EDITORIAL

GLOBAL ECONOMIC OUTLOOK: *BETTER, BUT NOT GOOD ENOUGH*

The mood in the global economy has brightened during the last year. Confidence indicators, industrial production, headline measures of employment, and cross-border trade flows have improved in most economies. However, this still-modest cyclical expansion is not yet robust enough to yield a durable improvement in potential output or to reduce persistent inequalities. Financial vulnerabilities could be realised by policy and geopolitical shocks. Compared to the 20-year pre-crisis average against which expectations have been set, OECD per capita GDP growth remains over ½ percentage point weaker and global growth overall, projected to rise to just above 3½ per cent by 2018, also lags. In sum, the global economic outlook is better, but not good enough to sustainably improve citizens' well-being.

Investment has been a missing support for global growth, trade, productivity and real wages. The *Economic Outlook June 2015 special chapter* on investment for inclusive growth noted three key signals for business to invest: A broad-based global cyclical upturn in demand, regulation that promotes competition, and low policy uncertainties. The first signal may be in train, although the dependence of emerging market and commodity-based economies, in particular, on developments in China clouds the stability of the overall global upturn. On the second signal, the *Business and Finance Outlook 2017* documents mergers and acquisitions and cartel behaviour that may dampen the competitive need to invest. On the third signal, protectionist policies in G20 countries and anti-globalisation rhetoric, along with other factors, raise uncertainties. All told, investment prospects are better, but with reservations as to the permanence and clarity of the signals.

Employment growth has recovered relatively well in recent years with trends for employment and labour force participation rates now higher than in the decade prior to the crisis (notably excepting the United States). But, along some dimensions – hours worked and part-time jobs – the quality of work is more precarious, as discussed in the forthcoming *Employment Outlook 2017*. Productivity and real wages both diverge, with a large gap between the highest productivity globalised firms and "the rest". So, while at the macro level labour market prospects and outcomes are better, the foundations for robust consumption and shared well-being are less apparent.

International trade growth revived in the last year, although it still remains less robust than in pre-crisis decades. Technology-driven and deeper trade integration through global value chains creates new markets and raises productivity. Access to a wider variety of goods and services at cheaper prices raises well-being and consumers' purchasing power, particularly low-income consumers. But these gains come with adjustment costs, neither of which have been equally shared across regions and individuals, yielding pressure to retreat from globalisation.

The analysis in the special chapter in this *Economic Outlook* documents that globalisation is part of broader trends: A changing pattern of tastes as income rises (which yields a greater demand for services compared to manufactured goods); on-going technological change (which reduces the workers needed to produce manufactured goods); and evolving trade patterns (wherein producers in advanced economies face enhanced competition not only from firms in emerging market economies but also from advanced economy peers). Manufacturing jobs – a key locus of the globalisation backlash – are more regionally concentrated than are services, adding to the burden of adjustment for those firms and workers.

There are upside risks to the projections for investment, trade, and productivity. Evidence from business surveys and from data suggest that the ageing of the capital stock may spur investment in higher quality capital with more advanced technology. This would improve cyclical conditions and support a revival of investment-intensive global value chains, with knock-on benefits to domestic demand. Higher quality capital would also improve productivity and boost potential output; but would also present new challenges, including to inclusiveness, as outlined in *The Next Production Revolution*.

Financial vulnerabilities continue to cloud the projections. Geopolitical shocks and trade protectionism could catalyse snap-backs in asset prices and realise downside risks through a variety of channels. Global equity prices have increased, reaching historic highs in the United States and Germany, despite little upward revision to GDP growth and inflation. Around $12 trillion of OECD countries' government bonds (32% of the total stock) continue to trade at negative yields. Big corrections in various asset prices would weigh on economic activity via wealth effects (more pervasive in advanced economies), via weak financial conditions of some firms and banks (currently reflected in high non-performing loans, especially in Europe), and via the mismatch of currencies and maturities of assets and liabilities (of particular relevance for some emerging market economies).

The global cyclical upturn is not yet assured; nor are the higher productivity, greater inclusiveness, and non-discriminatory international system that are needed to improve well-being for all. Policymakers cannot be complacent.

Monetary policy is appropriately moving toward a more neutral stance in the United States, as well Europe and Japan are using forward guidance. These actions and words help investors to assess policy risks, to bring asset price valuations into alignment with economic fundamentals, and to emphasise monitoring of exposures and vulnerabilities. Nevertheless, market participants, as reflected in their investment choices, apparently continue to expect monetary policy paths between the United States and the euro area and Japan to diverge over the projection period – to around 150 basis points by the end of 2018. Closing this policy-path gap will likely engender higher financial volatilities than are currently priced in.

Fiscal initiatives that mitigate sources of inequalities have long-run benefits for people, regions, and the fiscal budget. As outlined in the *Fiscal Approach to Inclusive Growth in the G7*, education, child-care, training, and mobility can help address underlying sources of inequalities in market incomes, including within and across regions. "High-multiplier" investments in public research and infrastructure, which were particularly hard hit during the financial crisis, catalyse private business activity including by helping to better connect firms to markets at home and abroad. Such an effective fiscal mix mitigates the need for income redistribution through taxes and transfers in the longer term, thus improving the fiscal position and future output to boost debt sustainability in the longer run.

Each country has its own coherent policy package to boost productivity, employment, and inclusiveness; *Going for Growth, 2017* suggests priorities for all G20 countries. These priorities are designed to maximise policy synergies, such as how addressing non-performing loans can also boost business dynamism, or how active labor market policies work best if there is a competitive business environment, or how promoting geographical mobility and improved skill matching are aided by housing policy reforms.

However, *national* policy settings interact with the nature and degree of *international* economic cooperation to affect firms and citizens. And, given the mutually reinforcing forces of tastes, technology, and trade that hit regions, firms and workers, *targeted* policies need to be reassessed.

So, *an integrated policy approach* is needed to make the whole system work better for more people. Beyond domestic policies, on the international front, policymakers need to harness the full range of international economic cooperation tools to level the playing field to ensure that international trade is governed by fair rules that are followed, that all businesses adhere to high standards of conduct, that cross-border tax arrangements are transparent and fair, that corruption is reduced, and that labour and environmental standards are respected.

Policymakers should recognise the interconnected nature of their efforts. Better choices on fiscal, monetary, structural, and international policies will improve the well-being of a country's own citizens, but also spill over to improve the outcome for others, raising the probability that the current cyclical upturn will endure and become the foundation for sustained and broad-based improvements in living standards around the world.

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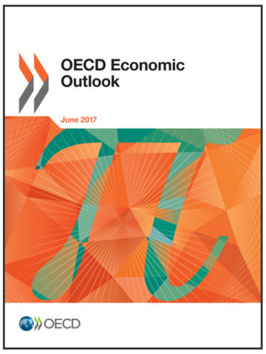

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