Business at OECD

Comments on the OECD Economic Outlook, November 2019

Finding the right policy mix: structural reform and fiscal policy as a key to tackle slowing economy

Introduction

Business at OECD shares the view of the OECD that the global economy continues to lose momentum as policy uncertainties intensify and business sentiment weakens. With almost all G20 economies seeing a downward revision in their economic outlook, the global economy is showing signs of further downturn. Growth in emerging markets is also subdued despite policy efforts to stimulate the economy.

In order for the global economy to get back on the right track, we stress that international cooperation is a matter of urgency to prevent further build-up of trade tensions and political uncertainty which hamper export and investment prospects. Next, improving the track record of structural reform implementation remains a crucial issue across economies to help not only boost potential output in the medium- to long-term but also cope with the impact of digitalization and climate change. While maintaining the current accommodative monetary policy as a basis for sufficient bank lending for investment, governments with fiscal space should consider deploying fiscal stimulus to ensure both short-term and long-term growth. For all governments there is scope to make public finances growth-supportive and more efficient, especially by targeted reductions in nonproductive public spending and by reductions in distortionary taxes that hamper growth. Fiscal policy and structural reform are ever more crucial especially as there are signs that monetary policy is increasingly reaching its limits or may even face stronger undesired side-effects of additional expansionary measures.

1. Economic Situation

- Global economic growth is experiencing a continued slowdown. As the OECD's latest forecast from 21st November underlines, rising trade and geopolitical tensions have taken a serious toll on business confidence, investment spending, and global trade. In 2020, the impact will continue to weigh heavily on investment, trade and growth. In some economies, negative spill-overs in a persistently strained policy environment from weak private investment into wages and consumption over the course of 2020 and 2021 will become more likely. All said, a risk of gliding into recession has become a serious concern in many EU economies and is non-negligible in Japan and the U.S.

- This is reflected in the OECD's latest projections for global growth, which saw a slight further downward revision to growth of now 2.9% for 2019 (-0.3 pp from May forecast), following growth of 3.5% in 2018. The 2020 forecast also saw a decline to now 2.9% (by -0.5 pp from May), with few indications that the downward trend will halt in the foreseeable future. While several major economies such as Australia, Canada, and Japan held up in the near term, those more susceptible to the trade policy issues and weakening investment suffered a sharper decline.

- The OECD notes that escalating trade and political tensions as well as prolonged policy uncertainty are the main reasons for the weakening growth outlook. *Business at OECD* does not expect a sudden and significant improvement in these conditions in 2020.

- Manufacturing companies are increasingly cautious on long-range spending and hold back machinery, equipment and other capital good purchases. As the latter are often imported, weak investment spending is further depressing global trade. The decline in global trade volumes in 2019 is a very serious warning of the repercussions of those factors. A resumption of trade growth in 2020 is not a given but depends on various positive developments in current high-risk scenarios.

- As bright spots, the OECD notes that increased monetary policy accommodation and the strong decline in long-term yields have cushioned the impact of these tensions on financial market sentiment and activity. In addition, it notes that supportive labor market conditions continue to support household incomes and consumer spending, at least in the near term, even though recent survey results indicate weakness ahead.

- At the same time, the OECD's Economic Outlook is increasingly vocal on key risks as well as the extent of the global slowdown, which in turn reiterates the importance of policy responses that would mitigate the uncertainty, boost the investors' morale, and revitalize growth. Significant uncertainty still persists regarding Brexit, including in relation to the UK December election, and the way forward after 31st January 2020 when the Brexit extension ends. Furthermore, there is the underlying risk that if financial markets turn risk-averse on the perception of an imminent recession, this may increase spreads for sovereign and corporate bonds alike.

2. Policy responses

- There is a pressing need to alleviate the growing global trade tensions and uncertainty on the economic outlook while coping with the impact of digitalization and climate change. Here, we agree with the OECD's view that "it would be a policy mistake to consider these shifts as temporary factors that can be addressed with monetary or fiscal policy: they are structural." Indeed, it is of utmost importance for governments to take a coordinated, multi-faceted approach where monetary, fiscal, and structural policy reforms work together, in order to ensure not only short-term but also mid- to long-term growth. As the OECD's Outlook rightly points out, cooperation within and across major economies will be required in the event of an even sharper global growth slowdown. *Business at OECD* and its members, including the leading business federations in all 36 OECD member countries, are committed to a global rules-based trade and investment system that opens international markets and removes trade and investment barriers and unfair practices that impede fair competition around the world. We remain committed to work with OECD to promote the benefits of trade.

- In terms of monetary policy, central banks have recently further eased their monetary policy accommodation (both through action and communication). It seems, however, that there is little room left for monetary policy in particular in the Eurozone and Japan now that the market interest rates are hovering at around (or even below) zero percent. That said, by keeping the finance cost low for business, monetary policy should continue to support private investment which is essential for the long-term growth. Clearly, the undesired side-effects of monetary policies become more of a concern and need to be managed carefully.

- In terms of fiscal policy, some countries with fiscal space would benefit from a fiscal expansion in order to address the investment needs to provide basis for longer-term growth. We understand that this is often easier said than done, so it should come with enabling policy environment. Investment in infrastructure would help countries to foster long-term growth. On the other hand, countries with high budget deficits need to be mindful of the risk of further inflating their stock of public debt, so it is a matter of urgency to promote structural reform to maximize the effect of public spending and overcome the limitation of monetary policy. In addition, in all governments there is scope to make public finances growth-supportive and more efficient, especially by eliminating red-tape and by reducing distortionary taxes that hamper growth.

- The importance of the optimal policy mix is emphasized in the November OECD outlook, which we fully concur with. The simulation results imply that there are many lessons to be learned for both Euro area policymakers and those in other economies when coming up with future policy mix rather than simply continuing to rely on QE, which brought about higher asset prices as a side effect.

- To support the effectiveness of monetary and fiscal policies, it should be put more emphasis on structural reform efforts. The skill shortages and mismatches are increasingly visible in not only OECD countries but also other parts of the world, which calls for more opportunities for life-long learning. Also, structural reforms should take into account the increasing life expectancy in developed economies. For example, more flexible workstyle innovation and the reform of retirement systems would help workers to maximize their participation in the labor market. Inclusive growth, which offers more opportunities for women, migrants, and non-standard workers alike, will address the productivity challenges that hamper economic growth.

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