2.2
Underlying cyclically-adjusted balance ²	-3.5	-3.1	-3.0	-2.9
Euro area				
Actual balance	-1.3	-0.6	-1.1	-1.2
Underlying cyclically-adjusted balance ²	-1.2	-0.7	-1.0	-0.8
OECD¹				
Actual balance	-1.5	-1.5	-2.5	-2.6
Underlying cyclically-adjusted balance ²	-2.1	-2.0	-2.9	-2.5

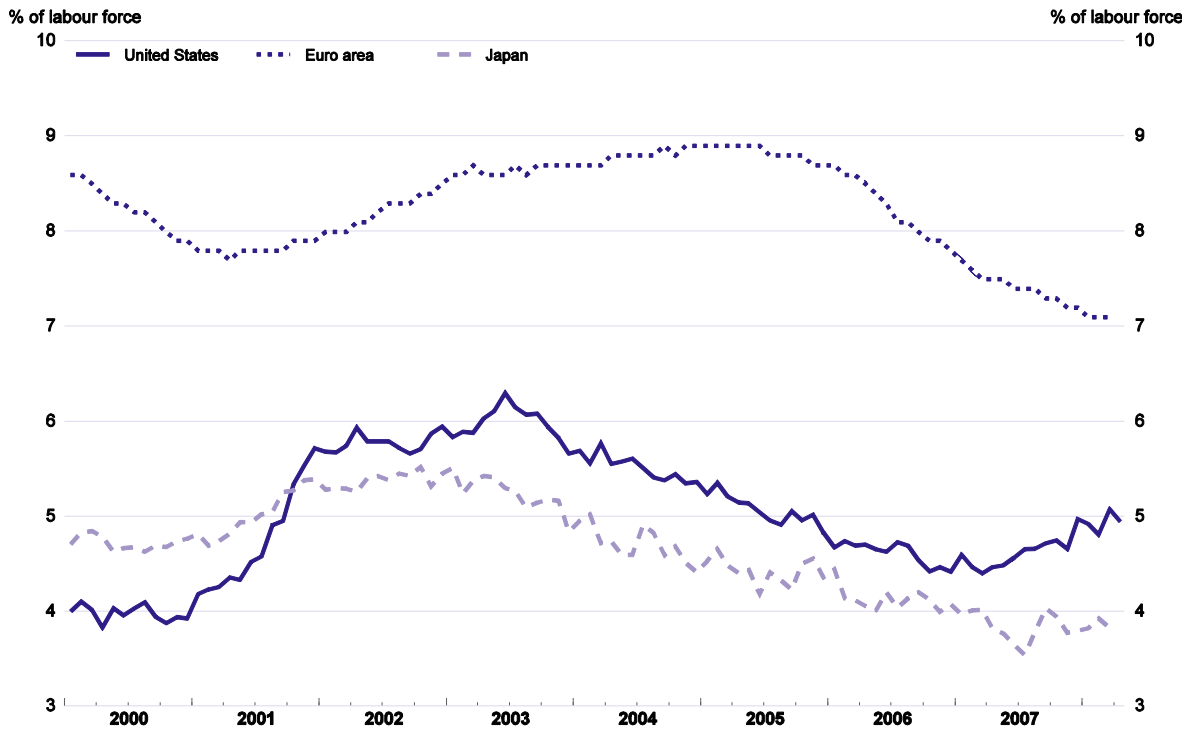
Note: Actual balances and liabilities are in per cent of nominal GDP. Cyclically-adjusted balances are in per cent of potential GDP. The primary cyclically-adjusted balance is the cyclically-adjusted balance less net debt interest payments.

1. Total OECD excludes Mexico and Turkey.

2. In this context "underlying" means that the balance has been purged of one-off and temporary measures, insofar as they have been identified. For European Union countries these adjustments are mainly taken from European Commission (2007).

Sources: OECD Economic Outlook 83 database, European Commission (2007), "Public Finances in Emu, 2007".

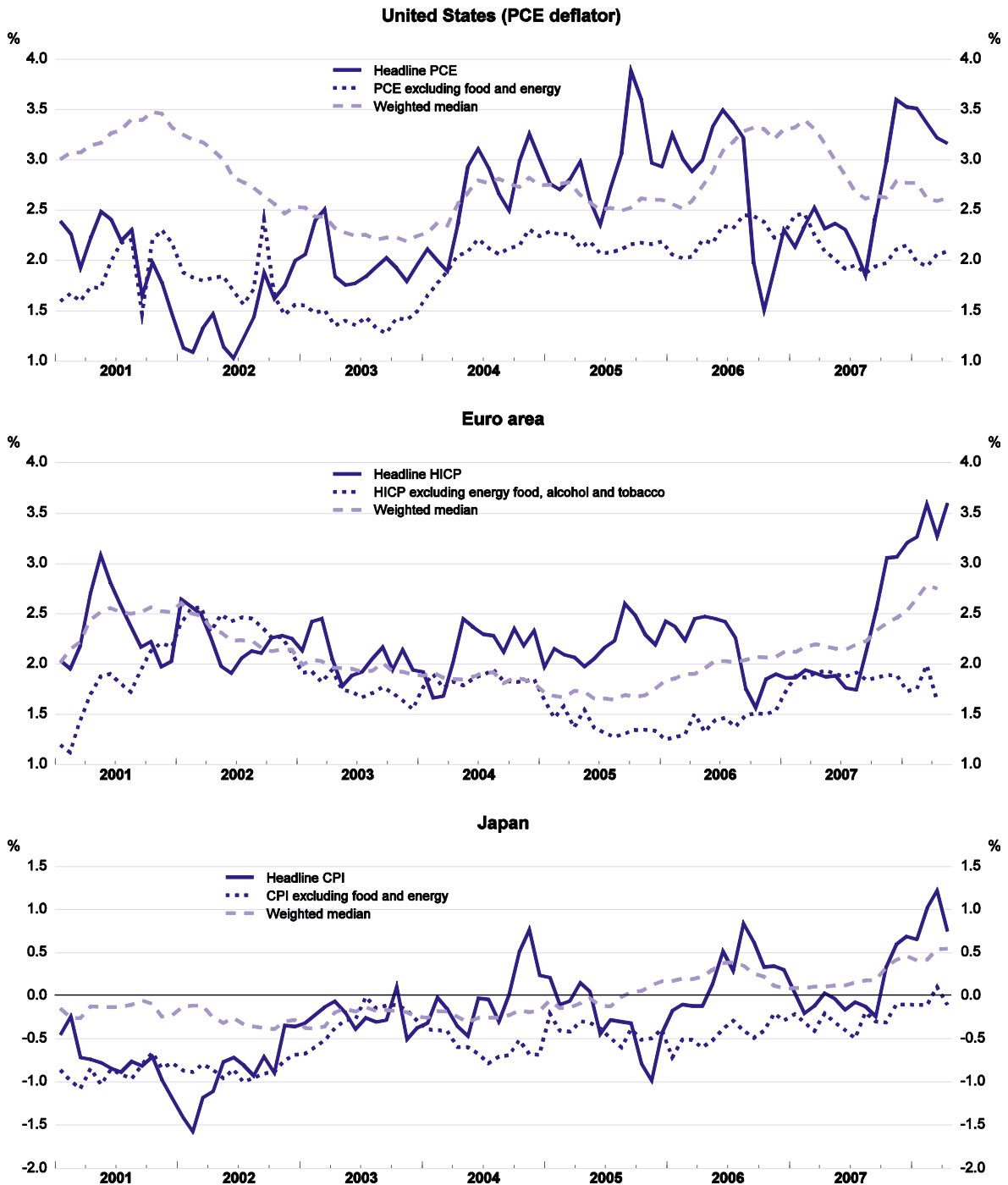
Unemployment is low and has fallen markedly in the euro area



Source: OECD, Main Economic Indicators database.

Headline inflation has picked up sharply

12-month percentage change



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

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