OECD Economic Outlook, Interim Report

Turning the Corner

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BETTER POLICIES FOR BETTER LIVES

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Summary

- Global output growth has remained resilient and inflation has continued to moderate. Growth has been relatively robust in many G20 countries including the United States, Brazil, India, Indonesia and the United Kingdom. In contrast, outcomes have remained soft in a few economies, including Germany, and output contracted in Argentina.
- Recent activity indicators suggest ongoing momentum, especially in services sectors. Real wage growth is now supporting household incomes and spending, though purchasing power has yet to fully return to pre-pandemic levels in many countries. Global trade is recovering faster than expected, but shipping costs remain elevated and export orders have recently moderated.
- Goods price inflation has now fallen to low levels, but cost and price pressures persist in many service sectors. Services price inflation may still need to decline by 1 percentage point or more in many economies to bring core inflation back to rates consistent with inflation targets.
- Global GDP growth is projected to stabilise at 3.2% in 2024 and 2025, with further disinflation, improving real incomes, and less restrictive monetary policy in many economies helping underpin demand.
- Annual GDP growth in the United States is projected to slow but be cushioned by monetary policy easing, with growth projected to be 2.6% in 2024 and 1.6% in 2025. Euro area GDP growth is projected to be 0.7% in 2024 and 1.3% in 2025, with activity supported by a recovery in real incomes and an improvement in credit availability. Growth in China is expected to ease to 4.9% in 2024 and 4.5% in 2025, with additional policy stimulus offset by subdued consumer demand and the ongoing deep correction in the real estate sector.
- Inflation is projected to be back to target in most G20 countries by the end of 2025. Headline inflation is projected to ease from 5.4% in 2024 to 3.3% in 2025 in the G20 economies, with core inflation in the G20 advanced economies easing to 2.7% in 2024 and 2.1% in 2025.
- Significant risks remain. Persisting geopolitical and trade tensions could increasingly damage investment and raise import prices. Growth could slow more sharply than expected as labour markets cool, and deviations from the expected smooth disinflation path could trigger disruptions in financial markets. On the upside, the recovery in real incomes could provide a stronger boost to consumer confidence and spending, and further oil price declines would hasten disinflation.
- As inflation moderates and labour market pressures ease further, monetary policy rate cuts should continue, though the timing and scope of reductions will need to remain data-dependent and be carefully judged to ensure underlying inflationary pressures are durably contained.
- Decisive fiscal actions are needed to ensure debt sustainability, preserve room for governments to react to future shocks and generate resources to help meet future spending pressures. Stronger efforts to contain spending and enhance revenues, set within credible medium-term adjustment paths, are key to ensuring that debt burdens stabilise.
- Reinvigorating product market reforms that promote open markets with healthy competitive dynamics is an essential step to foster stronger sustained economic growth and help alleviate longer-term fiscal pressures.

Table 1. Global growth is projected to remain around its recent pace

	2023	2024		2025	
		Interim EO projections	Difference from May EO	Interim EO projections	Difference from May EO
World	3.1	3.2	0.1	3.2	0.0
G20[1]	3.4	3.2	0.1	3.1	0.0
Australia	2.0	1.1	-0.4	1.8	-0.4
Canada	1.2	1.1	0.1	1.8	0.0
Euro area	0.5	0.7	0.0	1.3	-0.2
Germany	-0.1	0.1	-0.1	1.0	-0.1
France	1.1	1.1	0.4	1.2	-0.1
Italy	1.0	0.8	0.1	1.1	-0.1
Spain[2]	2.5	2.8	1.0	2.2	0.2
Japan	1.7	-0.1	-0.6	1.4	0.3
Korea	1.4	2.5	-0.1	2.2	0.0
Mexico	3.2	1.4	-0.8	1.2	-0.8
Türkiye	5.1	3.2	-0.2	3.1	-0.1
United Kingdom	0.1	1.1	0.7	1.2	0.2
United States	2.5	2.6	0.0	1.6	-0.2
Argentina	-1.6	-4.0	-0.7	3.9	1.2
Brazil	2.9	2.9	1.0	2.6	0.5
China	5.2	4.9	0.0	4.5	0.0
India[3]	8.2	6.7	0.1	6.8	0.2
Indonesia	5.0	5.1	0.0	5.2	0.0
Russia	3.6	3.7	1.1	1.1	0.1
Saudi Arabia	-0.7	1.0	1.2	3.7	-0.4
South Africa	0.7	1.0	0.0	1.4	0.0

Note: Difference from May 2024 OECD Economic Outlook in percentage points, based on rounded figures. World and G20 aggregates use moving nominal GDP weights at purchasing power parities (PPPs). Revisions to PPP estimates affect the differences in the aggregates. Based on data available up to 19 September 2024.

1. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.
2. Spain is a permanent invitee to the G20.
3. Fiscal years, starting in April.

Source: OECD Interim Economic Outlook 116 database; and OECD Economic Outlook 115 database.

Table 2. Headline inflation is projected to decline further

	2023	2024		2025	
		Interim EO projections	Difference from May EO	Interim EO projections	Difference from May EO
G20[1]	6.1	5.4	-0.5	3.3	-0.3
Australia	5.6	3.4	0.0	2.4	-0.5
Canada	3.9	2.5	0.1	2.2	0.1
Euro area	5.4	2.4	0.1	2.1	-0.1
Germany	6.0	2.4	0.0	2.0	-0.2
France	5.7	2.4	0.1	1.9	-0.1
Italy	5.9	1.3	0.2	2.2	0.2
Spain[2]	3.4	3.0	0.0	2.1	-0.2
Japan	3.3	2.5	0.4	2.1	0.1
Korea	3.6	2.4	-0.2	2.0	0.0
Mexico	5.5	4.5	0.0	3.0	-0.1
Türkiye	53.9	56.0	0.5	29.1	0.2
United Kingdom	7.3	2.7	0.0	2.4	0.1
United States	3.7	2.4	-0.1	1.8	-0.2
Argentina	117.2	147.5	-60.6	46.7	-24.5
Brazil	4.6	4.4	0.4	4.0	0.7
China	0.3	0.3	0.0	1.0	-0.3
India[3]	5.4	4.5	0.2	4.1	-0.1
Indonesia	3.7	2.6	-0.3	2.2	-0.7
Russia	6.0	7.8	0.4	5.5	0.8
Saudi Arabia	2.3	1.7	0.0	2.0	0.0
South Africa	5.9	4.6	-0.7	3.7	-0.9
Memorandum item					
G20 countries excluding Argentina and Türkiye	3.6	2.5	0.0	2.2	-0.1

Note: Difference from May 2024 OECD Economic Outlook in percentage points, based on rounded figures. The G20 aggregate uses moving nominal GDP weights at purchasing power parities (PPPs). Revisions to PPP estimates affect the difference in the aggregate. Based on data available up to 19 September 2024.

1. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.
2. Spain is a permanent invitee to the G20.
3. Fiscal years, starting in April.

Source: OECD Interim Economic Outlook 116 database; and OECD Economic Outlook 115 database.

Table 3. Core inflation is projected to return to target in most economies

	2023	2024		2025	
		Interim EO projections	Difference from May EO	Interim EO projections	Difference from May EO
G20 Advanced Economies[1]	4.2	2.7	0.2	2.1	0.0
Australia	5.8	3.6	0.2	2.6	-0.3
Canada	3.9	2.6	0.0	2.2	0.1
Euro area	4.9	2.8	0.2	2.2	0.1
Germany	5.1	3.2	0.4	2.2	0.0
France	4.0	2.5	0.5	2.2	0.2
Italy	4.5	2.3	0.0	2.2	0.1
Spain[2]	4.1	2.6	-0.3	2.2	0.0
Japan	2.7	1.9	0.1	1.9	-0.1
Korea	3.4	2.2	0.0	2.0	0.0
Mexico	6.7	4.1	-0.2	2.9	-0.2
Türkiye	58.5	58.1	0.6	28.9	0.2
United Kingdom	6.2	3.7	0.4	2.8	0.3
United States	4.1	2.7	0.1	2.0	-0.1
South Africa	5.1	4.4	-0.5	3.8	-0.8

Note: Difference from May 2024 OECD Economic Outlook in percentage points, based on rounded figures. The G20 advanced economies aggregate uses moving nominal GDP weights at purchasing power parities (PPPs). Revisions to PPP estimates affect the difference in the aggregate. Core inflation excludes food and energy prices. Based on data available up to 19 September 2024.

1. The European Union is a full member of the G20, but the G20 aggregate only includes EU countries that are also G20 members in their own right.
2. Spain is a permanent invitee to the G20.

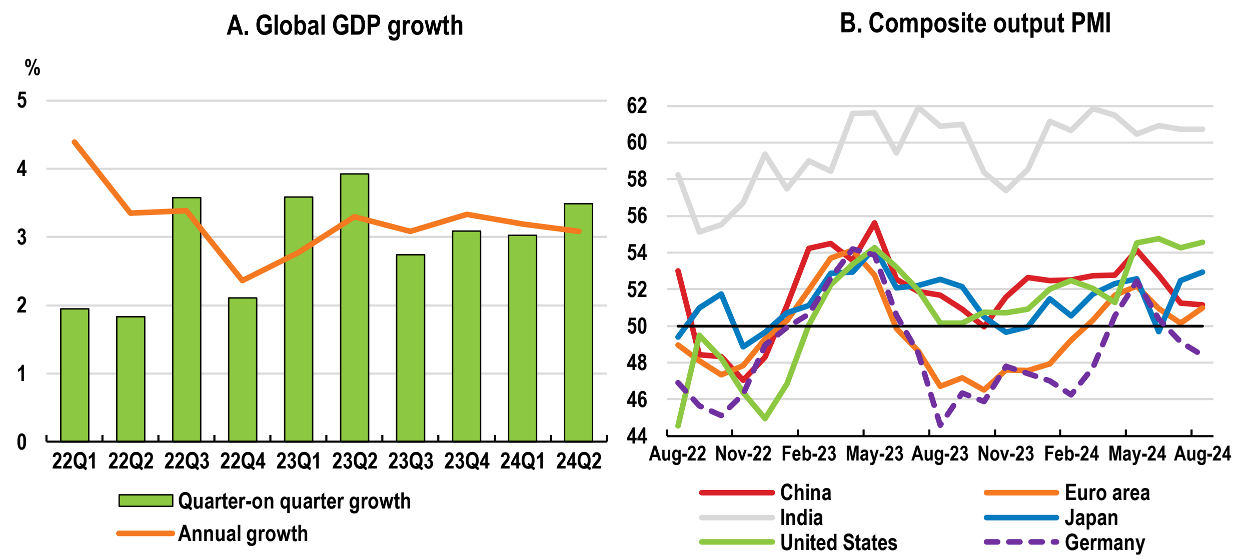
Source: OECD Interim Economic Outlook 116 database; and OECD Economic Outlook 115 database.

Recent developments

Global growth has been resilient and inflation has declined further

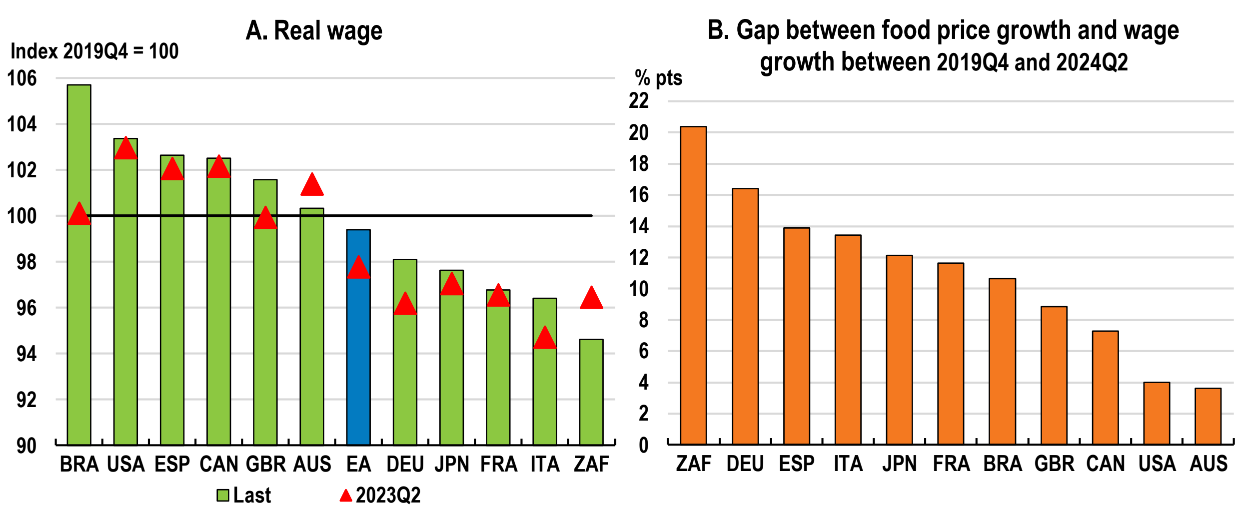
1. The global economy remained resilient in the first half of 2024, with output growing at an estimated annualised rate of 3.2% (Figure 1). Declining consumer price inflation has supported household spending, providing a counterbalance to the negative impact from restrictive financial conditions and the uncertainty about the ongoing war in Ukraine and the evolving conflicts in the Middle East. Growth in the United States strengthened in the second quarter of 2024, with private consumption underpinned by real wage gains partly owing to falling inflation (Figure 2, Panel A). GDP growth was also relatively robust in several other advanced economies including Canada, Spain and the United Kingdom. In Japan, growth picked up sharply in the second quarter after contracting in the first amid temporary supply disruptions. Nonetheless, there have been less favourable recent outcomes in some other advanced economies, notably Germany, where weak sentiment has contributed to elevated saving rates in both the household and corporate sectors and industrial activity has been weak. Emerging market economies have also displayed diverse growth patterns. Domestic demand has buoyed activity in Brazil, India and Indonesia, but has slowed in Mexico with the services sector losing momentum. In China, industrial production growth has been underpinned by strengthening exports, but consumer demand remains modest and a protracted correction in the real estate sector is ongoing.

Figure 1. Stable global growth has masked differences across countries



Note: In Panel A, global GDP growth is calculated using moving nominal GDP weights at purchasing power parities. Quarter-on-quarter growth is expressed at an annualised rate. In Panel B, values below 50 indicate that a balance of firms report a contraction in output.
Source: OECD Interim Economic Outlook 116 database; and S&P Global.

Figure 2. Real wages have increased in many countries as inflation has eased, but purchasing power has not fully recovered



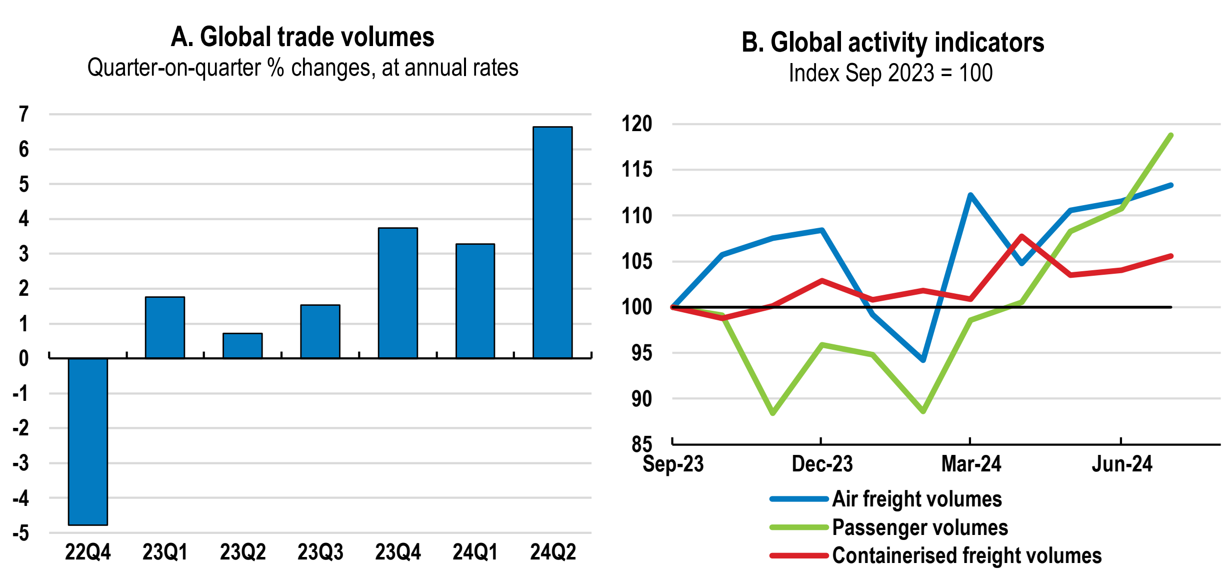
Note: The last available data corresponds to 2024Q1 for Italy and the euro area and 2024Q2 for remaining countries. In Panel A, real wages correspond to labour compensation per employee deflated by the private consumption deflator, except for Brazil where it is the real wage from the Continuous National Household Survey. In Panel B, the numbers show the gap between the cumulative change in food prices over 2019Q4-2024Q2 and the change in nominal wages. Wages are nominal labour compensation per employee except for Brazil where it is constructed using real wages in Panel A and the consumer price index.
Source: OECD Interim Economic Outlook 116 database; CEIC; and OECD calculations.

Recent activity indicators suggest services activity continues to outperform

2. High-frequency activity indicators suggest stable growth momentum overall for most economies. Business surveys continue to point to stronger activity in services than in manufacturing sectors, where elevated inventory-to-sales ratios in many major advanced economies may weigh on output in the short-term. In the advanced economies, the recent strength of services activity has partly reflected the rebalancing of demand back to services following the pandemic. This process is gradually easing, with the ratios of goods to services consumption volumes now approaching levels consistent with pre-pandemic trends in many countries. Surveys indicate improving consumer confidence in Europe as well as in some emerging economies where growth has been resilient, such as Indonesia. Nonetheless, consumer confidence remains subdued relative to long-term norms in most major advanced economies despite the ongoing rebound in real incomes, possibly reflecting perceptions of lower purchasing power. Relatively large price increases for items salient to household budgets may be shaping such perceptions, especially for lower income households. In particular, food price inflation has generally outstripped growth in nominal wages since the onset of the pandemic (Figure 2, Panel B).

3. The recovery in global trade continued in the first half of 2024, with growth in trade volumes in both goods and services strengthening, especially in the second quarter (Figure 3, Panel A). An upturn in US import growth, in part due to stronger equipment investment, and greater trade dynamism in key emerging market economies, including China, the Dynamic Asian Economies, Brazil and India, were key factors behind the stronger-than expected resilience of trade. Monthly activity indicators have generally remained firm, with global container trade volumes, air freight volumes and international passenger volumes all rising steadily through to July (Figure 3, Panel B). While this provides a positive signal of demand, survey measures of export orders have begun to weaken again, suggesting that at least part of the trade boost in mid-year may have come from earlier-than-usual orders for the peak season in the advanced economies in an effort to avoid congestion later in the year.

Figure 3. Global trade growth has picked up recently



Note: Panel A shows the growth of world trade volumes of goods plus services. Panel B shows global container port throughput, the volume of international air cargo and international revenue per passenger kilometre. The last data point is July 2024.
Source: OECD Interim Economic Outlook 116 database; RWI/ISL container throughput index; IATA; and OECD calculations.

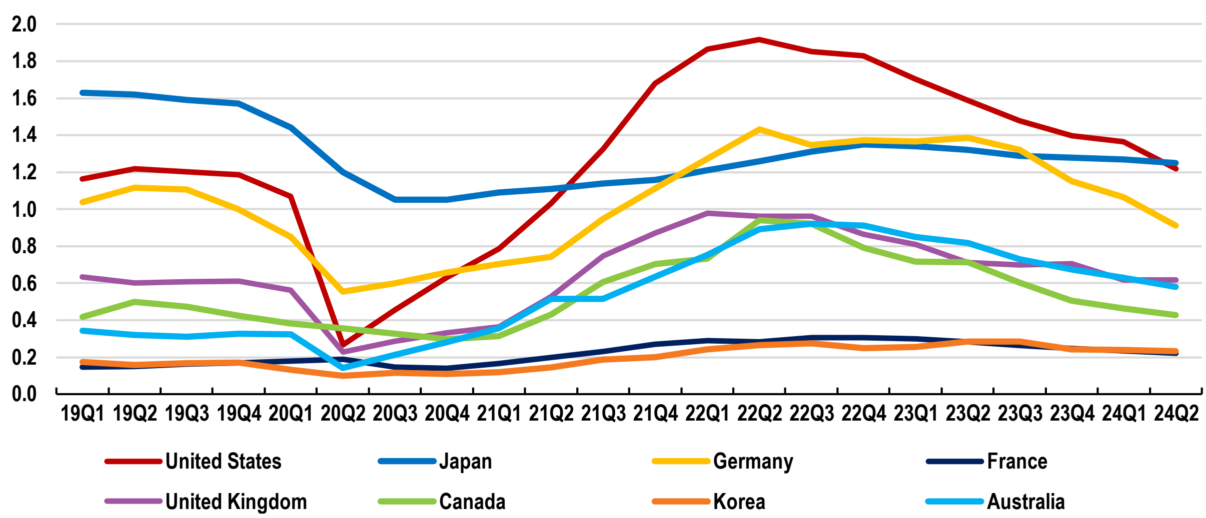
4. Global container shipping has mostly adapted to the effective closure of the Red Sea route, and lower water levels in the Panama Canal, but journey times have lengthened and congestion has risen in some key Asian ports. Container shipping costs have strengthened significantly through 2024. Even with some moderation since August, costs remain around 160% higher than a year earlier, with even larger increases for some routes between Asia and Europe. These past increases will feed through into consumer prices, but the impact will be relatively modest if costs continue their recent decline, and falls in merchandise export prices from some countries, especially China, as well as lower global commodity prices, are sustained.

Labour market pressures have eased, partly due to rising labour supply

5. Labour markets have continued to loosen (Figure 4). The number of job vacancies per unemployed worker has fallen steadily and is now back to levels observed immediately prior to the pandemic. Survey measures of labour shortages have also continued to moderate in many major advanced economies. Unemployment has also risen by 0.5 percentage point or more in Argentina, Canada, South Africa, Türkiye and the United States. In part this reflects moderating demand, with employment growth slowing in some countries, including Japan, Korea, Mexico, Türkiye, South Africa and the United States. However, rising labour supply has also been a key element, often reflecting stronger immigration flows. Increases in foreign-born workers have accounted for the majority of labour force growth since the start of 2023 in Australia, Canada, the United States and many European countries.

Figure 4. Labour demand has cooled

Job vacancies per unemployed



Note: Job vacancies per unemployed for Australia, Canada, France, Germany, Korea, the United Kingdom and the United States is the number of unfilled vacancies over the number of unemployed. The unemployed population is the unemployed aged 15 and over for Australia, Canada, the United Kingdom and the United States, and the 3-month average of the unemployed population aged 15-74 for France and Germany. For Japan, job vacancies per unemployed is the ratio of active job openings to active applicants. For the euro area, Canada and the United Kingdom all sectors are covered except agriculture, forestry, fishing and hunting.
Source: OECD Short Term Labour Situation database; FRED; Statistics Canada; Eurostat; Ministry of Health, Labour and Welfare, Japan; Ministry of Labour, South Korea; Office for National Statistics, United Kingdom; and OECD calculations.

6. Nominal wage growth remains high, particularly in Germany and the United Kingdom, but is now moderating. In contrast, pay growth is gaining pace in Japan, with significant base pay gains in the spring wage round and strong bonus payments boosting total cash earnings in recent months. Growth in unit labour costs has generally eased, in keeping with moderating wage increases, but remains elevated in many countries due to sluggish labour productivity growth, especially in Europe. In contrast, strong productivity gains in the United States kept unit labour costs in the non-farm sector unchanged over the year to the second quarter of 2024.

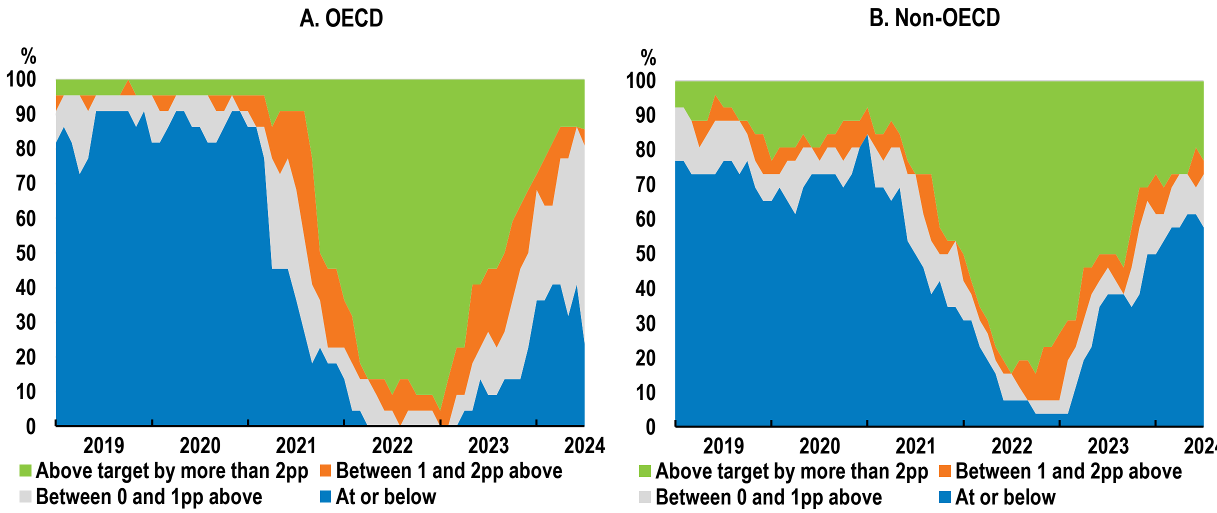
Inflation is continuing to moderate gradually

7. Headline inflation has continued to fall this year in most countries, partly due to further declines in food price inflation and low, or negative, energy and goods price inflation. Exceptions include Mexico and Brazil, where inflation has drifted higher, in part due to currency depreciations. The recent steep fall in oil prices, and the ongoing easing of global food prices could place further downward pressure on headline inflation in the short-term. Oil prices have declined by over 10% since July, amid expectations for excess supply next year and market concerns about weakening oil demand growth in some major economies, particularly China. If oil prices remain at their current level, global headline inflation could be reduced by around 0.5 percentage points over the coming year. Indicators of short-term inflation expectations of households in the major advanced economies have also continued to ease, in line with actual inflation outcomes. A decomposition of GDP deflator growth in nine major economies suggests that unit labour costs are currently accounting for the majority of inflation, consistent with the greater weight of labour costs in most service sectors. Unit profit growth has moderated, now contributing only a small share to inflation, and helping to offset other cost pressures.

8. Inflation is now at, or approaching, central bank targets in an increasing proportion of countries (Figure 5). Nonetheless, the prices of over half the items in the United Kingdom inflation basket were still growing at an annual rate above 3% in July 2024, with over 40% of the items rising above this threshold in the United States. This points to some lingering underlying pressures. Services price inflation is still proving particularly sticky and has abated only slowly. If core goods price inflation remains unchanged at the current rate, year-on-year aggregate services price inflation may need to decline by 3 percentage points in Mexico, 2.5 percentage points in the United Kingdom, 1.2 percentage points in the euro area and 0.8 percentage points in the United States to bring aggregate core inflation back to a rate consistent with the inflation target (Figure 6).

Figure 5. Inflation is increasingly moving back towards target

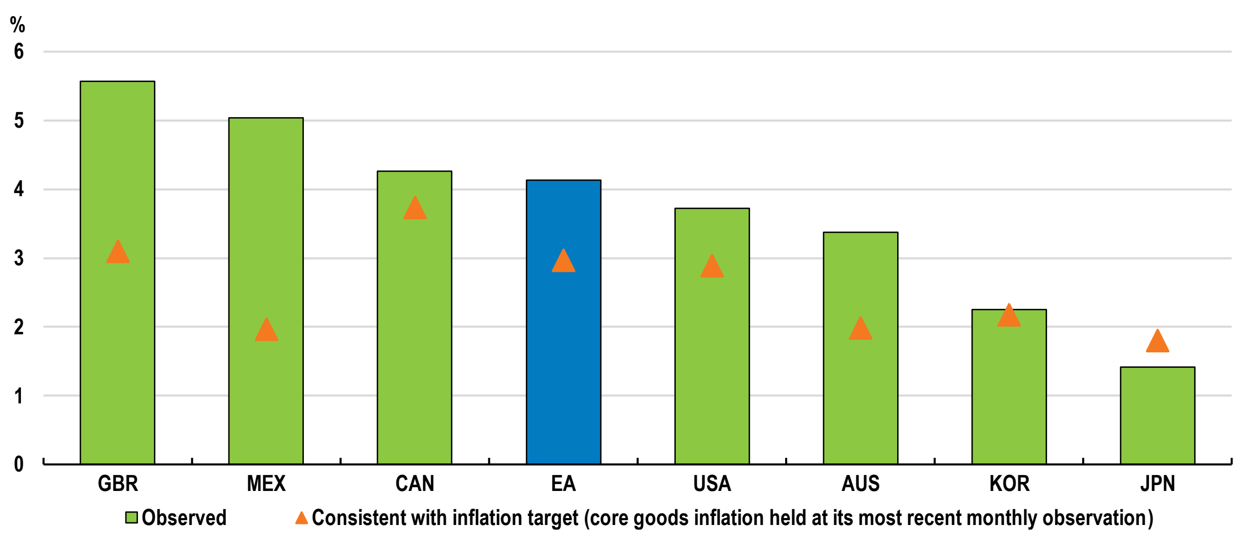
Differences between current inflation and the inflation target, % of countries



Note: Panel A covers 22 OECD economies and Panel B covers 26 non-OECD economies. For central banks with a target range, the upper point of the range was used. The last data point is July 2024.
Source: OECD Consumer Price database; Eurostat; various Central Banks; and OECD calculations.

Figure 6. Services inflation will need to decline further to bring inflation to target

Services price inflation, year-on-year



Note: The scenario assumes that core goods inflation is maintained at the last observed rate (July 2024 for Mexico and the United States; August 2024 for Canada, the euro area, Japan, Korea and the United Kingdom; and 2024Q2 for Australia). Core goods inflation corresponds to goods inflation excluding food and energy products and differs slightly in exact definition by country. The markers show the pace of annual services price inflation needed to return underlying (core) inflation to the inflation target. In cases where the inflation target is specified as a range (Mexico and Australia), the scenario is based on returning to the top of the target range. Based on the personal consumption expenditure deflator for the United States, harmonised consumer prices for the euro area and the United Kingdom, and national consumer price indices for all other countries.
Source: US Bureau of Economic Analysis; Eurostat; Statistics Japan; UK Office for National Statistics; Statistics Canada; OECD Consumer Price database; Australian Bureau of Statistics; and OECD calculations.

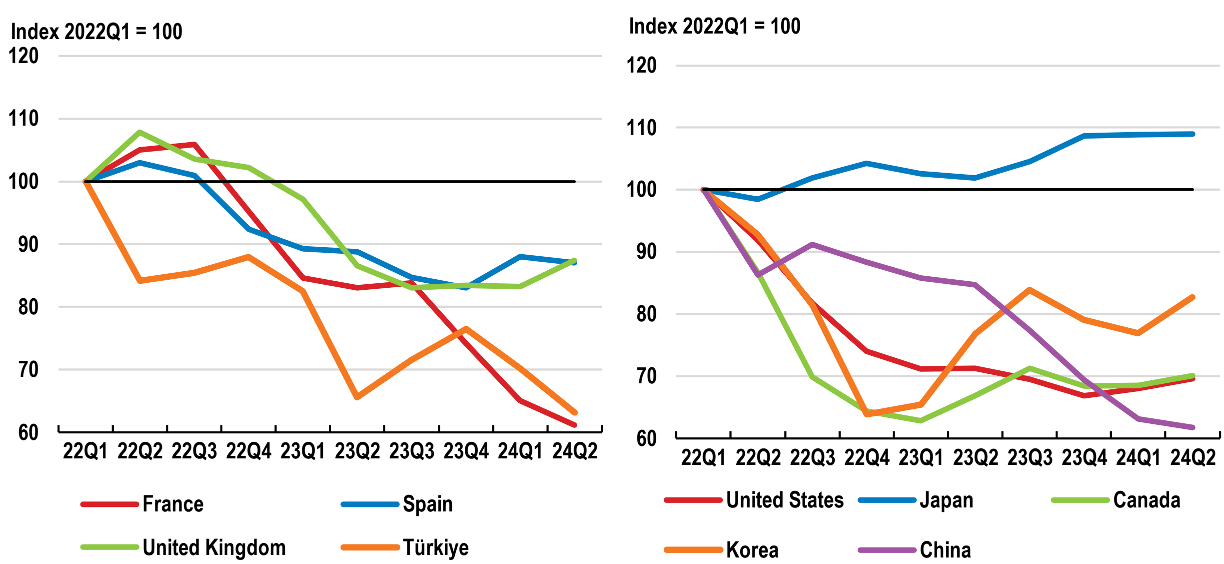
Financial conditions have eased somewhat

9. Global financial conditions remain restrictive but are continuing to ease, with financial market participants anticipating policy rate reductions will be faster than previously expected. Long-term real interest rates are still at high levels relative to the previous decade in the United States, the euro area, the United Kingdom and in emerging markets such as Brazil. However, long-term nominal bond yields have declined, and corporate bond issuance has picked up as borrowers capitalise on strong demand and compressed spreads. Indicators of systemic stress remain at low levels, though market volatility soared briefly in early August in response to unexpectedly weak economic data. Equity prices have strengthened in the United States, even though equity price-to-earnings ratios remain high by historical standards, as well as in several emerging markets including India, Brazil and South Africa. While credit growth has started to recover in some advanced economies, bank lending standards remain tight. Currency depreciation in Brazil, Argentina, Mexico and Türkiye has supported export earnings but increased US-dollar denominated debt servicing costs and exerted some upward pressure on inflation. Sovereign debt distress persists in some emerging market economies, particularly in lower-income economies, though dollar-denominated government bond spreads have remained stable in most countries.

10. House prices have now stabilised or recently increased in some countries, supported by mortgage interest rates edging down and structural factors, including strong population growth and limited housing supply. While the number of housing transactions continues to fall in China and Türkiye, sales have picked up in some advanced economies including the United Kingdom, Korea, Canada and the United States (Figure 7). After a period of significant weakness, housing investment has now started to turn up in the United States but remains tepid elsewhere.

Figure 7. Housing transactions have begun to recover in some economies

Total number of housing transactions, two-quarter moving average



Note: Estimates for the two-quarter moving average in 2024Q2 are based on partial data for France and Spain (2024Q1 only).
Source: The Canadian Real Estate Association; CEIC; Eurostat; Korea Real Estate Board; Turkish Statistical Institute; UK HM Revenue & Customs; US National Association of Realtors; and OECD calculations.

Projections

Growth is expected to stabilise and inflation to ease further

11. Global growth is expected to stabilise over the projection period at 3.2% in both 2024 and 2025, in line with the average pace observed through the first half of this year (Figure 8, Panel A). The lagged impact of monetary policy tightening in advanced economies on growth has begun to moderate, and further monetary policy easing as inflation declines will support interest-rate-sensitive expenditures in 2025. The decline in inflation will also provide a further boost to real income growth and a tailwind to private consumption in many economies.

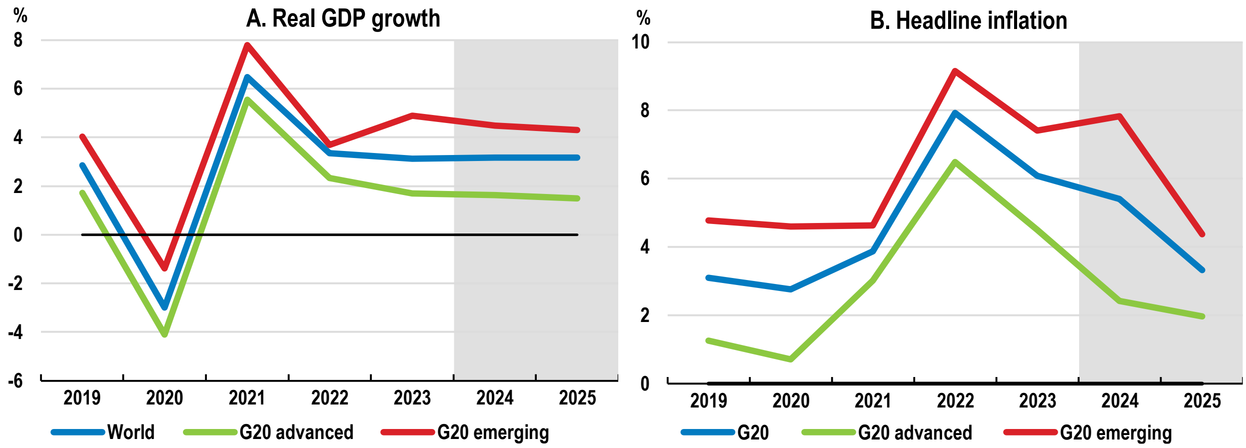
12. In the United States and Canada, economic growth is projected to slow over the coming quarters from the solid pace observed in the first half of 2024. Nonetheless, monetary easing is projected to help underpin stronger growth through the second half of next year. On an annual basis, real GDP growth is projected to be 2.6% in 2024 and 1.6% in 2025 in the United States and 1.1% and 1.8% in Canada. Europe will also benefit from policy rate reductions and the further recovery in real incomes, with euro area growth projected to be 0.7% in 2024 and 1.3% in 2025, and the UK economy expanding by 1.1% in 2024 and 1.2% in 2025. In Japan, while the weak first quarter outturn reduces projected annual growth in 2024 to -0.1%, strong real wage gains are expected to offset the impact of tighter macroeconomic policies, with output expanding by 1.4% in 2025. Growth is projected to be stable in Korea, at 2.5% this year and 2.2% in 2025, with exports aided by ongoing strength in global semiconductor demand. In Australia, growth is projected to pick up from 1.1% this year to 1.8% in 2025, with household consumption supported by a recovery in real disposable incomes.

13. Economic growth in the emerging market G20 economies is expected to remain broadly stable, despite diverse projected outcomes within the group. In China, growth is expected to be supported through the second half of 2024 by an increase in government spending following a recent rise in local government bond issuance. Even so, the protracted correction in the real estate sector is anticipated to continue and inadequate social safety nets and soft consumer confidence will remain a drag on private consumption growth, with GDP growth projected to be 4.9% in 2024 and 4.5% in 2025. Solid domestic demand growth is projected to continue in India and Indonesia over the next two years. In India, GDP growth is projected to be 6.7% in FY 2024-25 and 6.8% in FY 2025-26, while Indonesia is projected to grow by 5.1% in 2024 and 5.2% in 2025. Brazil is anticipated to maintain some of the solid economic momentum observed through the first half of 2024, helped by higher fiscal spending. Despite a slower pace of monetary policy easing, annual growth is projected to be 2.9% in 2024 and 2.6% in 2025. Growth in Mexico is projected to moderate to 1.4% in 2024 and 1.2% in 2025, with the current slowdown in domestic demand growth persisting into next year.

14. Aggregate consumer price inflation for the G20 is projected to decline markedly, helped by lower commodity prices and easing service price inflation as labour cost pressures moderate (Figure 8, Panel B). Headline inflation in the G20 is projected to fall from 6.1% in 2023, to 5.4% in 2024 and 3.3% in 2025. Core inflation in the G20 advanced economies is anticipated to ease and be in line with central bank objectives in most G20 countries by the end of next year, declining from 4.2% in 2023 to 2.7% in 2024 and 2.1% in 2025.

15. Inflation in the emerging-market economies is projected to remain generally higher than in the advanced economies, while also easing gradually. Even so, there are disparate patterns across countries. Inflation in Argentina and Türkiye is expected to ease through 2024 and 2025, but to remain at double digit rates. In China, inflation is expected to gradually increase but to stay at very low levels. The recent resurgence in price pressures in Brazil means inflation is now expected to be slightly higher at the end of 2025 than previously anticipated, although still in accordance with the central bank inflation target range.

Figure 8. G20 economies are projected to have moderate growth and easing inflation



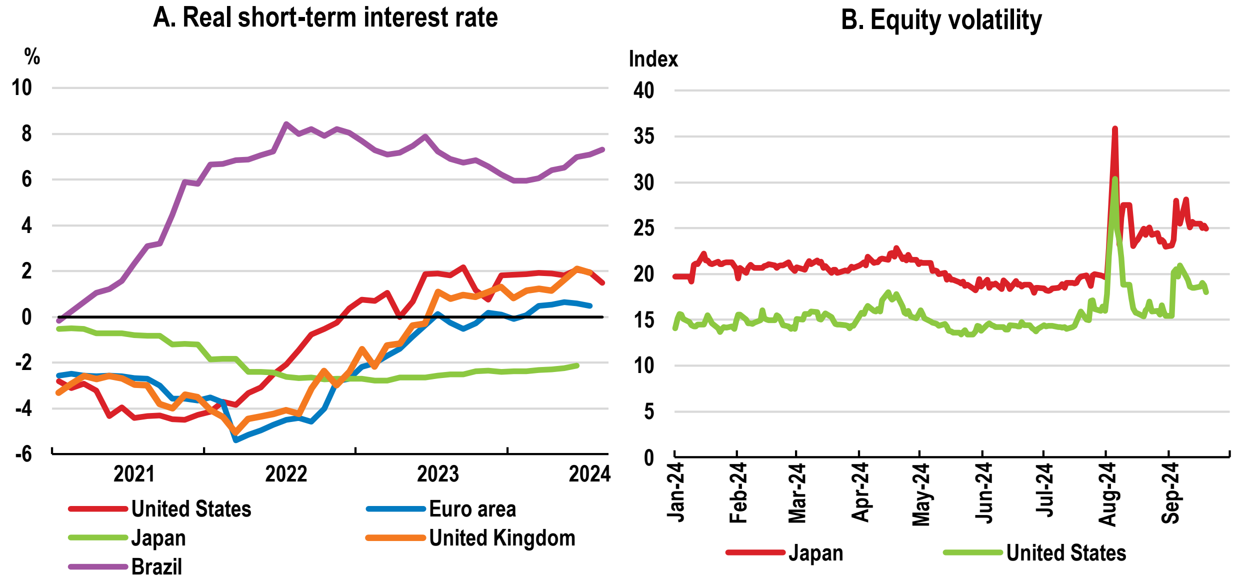
Note: The world and G20 aggregates use moving nominal GDP weights at purchasing power parities.
Source: OECD Interim Economic Outlook 116 database; and OECD calculations.

Risks and challenges

16. The projected outlook is comparatively benign, with steady or improving growth and moderating inflation. Significant downside risks nonetheless remain, reflecting the uncertainty about ongoing geopolitical conflicts, the pace at which inflation will decline and the lingering impact of still high real interest rates (Figure 9, Panel A). Potential sources of sticky inflation include the pass-through from continued labour cost growth, elevated mark-ups in some sectors, persistently high shipping costs, and additional geopolitical or trade tensions that raise the costs of imported goods. A slower-than-expected disinflation path might also push up household and corporate inflation expectations once again. Another key downside risk is that growth could slow more sharply than expected in many countries as labour markets cool. Borrowing rates continue to be renegotiated, and debt with very low interest rates is maturing and being replaced by new household and business loans. About 30% of existing corporate debt in advanced economies is due to mature by 2026, with an even higher share in emerging-market economies. Business failures in many advanced economies have also already risen to levels well above those observed prior to the pandemic.

17. Surprises on either the pace of economic growth or inflation could trigger disruptive corrections in financial markets. The short-lived bout of financial market volatility in early August was partly triggered by perceived weakness in economic indicators for the United States and the changes to market expectations of policy interest rates and yield differentials with other economies, particularly Japan (Figure 9, Panel B). Further deviations from the expected smooth disinflation path could cause financial markets to reassess the likely pace of monetary policy easing, with implications for risk and term premia, potentially exposing vulnerabilities in some financial sectors. The financial implications could be especially pronounced in a high debt environment: total debt as a share of GDP is now markedly higher than in the 2010s or any previous decade for both advanced and emerging market economies. Sizeable near-term debt refinancing is also occurring in some particularly vulnerable markets, such as commercial property.

Figure 9. Real interest rates remain restrictive and economic surprises could cause financial market volatility



Note: In Panel A, the real short-term interest rates are calculated using nominal one-year government bond yields and one year-ahead inflation expectations by consumers in the United States, the euro area and the United Kingdom, by corporates participating in the Tankan Survey in Japan, and by market professionals participating in the Focus Survey in Brazil. In Panel B, the series for Japan is an implied volatility series for Japanese equity markets. The USA line shows the VIX Index.
Source: OECD Interim Economic Outlook 116 database; Bank of England; Bank of Japan; Board of Governors of the Federal Reserve System; European Central Bank; University of Michigan; Federal Reserve Bank of Saint Louis; and OECD calculations.

18. An upside risk for growth is that consumer confidence could rebound more durably, driving further growth in private consumption. A catalyst could be the ongoing recovery in real incomes, and the associated improvement in household purchasing power, having a surprisingly large positive impact on sentiment. Such a scenario could also induce a decline in household saving rates as more optimistic households further draw down the excess savings accumulated through the pandemic. An additional upside risk is that further declines in global oil prices could occur, especially if anticipated excess supply next year does not diminish. This would subtract materially from headline inflation in many economies, support growth in oil-importing economies, and potentially allow a faster pace of monetary policy easing than assumed in the projections.

Policy requirements

There is room to lower policy interest rates, but monetary policy should remain prudent

19. Policy interest rates have been reduced in most major advanced economies in recent months and central bank balance sheet reductions have continued, or got underway. Nonetheless, the monetary policy stance generally remains restrictive. Forward-looking real interest rates are still elevated and above pre-pandemic norms, with the notable exception of Japan where policy accommodation is being withdrawn slowly. The cumulative effects of past tightening on economic growth are now past their peak, though the ongoing refinancing of debt at higher rates, including the renegotiation of fixed mortgage rates in some countries, continues to keep debt service burdens elevated for many households and companies.

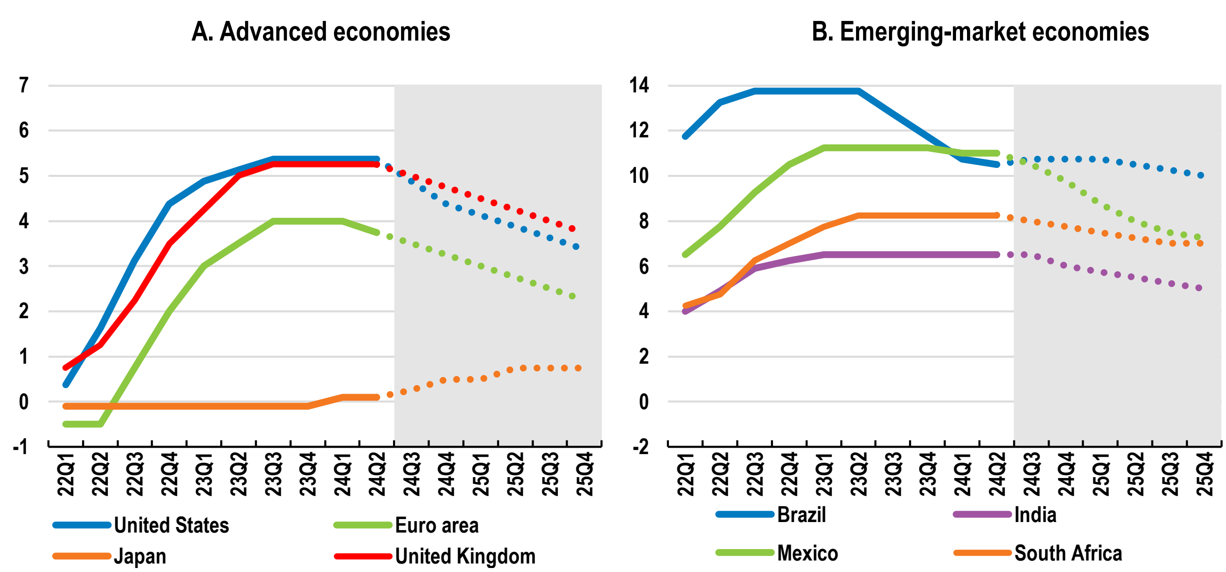
20. As inflation moderates and labour market pressures ease, policy rate reductions should continue, though the timing and scope of reductions will need to remain data-dependent and be carefully judged to ensure that underlying inflationary pressures are durably contained (Figure 10, Panel A). In the United States and the euro area, policy interest rates are projected to decline by a further 1½ and 1¼ percentage points respectively by the end of 2025, bringing them towards neutral levels. In Japan, by contrast, further mild increases in policy interest rates are warranted, with policy accommodation gradually withdrawn, provided inflation settles at 2% as projected.

21. Quantitative tightening has so far proceeded smoothly, with reductions in bond holdings placing only mild upward pressure on bond yields. However, as policy rate reductions gain pace, clear communication about balance sheet policies over the next few years will be needed to avoid confusion about the pursuit of two policies with potentially diverging impacts on long-term yields and financial conditions more generally.

22. Easier global financial conditions, and ongoing rate reductions in the advanced economies, particularly the United States, enhance policy space in the emerging-market economies. At the same time, underlying economic developments vary widely across countries, pointing to differences in policy priorities. Risks of deflation and pressures on growth are likely to keep interest rates low in China. In Türkiye, a tight monetary stance should be maintained until well into 2025 to ensure that inflation is clearly on a path to target. By contrast, scope exists for policy rate reductions in most other major economies over the next year (Figure 10, Panel B), though the pace of any rate reductions will need to remain cautious to maintain anchored inflation expectations and avoid disruptive capital outflows as yield differentials narrow with the advanced economies. If necessary, as in Brazil where growth and inflation have surprised on the upside, rate reductions may need to be reversed, at least temporarily, to ensure price stability. Enhanced supervision of bank capital quality and levels would also help to strengthen the health and resilience of banking sectors in emerging-market economies.

Figure 10. Policy interest rates are projected to decline gradually

Policy interest rates, per cent



Note: Panel A shows the midpoint of the federal funds target range for the United States and the deposit facility rate for the euro area.
Source: OECD Interim Economic Outlook 116 database; and OECD calculations.

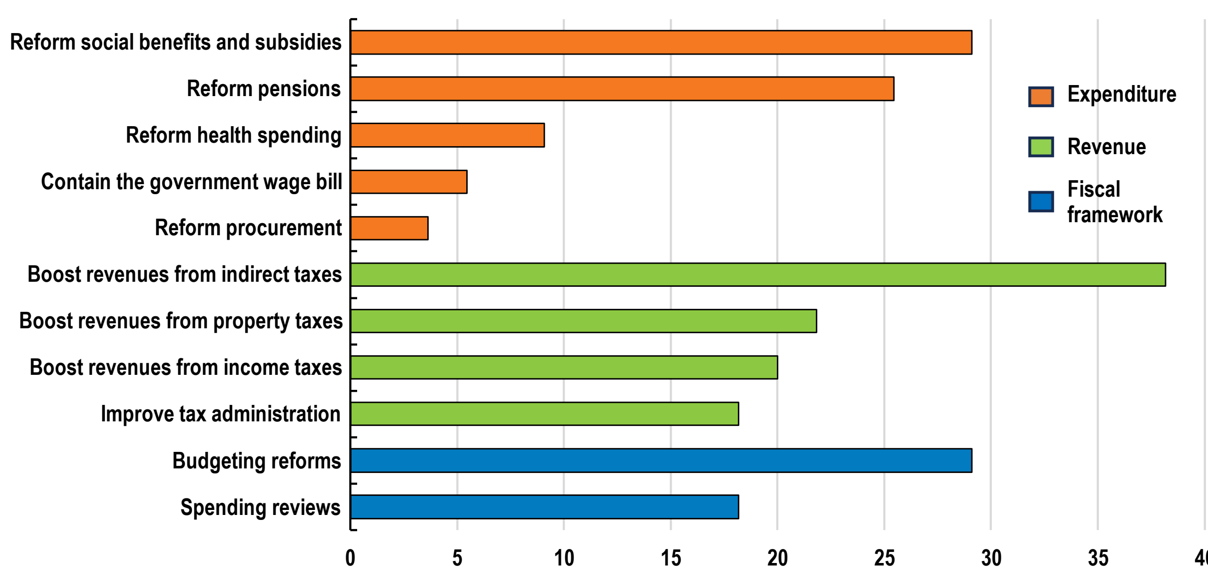
Decisive actions are needed to ensure debt sustainability

23. Governments face significant fiscal challenges from higher debt and the additional spending pressures arising from ageing populations, climate change mitigation and adaptation measures, plans to raise defence spending, and the need to finance new reforms. Debt-service costs are also increasing as low-yielding debt matures and is replaced by new issuance. Without sustained action, future debt burdens will rise significantly further and scope to react to future downside shocks will be increasingly limited. On current plans, few countries appear likely to achieve a sustained primary budget surplus, a key factor for stabilising or eventually reducing debt burdens. Several have large budget deficits that appear increasingly structural as spare capacity diminishes.

24. Stronger efforts to contain spending and enhance revenues, set within credible medium-term plans with a pace of adjustment tailored to country-specific circumstances are needed to improve the prospects for debt sustainability. Consolidation efforts have already begun in many countries and should intensify as the monetary policy stance becomes less restrictive, provided growth does not slow substantially. Priorities differ across countries, but in many include the need to improve the targeting of benefits and subsidies, and further reforms to pension entitlement to take due account of rising longevity (Figure 11). On the revenue side, efforts to eliminate distortive tax expenditures and enhance revenues from indirect, environmental and property taxes are called for in many countries. These would expand the tax base and revenues, provide funds to help meet new spending needs, and make the tax system more supportive of growth. Improvements to medium-term budgeting and fiscal rules, the introduction or strengthening of independent fiscal institutions, and thorough reviews of spending are also key policy priorities in many economies.

Figure 11. Spending restraint, enhanced revenues and budgetary reforms are key policy priorities to ensure debt sustainability

Per cent of countries



Note: The figure reports the share of 55 countries for which each action is assessed to be a key policy priority. This covers 34 advanced economies and 21 emerging-market economies. “Indirect taxes” include consumption and environmental taxes. “Income taxes” covers personal and corporate income tax and social security contributions. “Tax administration” reforms include measures to strengthen enforcement and tackle tax evasion. “Budgeting reforms” include measures to improve medium-term budgeting, and implement or strengthen fiscal rules.
Source: OECD Economic Outlook 115 database; and OECD calculations.

25. Many emerging-market economies face similar challenges to advanced economies from rising debt pressures and elevated debt servicing costs, but are more exposed to shifts in global financial conditions. A significant proportion of low-income countries continue to be either in sovereign debt distress, or at high risk of it, with debt often denominated in foreign currencies. Reforms to strengthen revenue collection and spending efficiency, fight tax evasion, lower the burden of state-owned enterprises, and reduce informality are key fiscal priorities in many countries. Such efforts would help to rebuild fiscal space, provide resources to finance public investment and strengthen social protection systems. Improvements to budgetary frameworks, with transparent and credible fiscal rules and institutions are also key to help to lower financing costs and enhance stability.

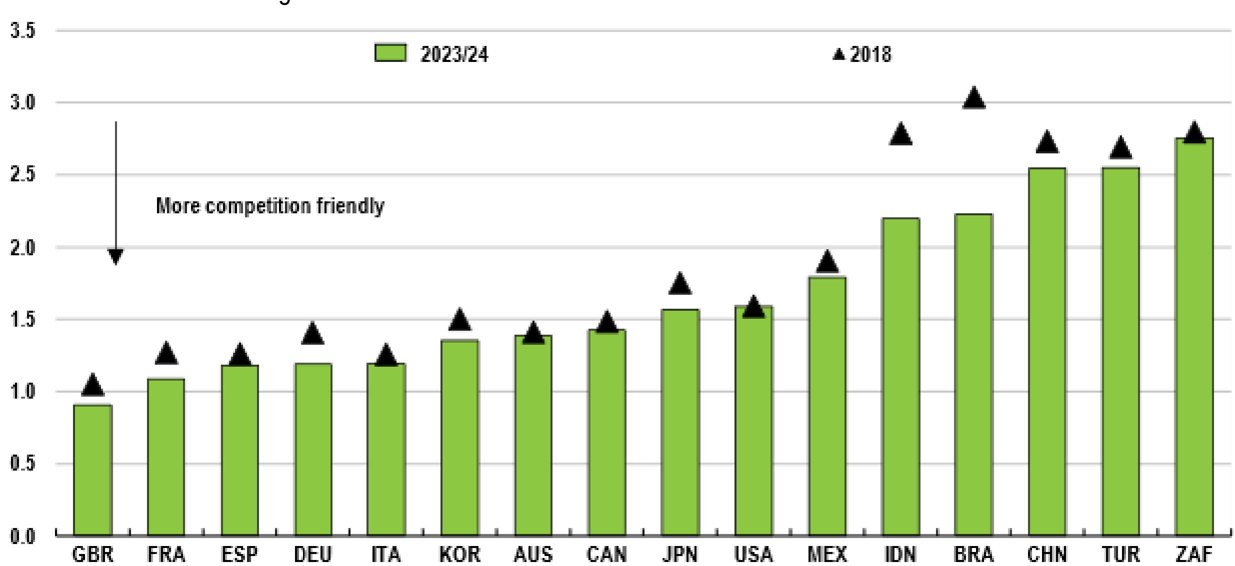
Structural policies should aim to strengthen the foundations for sustainable growth

26. Faced with modest growth prospects ahead, ambitious policy reforms are needed in all countries to help strengthen the foundations for sustainable economic growth. Well-designed structural reforms would improve long-term growth prospects and also help overcome the fiscal challenges that countries face. In particular, sustainably boosting productivity growth and investment requires open markets with healthy competitive dynamics. Such environments foster innovation and employment growth given the critical role of firm entry in job creation. The positive employment effects of such reforms have also been found to be particularly pronounced for vulnerable groups such as women and younger workers in past OECD research. Enhanced competition could also lower mark-ups and prices, especially in service sectors.

27. The newly updated OECD Product Market Regulation indicators highlight that the pace of reform has generally remained subdued in recent years. Some G20 countries have taken positive steps to reduce regulatory barriers to firm entry and growth since 2018, contributing to a longer-term process to eliminate regulatory obstacles to competition (Figure 12). Brazil, Indonesia, Germany and Japan have all implemented competition-enhancing structural reforms over the period. However, recent progress across countries has been confined to certain areas and there are important sectors of economies that would substantially benefit from further reforms.

Figure 12. A few countries have undertaken notable competition-enhancing reforms

Overall Product Market Regulation Indicators

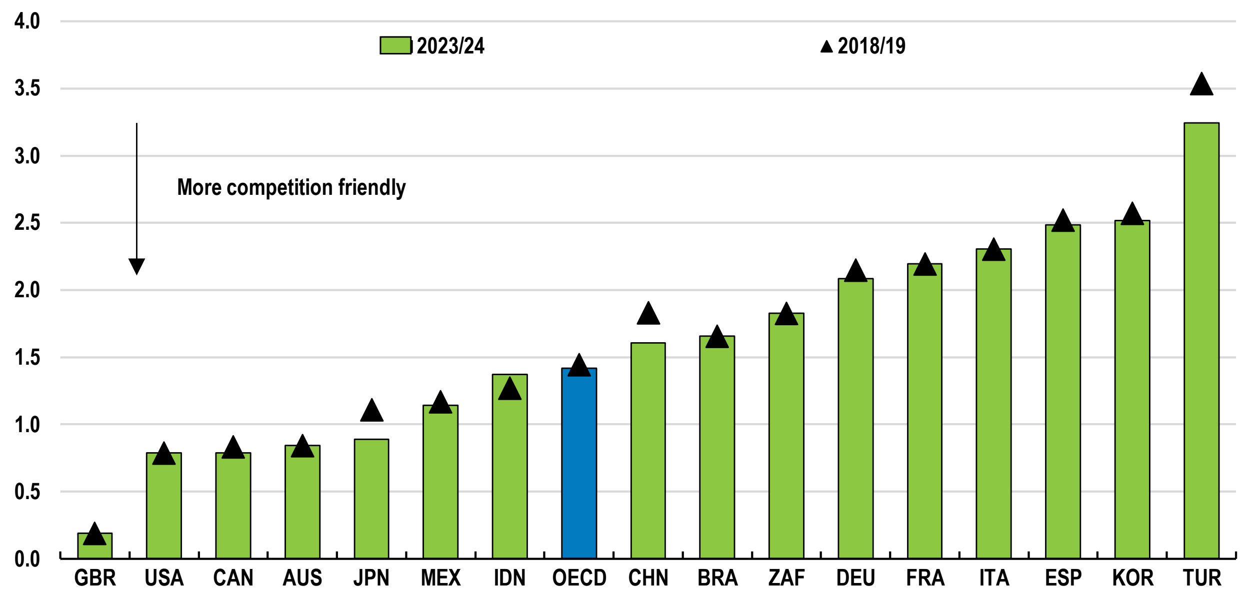


Source: OECD PMR database and OECD-WBG PMR database for 2023/2024 and 2018/2019.

28. Services sectors in many G20 countries still face regulatory environments that constrain competition (Figure 13). This is particularly concerning given the rising importance of services in most economies, and currently elevated services price inflation. Regulatory barriers to competition include those affecting existing firms as well as restrictions that limit the entry of new firms, and are relatively high in some countries, particularly Türkiye and Korea. In particular, cross-country differences in barriers to entry in services are sizeable. In some countries, including Italy, France and South Africa, entry restrictions into regulated professions remain tight, reducing competition, job mobility and negatively impacting on the competitiveness of firms in downstream industries that use these services. Similarly, there is significant scope to reduce barriers to entry in network sectors (energy, telecommunications and transport), including in Indonesia and South Africa. This could improve efficiency and yield substantial benefits for consumers and other sectors of the economy.

Figure 13. Services sectors regulations remain overly stringent in some countries

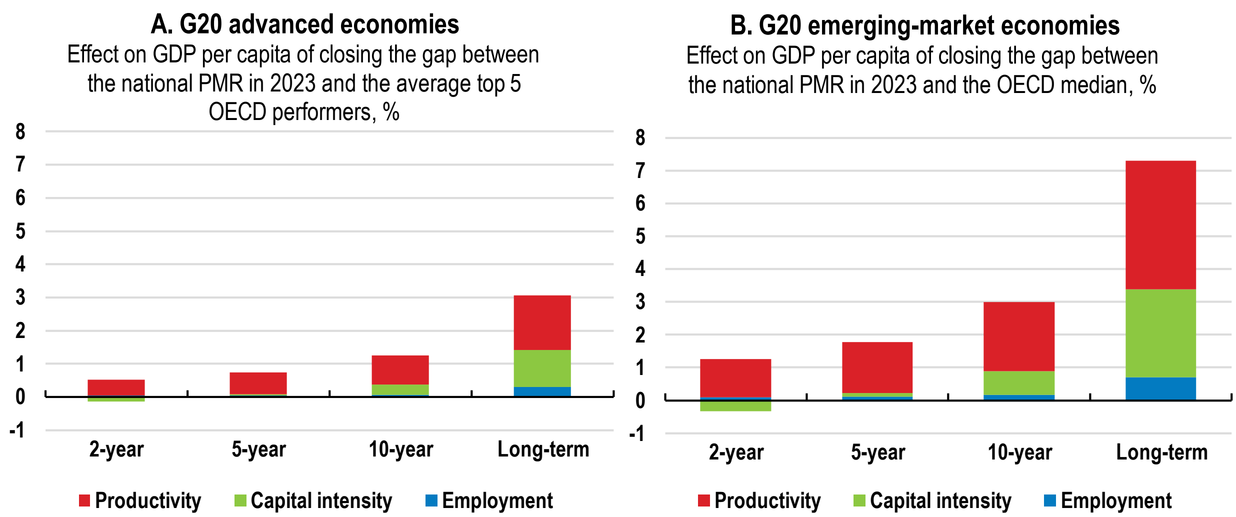
Barriers to competition in services sectors



Source: OECD PMR database and OECD-WBG PMR database for 2023/2024 and 2018/2019.

29. The potential economic benefits from broad product market reforms are substantial. OECD estimates suggest that reforms in advanced economies that close the gap between their regulations and the average of the top 5 OECD performers would increase GDP per capita by over 1% after ten years (Figure 14, Panel A) and continue to strengthen thereafter. The payoffs of such reforms are estimated to be even larger in many emerging-market economies (Figure 14, Panel B).

Figure 14. Product market reforms have the potential to boost living standards



Note: In Panel A, the figure shows the average effect across G20 advanced economies. In Panel B, the figure shows the average effect in Brazil, China, Indonesia, Mexico, South Africa and Türkiye.
Source: Égert, B. (2018), "The quantification of structural reforms", OECD Economics Department Working Papers, No. 1482, OECD Publishing, Paris.

OECD Economic Outlook, Interim Report

Turning the Corner

The global economy remained resilient in the first half of 2024, and inflation has continued to moderate. These trends are projected to continue into 2025, with global growth stabilising at a moderate pace and inflation returning to target in most countries by the end of 2025. Key near term risks include persisting geopolitical and trade tensions, the possibility of a growth slowdown as labour market pressures fade, and potential disruptions in financial markets if the projected smooth disinflation path does not materialise.

The Interim Report says that policy interest rates should be lowered as inflation declines, though the timing and pace of rate reductions should be judged carefully to ensure that inflation returns durably to target. Stronger efforts to contain government spending, enhance revenues and improved budgetary frameworks are needed to ensure fiscal sustainability. Reinvigorating product market reforms to strengthen competition is an essential step to turn the corner on growth and help alleviate fiscal pressures.

The Interim Report is an update on the assessment in the May 2024 issues of the OECD Economic Outlook (Volume 2024 Issue 1).

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