What is the economic outlook for OECD countries?

An interim assessment

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11h Paris time

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1. The news has of course been dominated by the disaster in Japan following the Great East Japan earthquake and tsunami. We express our deep sorrow at the enormous loss of life and offer our condolences to those affected by this tragedy. The full cost of the disaster is not yet known, but the authorities' preliminary estimate is that the loss of physical capital amounted to 3.3 to 5.2% of annual GDP. It is impossible at this point to assess the effect on economic growth, and therefore this interim outlook contains no projections for Japan. As a first estimate, growth in Japan might be reduced between 0.2 and 0.6 percentage points (non-annualised rates) in the first quarter and by somewhere between 0.5 and 1.4 percentage points in the second quarter. This includes the impact of the disaster on production in the areas hit directly, the rationing of power, the hit to confidence and supply chain disruptions. Reconstruction efforts are likely to begin relatively quickly, and these could begin to outweigh the negative effects on GDP by as early as the third quarter.

2. Against this background and according to the OECD short-term forecasting models, growth in the G7 economies outside Japan could rise to an annualised rate of about 3% in the first half of the year (see table opposite). However, although labour market conditions have been improving somewhat in most OECD countries in recent months, the OECD-wide unemployment rate remains over 2 percentage points higher than at the onset of the crisis. As regards inflation, headline measures have picked up significantly in most major OECD economies due to rising commodity prices and, in some countries, price-level adjustments following increases in indirect tax and administered prices. Moreover, inflation expectations have been creeping up. Nevertheless, underlying inflation rates are still low reflecting the large excess capacity that remains in labour and product markets. Inflationary pressures are stronger in some of the large emerging-market economies, prompting a tightening of monetary policy.

3. Aside from the situation in Japan, there are both downside and upside risks:

   - Instability in the Middle East and North Africa and an associated possible further increase in oil prices could act as a drag on economic activity in the near term. Another source of uncertainty stems from sovereign risks in the euro area periphery, while a more generalised rise in bond yields could materialise in view of the high level of public debt in a wide range of countries. As well, housing markets in several countries show signs of continued weakness, with bank exposures possibly entailing financial fragilities.

   - As for strengths, non-financial corporate balance sheets look very healthy, and this could add momentum to economic growth via private investment. Moreover, in spite of still high unemployment in many countries, developments in labour markets look better than expected a few months ago, which could have a favourable impact on private consumption. More generally, the underlying momentum in economic growth in most countries appears stronger than in earlier projections even if, at least in Europe, this has been masked by a noticeable negative impact of severe weather conditions in the final quarter of last year.

4. Considering the balance of strengths and fragilities discussed above, and with financial conditions improving across the board, it seems likely that the recovery is becoming self-sustained. Meanwhile, in some OECD countries monetary policy will need to deal with a risk that inflation expectations may become un-anchored. Public finances remain in distress in most OECD countries. The priority is therefore to consolidate budgets and establish credible and growth-friendly medium-term plans. To facilitate the tasks of monetary and fiscal authorities, pro-growth structural reforms should be implemented. Finally, OECD analysis has shown that a combination of well-targeted macroeconomic and structural policies could achieve a sustained reduction in the still wide global imbalances, as well as contribute to fiscal consolidation.

GDP growth in the G7 economies (excluding Japan)[1]

In per cent

	Annualised quarter-on-quarter growth[2]							
	09Q3	**09Q4**	**10Q1**	**10Q2**	**10Q3**	**10Q4**	**11Q1**	**11Q2**
United States	1.6	5.0	3.7	1.7	2.6	3.1	3.1 (+/-1.6)	3.4 (+/-1.6)
Germany	2.8	1.3	2.6	9.2	2.8	1.5	3.7 (+/-1.9)	2.3 (+/-1.9)
France	0.7	2.3	1.1	2.4	1.0	1.4	3.4 (+/-1.0)	2.8 (+/-1.2)
Italy	1.6	0.1	2.1	2.1	1.3	0.5	1.1 (+/-1.4)	1.3 (+/-1.6)
UK	-1.1	1.9	0.8	4.3	2.9	-1.9	3.0 (+/-1.2)[3]	1.0 (+/-1.3)
Canada	0.9	4.9	5.5	2.2	1.8	3.3	5.2 (+/-1.0)	3.8 (+/-1.9)
G7	***0.9***	***4.2***	***3.5***	***2.8***	***2.5***	***1.6***	**-**	**-**
G7 excl Japan	***1.4***	***3.6***	***3.1***	***3.0***	***2.3***	***2.1***	***3.2 (+/-1.4)***	***2.9 (+/-1.6)***
Euro3[4]	1.8	1.3	2.0	5.3	1.9	1.2	3.0 (+/-1.5)	2.2 (+/-1.6)

1. Japan is excluded from the projections due to the 11 March 2011 Great East Japan earthquake and tsunami. At the time of this release there were insufficient post-earthquake indicators available.

2. GDP releases and high-frequency indicators published by 1 April 2011. Seasonally and in some cases also working-day adjusted. Annualised real GDP growth rates; associated standard error ranges are in parentheses.

3. First quarter 2011 adjusted for impact of exceptional weather in December 2010.

4. Weighted average of the three largest countries in the euro area (Germany, France and Italy).

Underpinnings and status of the interim forecast

Since March 2003, the OECD has presented a brief overview of the near-term prospects in the major OECD economies between each issue of the *Economic Outlook*. This interim assessment should not be seen as a full update of the biannual *Economic Outlook* projections, since it rests on a more limited information set, has a shorter horizon and covers a much smaller number of economic variables and countries. However, it helps evaluate the extent to which the latest *Economic Outlook* projections are still on track for the larger economies.

In this context, the main tool is a suite of indicator-based models that serve to forecast real GDP for each of the G7 economies.* These models cover the two quarters following the last one for which official data have been published. They use a small, country-specific selection of monthly indicators, hard (*e.g.* industrial production, retail sales) and/or soft (*e.g.* business confidence). These models have been shown to outperform a range of other models relying solely on published quarterly data, as regards both forecast-error size and directional accuracy. The weight of the different models varies across countries and over time, according to observed forecasting performance. The models used for the US and the UK economies have been modified to better capture the influence of developments in the housing sector, with the inclusion of various forward-looking housing indicators.

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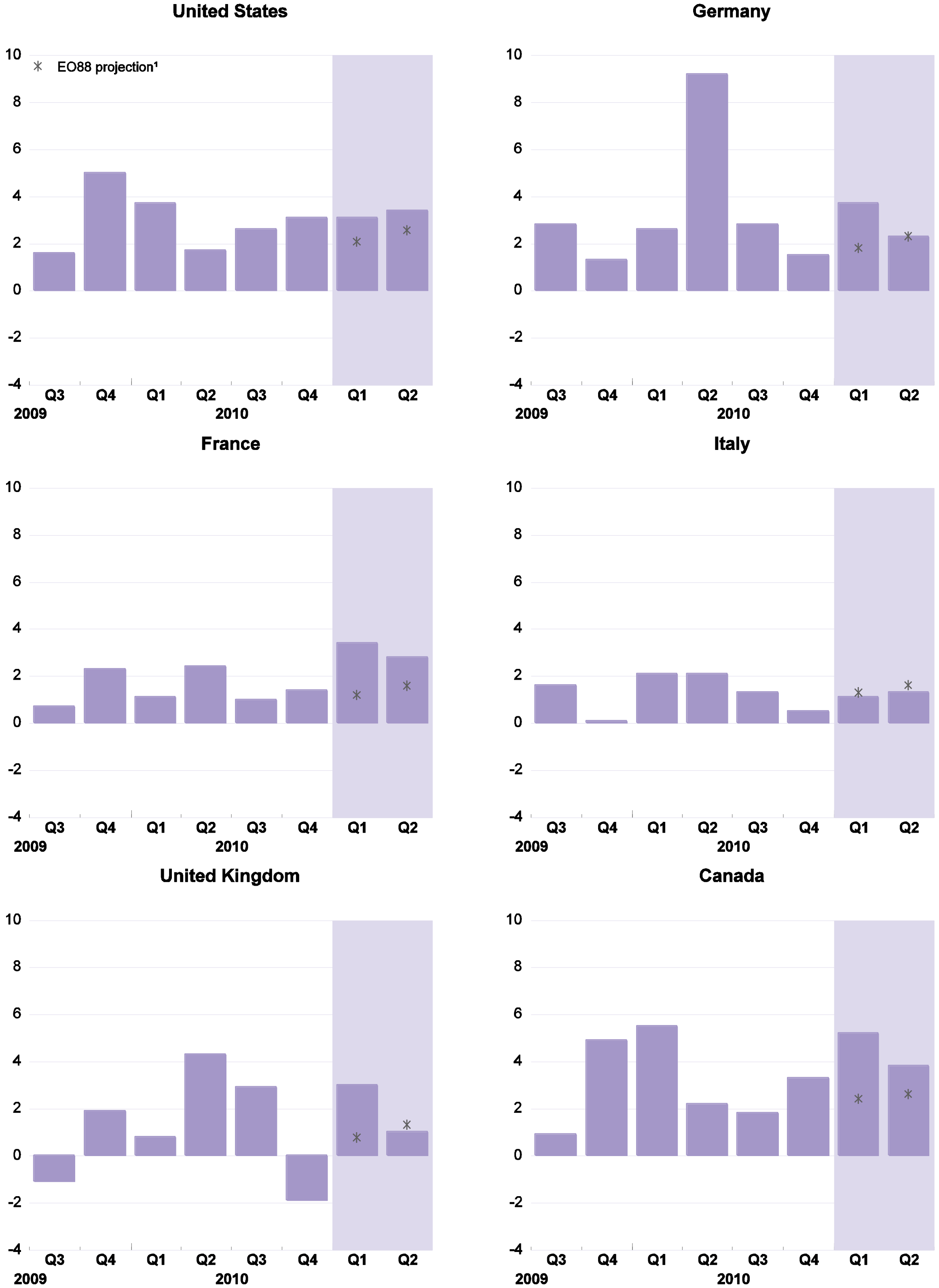
* See Pain, N. and F. Sédillot, "Indicator models of real GDP growth in the major OECD economies", *OECD Economic Studies*, No. 40, 2005 and Mourougane, A., "Forecasting monthly GDP for Canada", *OECD Economics Department Working Paper*, No. 515, 2006.

First-quarter outcomes are likely to be stronger than anticipated

Annualised quarter-on-quarter real GDP growth, in per cent

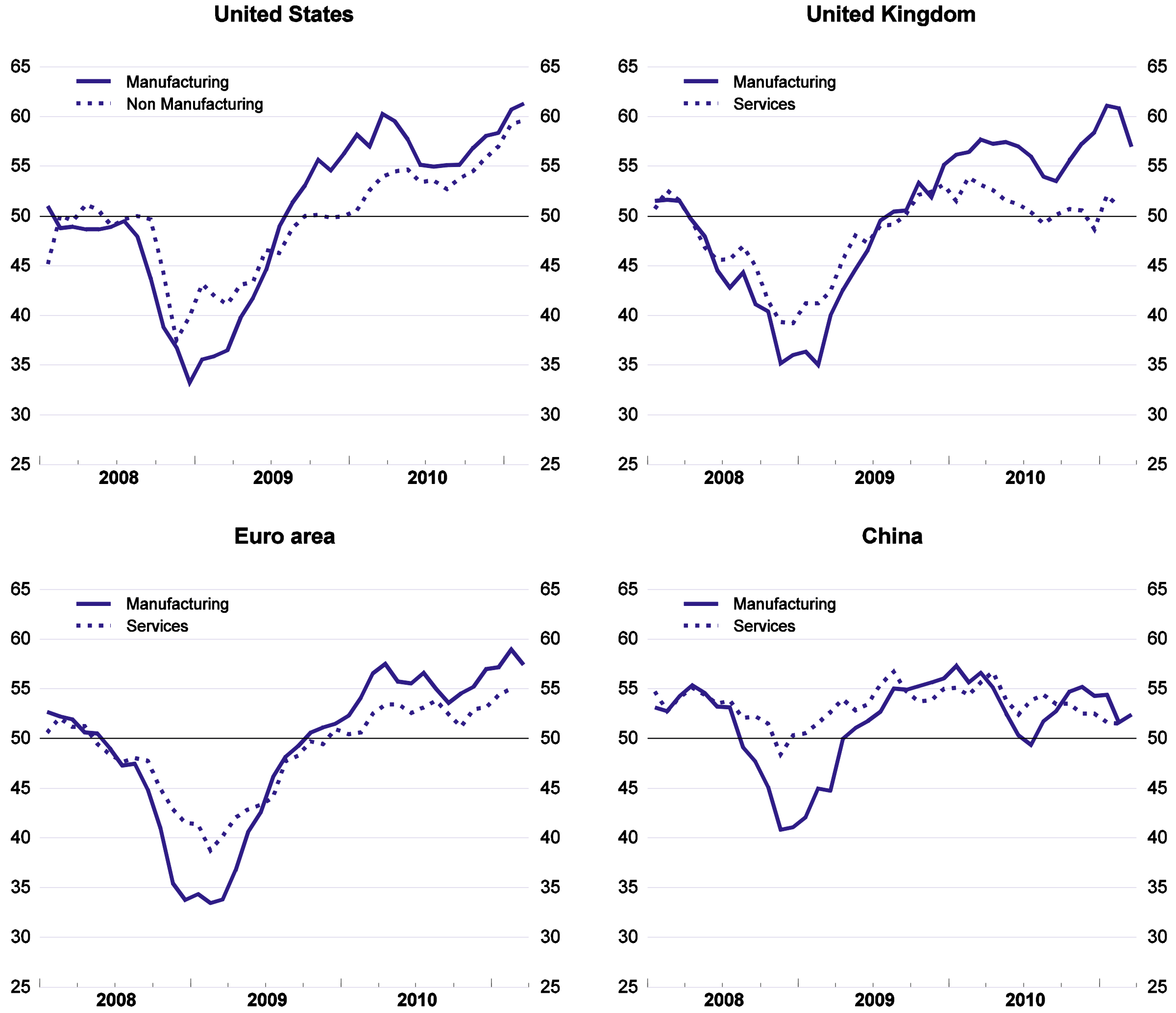


1. Refers to OECD Economic Outlook No. 88 projections (published in November 2010).

Source: OECD, Quarterly National Accounts database; OECD Economic Outlook 88 database; and OECD Indicator Model forecasts.

Business confidence is strong outside Asia

Purchasing Managers' Indices for manufacturing and services[1]

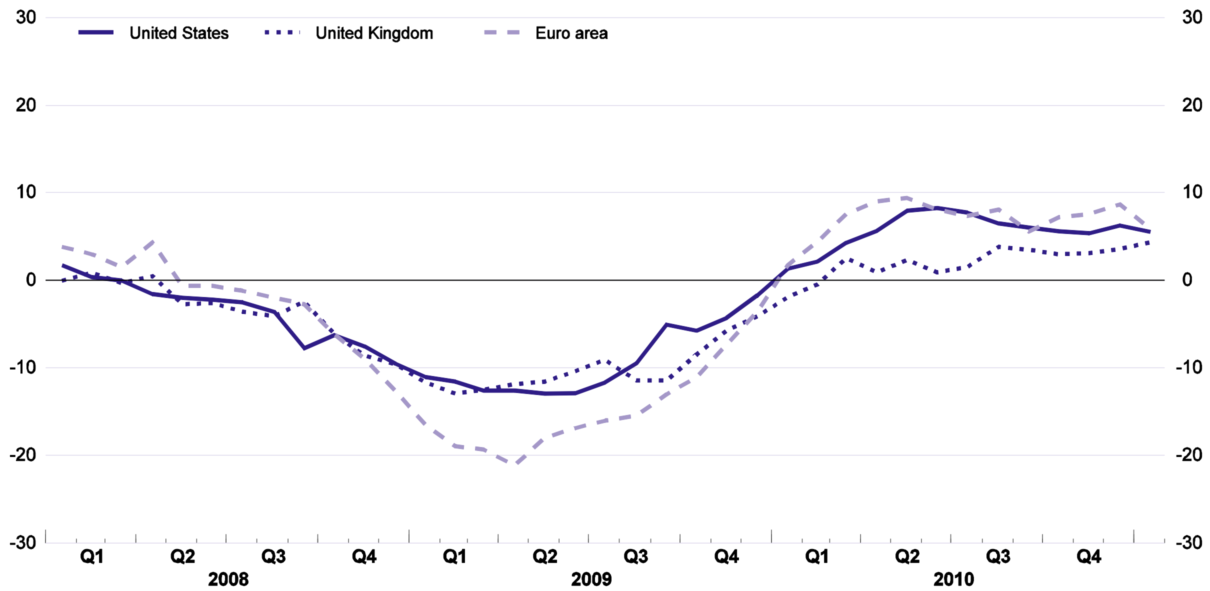


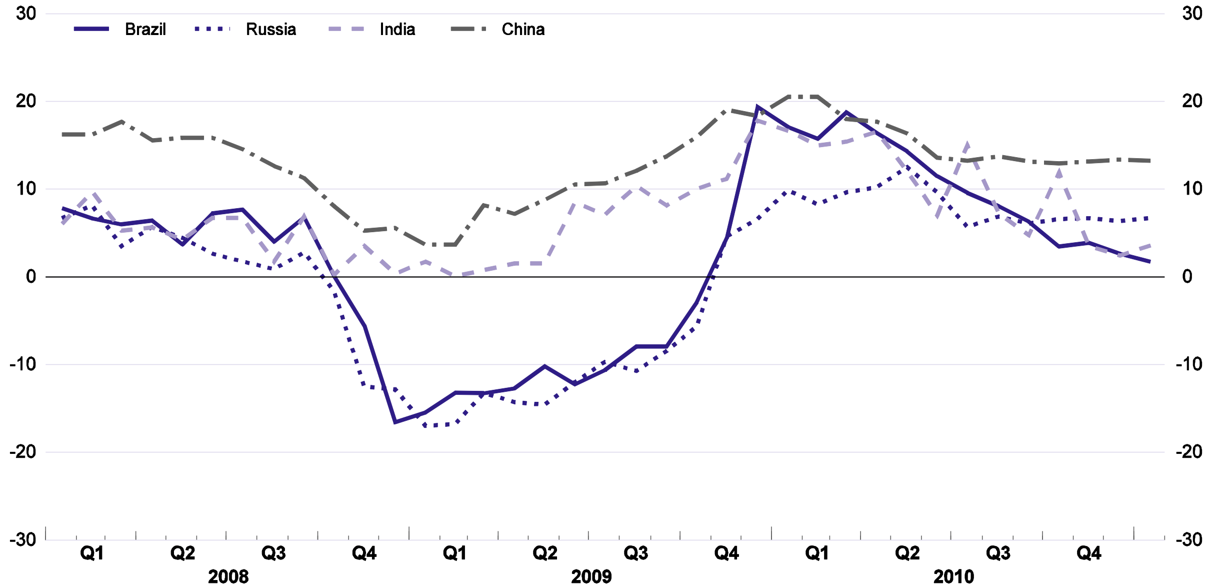
1. Value greater than 50 signifies an improvement in economic activity.

Source: Markit Economics Limited.

Industrial production growth has been steady

Year-on-year percentage changes



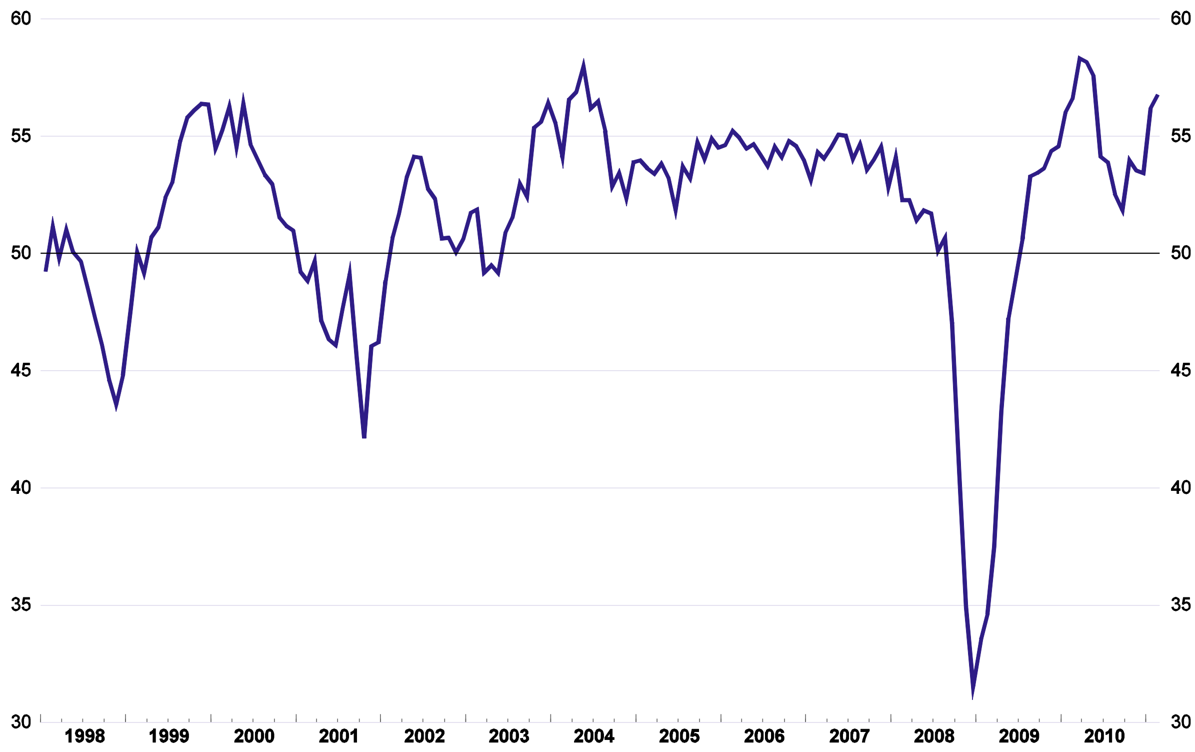


Note: Data for China are OECD estimates.

Source: Datastream; and OECD estimates.

World trade is picking up again

Purchasing Managers' Index: Global Manufacturing New Export Orders Index[1]



1. Value greater than 50 signifies an increase in new export orders.

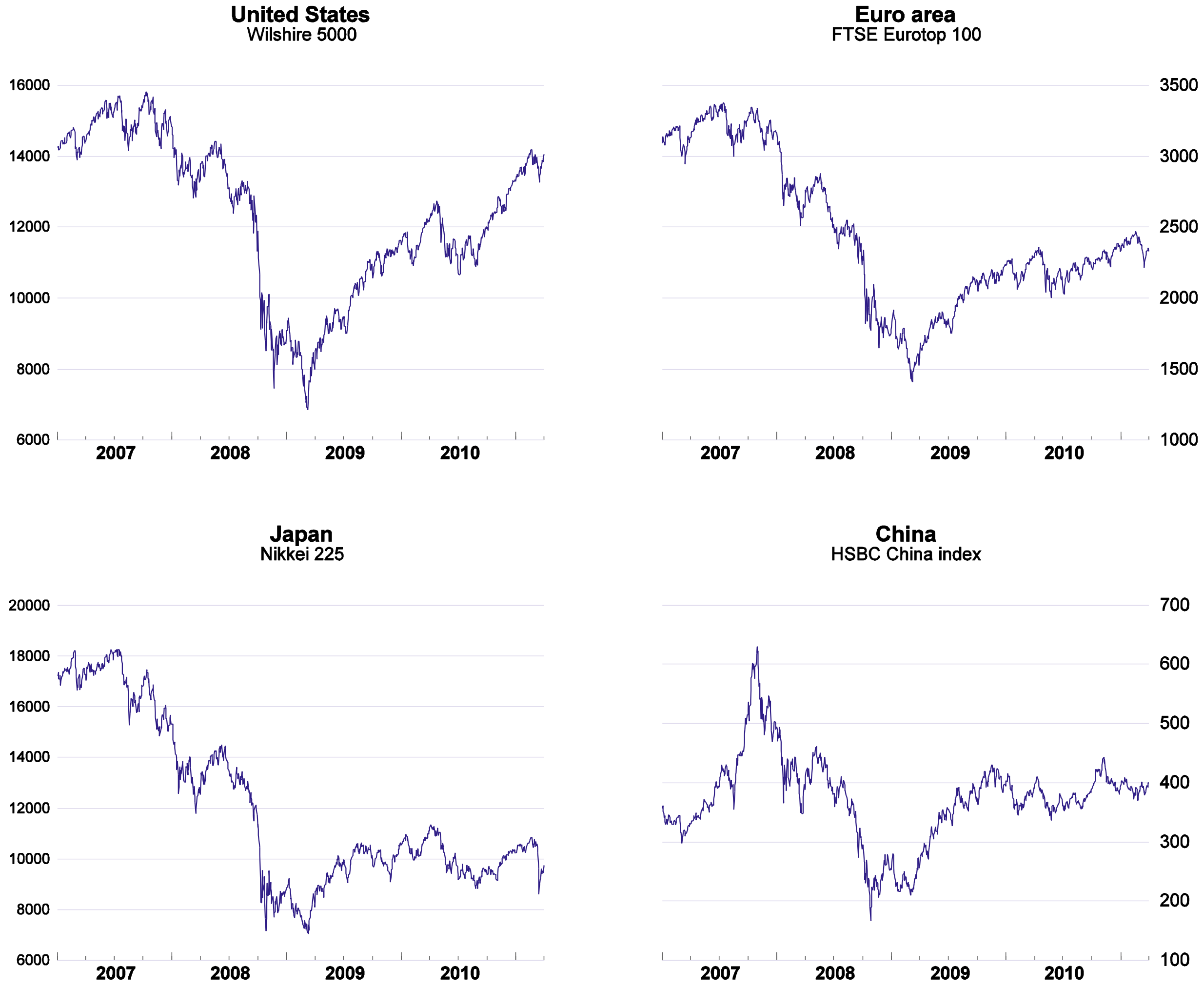
Source: Markit Economics Limited.

The level of world trade has now exceeded the pre-crisis peak

Export volumes, index Q1 2005 = 100

Source: OECD, Quarterly National Accounts database.

Share price indices have been impacted by recent events

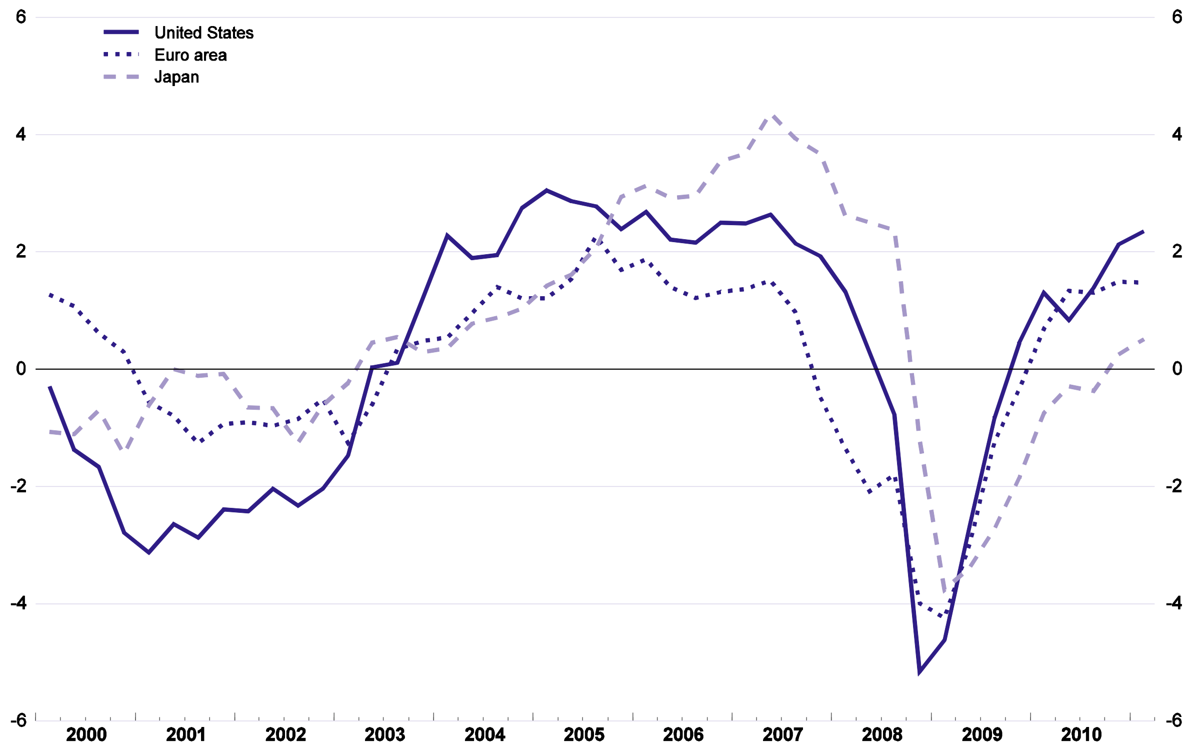


Note: Last observation is 31 March 2011.

Source: Datastream.

Financial conditions have improved

OECD Financial Conditions Index[1]

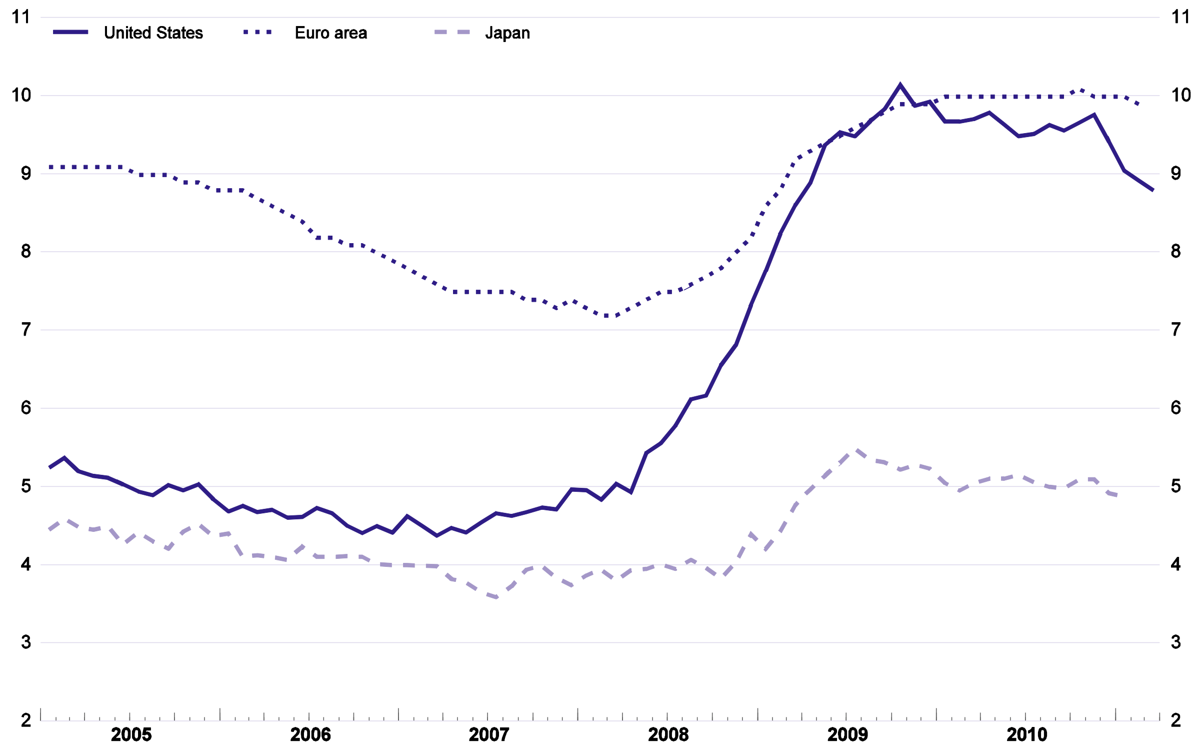


1. A unit decline in the index implies a tightening in financial conditions sufficient to produce an average reduction in the level of GDP by 1/2 to 1% after four to six quarters. See details in Guichard, S., D. Haugh and D. Turner (2009), "Quantifying the effect of financial conditions in the Euro Area, Japan, United Kingdom and United States", *OECD Economics Department Working Papers*, No.677. Some components of the index are estimates for 2011 Q1.

Source: Datastream; and OECD calculations.

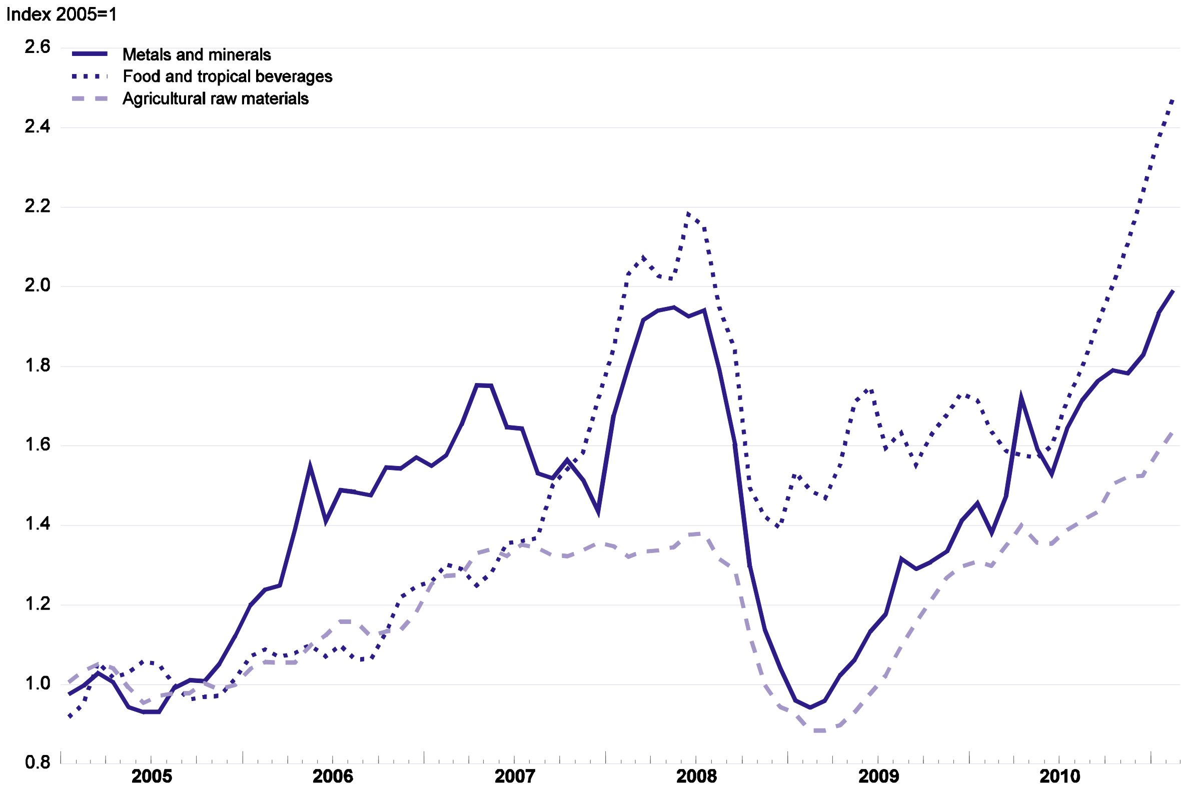
Unemployment rates are beginning to decline but remain high in major economies

In per cent of the labour force



Source: OECD, Main Economic Indicators database.

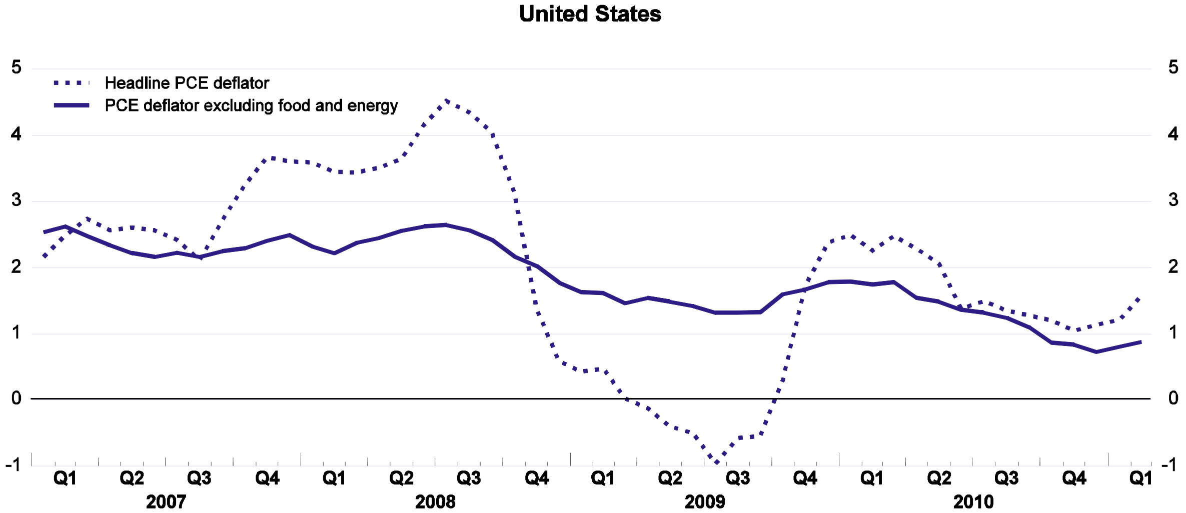
Oil and other commodity prices are surging

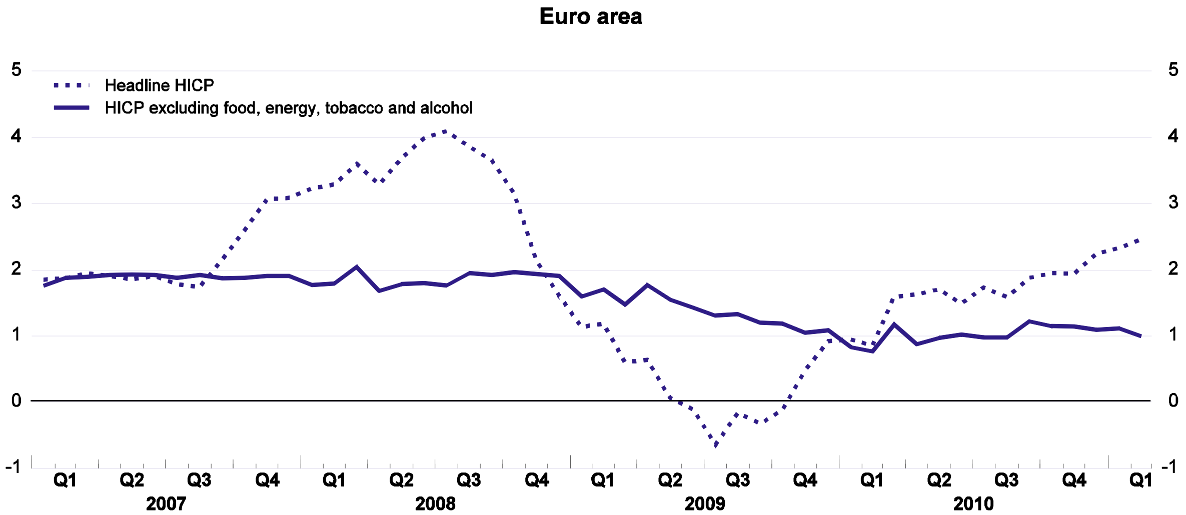


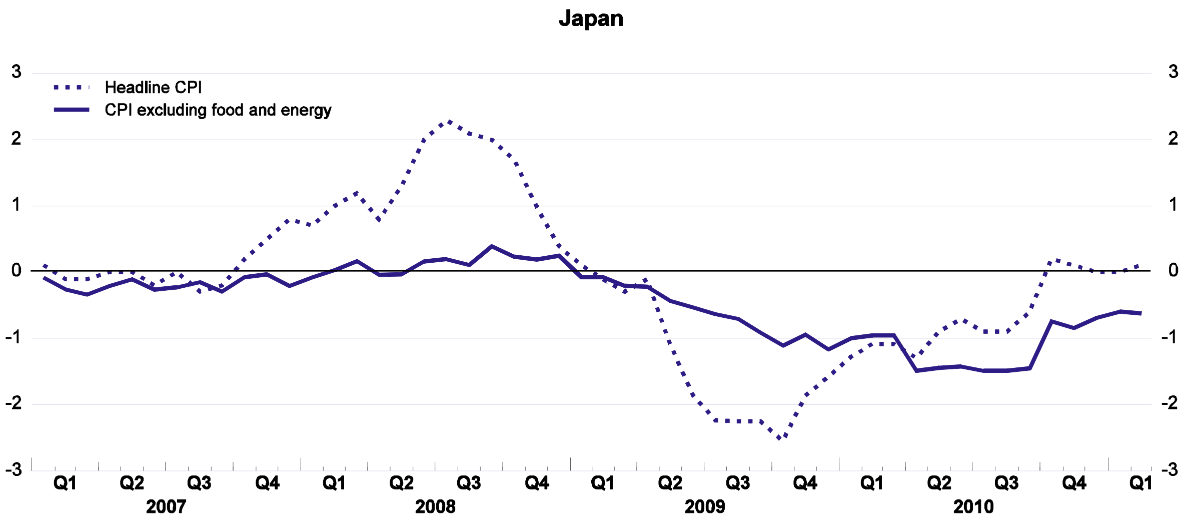
Source: Datastream; and OECD, Main Economic Indicators database.

Underlying inflation remains moderate

12-month percentage change





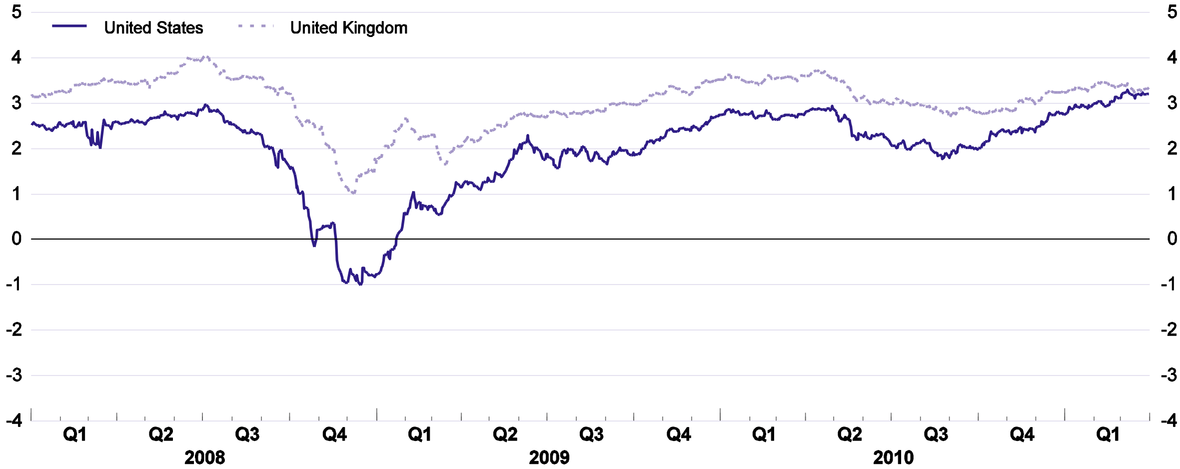


Note: PCE deflator refers to the deflator of personal consumption expenditures, HICP to the harmonised index of consumer prices and CPI to the consumer price index.

Source: OECD, Main Economic Indicators database.

Inflation expectations are creeping upwards

Based on bond yield differentials (Merrill Lynch), percentage points

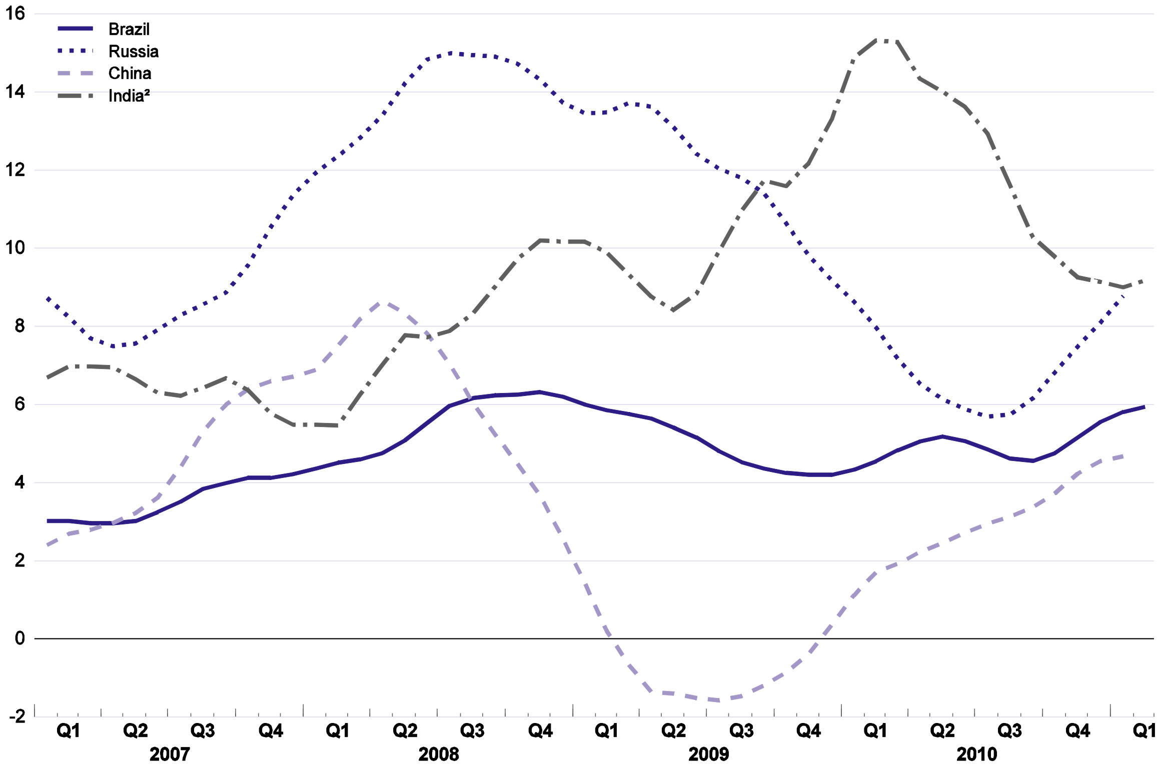


Note: Expected inflation implied by the yield differential between the ten-year government benchmark and inflation-indexed bonds. Last observation is 31 March 2011.

Source: Datastream.

Emerging-market economies are facing inflationary pressures

Consumer price index, 12-month percentage change[1]



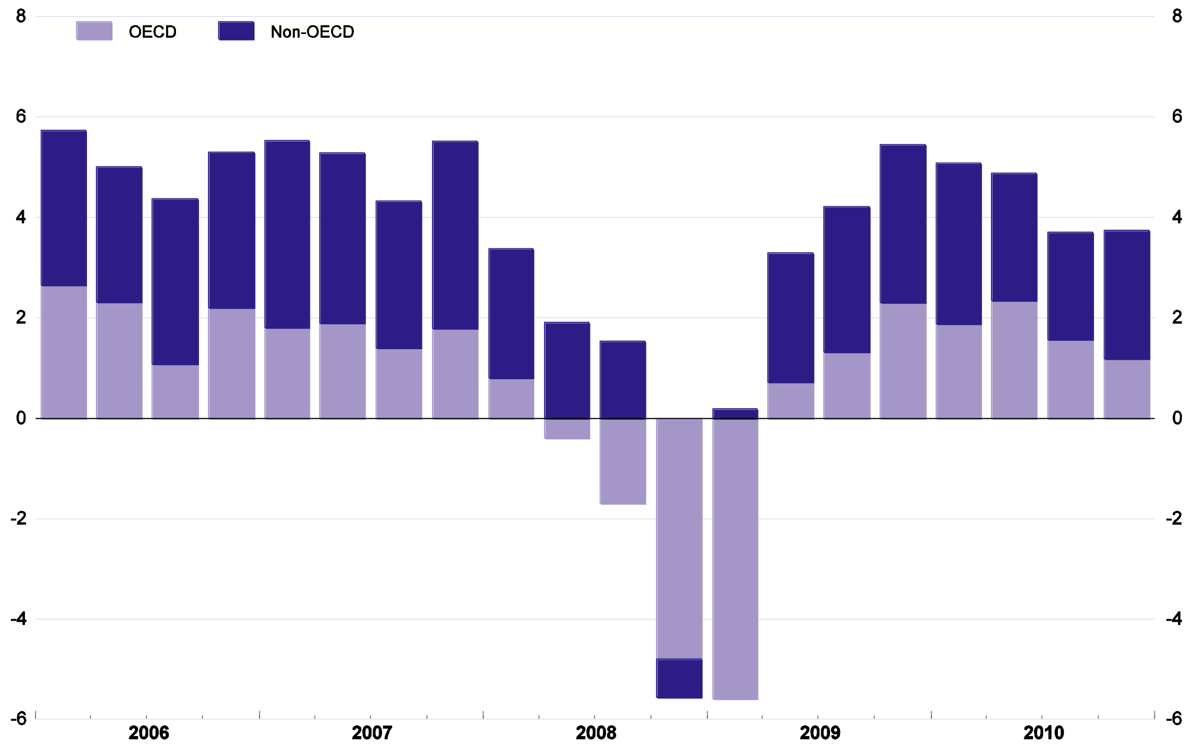
1. Three-month moving average.

2. Consumer price index, industrial workers.

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

Emerging-market economies are underpinning the global recovery

Contribution to annualised quarterly world real GDP growth, in per cent

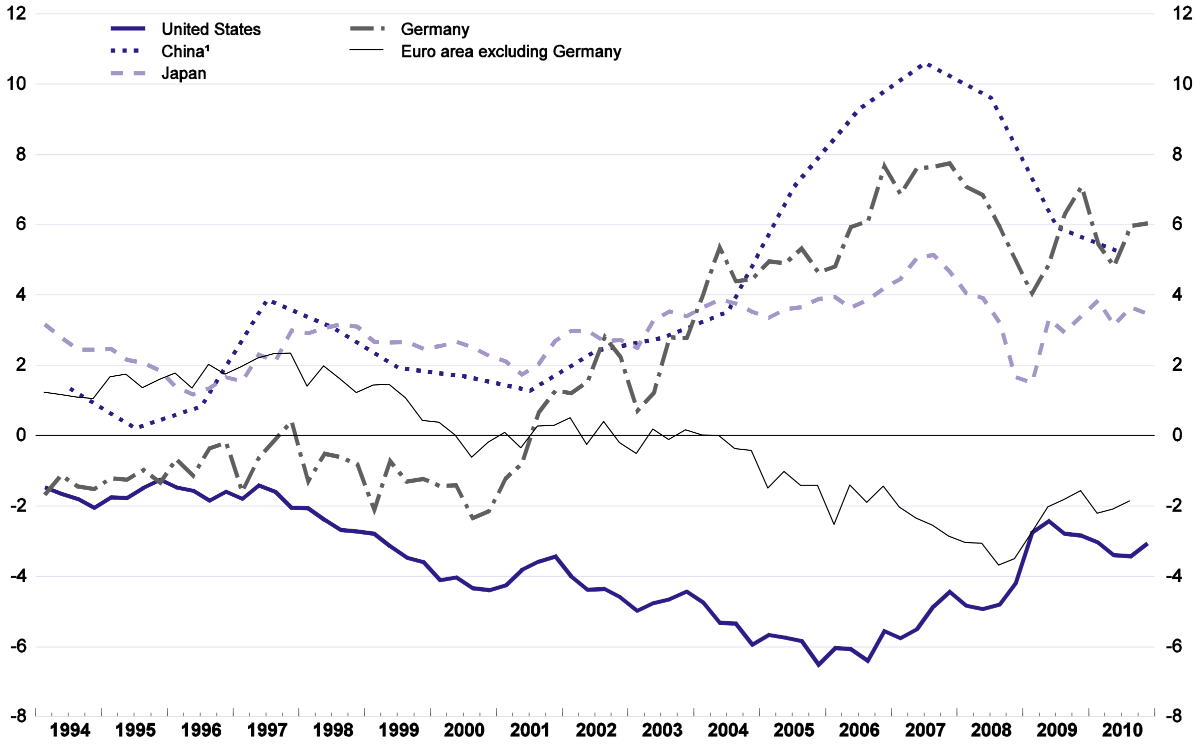


Note: Calculated using moving nominal GDP weights, based on national GDP at purchasing power parities.

Source: OECD, Quarterly National Accounts database; and OECD estimates.

Global imbalances continue to be pronounced

Current account balance, in per cent of GDP

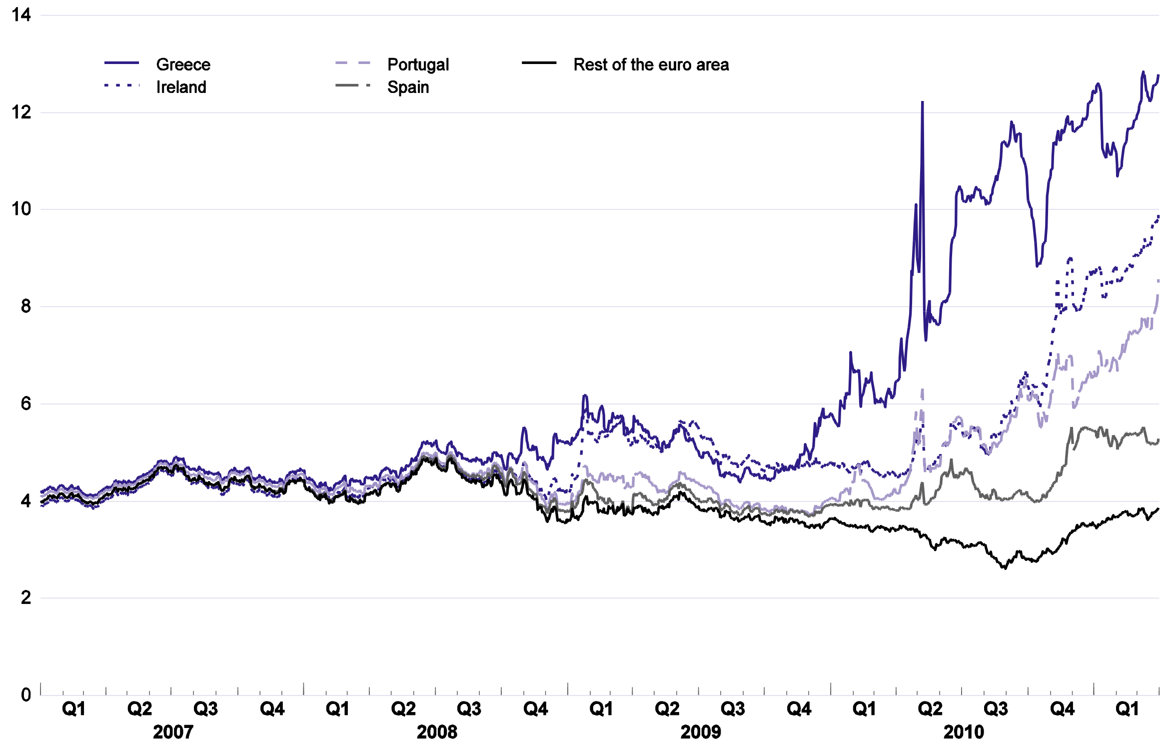


1. Annual frequency.

Source: OECD, Quarterly National Accounts database; and OECD, System of National Accounts database.

Euro-area long-term interest rates reflect persistent uncertainty in the periphery

10-year government bond yields, percentage points

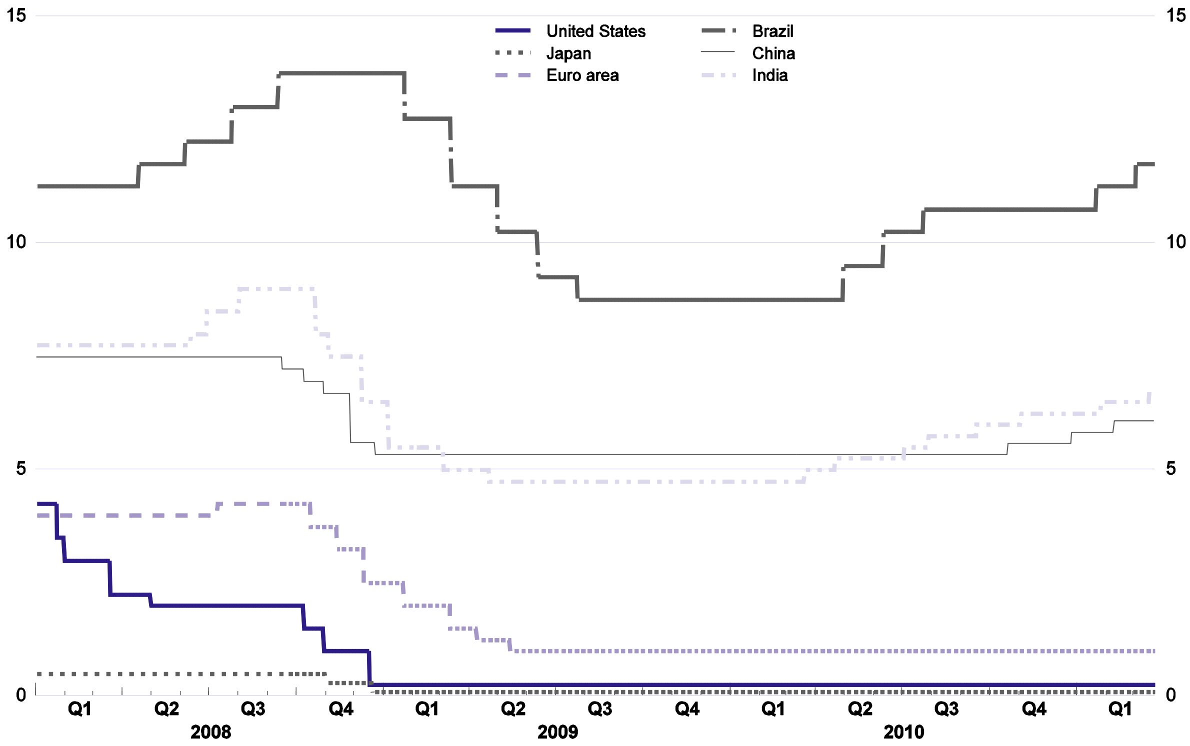


Note: Last observation is 31 March 2011.

Source: Datastream; and OECD calculations.

Monetary policy is tightening in emerging-market economies

Policy interest rates, percentage points

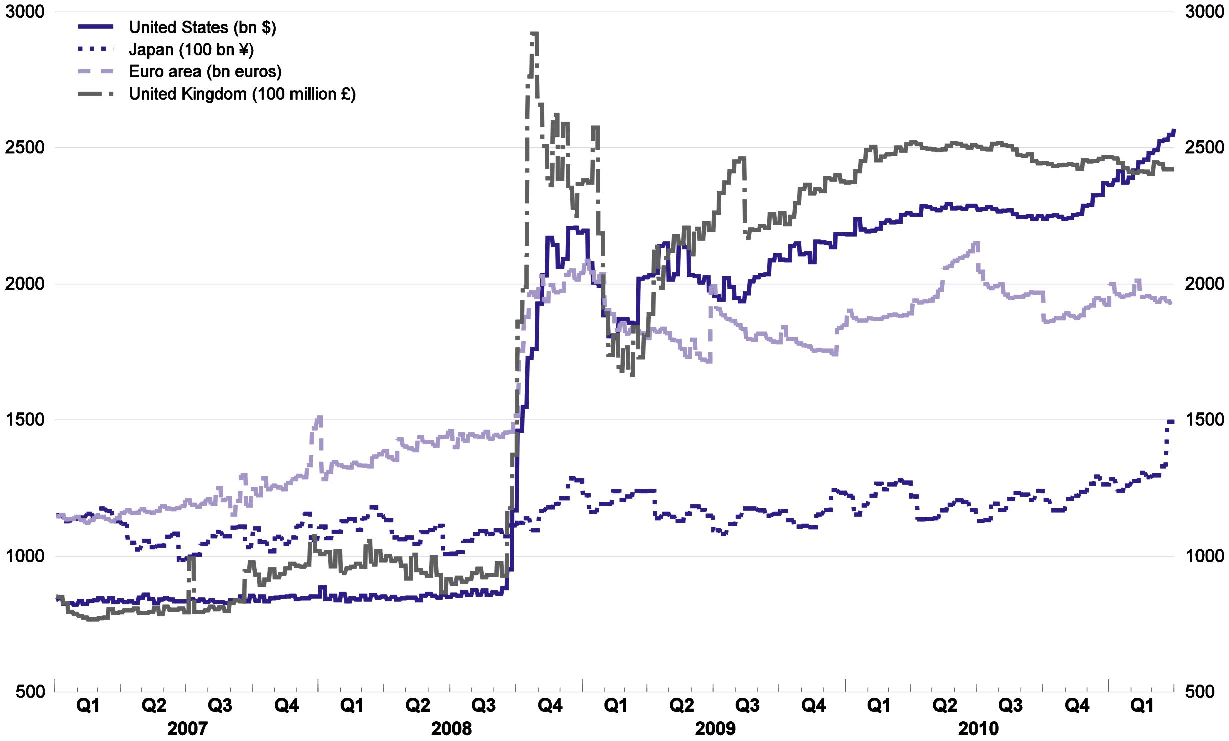


Note: Last observation is 31 March 2011.

Source: Federal Reserve; Bank of Japan; European Central Bank; Central Bank of Brazil; Reserve Bank of India; and People's Bank of China.

Central bank balance sheets continue to expand in the US and Japan

Central bank liabilities, local currency

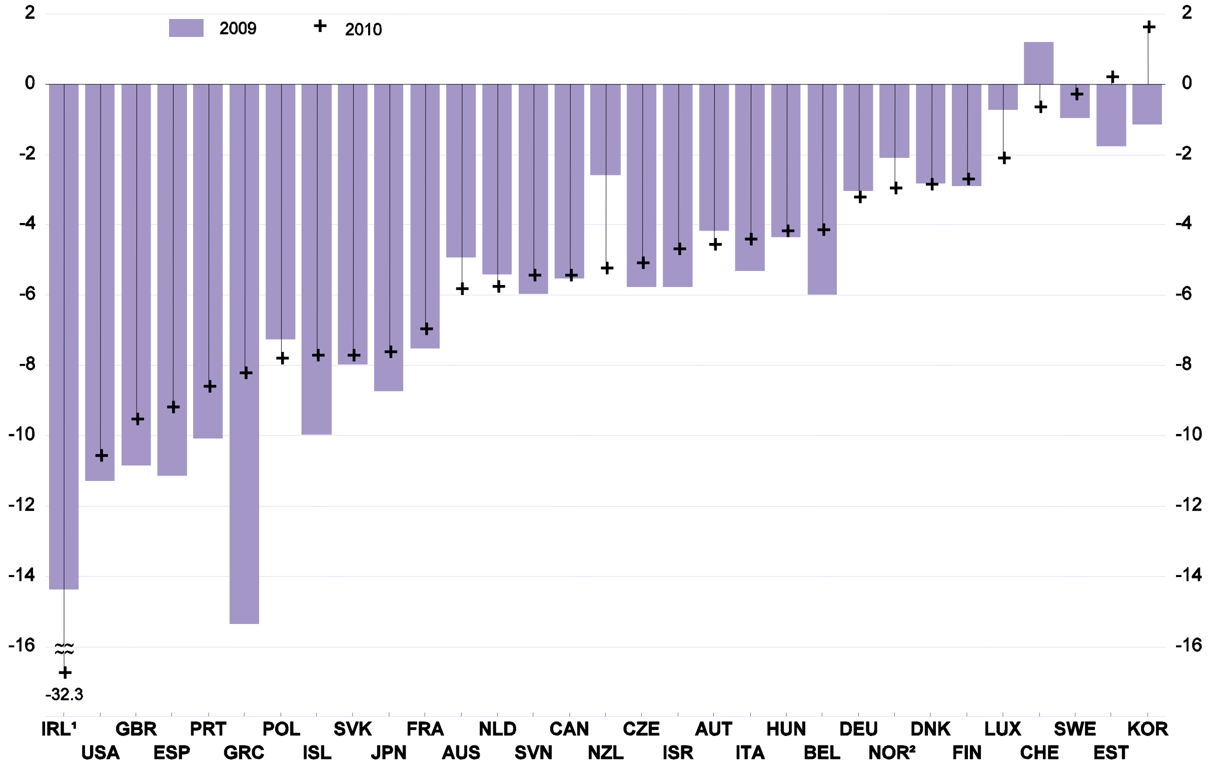


Note: Last observation is 31 March 2011.

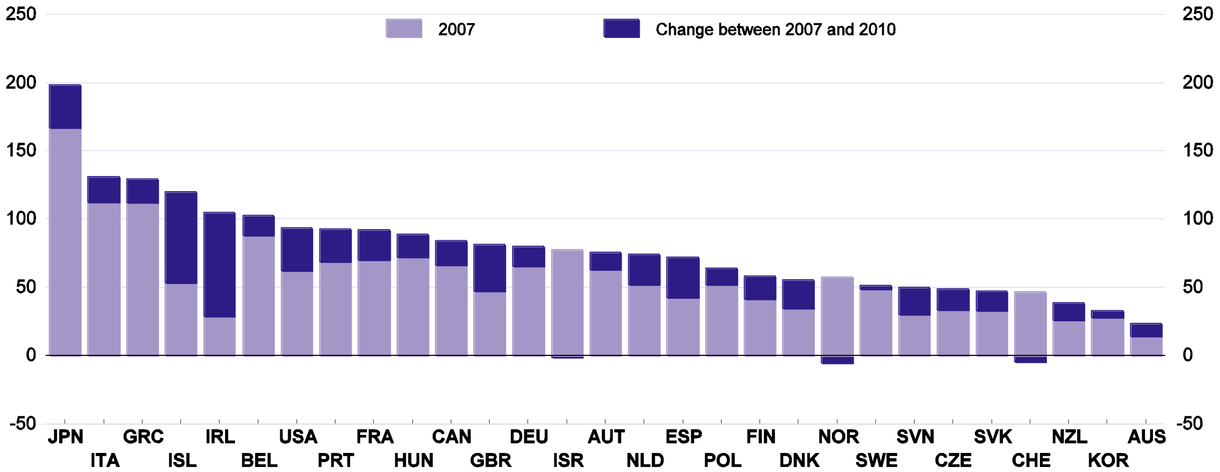
Source: Federal Reserve; Bank of Japan; European Central Bank; and Bank of England.

Fiscal positions have improved somewhat but debt levels are still high

General government balance, in per cent of GDP



Gross government debt, in per cent of GDP

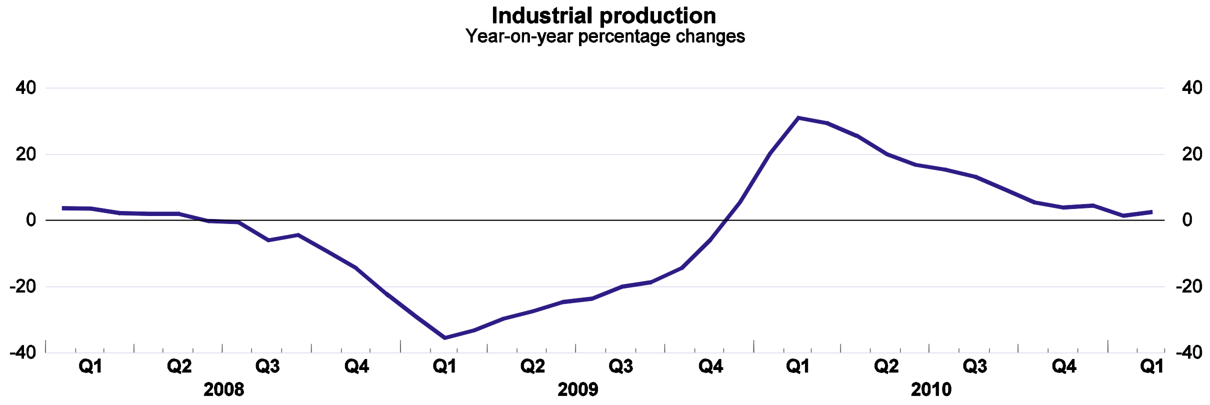


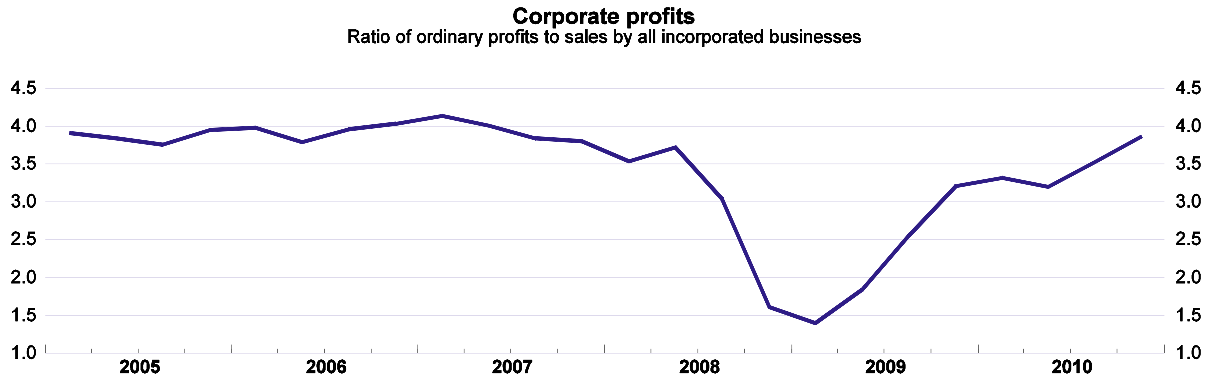
Note: Data for 2010 for some countries are OECD Economic Outlook 88 projections (published in November 2010).

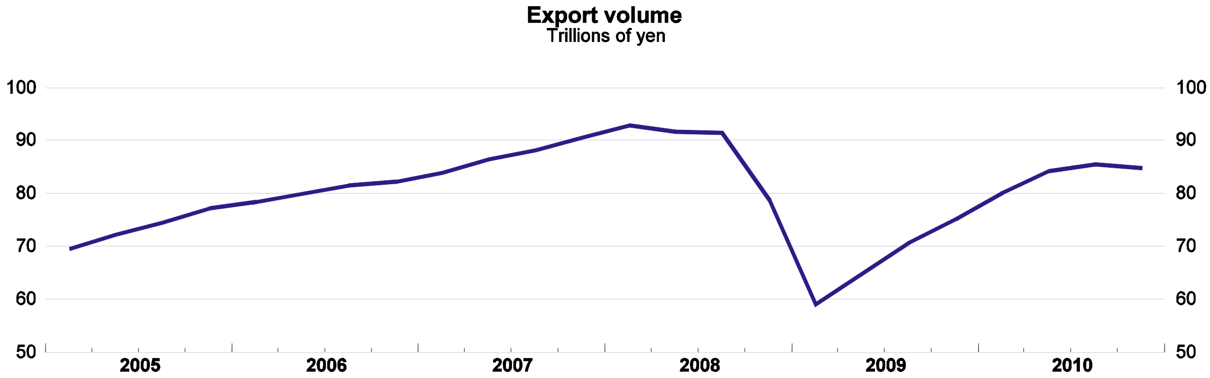
1. The underlying deficit for Ireland in 2010 excluding bank support measures (20% of GDP) is estimated to be 12% of GDP.
2. Mainland Norway only.

Source: OECD, System of National Accounts database; and OECD Economic Outlook 88 database.

Japanese indicators prior to the earthquake

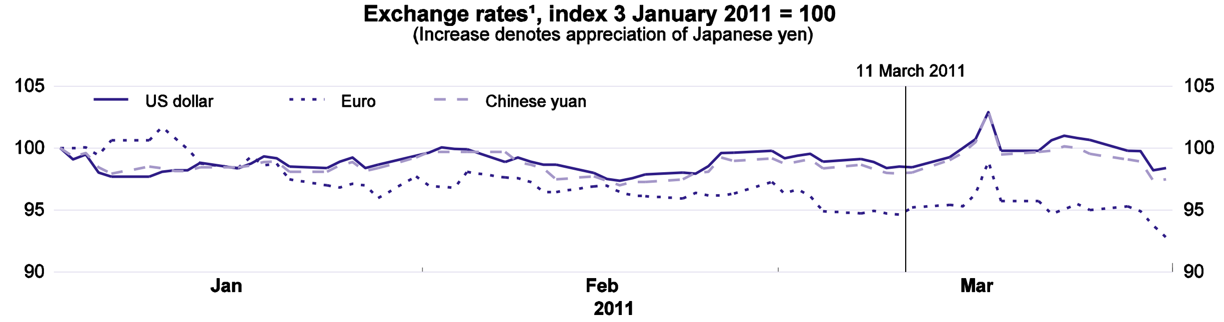


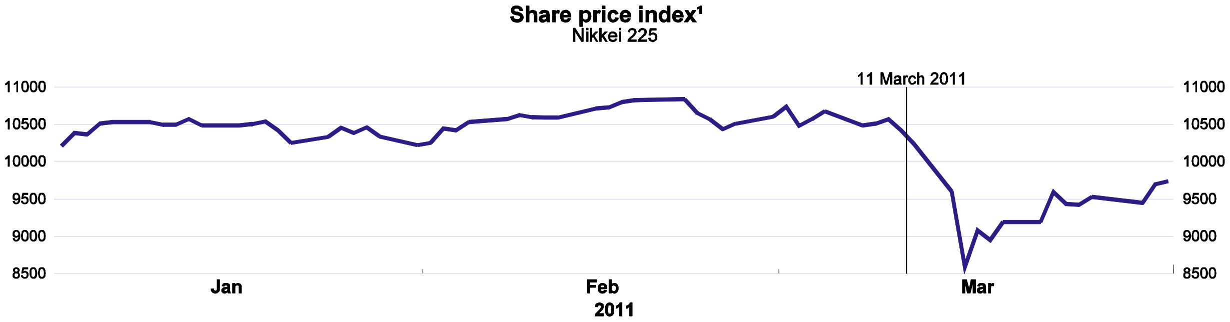


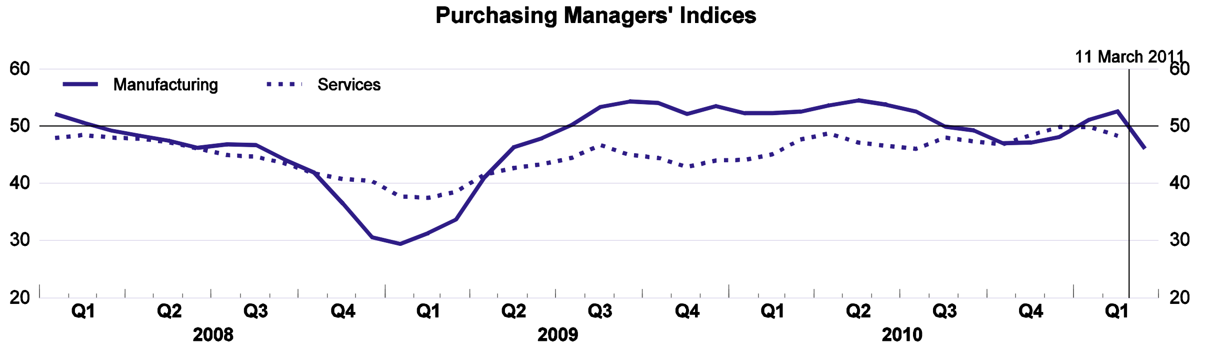


Source: Datastream; and OECD, Quarterly National Accounts database.

Japanese indicators immediately after the earthquake







1. Last observation is 31 March 2011.

Source: Datastream; and Markit Economics Limited.