Trade Union
Advisory Committee
to the OECD
*Commission
syndicale consultative
auprès de l'OCDE*

Release of the OECD Interim Economic Outlook

The slowdown in growth is happening, highlighting the urgency of improving coordination between monetary and fiscal policy

Paris, 6th March 2019

Key findings

- The Interim Economic Outlook released today by the OECD confirms that the slowdown in global growth is continuing and even intensifying;
- The policy response put forward is unconvincing however, focussing on pro-competition/market-friendly reforms while giving demand side policy a more limited and auxiliary role;
- Policy makers, including the OECD, should urgently reflect upon a policy package combining current slack with a (public) investment programme into a low carbon economy that is supported financially by monetary policy in the form of 'quantitative greening'.

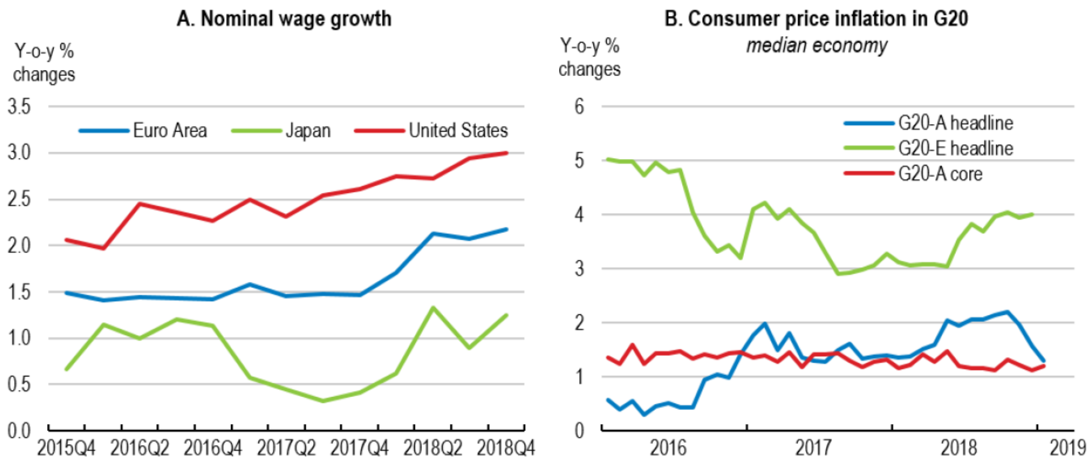
The slowdown is intensifying

The Interim Economic Outlook released today by the OECD confirms that the slowdown in global growth is continuing and even intensifying.
Particularly worrying are the Euro Area, the UK and Canada where forecasts are seriously downgraded (between -0,7 and -1,1) and 2018 growth dives significantly below 1%, with Italy even tipping in recession (-0,2).

While increased policy uncertainty, persistent trade tensions and ongoing declines in confidence are to blame, the OECD fails to clearly identify key shifts in policy making that have been ongoing over the course of 2017. In particular, a tightening of monetary conditions in the US (causing amongst others negative spillovers in emerging markets) and restriction of credit expansion to tackle high indebtedness in China are being overlooked.

The OECD is however correct to identify household spending, supported by improving labour market conditions and including a (modest) recovery in wage dynamics, as a force driving the economy forward (see graph below).

Figure 5. Wage growth is starting to strengthen but inflation remains modest



Note: Employment Cost Index: wages and salaries for all civilian workers in the United States; negotiated wages in the euro area; and compensation per employee in Japan. G20-A denotes the G-20 advanced economies, G20-E denotes the G-20 emerging-market economies. Based on monthly data for consumer price inflation. Core consumer price inflation excludes food and energy. Data for Australia and Argentina are not included.

Source: OECD Economic Outlook database; OECD Consumer Price database; Statistics Canada; Bureau of Labour Statistics; ECB; and OECD calculations.

The focus on the European economy as the next weak link in this process of a weakening of the global economy is also to the point. This concern can be illustrated by comparing the OECD forecast with the one released by the European Commission just a few weeks ago. It appears (see table below) that the Commission is hoping for a "soft landing" whereas the OECD is actually raising the alarm.

	OECD		**Commission**	
	2019	2020	2019	2020
Euro Area	1	1,2	1,3	1,6
UK	0,8	0,9	1,3	1,3
Germany	0,7	1,1	1,1	1,7
France	1,3	1,3	1,3	1,5
Italy	-0,2	0,5	0,2	0,8

Source: OECD, EU Commission

A 'Reform Trap" for Europe

However, the policy response the OECD is proposing to address weakness in the European economy is unconvincing. The OECD is essentially calling for a co-ordinated program of pro-competition/market-friendly reforms (liberalisation of services market for example) while giving demand side policy only a limited and auxiliary role.

The OECD's policy scenario raises several questions:

- The OECD assumes that pro-market reforms "consist of measures that raise total factor productivity growth by 0, 2 percentage point per annum" (see box page 11). Such an assumption may seem courageous given the experience over the past decade(s) of pro market reforms coinciding with productivity growth slowing down instead of strengthening.

- Given the long term trend of real wages lagging behind productivity (a trend documented by the OECD itself), the assumption that the medium term increase (5 years) in the level of productivity will be strongly reflected in nominal and real wages is doubtful.

- The fact that structural reforms tend to have an immediate negative impact (both in terms of jobs and inflation), thus possibly worsening the ongoing economic slowdown is not sufficiently taken on board, even if former OECD work documents this.

- The assumed beneficial effects of structural reforms are to be pushed forward by accommodative monetary policy. However, with euro area interest rates at the zero bound, monetary policy may have little or no room to respond adequately.

- Meanwhile, the role of fiscal policy in responding to the economic slowdown is limited to a temporary increase in public investment of 0, 5% of GDP restricted to those countries that have ample fiscal space (Germany and a series of small euro area economies that are highly integrated in the German supply chain). Whether such fiscal expansion is sufficient and able to spill over into those member states facing substantial stress in their economies and labour markets can be doubted.

To conclude, the opportunity is missed to adopt an innovative policy approach by drawing from lessons from the financial crisis, in particular the fact that monetary policy *on its own* can only do so much while fiscal policy *when backed up by central bank action* can be highly effective as quantitative easing allows to *increase fiscal space*. This is especially important in the euro area where sovereign debt, unless shielded by the ECB, is vulnerable to financial market speculation.

Even more innovative would be to link up such mutual strengthening of fiscal and monetary policy with the pressing challenge of investing in a sustainable economy. Policy makers, including the OECD, should urgently reflect upon a policy package combining current slack with a (public) investment programme into a low carbon economy that is supported financially by monetary policy in the form of 'quantitative greening'.