



ECONOMIC OUTLOOK No.81

Press Conference

**Paris, 24th May 2007
11h**

**Jean-Philippe Cotis
Chief Economist**

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

Summary of projections

	2006	2007	2008	2006		2007		2008					Fourth quarter		
				Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2006	2007	2008
Per cent															
Real GDP growth															
United States	3.3	2.1	2.5	2.5	1.3	2.5	2.3	2.5	2.5	2.6	2.7	2.7	3.1	2.1	2.6
Japan	2.2	2.4	2.1	5.5	2.4	1.8	1.9	2.0	2.1	2.2	2.1	2.2	2.5	2.0	2.2
Euro area	2.8	2.7	2.3	3.4	2.4	2.6	2.5	2.4	2.3	2.2	2.1	2.1	3.3	2.5	2.2
Total OECD	3.2	2.7	2.7	3.4	2.3	2.7	2.6	2.7	2.7	2.7	2.7	2.7	3.2	2.6	2.7
Inflation															
United States	2.9	2.6	2.2	1.6	4.0	2.3	2.0	2.2	2.4	2.2	2.1	2.1	2.5	2.6	2.2
Japan	-0.9	-0.4	0.2	0.1	-0.8	-0.4	0.0	0.1	0.2	0.3	0.4	0.6	-0.5	-0.3	0.4
Euro area	1.7	2.0	2.0	1.5	3.2	1.0	2.0	2.0	2.0	2.1	2.2	2.2	1.6	2.0	2.1
Total OECD	2.2	2.1	2.0	1.1	3.1	1.9	2.0	2.0	2.0	2.0	2.0	2.0	1.8	2.3	2.0
Unemployment rate															
United States	4.6	4.6	4.8	4.5	4.5	4.5	4.6	4.7	4.8	4.8	4.8	4.9	4.5	4.7	4.9
Japan	4.1	3.8	3.6	4.1	3.9	3.8	3.7	3.7	3.6	3.6	3.6	3.6	4.1	3.7	3.6
Euro area	7.8	7.1	6.7	7.5	7.2	7.1	7.0	6.9	6.9	6.8	6.7	6.6	7.5	6.9	6.6
Total OECD	5.9	5.6	5.5	5.7	5.7	5.6	5.6	5.6	5.5	5.5	5.5	5.4	5.7	5.6	5.4
World trade growth	9.6	7.5	8.3	8.4	6.7	7.7	8.2	8.4	8.3	8.3	8.2	8.2	8.6	7.7	8.3
Current account balance															
United States	-6.5	-6.1	-6.2												
Japan	3.9	4.8	5.4												
Euro area	0.1	0.4	0.4												
Total OECD	-1.9	-1.5	-1.5												
Cyclically-adjusted fiscal balance															
United States	-2.5	-2.8	-2.8												
Japan	-2.2	-2.7	-3.2												
Euro area	-1.0	-0.8	-0.7												
Total OECD	-1.7	-1.8	-1.9												
Short-term interest rate															
United States	5.2	5.3	5.0	5.3	5.3	5.3	5.3	5.2	5.1	5.1	5.0	4.9			
Japan	0.2	0.5	0.6	0.4	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.7			
Euro area	3.1	4.1	4.3	3.6	3.7	4.0	4.2	4.3	4.3	4.3	4.3	4.3			

Note: Real GDP growth, inflation (measured by the increase in the GDP deflator) 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. The unemployment rate is in per cent of the labour force while the current account balance is in per cent of GDP. The cyclically-adjusted fiscal balance is in per cent of potential GDP. 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 9 May 2007; in particular 1\$ = 119.72 yen and 0.74 euros;

The cut-off date for other information used in the compilation of the projections is 15 May 2007.

Source: OECD Economic Outlook 81 database.

ACHIEVING FURTHER REBALANCING

In its *Economic Outlook* last Autumn, the OECD took the view that the US slowdown was not heralding a period of worldwide economic weakness, unlike, for instance, in 2001. Rather, a “smooth” rebalancing was to be expected, with Europe taking over the baton from the United States in driving OECD growth.

Recent developments have broadly confirmed this prognosis. Indeed, the current economic situation is in many ways better than what we have experienced in years. Against that background, we have stuck to the rebalancing scenario. Our central forecast remains indeed quite benign: a soft landing in the United States, a strong and sustained recovery in Europe, a solid trajectory in Japan and buoyant activity in China and India. In line with recent trends, sustained growth in OECD economies would be underpinned by strong job creation and falling unemployment.

Recent “hard data”, as well as consumer and business confidence, suggest that in the euro area a vibrant German-led recovery has remained on track, despite a large VAT hike at the start of this year. Interestingly, the so-far lagging Italian economy has been sharing in the upswing, notwithstanding the volatility of the quarterly accounts. All told, the recovery in Germany and Italy in 2006-07 is set to be much stronger than initially expected.

In the United States, the incoming data suggest that, following a weak first quarter, economic activity should gradually regain momentum. Sustained job and labour income growth should provide the basis for a progressive return to economic normality, while excess supply of housing is being gradually worked off.

In China, the authorities are struggling to contain business investment with a view to reining in the pace of the economic expansion, which at over 11% most recently may have exceeded the speed limit. Such buoyancy should provide solid support both for the ongoing Japanese export-led expansion and other trading partners.

The rebalancing is not without risks, however. To be sure, stronger growth in the hitherto weaker OECD economies is to be warmly commended. But going forward, several other sources of imbalance may still be standing in the way of sustained and steady growth. On the monetary front, there is a risk that, in many places, the balance between aggregate demand and supply has already started shifting towards overheating, at a time when the appetite for fiscal tightening may be waning. Looking further ahead, there is also little sign that, once adjusted for cyclical influences, current account imbalances have retreated in the United States, while they are getting even more pronounced in countries such as China and Japan, where time and again household demand seems to be lagging behind.

Imbalances may have developed in financial and housing markets too. As a general rule, spreads on risky bonds are close to historical lows and for a range of financial assets OECD analysis suggests that risk may be under-priced. Equity prices may be somewhat on the high side, for example, although current potential overvaluation in stock markets pales in comparison with the excesses that prevailed in the late 1990s. Last but not least, housing investment is at ten-year highs in many OECD countries.

Assessing more precisely the extent of such remaining imbalances is of some importance to gauge the uncertainties surrounding our smooth rebalancing scenario.

In the US case, the diagnosis is tricky. On the one hand, the issue may just be one of an over-extended housing market still in need of correction. But such a sanguine assessment may need to be qualified in at least two ways. First, recent housing developments may point to the risk of a slower overall recovery. Compared to previous OECD forecasts, the housing sector has cooled somewhat more than expected, leading to a disquieting build-up in the stock of unsold housing. Second, the slowdown of the US economy could turn out to be of a broader nature. It might involve a mild form of stagflation, with weaker trend productivity and output growth than assumed heretofore translating into more overheating. Weaker prospects for long-term growth would help to explain, for instance, why inflation has been more persistent than expected and why business investment faltered recently, despite ample profits and still favourable financial market conditions.

The amount of residual economic slack is also uncertain in some of the other main OECD regions, notably in Continental Europe and the United Kingdom. This constitutes a challenge for central banks which, on both sides of the Atlantic, should probably err on the side of tightness.

In the United States, with core inflation still higher than desired and unemployment below most estimates of its sustainable level, there is a case for keeping a slightly restrictive monetary stance and not cutting policy rates in 2007. There may even be a case for additional tightening in the United Kingdom, should inflationary pressures persist, and more clearly so in the euro area, where core inflation has essentially reached the 2% mark, while activity is set to continue to expand vigorously.

In Japan, by contrast, where deflation has not yet been rooted out and economic slack may be larger than expected, policy rates would need to remain on hold for some time.

Fiscal policy has a role to play in smoothing out the current economic upswing, in improving the long-term sustainability of public finances in most OECD countries, and in providing enough scope for automatic stabilisers to act in the next downturn. Policymakers are facing treacherous waters, however. On the positive side, public deficits have finally been shrinking, in most OECD countries, over the past two or three years. However, consolidation has been overly reliant on cyclical revenue gains rather than on lasting spending restraint. Looking forward, decisive reductions in structural deficits appear both highly desirable and rather unlikely. But, given the high stakes, there is at the very least a need to avoid, over the next few years, the unravelling of past fiscal consolidation.

In such a challenging context, policymakers need to save current tax windfalls, so that fiscal policy does not exacerbate, in the short run, the present economic upswing while preventing, in the long run, the repeat of those depressing “post-boom” budgetary crises of the past. But spending pressures will be extremely strong, given the considerable magnitude of the unforeseen capital and corporate tax receipts. Sticking to tight spending plans and waiting long enough before contemplating new tax cuts should be the “categorical imperative” for forward-looking policymakers.

Against this worrying backdrop, this *Economic Outlook* incorporates a special chapter on the political economy of fiscal consolidation, trying to infer from past experiences the policies and institutional factors that underpin successes and failures. This work yields challenging conclusions. It suggests, for instance, that successful and lasting consolidations often emerge from fiscal crisis and work better when conducted from the expenditure side. It also underlines the useful role that can be played by fiscal rules, in particular those that include a focus on expenditure control alongside budget-balance rules. Even so, there are probably no mechanical means to lock in fiscal consolidation. In the current circumstances, characterised

by buoyant activity and large revenue increases, what is needed, ultimately, is political will and strong leadership.

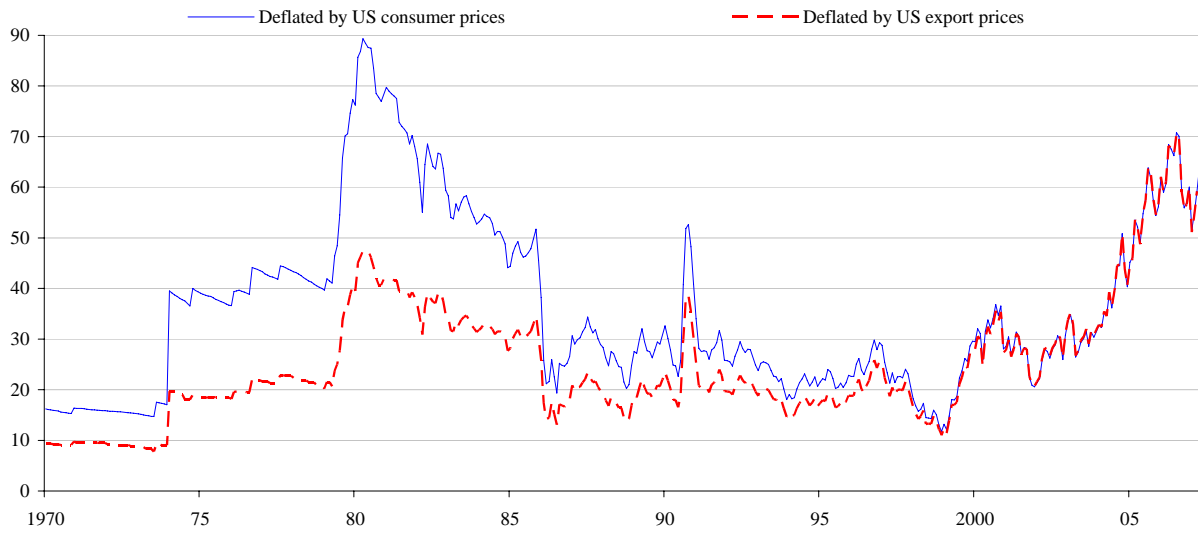
Political will and collective wisdom will also be needed to achieve a successful conclusion of WTO negotiations. The potential costs of stalling trade integration, possibly followed by various sorts of backpedalling, could be of unforeseen magnitude. With so much emphasis in the public arena put on the drawbacks of globalisation, one may easily lose sight of the multifaceted gains arising from a more integrated world. This is indeed the central message of our second special chapter entitled “Making the most of globalisation”. It reviews, from a long-term perspective, both the potential benefits and the economic and social challenges stemming from globalisation, and highlights the importance of public policies for effectively translating the huge potential of globalisation into shared well-being.

21 May 2007

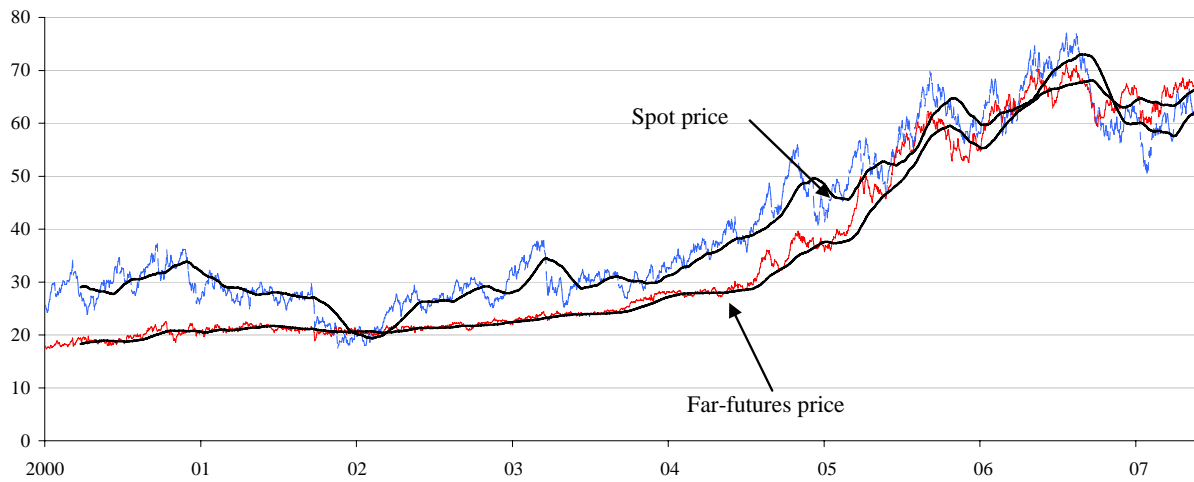
Handwritten signature of Jean-Philippe Cotis in black ink, consisting of the initials 'JP' followed by the name 'Cotis' in a cursive script.

Jean-Philippe Cotis
Chief Economist

Spot oil prices remain high and volatile
 Brent crude, price per barrel in 2005 dollars (monthly average)



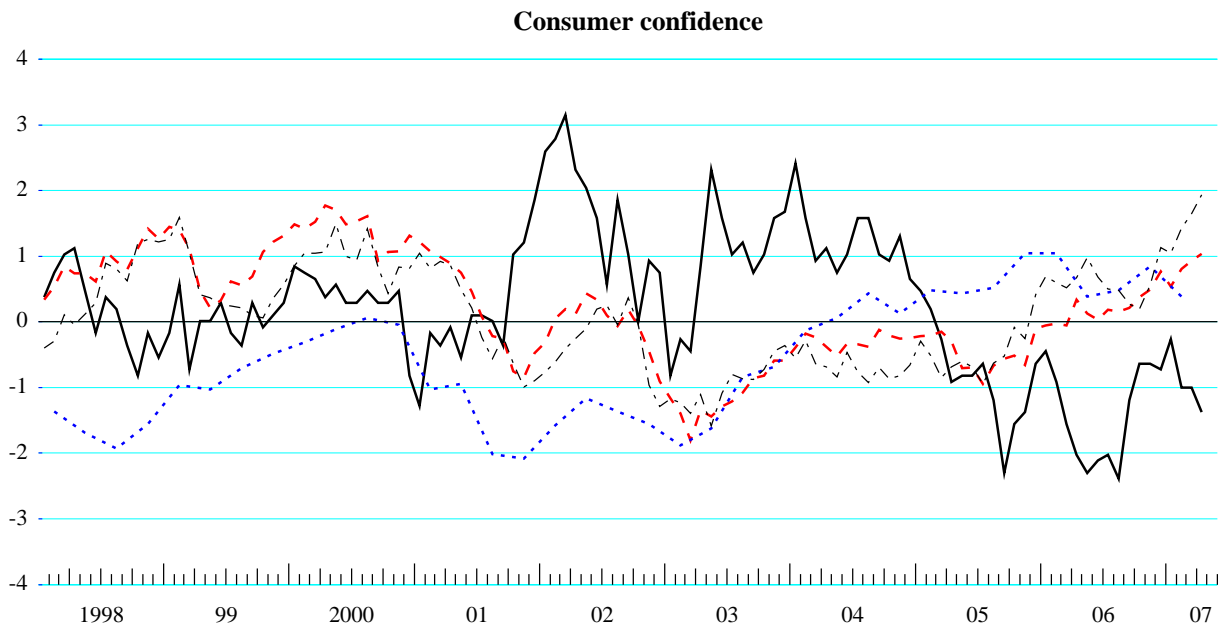
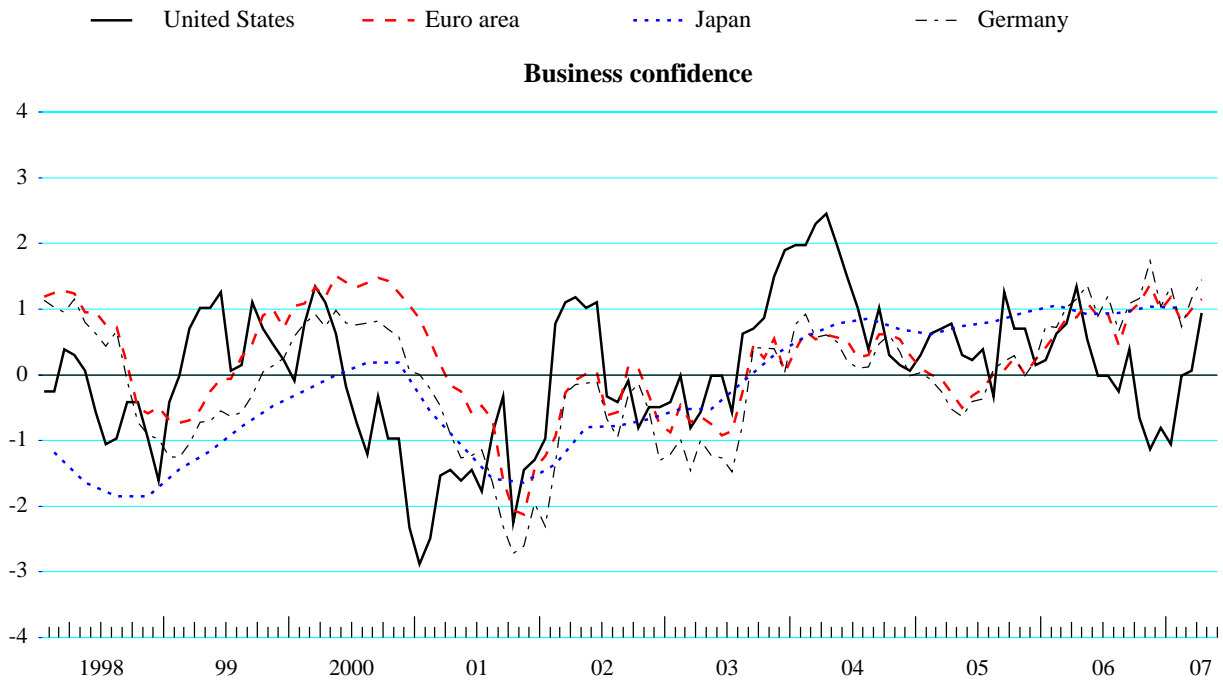
Futures suggest oil prices could stay at high levels
 West Texas Intermediate (WTI), current dollars, daily observations and trend



Note: Far-futures prices refer to the New York Merchandise Exchange contract on light crude with the farthest maturity (6 to 7 years). Trends are three-month moving averages.

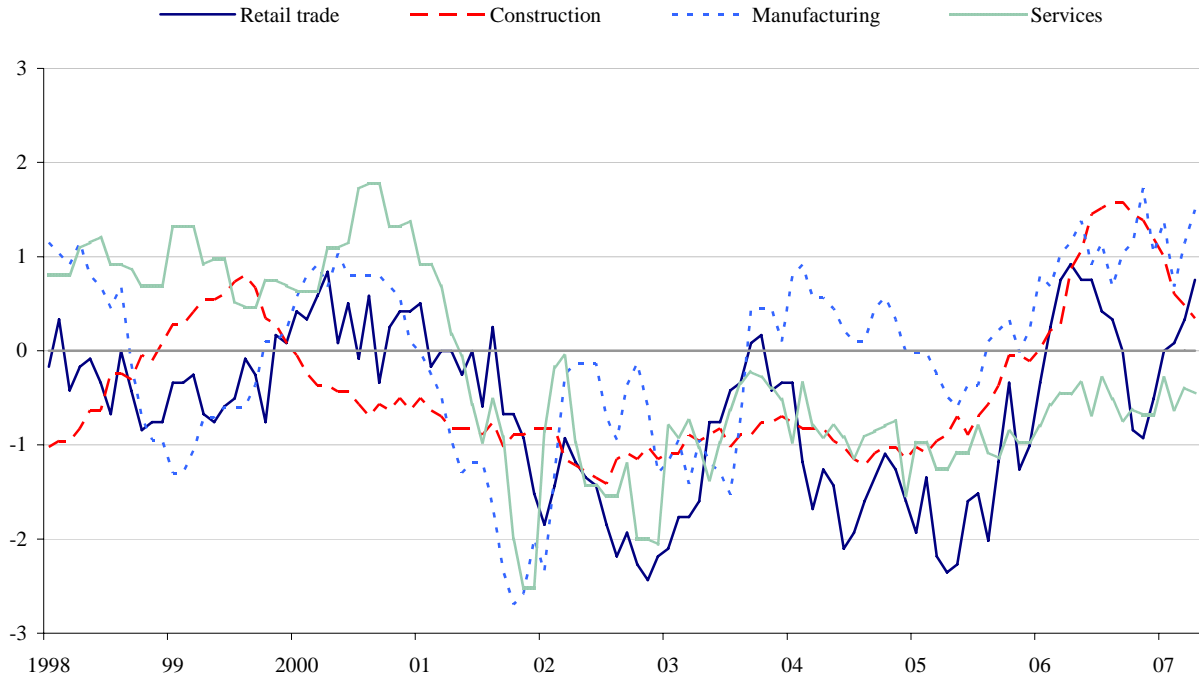
Source: OECD Economic Outlook 81 database and Datastream.

Confidence is high except among US consumers



All series have been normalised at the average for the period starting in 1985 and are presented in units of standard deviation.
Source: OECD Main Economic Indicators.

Business confidence has become more upbeat across sectors in Germany over the past two years

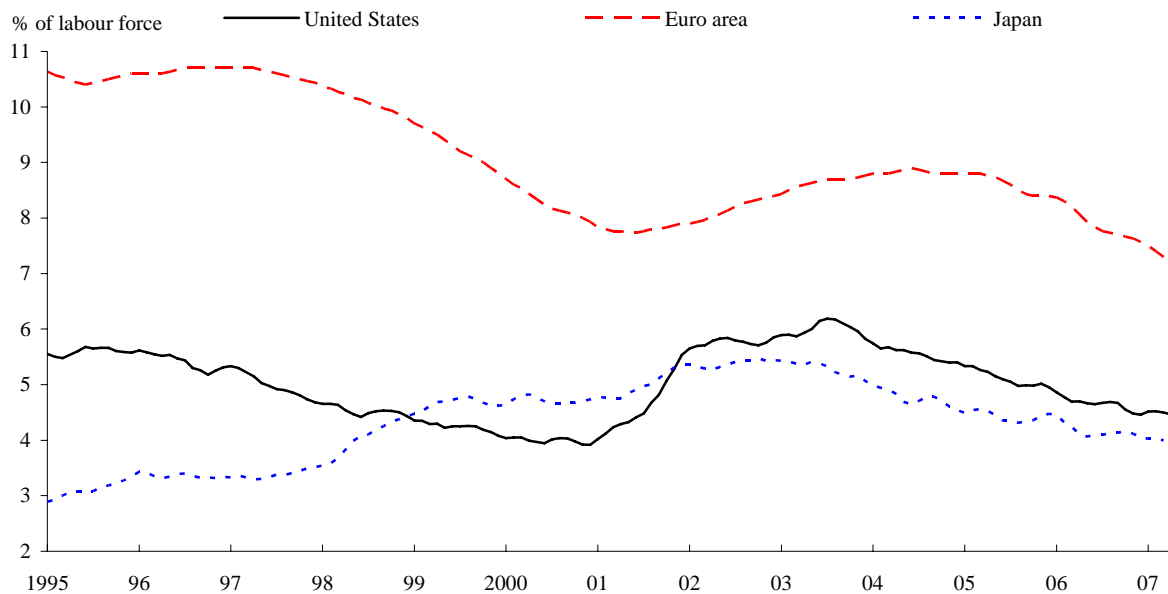


Source: OECD Main Economic Indicators.

Labour market conditions continue to improve

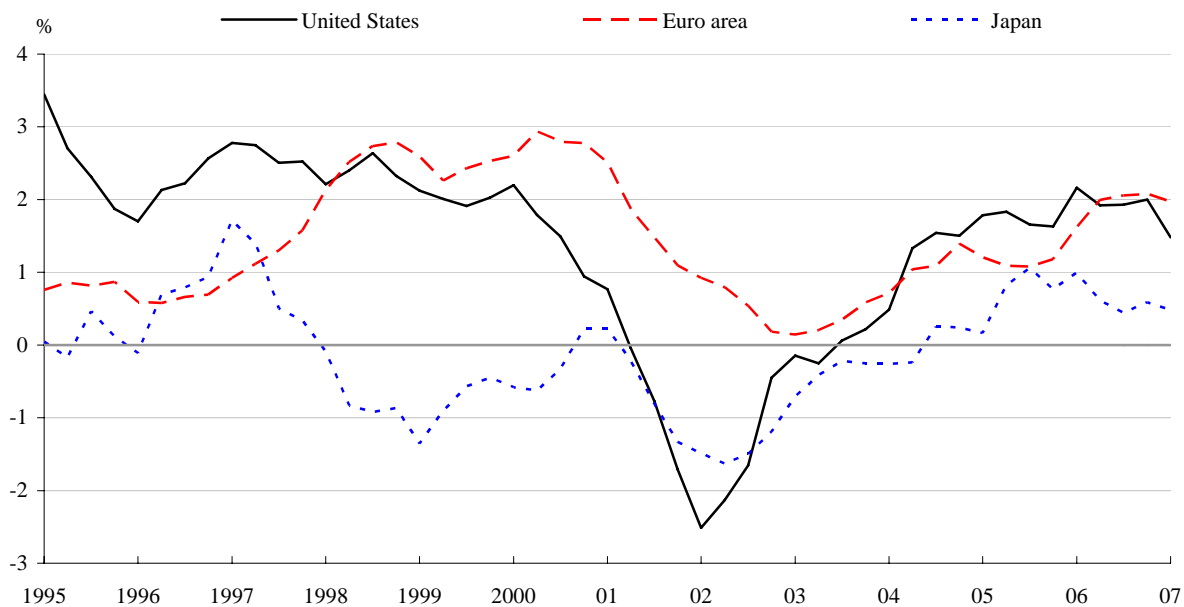
Unemployment

3-month moving average of standardised unemployment rate



Business sector employment

Year-on-year growth



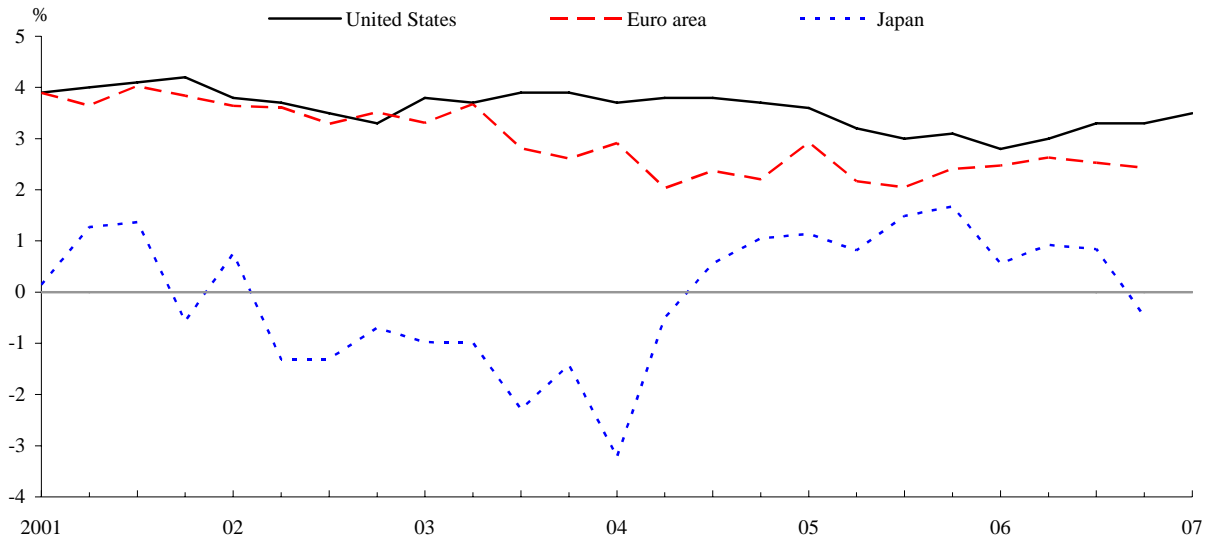
Note: Employment growth for the euro area and Japan in 2007Q1 is an OECD estimate.

Source: OECD Main Economic Indicators and Economic Outlook 81 database.

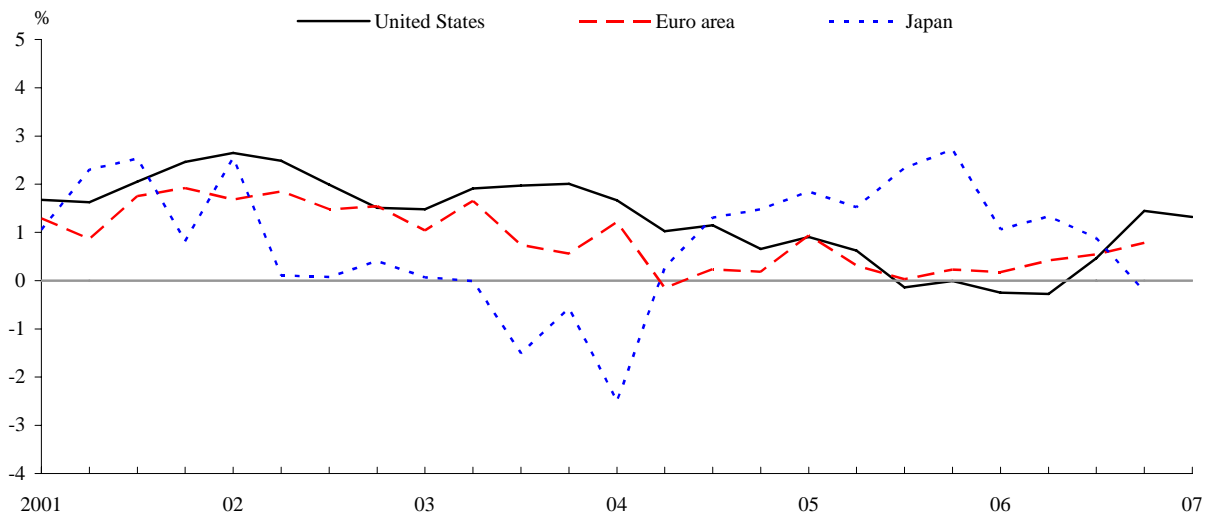
Labour cost developments vary across the main economic regions

Year-on-year percentage change

Nominal labour costs



Real labour costs



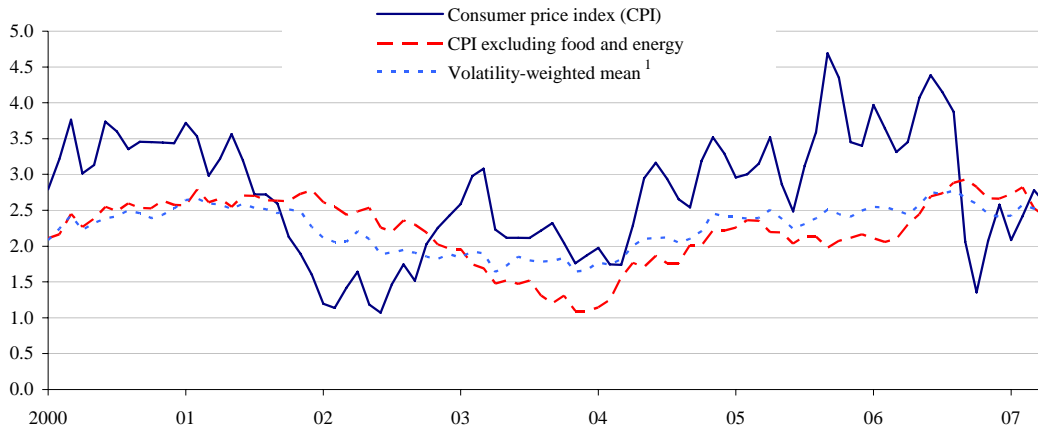
Note: Real labour costs are nominal costs deflated by the index of private consumption prices.

Source: Eurostat, Japanese Cabinet Office, US Bureau of Labor Statistics, OCDE Economic Outlook 81 database.

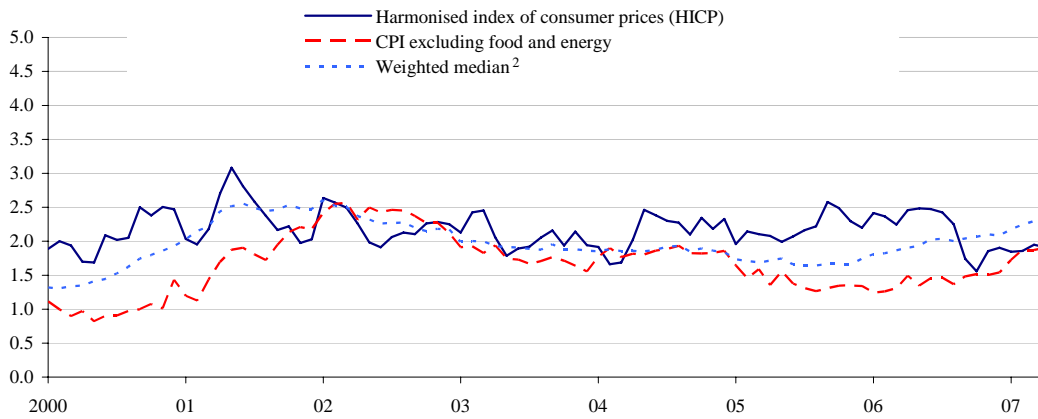
Headline and core inflation are converging

Year-on-year percentage change

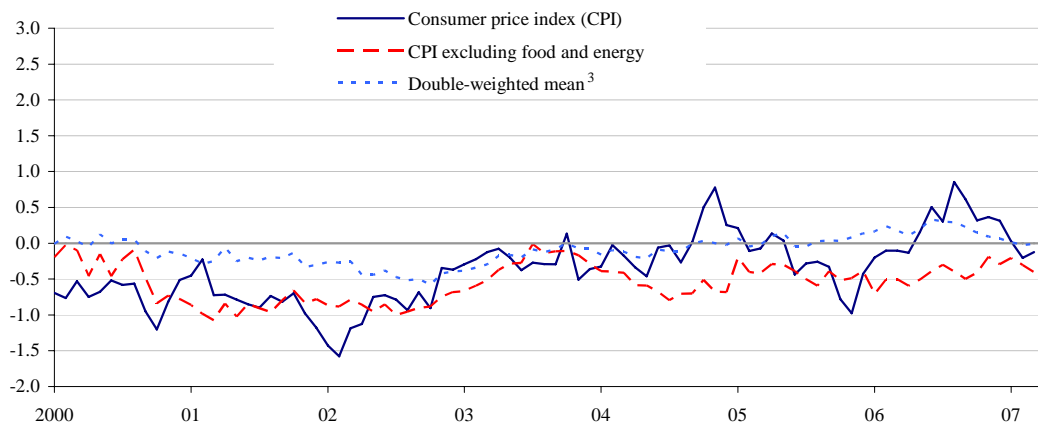
United States



Euro area



Japan



1. The volatility-weighted mean refers to an average of price increases of CPI components weighted by the inverse of the standard deviation of the price second difference.

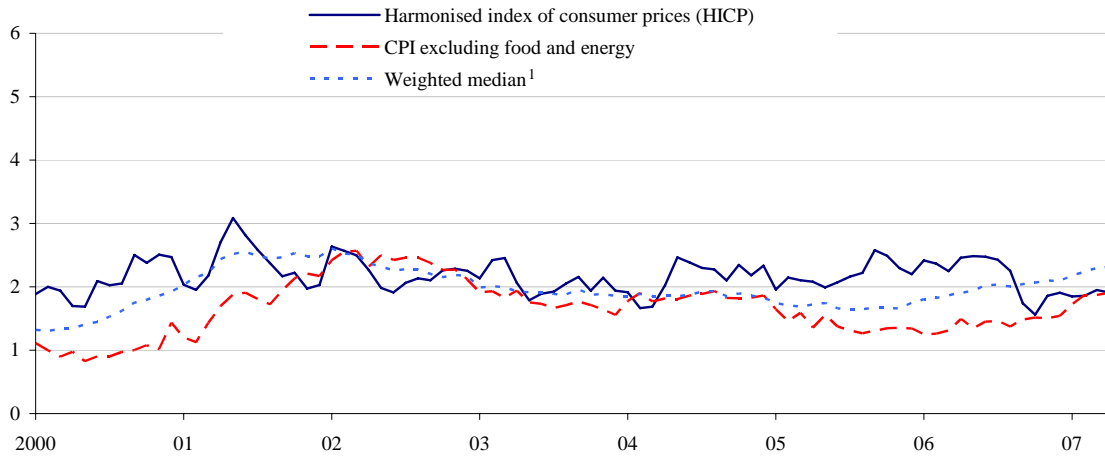
2. The weighted median is, each month, the middle element in the distribution of CPI price changes, that is, the one leaving 50% of the components (in terms of CPI weights) on each side.

3. The double-weighted mean combines original CPI expenditure-based weights and weights related to volatility. It is an average of price increases weighted by the original CPI weights divided by the standard deviation of the price second difference.

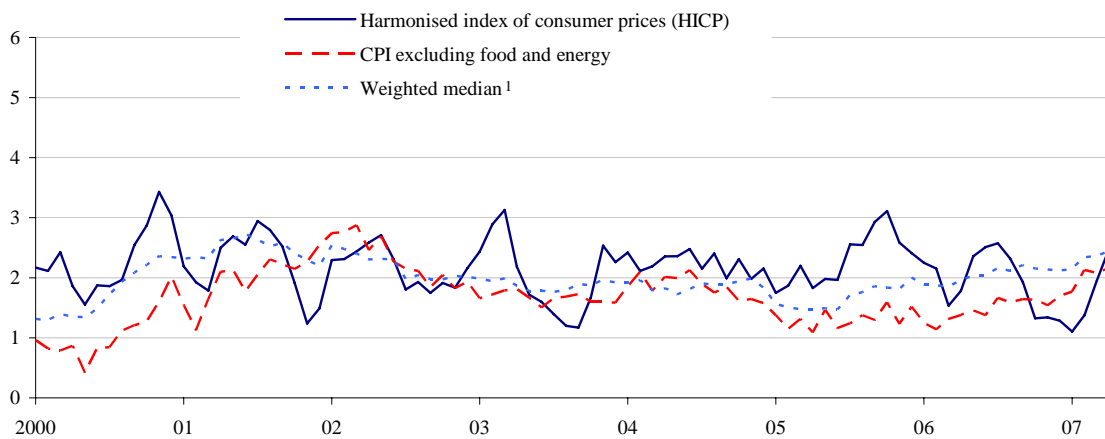
Source : OECD Main Economic Indicators and OECD calculations.

Core inflation has moved up in the euro area

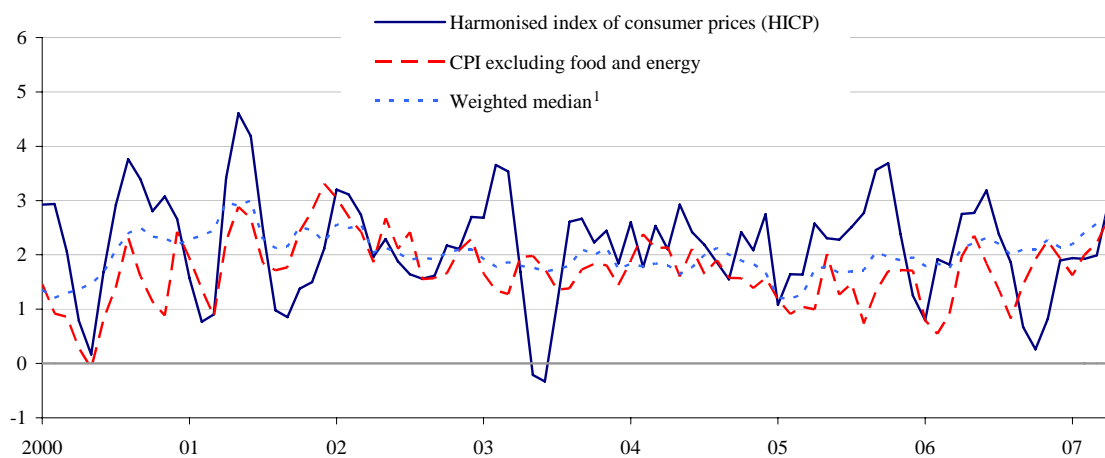
Year-on-year percentage change in headline and core price indices



6-month annualised inflation rate



3-month annualised inflation rate

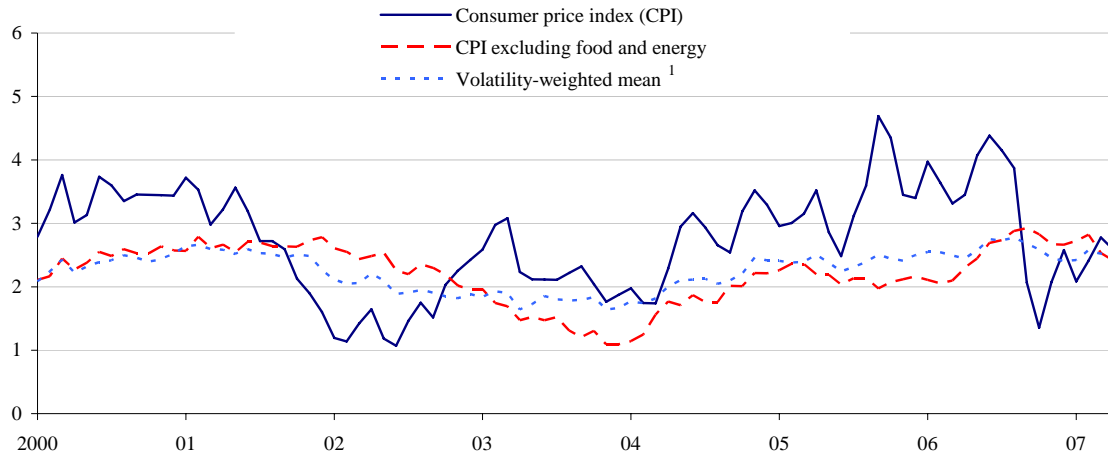


1. The weighted median is, each month, the middle element in the distribution of CPI price changes, that is, the one leaving 50% of the components (in terms of CPI weights) on each side.

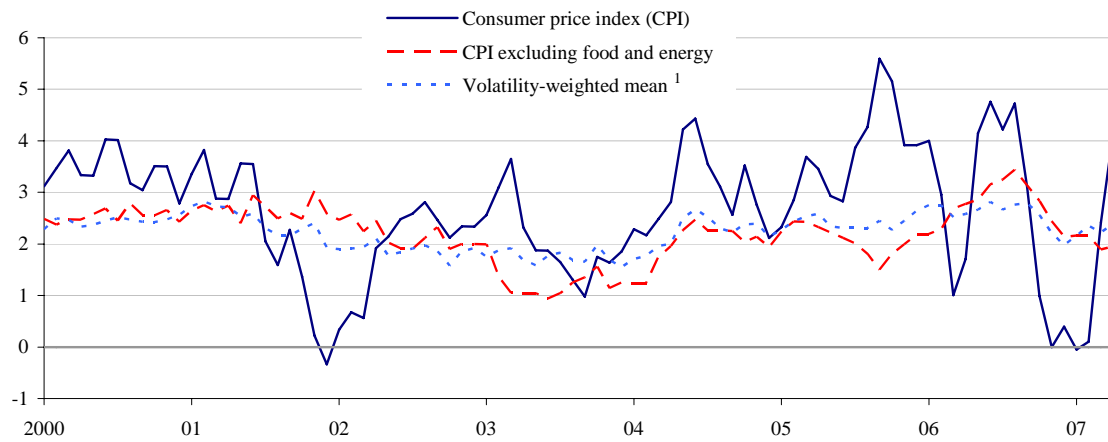
Source : OECD Main Economic Indicators and OECD calculations.

Inflation in the United States is still too high for comfort

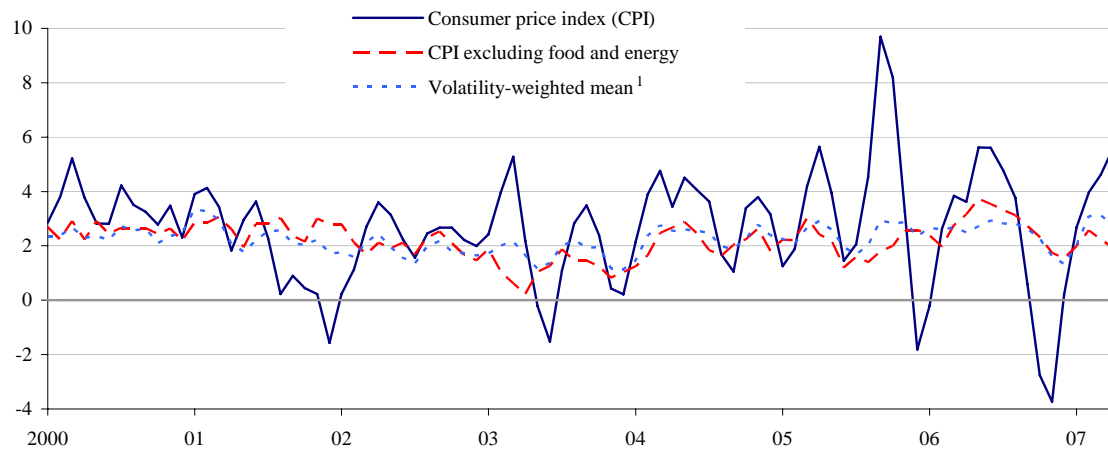
Year-on-year percentage change in headline and core price indices



6-month annualised inflation rate



3-month annualised inflation rate

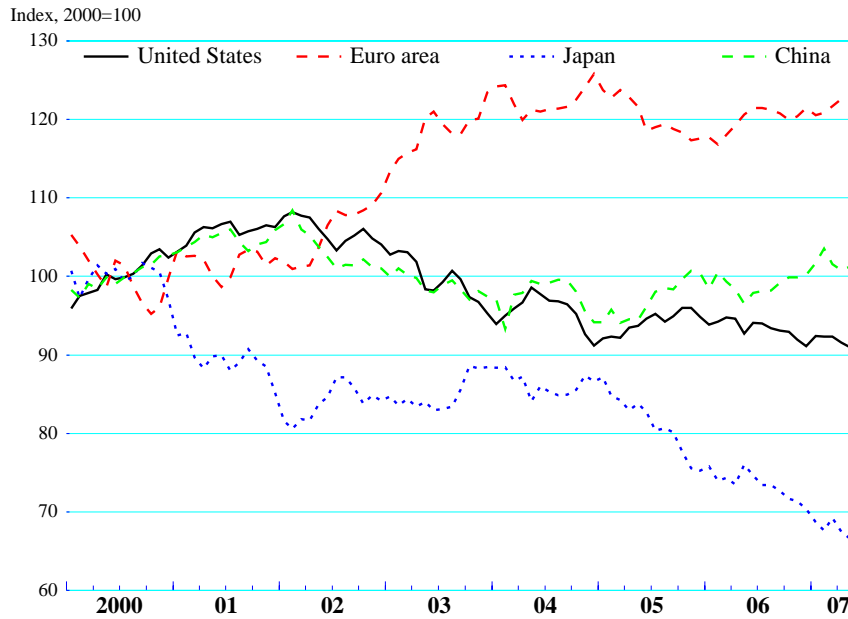


1. The volatility-weighted mean refers to an average of price increases of CPI components weighted by the inverse of the standard deviation of the price second difference.

Source : OECD Main Economic Indicators and OECD calculations.

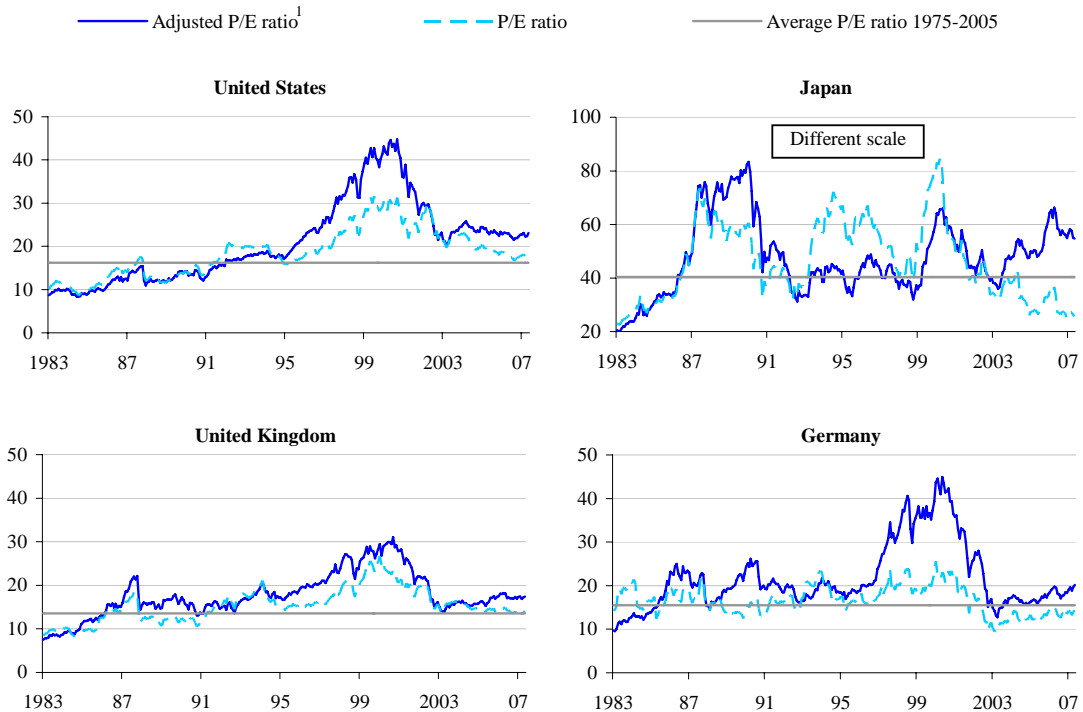
The yen has weakened considerably

Real effective exchange rates



Note: The real effective exchange rate is based on the consumer price index.
Source : OECD Economic Outlook 81 database.

Equity markets are tightly priced



1. Adjusted P/E ratios are calculated as the ratio of stock prices to the moving average of the previous 10 years' earnings, adjusted for nominal trend growth.

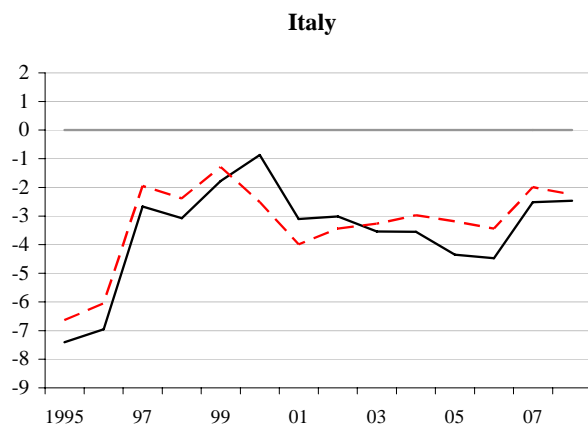
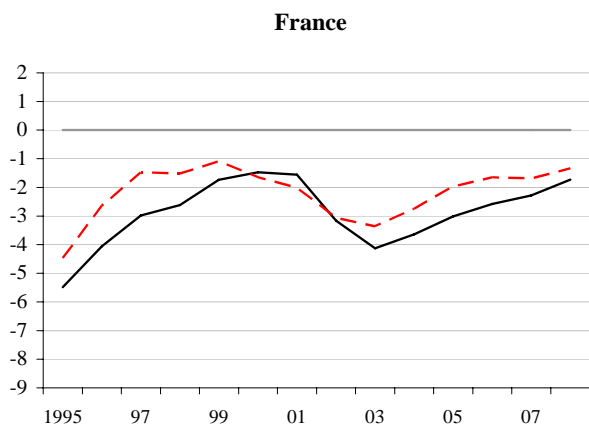
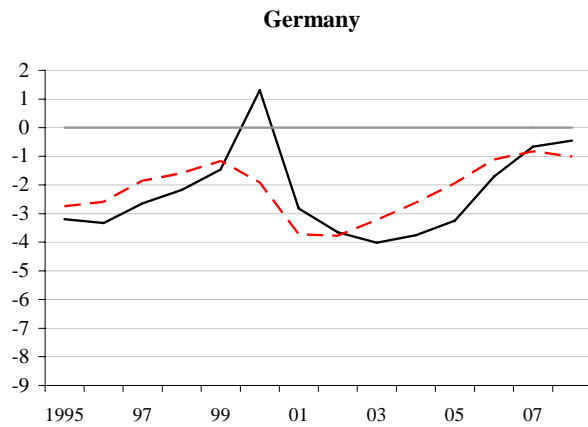
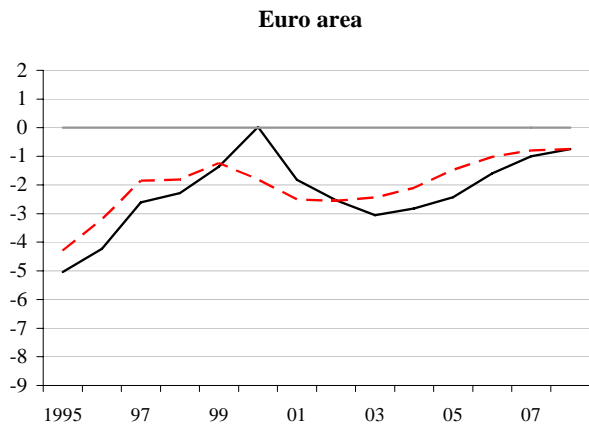
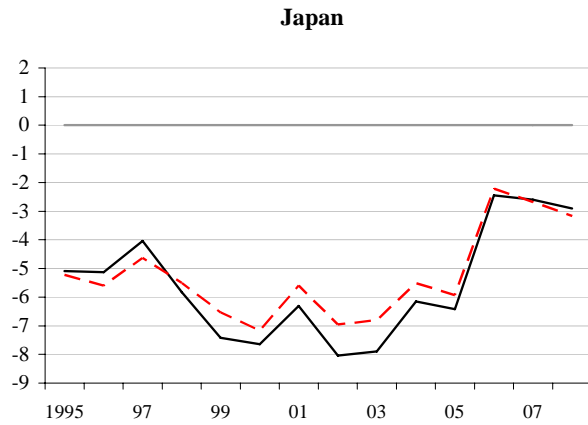
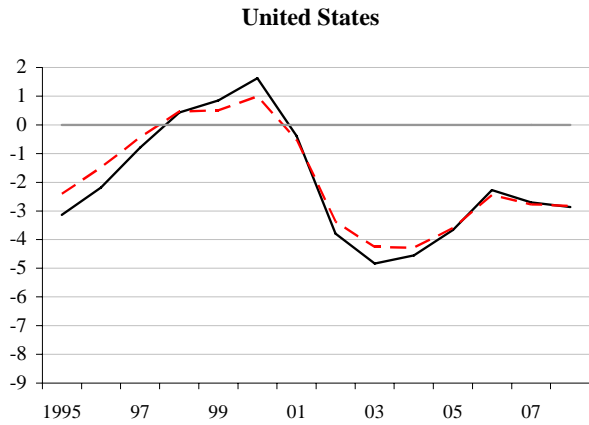
Source: Datastream; OECD calculations.

There is little fiscal consolidation in sight

Per cent of GDP¹

— General government financial balances²

- - - Cyclically-adjusted general government balances



1. Per cent of potential GDP for cyclically-adjusted general government balances.

2. Excluding third-generation telephone licence proceeds.

Source: OECD Economic Outlook 81 database.

Spending pressures from ageing

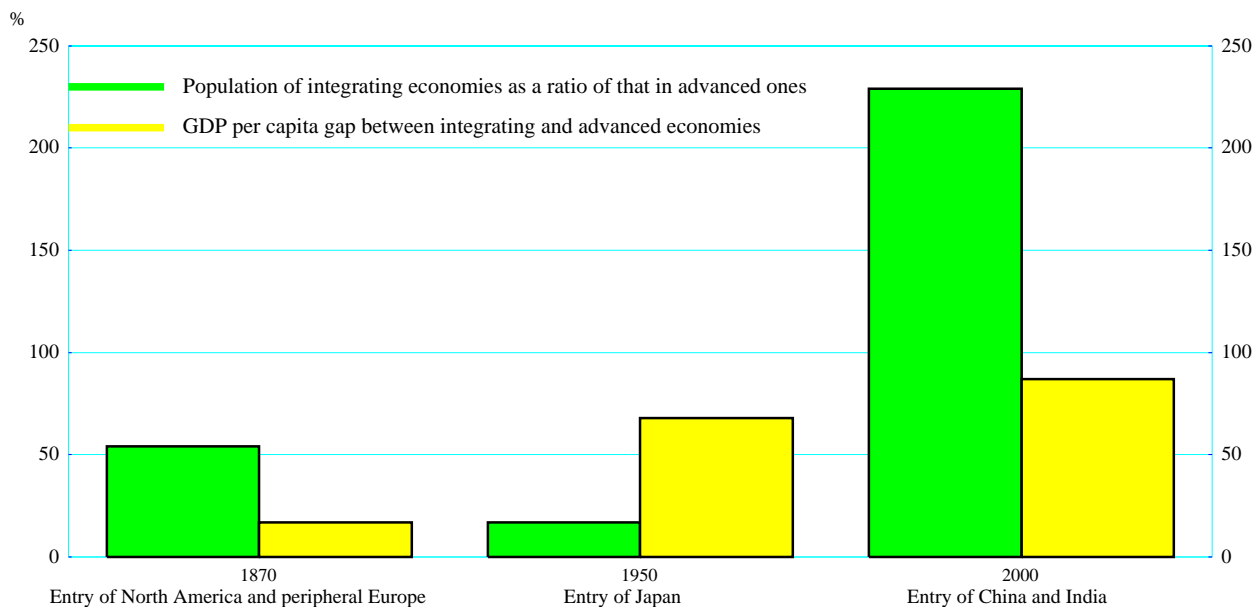
From 2005 levels, in percentage points of GDP

	Health care		Long-term care		Pensions		Total		Cumulative increase in public debt ratios
	2025	2050	2025	2050	2025	2050	2025	2050	2005-2050
	Australia	1.8	4.2	0.5	2.0	1.0	1.7	3.3	7.9
Austria	1.5	3.8	0.6	2.0	0.1	-1.0	2.2	4.8	111
Belgium	1.3	3.3	0.6	1.9	3.0	5.1	4.8	10.3	241
Canada	1.9	4.1	0.6	2.1	0.8	1.7	3.3	7.9	176
Denmark	1.5	3.5	0.4	1.5	2.5	3.2	4.3	8.2	203
Finland	1.8	3.6	0.8	2.4	2.8	3.3	5.4	9.3	241
France	1.5	3.5	0.4	1.7	1.2	2.1	3.1	7.3	164
Germany	1.5	3.6	0.8	1.9	0.2	2.0	2.5	7.5	153
Greece	1.6	3.9	1.3	2.7	4.6	10.3	7.5	16.8	386
Ireland	1.6	4.0	1.5	3.8	2.5	6.5	5.6	14.4	312
Italy	1.6	3.8	1.3	2.9	0.2	0.4	3.1	7.0	160
Japan	1.9	4.3	1.1	2.2	0.3	0.6	3.4	7.1	168
Luxembourg	1.4	3.7	1.3	3.1	3.7	7.4	6.3	14.3	326
Netherlands	1.7	3.8	0.7	2.0	2.0	3.8	4.4	9.6	223
New Zealand	1.8	4.3	0.6	2.0	3.2	5.9	5.7	12.0	283
Portugal	1.6	4.2	0.6	2.0	3.9	9.3	6.1	15.5	338
Spain	1.6	4.1	1.1	2.4	1.8	7.0	4.5	13.5	276
Sweden	1.4	3.2	0.3	1.1	0.1	0.8	1.8	5.1	106
United Kingdom	1.4	3.6	0.6	1.9	0.7	1.7	2.8	7.2	156
United States	1.5	3.4	0.4	1.7	0.9	1.8	2.9	7.0	156
Euro area	1.5	3.7	0.9	2.2	1.1	3.0	3.5	8.9	194

Source: OECD (2006), "Projecting OECD Health and Long-term Care Expenditures: What Are the Main Drivers?", *OECD Economics Department Working Papers*, No. 477, Paris; Visco, I. (Ed.) (2005), "Ageing and Pension System Reform: Implications for Financial Markets and Economic Policies", in *Financial Market Trends*, November 2005 Supplement, OECD, Paris.

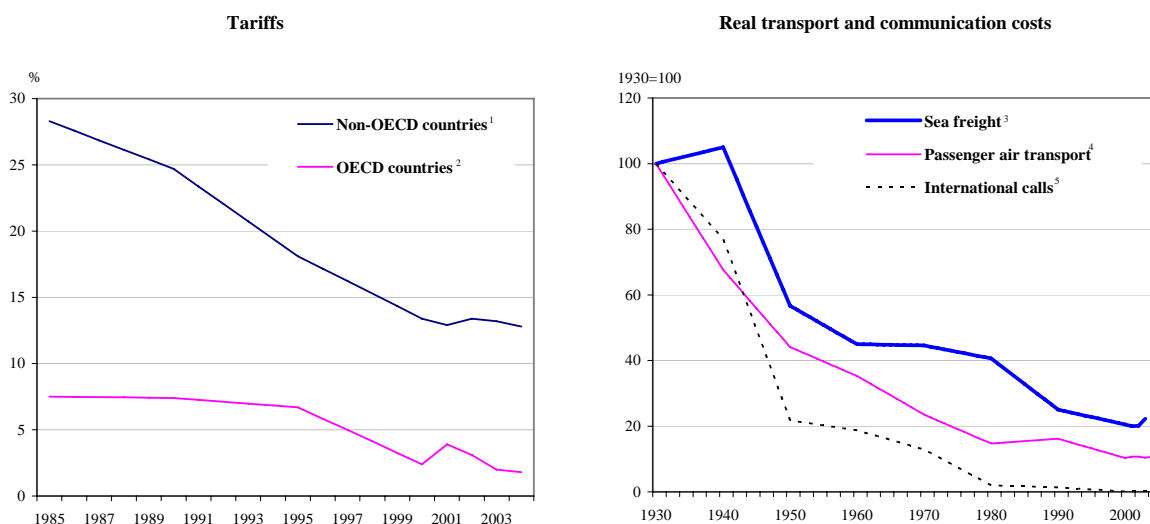
International integration is taking place on an unprecedented scale

Episodes of countries entering the internationalised economy



Source: Maddison (2007).

Trade and transaction costs have plummeted



1. Median across non-OECD countries of national mean bound tariffs.

2. Median across OECD countries of national mean bound tariffs.

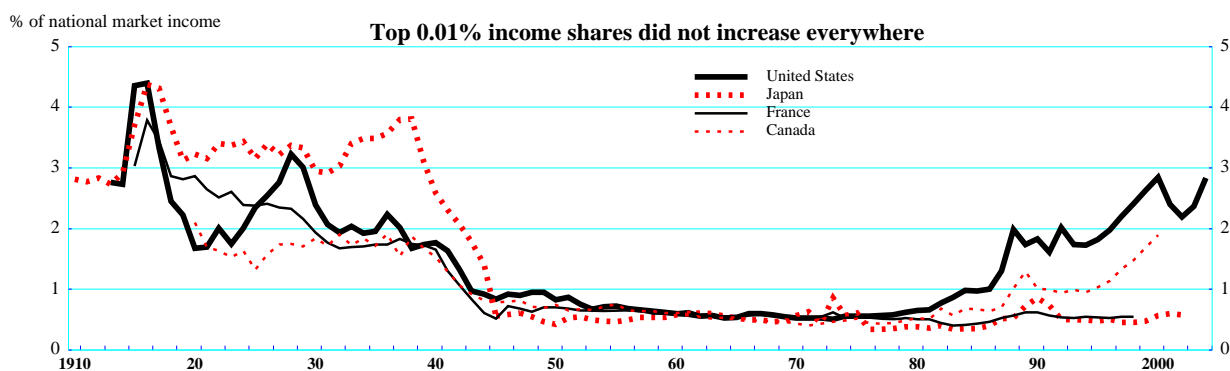
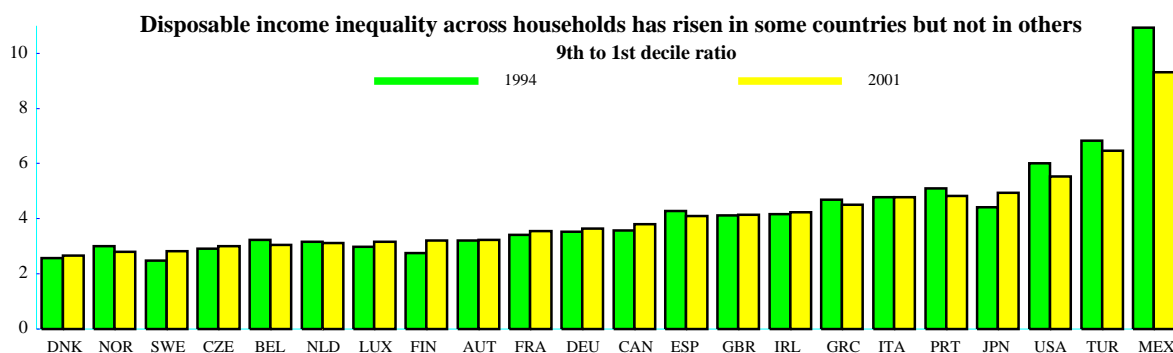
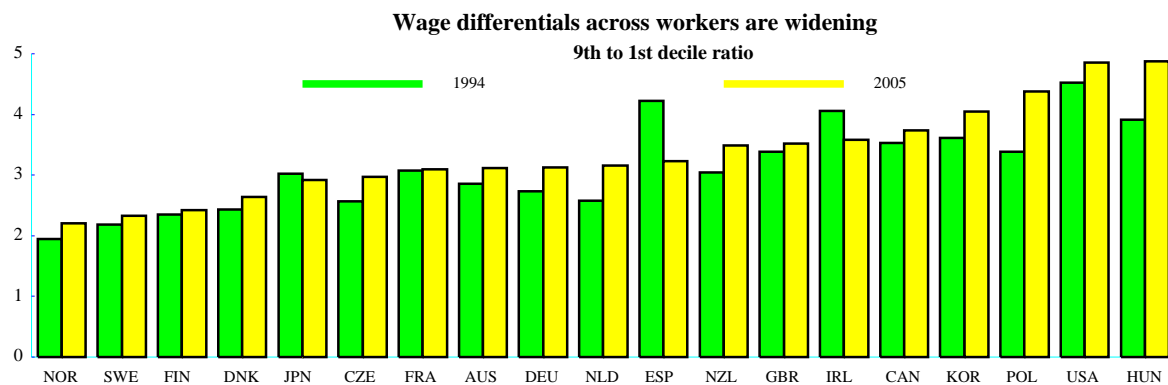
3. Average international freight charges per tonne.

4. Average airline revenue per passenger mile until 2000 spliced to US import air passenger fares afterwards.

5. Cost of a three-minute call from New York to London.

Source : World Bank, World Development Indicators; Fraser Institute; Busse, M. (2003); Hummels, D. (2006); US Bureau of Labour Statistics; Nordhaus (2001); OECD calculations.

Wage dispersion is rising but income inequality shows no general trend



Top panel : For full-year, full-time workers.

1994-1999 for Netherlands, 1994-2000 for Hungary and Ireland, 1994-2002 for France, Germany, Korea and Poland, 1995-2002 for Spain, 1996-2003 for Czech Republic and Denmark, 1997-2002 for Norway, 1997-2003 for Canada.

Middle panel :

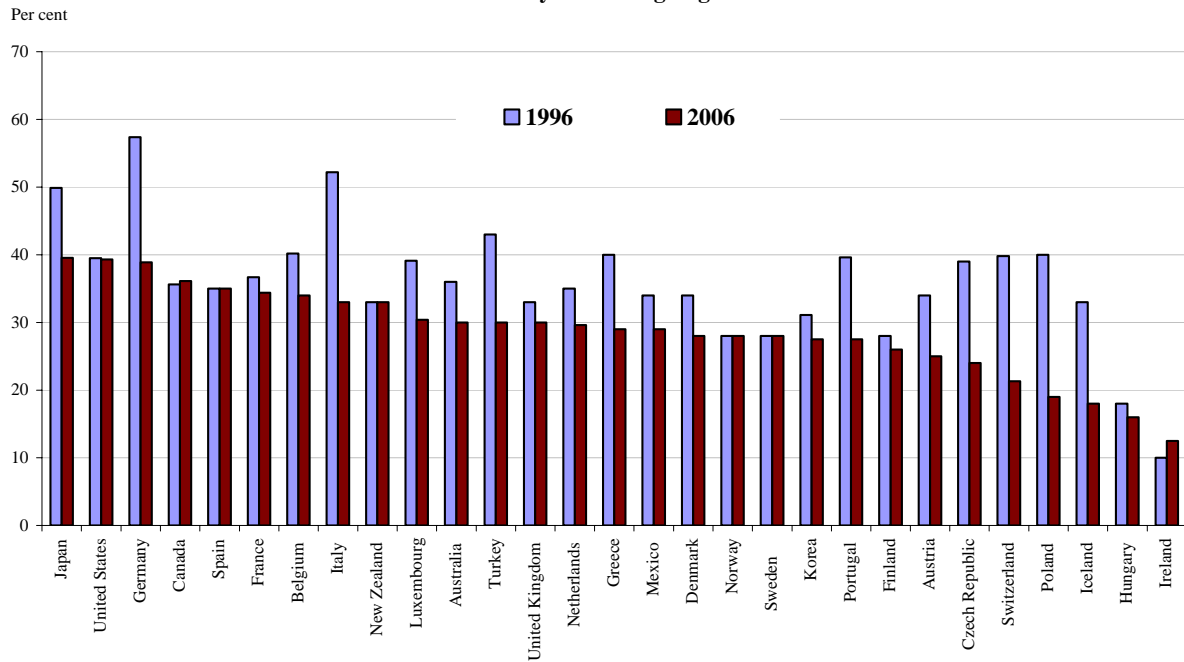
1994-2000 for Japan, 1994-2002 for Mexico and Turkey, 1995-2000 for Canada and Norway, 1995-2001 for Belgium, Finland, Italy, Portugal and Sweden, 1996-2002 for Czech Republic.

Bottom panel : For tax units: households in France and the United States; individuals in Canada and Japan.

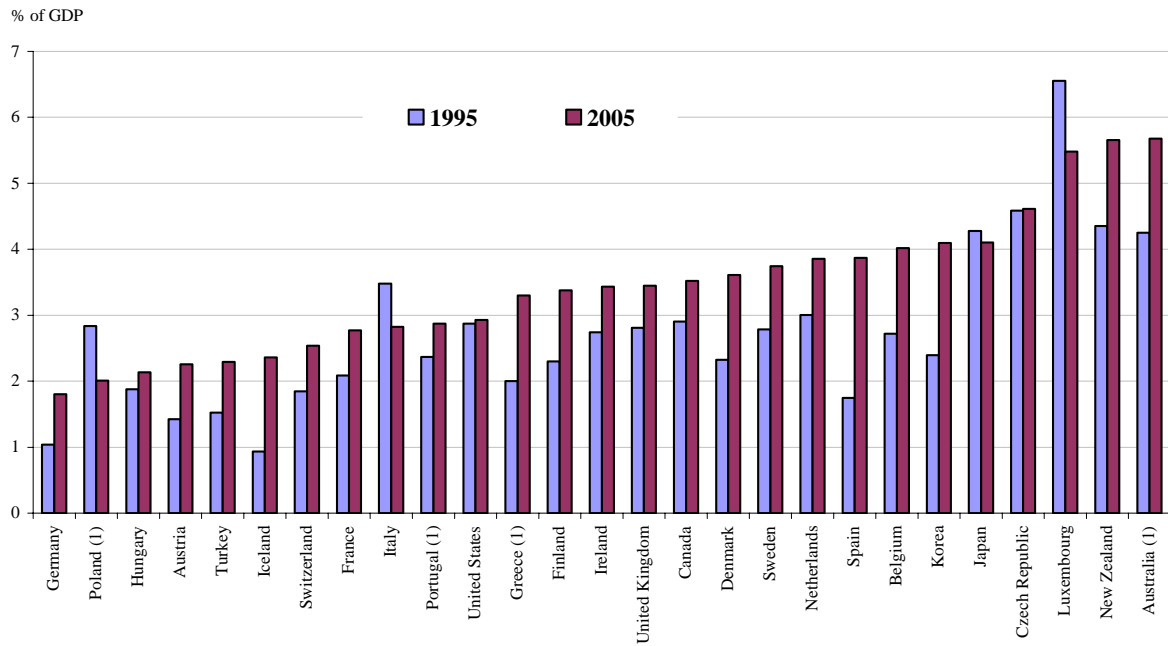
Source: OECD Employment Outlook (2006); Burniaux et al. (2006); Saez and Piketty (2007); Moriguchi and Saez (2006); Piketty (2001); Saez (2005).

Corporation tax has become more broad-based

Statutory rates are going down...



... but tax revenues are increasing

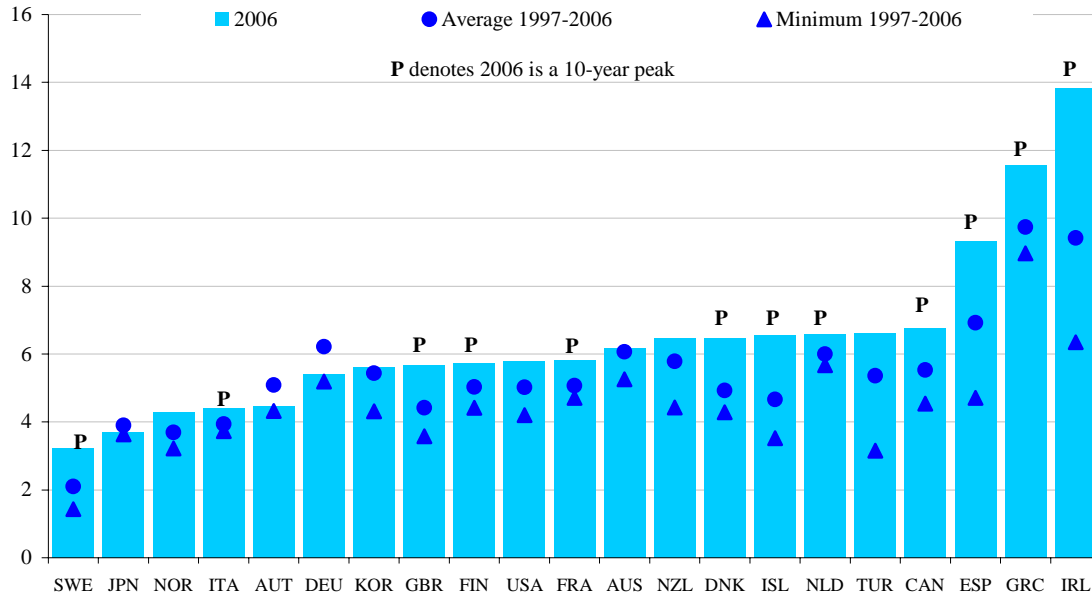


1. Data refer to 2004 instead of 2005.

Source: Yoo (2003); OECD Tax Database; OECD Revenue Statistics.

Housing investment is at ten-year highs in many countries

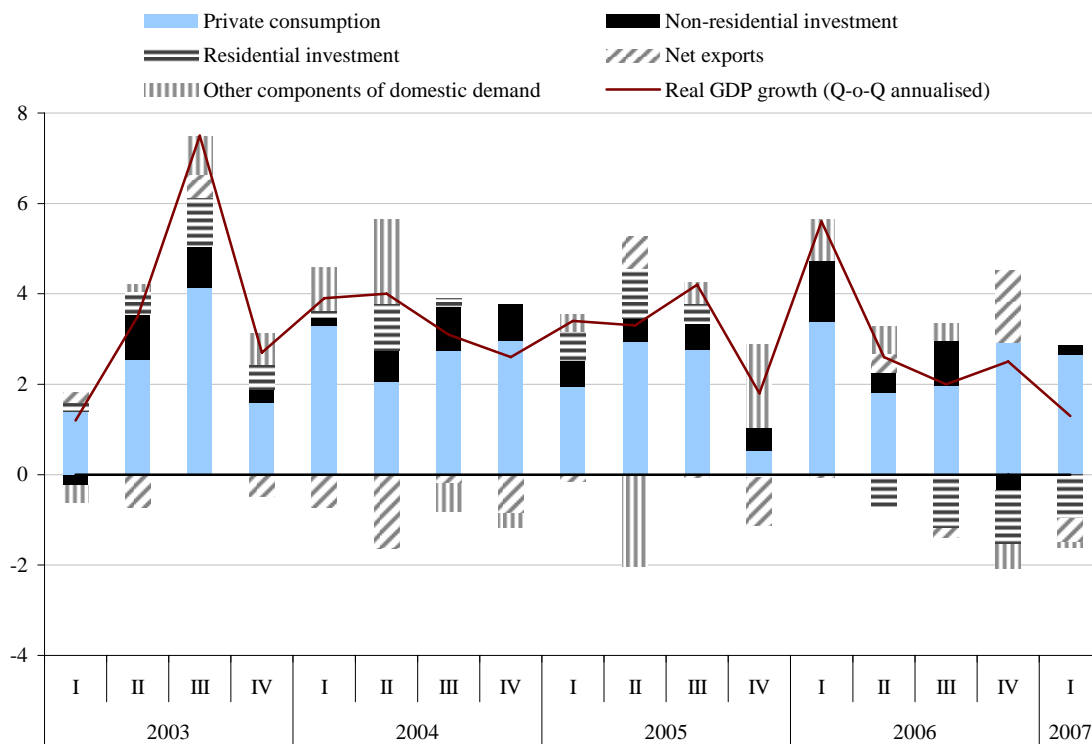
Per cent of GDP



Source: OECD Economic Outlook 81 database and OECD Quarterly National Accounts.

Residential investment is a drag on growth in the United States

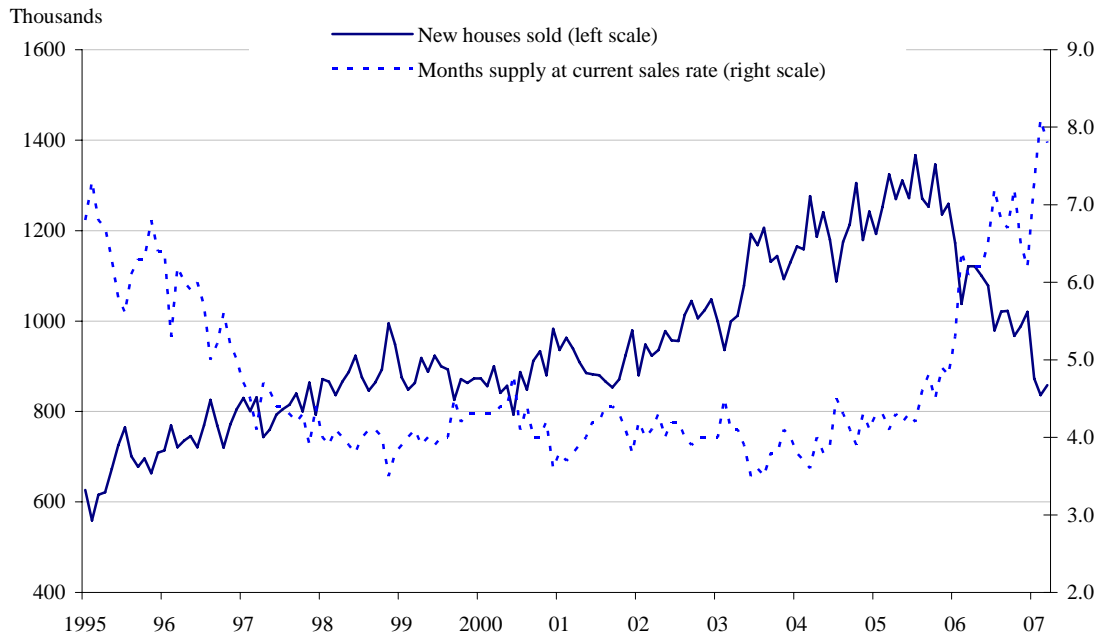
Contributions to per cent change in real GDP



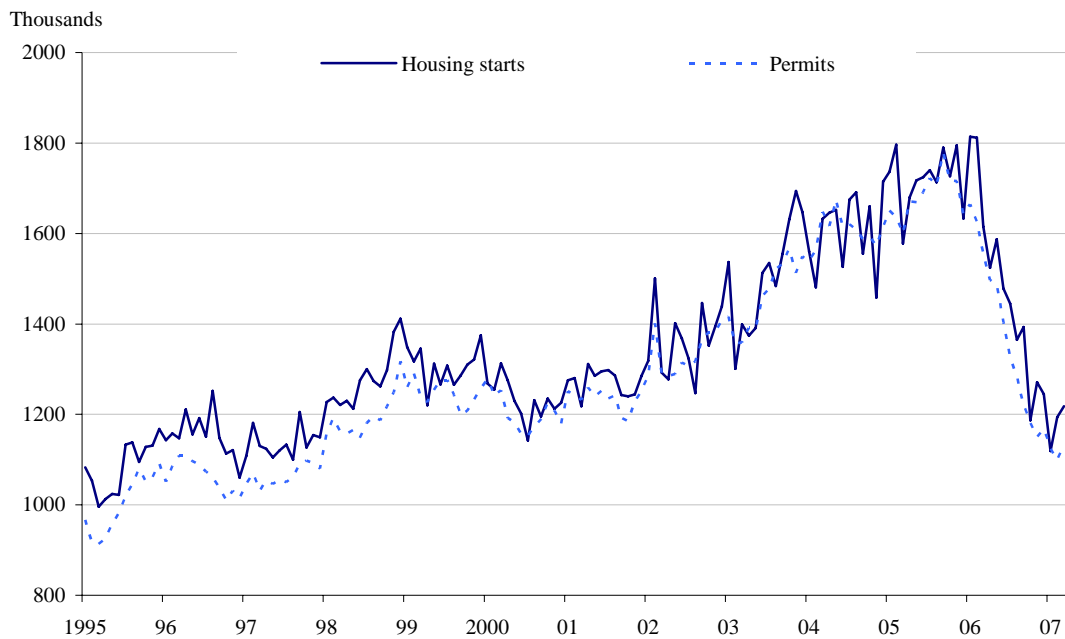
Source: US Bureau of Economic Analysis.

The US housing market

Sales of new houses and supply



Housing starts and permits



Note: Data refer to single-family houses. Months supply at current sales rate is the ratio of houses for sale to houses sold.

Source: U.S. Census Bureau.