International Monetary and Financial Committee

Thirty-Seventh Meeting
April 20–21, 2018

Statement No. 37-15

Statement by Mr. Gurría
OECD

2018 IMF and World Bank Spring Meetings

Written Statement to the IMFC

Angel Gurría
OECD Secretary-General

21 April 2018
Washington, D.C.

We are living through a moment of great complexity. International realities are increasingly affecting domestic outcomes, while at the same time traditional 'domestic' policies are having impacts beyond national borders. The speed of the digital revolution and the pace of global integration have dissolved the distance between the furthest reaches of the world. We are a global society. We are a global economy. We are interconnected.

How we respond to this, to ensure that globalisation works for all, is currently under discussion by an array of political actors, and in a variety of fora, including the OECD. Multilateralism is at a crossroads; it's in a state of transition. This brings uncertainty, but it also brings opportunity to shape the kind of multilateral co-operation that our global challenges require.

Multilateralism is not an end in itself, but rather the only means to ensure that all our countries can benefit from this interconnectedness in ways that deliver peace, promote human progress and protect our planet.

By its very nature, multilateralism is always a work in progress. While we have achieved a lot, including the Paris Agreement and the 2030 Sustainable Development Agenda, we continue to face great global challenges. Delivering on all the commitments that were made at COP21 will still not lead us to the two degree target.

We also face great economic challenges on issues like market distorting support to internationalised state-owned enterprises or to certain sectors, which is contributing to overcapacity. This is an area in which multilateral co-operation is the only way forward.

Take another inherently international example: tax. The implementation of the OECD-G20 Base Erosion and Profit Shifting (BEPS) Project can support countries to tax multinational enterprises more effectively, potentially up to 240 billion US dollars per year. The Automatic Exchange of Tax Information (AEOI) has helped countries raise 85 billion euros so far in increased revenues.

Taxation is helping to show us that we can no longer distinguish a part of the economy that is "digital" from the rest. We are seeing firms with enormous economic presence yet with little to no physical presence. Only internationally-agreed rules and standards will enable countries to collect taxes from these companies.

The digital revolution is of course also driving great innovation. New technologies are emerging with important potential to support growth and well-being, like Fintech, blockchain and artificial intelligence. However, these are uncharted waters. They bring possible disruptions and challenges in trade, employment, regulation, security, safety, privacy and consumer protection. We need to open new multilateral channels to address these challenges together.

As demonstrated at the OECD's Anti-Corruption and Integrity Forum in March, the intensification of international connections also has a "dark side". Some cross-border criminal activity has become easier to engage in and harder to detect, including bribery and corruption, tax evasion, counterfeiting, piracy and human trafficking. All our countries and citizens stand to gain from a robust and collective response.

Last but certainly not least, we need to confront increasing inequalities of income, wealth and opportunities, by learning from each other and implementing a coherent and coordinated set of domestic and international policies.

The OECD's written statement is framed in this context.

The Global Economic Outlook

1. **In 2017, global GDP growth reached 3.7 per cent — the strongest outcome since 2011 — with positive growth surprises in both advanced and emerging market economies.** Industrial production, investment and trade have rebounded, with global trade growth reaching an estimated 5¼ per cent in 2017. Business and consumer confidence remain elevated. Improved cyclical conditions are also reflected in commodity and labour markets, and are helping to broaden the recovery further. In the OECD's March 2018 *Interim Economic Outlook*, global GDP growth is projected to strengthen further to close to 4 per cent in both 2018 and 2019.

2. **The improved outlook is welcome, but policymakers must guard against complacency.** Trade protectionism remains a key risk that would negatively affect confidence, investment and jobs. Safeguarding the rules-based international trading system and avoiding escalation is essential to prevent the harm that would result from a retreat from open markets. In the short-run, most major economies are not well-placed to deal with a new recession, while the longer-term losses of potential output arising from a world-wide cycle of protectionism could be enormous, to say nothing of the risks that trade conflicts spill into other spheres. Risks also remain that the gradual normalisation of interest rates in some economies could expose financial vulnerabilities created by elevated risk-taking and high debt levels. Comprehensive reforms are needed to strengthen growth and improve living standards in the medium-term, and offset the drag from less favourable demographic trends and a decade of sub-par investment and productivity.

3. **Supportive macroeconomic policies, strong job growth and a recovery in investment are helping to underpin growth prospects in the advanced economies.**

- In the United States, GDP growth is projected to maintain its momentum, averaging 2¾-3 per cent over 2018-19. Fiscal stimulus will add to the growth in domestic demand that is already resulting from strong confidence, solid job creation, past gains in household wealth and the rebound in oil production, while the measured withdrawal of monetary stimulus will continue. Wage growth and inflationary pressures remain modest, but should slowly pick up as the labour market tightens further.

- Growth in the euro area is set to remain robust and broad-based at between 2-2¼ per cent over 2018-19. Accommodative monetary and fiscal policies, improving labour markets and high levels of business and consumer confidence are all helping to boost demand. Investment is also becoming increasingly supportive, on the back of strong global demand and favourable financing conditions. While growth is set to remain solid in Germany and France, it is projected to continue at a more moderate pace in Italy.

- GDP growth in Japan is set to remain at around 1½ per cent in 2018 before easing to around 1% in 2019. Export growth has improved, particularly in Asian markets, and the additional spending announced in the recent supplementary budget will help to support demand in 2018. Strong corporate profitability should continue to underpin business investment, but private consumption may remain subdued, with real wage growth remaining weak despite the tight labour market.

- GDP growth in the United Kingdom is projected to ease to a little over 1¼ per cent in 2018 and 1% in 2019. High inflation continues to damp real household income growth and consumer spending, and business investment growth is slowing, amidst continued uncertainty about the future relationship between the United Kingdom and the European Union.

4. **The upturn in global trade, firmer commodity prices, improving sentiment and strong infrastructure investment in China all contributed to the welcome rebound in growth in emerging market economies last year.** Collectively, growth prospects in these economies appear solid for 2018 and 2019; however, this masks diverging developments across the major economies.

- After surprising on the upside in 2017, growth in China is set to soften to below 6½ per cent by 2019. Macroeconomic and regulatory policies are gradually becoming more restrictive, the working age population is now declining and credit conditions are less expansionary. Efforts are continuing to reduce financial risks (which remain elevated), deal with overcapacity in some sectors and improve environmental quality. Fiscal policy is now broadly neutral, but additional stimulus measures could be implemented if output growth were to slow sharply.

- In contrast, robust domestic demand growth is projected to help GDP growth strengthen in India to around 7¼ per cent and 7½ per cent in FY 2018 and FY 2019 respectively, with past reforms helping to drive a strong rebound in private investment growth from the transitory effects of demonetisation and the introduction of the Goods and Services Tax.

- Moderate growth resumed in Brazil and Russia in 2017 and is projected to continue in 2018-19, with activity supported by monetary policy easing.

5. **In line with the conclusions of the OECD's 2017 Ministerial Council Meeting, *Making Globalisation Work: Better Lives for All*, more must be done to ensure that the benefits of the recovery are widely shared.** Stronger GDP growth has helped to boost job creation, and the OECD-wide unemployment rate has finally fallen below the pre-crisis level. But the recovery in employment remains uneven: while the employment rates of older workers (aged 55 and above) have risen sharply in recent years, prime-age and youth employment rates are only at, or still below, pre-crisis levels in many countries. Despite steady declines in unemployment, wage growth generally remains soft, contributing to popular dissatisfaction with economic performance. Many households have seen little growth in real disposable incomes over the past decade, particularly those with low incomes.

Higher interest rates could expose tensions and financial vulnerabilities

6. **Financial conditions have begun to normalise in many major economies since the start of the year, largely reflecting the stronger recovery and associated expectations of higher inflation and less accommodative monetary policy.** Equity prices in the major economies remain elevated, despite recent declines, but stock market volatility has picked up from the unusually low levels seen in 2017, which should help to reduce excessive risk-taking. Credit markets have largely been calm and corporate and emerging-market bond spreads generally remain low. Government bond yields have risen over the past year in many advanced economies, but remain low by longer-term standards.

7. **To the extent that recent financial market developments reflect a necessary adjustment in bond yields due to expectations of less accommodative monetary policy, the direct impact on growth may be modest.** However, significant vulnerabilities remain, which could be exposed if interest rates rise further. The prolonged period of low interest rates and volatility has encouraged greater risk-taking, making the financial system more exposed to shifts in market sentiment as monetary policy normalises. New tensions and further corrections in asset prices are particularly likely if policy rates were to be changed abruptly in the event of an upside inflation surprise.

8. **Financial stability concerns also arise from still-low credit risk spreads and high private and public debt levels in many countries.** Stronger nominal GDP growth and more moderate credit provision in China have helped to slow the rise in the global debt-to-GDP ratio, but debt in many countries and sectors remain above pre-crisis levels. Risks remain that high indebtedness could amplify the impact of any further correction in asset prices and bond yields, with adverse effects on growth through rising defaults, higher debt-service burdens and a retrenchment in private sector spending.

Policy should be focused on achieving a durable and inclusive improvement in living standards

9. **As the global economy continues to strengthen, policies should be calibrated to foster productivity, deliver more inclusive growth, and enhance resilience against possible risks.** The need for monetary policy support can be eased gradually as economies approach full employment. Fiscal and structural measures should be focused on the medium-term, and used to strengthen investment and productivity growth and ensure that the benefits from growth are distributed more widely.

Monetary policies are set to diverge

10. **A gradual normalisation of monetary policy is needed in the major economies, but to a varying degree, reflecting differing outlooks for growth, inflation and financial market developments.** Improved growth prospects could result in a faster and larger withdrawal of monetary policy support than previously anticipated. At the same time, a moderate upturn of inflation, even if that resulted in a mild overshooting of medium-term objectives, would not merit an abrupt increase in policy rates. Continued clear communication about the path towards monetary policy normalisation is essential to minimise financial market disruptions.

11. **The US Federal Reserve should continue to increase policy rates gradually and progress with balance sheet reduction, with additional fiscal stimulus implemented in 2018-19 likely to raise the path for policy interest rates over the next two years.** In the euro area, an upturn in actual and expected inflation would allow the European Central Bank to reduce asset purchases gradually in 2018 and subsequently phase out the negative interest rate policy. In contrast, current stimulus measures need to be continued in Japan, where underlying inflation and inflation expectations remain low. Amongst the major emerging market economies, there may be scope for future policy easing in Brazil and Russia, if inflationary pressures subside further, but less so in India. In China, policy should contribute to the need to reduce the high level of corporate debt.

12. **Risks of spillovers via exchange and interest rates arise from the likely further divergence in policy rates across the major economies over the next two years.** Given the importance of US financial developments for global financial markets, there is a risk of repricing in other asset markets and more volatile capital flows if US monetary policy is tightened more abruptly than expected. Active and timely deployment of prudential and supervisory policies would help to reduce the risks from financial vulnerabilities in both advanced and emerging market economies, including those from dollar-denominated foreign debt in many emerging market economies.

<u>Fiscal policies need to be focused on medium term challenges</u>

13. **The supportive fiscal measures put in place by many countries over the past two years have helped to achieve the cyclical upturn after years of sub-par outcomes.** Fiscal easing is continuing in 2018 in many advanced economies, by around ¼ per cent of GDP in the typical economy, and by substantially more in the United States. Additional easing is likely to occur in 2019 in a handful of countries, including the United States and Germany. Policy has also been eased implicitly by the decision to push longstanding budgetary objectives further into the medium-term in some countries, such as Japan and the United Kingdom. Amongst emerging market economies, fiscal policy is becoming broadly neutral in China, but is being tightened modestly in many other countries. Some, such as Brazil, also need to implement additional fiscal and pension reforms to help ensure longer-term fiscal sustainability.

14. **With many economies now enjoying economic recovery and improved budget revenues, an emerging danger is of fiscal policy becoming excessively pro-cyclical.** There are, however, still opportunities to use fiscal policy to address structural challenges that hamper prospects for solid and more inclusive growth in the medium-term. Choices about spending and tax policies need to be well-targeted, enhance incentives to invest and participate in the labour market, and ensure that increases in incomes and living standards are shared more widely. Improved growth potential can in turn do much to underpin fiscal sustainability by helping reduce public debt-to-GDP ratios.

<u>Structural policy ambition needs to be stepped up to achieve stronger medium-term inclusive growth</u>

15. **The much improved economic outlook provides an opportune moment to implement more ambitious structural reforms to improve medium-term prospects for investment, trade and productivity, and to ensure that the recovery yields benefits for all.** Yet, as highlighted in the OECD's report, *Going for Growth 2018*, structural reform efforts generally slowed in both advanced and emerging market economies in 2017 from the already modest pace seen in the previous two years. A continuation on this path, with weak productivity and wage outcomes, raises the risk of larger shortfalls from past performance in the growth of living standards, further diminishing trust in policymakers.

16. **Coherent reform strategies are crucial to reap synergies, manage trade-offs and ensure that the benefits are broadly shared over time.** More can be done to exploit opportunities to combine measures to boost competition, either in domestic product markets or through lower barriers to international trade and investment, with specific labour reforms that help workers transition to new jobs and acquire new skills. Other actions needed to enhance inclusiveness, such as improving the participation of under-represented groups in the labour market, are also more likely to have durable benefits if implemented at a time of job-rich growth. Improved redistribution through tax and transfer policies is also an integral part of well-designed policy packages, to make work pay, provide support for vulnerable groups, and help strengthen real income growth amongst poorer households.

17. **In advanced economies, modest medium-term growth prospects also point to a widespread need for renewed efforts to implement competition-friendly regulations, including via trade policy.** These would enhance incentives to invest and help revive the diffusion of innovations between frontier firms and the rest of the economy. Moving towards more reallocation-friendly insolvency regimes would free resources trapped in high-debt "zombie" firms, improving the ability of more productive firms to attract additional capital.

18. **Renewing economic dynamism in emerging market economies is also essential to improve prospects for further convergence in living standards across economies.** Better performance could be achieved by lowering barriers to foreign trade, investment and firm entry. Tackling structural bottlenecks, expanding public investment in infrastructure and human capital, and strengthening resilience by addressing potential financial vulnerabilities would help to foster long-term investments. Improving education and tackling labour market informality would also help make growth more inclusive.

19. **Enhanced multilateral co-operation — alongside measures to rebuild trust in multilateral institutions and processes — is also essential to ensure the success of these efforts.** This imperative will be the focus of the OECD's 2018 Ministerial Council Meeting, *Reshaping Multilateralism for More Responsible, Effective and Inclusive Outcomes* on 30-31 May in Paris.