OECD ECONOMIC OUTLOOK

113

JUNE 2023

PRELIMINARY VERSION

BETTER POLICIES FOR BETTER LIVES

Please cite this publication as:
OECD (2023), *OECD Economic Outlook, Volume 2023 Issue 1: Preliminary version*, No. 113, OECD Publishing, Paris, https://doi.org/10.1787/ce188438-en.

ISBN 978-92-64-85354-6 (print)
ISBN 978-92-64-58958-2 (pdf)
ISBN 978-92-64-86968-4 (HTML)
ISBN 978-92-64-61777-3 (epub)

OECD Economic Outlook
ISSN 0474-5574 (print)
ISSN 1609-7408 (online)

Photo credits: Cover © welcomeinside/Shutterstock.com.

Corrigenda to OECD publications may be found on line at: www.oecd.org/about/publishing/corrigenda.htm.

Table of contents

FIGURES

TABLES

BOXES

Follow OECD Publications on:

https://twitter.com/OECD

https://www.facebook.com/theOECD

https://www.linkedin.com/company/organisation-eco-cooperation-development-organisation-cooperation-developpement-eco/

https://www.youtube.com/user/OECDiLibrary

https://www.oecd.org/newsletters/

This book has...

StatLinks

A service that delivers Excel® files from the printed page!

Look for the StatLink at the bottom of the tables or graphs in this book. To download the matching Excel® spreadsheet, just type the link into your Internet browser or click on the link from the digital version.

Acknowledgements

This edition of the OECD Economic Outlook was prepared by the Economics Department under the general supervision of Clare Lombardelli, Luiz De Mello, Álvaro Pereira, Isabell Koske and Alain de Serres, and managed by Nigel Pain.

Chapter 1 was prepared in the Macroeconomic Policy Division and supervised by Nigel Pain, with Geoff Barnard and Álvaro Pina as principal authors; and Catherine MacLeod, Patrice Ollivaud, Nobukazu Ono, Lucia Quaglietti, Elena Rusticelli, and Enes Sunel providing substantive contributions.

Chapter 2 was prepared in the Structural Policy Analysis Division and supervised by Filiz Unsal, with Christophe André as the principal author; and Orsetta Causa, Emilia Soldani and Douglas Sutherland providing substantive contributions.

Chapter 3 was prepared by the Country Studies Branch, with contributions from Michael Abendschein, Müge Adalet McGowan, Hansjörg Blöchliger, Martin Borowiecki, Tim Bulman, Gabriele Ciminelli, Ben Conigrave, Charles Dennery, Federica De Pace, Falilou Fall, Priscilla Fialho, Erik Frohm, Paula Garda, Daniela Glocker, Andrea Goldstein, Nicolas Gonne, Antoine Goujard, Robert Grundke, David Haugh, Philip Hemmings, Jens-Christian Høj, Hyunjeong Hwang, Yosuke Jin, Nikki Kergozou, Eun Jung Kim, Caroline Klein, Viktoriia Klimchuk, Michael Koelle, Vassiliki Koutsogeorgopoulou, Ze’ev Krill, Kyongjun Kwak, Álvaro Leandro, Timo Leidecker, Gabriel Machlica, Alessandro Maravalle, Margit Molnar, Kei Oguro, Alberto González Pandiella, Jon Pareliussen, Pierre-Alain Pionnier, Bertrand Pluyaud, Axel Purwin, Adolfo Rodriguez-Vargas, Oliver Röhn, Cyrille Schwellnus, Patrizio Sicari, Urban Sila, Zuzana Smidova, Donal Smith, Jonathan Smith, Sébastien Turban, Jan Strasky, Kosuke Suzuki, Tomomi Tanaka, Srdan Tatomir, Ania Thiemann, Elena Vidal, Ben Westmore, Yoonyoung Yang and Zvezdelina Zhelyazkova. The preparation of the country notes was supervised by Jens Arnold, Sebastian Barnes, Aida Caldera Sanchez, Mame Fatou Diagne, Philip Hemmings, and Vincent Koen.

Overall coordination and key editorial and statistical support was provided by Isabelle Fakih and Jérôme Brézillon.

Statistical support was given by Paula Adamczyk, Damien Azzopardi, Corinne Chanteloup, Ane Kathrine Christensen, Lutécia Daniel, Véronique Gindrey, Federico Giovannelli, Béatrice Guérard, Mauricio Hitschfeld, Tony Huang, Eun Jung Kim, Seung-Hee Koh, Anne Legendre, Natia Mosiashvili, Axel Purwin and Mafalda Trincão. Editorial support for the country notes was provided by Jean-Rémi Bertrand, Emily Derry, Karimatou Diallo, Laura Fortin, Robin Houng Lee, Elodie Lormel and Michelle Ortiz.

Background analysis and key database management was provided by the Macroeconomic Analysis Division, with contributions from Yvan Guillemette and Jeroen Meyer, under the supervision of David Turner.

An initial draft of the report was discussed by the OECD Economic Policy Committee. This report is published under the responsibility of the Secretary-General of the OECD.

Editorial

A Long Unwinding Road

The global economy is turning a corner but faces a long road ahead to attain strong and sustainable growth. Global GDP growth slowed substantially throughout 2022, but several of the factors weighing negatively are now unwinding. Falling energy prices and headline inflation, easing supply bottlenecks and the reopening of China's economy, coupled with strong employment and relatively resilient household finances, all contribute to a projected recovery. Nevertheless, the recovery will be weak by past standards. We project global growth to be 2.7% in 2023, with a modest pick-up to 2.9% in 2024 – both well below the average growth rate in the decade preceding the COVID-19 pandemic.

Policymakers need to act decisively on macroeconomic and structural policy to deliver stronger and more sustainable growth. This is hard. Core inflation remains too persistent. Debt levels are too high. And potential output is too low.

Monetary policymakers need to navigate a difficult road. Although headline inflation is declining thanks to lower energy prices, core inflation remains stubbornly high, more so than previously expected. Central banks need to maintain restrictive monetary policies until there are clear signs that underlying inflationary pressures are abating. Some economies grappling with stubbornly high core inflation may require additional interest rate increases. However, policymakers must keep a watchful eye, given the uncertainties around the exact impact of the rapid and globally synchronised monetary policy tightening following an extended period of low interest rates. The tightening has already revealed some vulnerabilities in financial markets. Should further financial market stress arise, central banks should deploy financial policy instruments to enhance liquidity and minimise contagion risks. Clear communication will be crucial to avoid confusion about the potential conflict between pursuing price stability and financial stability mandates.

The choices for fiscal policymakers are clearer but no easier to implement given the inherent political sensitivity of policy choices with direct redistributive effects. Fiscal policy played a vital role in supporting the global economy through the shocks of the COVID-19 pandemic and Russia’s war in Ukraine. However, in the aftermath, most countries are grappling with higher budget deficits and higher public debt. The burden of debt servicing is increasing and spending pressures related to ageing and the climate transition are building.

As the recovery takes hold, fiscal support should be scaled back and better targeted. Energy price support should be withdrawn as energy prices fall. Vulnerable households inadequately covered by existing social protection systems, will continue to need support, as still high food and energy prices particularly burden the most disadvantaged. Limited resources should be targeted only to those who really need it and to high-priority productivity-enhancing investments, including those driving the green transition and improving labour supply and skills. Gradually unwinding fiscal support will help reduce the burden on monetary policy, strengthen buffers against future crises and prepare for longer-term challenges.

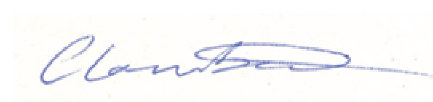
Emerging-market economies face challenges from tight global financial conditions: higher debt servicing costs, capital outflows, and reduced credit availability from foreign lenders. Moreover, rising geopolitical tensions and concerns about supply chain security have prompted several countries to implement trade and investment restrictions. Increasingly restrictive trade policies risk curtailing the gains from global trade and harming the development prospects of low-income countries.

Ultimately only ambitious structural policy reforms can sustainably raise long-term economic growth and people's quality of life around the world. Revitalising labour and product markets; removing barriers to cross-border trade; promoting competition and adapting competition policies to the digital era; and enhancing skill development are essential elements of the structural reform agenda.

Private and public investment is needed in human, tangible and intangible capital to enable people to make the most of their skills and capabilities, and to harness the ever-increasing opportunities from technological transformation. Investment in education and skills is critical to enable people to flourish in the future economy and reap the benefits of increased productivity.

Policymakers need to unwind the impact of a sequence of negative shocks to the global economy and face a complex set of challenges in doing so. They need to calibrate monetary and fiscal policies to curtail inflation and rebuild fiscal buffers without overly reducing growth. Delivering sustainably higher rates of growth will need bold and forward-thinking structural policy reforms allowing us to harness the opportunities of rapid technological advances, demographic shifts, and the climate transition.

7 June 2023



Clare Lombardelli

OECD Chief Economist

1 General assessment of the macroeconomic situation

Introduction

Global economic developments have begun to improve, but the upturn remains fragile. Lower energy prices are helping to bring down headline inflation and ease the strains on household budgets, business and consumer sentiment are picking up from low levels, and the earlier-than-expected full reopening of China has provided a boost to global activity. At the same time, core inflation is proving persistent, reflecting higher profits in some sectors and still-elevated cost pressures in resilient labour markets. The impact of higher interest rates around the world is also increasingly being felt, particularly in property and financial markets. Signs of stress have started to appear in some financial market segments as investors reassess risks, and credit conditions are tightening. Global GDP growth is projected to moderate from 3.3% in 2022 to 2.7% in 2023, before edging up to a still subdued 2.9% in 2024. Restrictive monetary policy will constrain demand growth for some time to come, with the full effects from policy tightening in 2022 only appearing later this year or in the early part of 2024. Annual consumer price inflation in the G20 economies is projected to decline from 7.8% in 2022 to 6.1% in 2023 and 4.7% in 2024, helped by lower energy and food retail prices, moderating demand pressures and lower supply bottlenecks. Core inflation is projected to be relatively sticky but ease gradually towards target in the major advanced economies by the end of next year.

Significant uncertainty about economic prospects remains, and the major risks to the projections are on the downside. One key concern is that inflation could continue to be more persistent than expected. Significant additional monetary policy tightening may then be required to lower inflation, raising the likelihood of abrupt asset repricing and risk reassessments in financial markets. A related concern is that the strength of the impact from the monetary policy tightening that has already occurred is difficult to gauge after an extended period of very accommodative policy and the speed at which policy interest rates have subsequently been raised. While a cooling of overheated markets and moderation of credit growth are standard channels through which monetary policy normally takes effect, the impact on economic growth could be stronger than expected if tighter financial conditions were to trigger stress in the financial system and undermine financial stability. Sharp changes in the market value of bond portfolios may further expose liquidity and duration risks. Rising household and corporate debt-service burdens and the greater potential for loan defaults also raise credit risks at banks and non-bank financial institutions, and could result in a further tightening of lending standards. Tighter than expected global financial conditions could also intensify vulnerabilities in emerging-market economies, adding to debt servicing costs and capital outflows, and reducing credit availability for borrowers relying on foreign lenders. Another key downside risk to the outlook relates to the uncertain course of Russia's war of aggression against Ukraine and the associated risks of renewed disruptions in global energy and food markets. On the upside, reduced uncertainty from an early end to the war, easier-than-expected financial conditions, more robust labour force growth, and greater use of accumulated savings by households and businesses would all improve growth and investment prospects. However, the impact of these individual shocks on inflation could vary.

The need to durably lower inflation, adjust fiscal policy support and revive sustainable growth creates difficult challenges for policymakers.

- Monetary policy needs to remain restrictive until there are clear signs that underlying inflationary pressures are durably reduced. This may require additional interest rate increases in economies in which high core inflation is proving persistent. Policy decisions will need to be carefully calibrated given uncertainty about financial market developments and the need to take stock of the cumulated impact of past interest rate increases. If additional financial market stress occurs, central banks should make full use of the set of financial policy instruments available to enhance liquidity and minimise contagion risks. Clear communication will be necessary to minimise uncertainty about apparent conflicts between the pursuit of price stability and financial stability mandates. Policy space in most emerging-market economies is constrained by the need to keep inflation expectations anchored and tight global financial conditions. In the event of exchange rate pressures, countries should let their currencies adjust as much as possible to reflect underlying economic fundamentals. However, temporary foreign exchange interventions or restrictions on capital movements could be employed to mitigate sudden moves that generate severe risks to domestic financial stability.

- Ensuring the sustainability of the public finances has become more challenging due to the multiple impacts of the pandemic, the war and energy shocks. Almost all countries have higher budget deficits and debt levels than before the pandemic, and many face rising future spending pressures from ageing populations, the climate transition and the growing burden of servicing public debt given higher interest rates. Careful choices are needed to preserve scarce budget resources for future policy priorities and to ensure debt sustainability. Credible fiscal frameworks setting out future expenditure and tax plans are needed to provide clear guidance about the medium-term trajectory of the public finances. In the near term, with food and energy prices having declined, and minimum wages and welfare benefits having now been permanently increased to take account of past inflation in many countries, fiscal support to mitigate the impact of higher food and energy prices should become targeted on vulnerable households inadequately covered by the general social protection system. This would preserve incentives to reduce energy use, help to limit aggregate demand pressures on inflation, and better align fiscal and monetary policies.
- The conjuncture, the long-term decline in potential growth rates, and pressing future challenges such as ageing populations and the climate transition point to a clear need for ambitious supply-boosting structural reforms. Rekindling reform efforts to reduce constraints in labour and product markets, and strengthen investment, labour force participation and productivity growth would improve sustainable living standards and strengthen the recovery from the current slowdown. Enhancing business dynamism, lowering barriers to cross-border trade and economic migration, and fostering flexible and inclusive labour markets, including through skill improvements and the removal of remaining barriers to labour force participation, are all key policy areas where well-designed reforms would help to boost competition, revive investment, and alleviate supply constraints.
- Gender employment and wage gaps have generally narrowed at a relatively modest pace over the past decade, calling for further action across a broad range of policy areas to strengthen participation, skills and opportunities for women. Such action would improve growth prospects, make them more inclusive and ensure that all talent is utilised effectively. Key priorities include improving access to affordable high-quality childcare, incentivising better sharing of parental leave between parents, reforming tax-benefit systems to remove disincentives for women to participate in labour markets, and encouraging gender equality within firms.

The series of shocks to the global economy in recent years and longer-term global challenges such as climate change underline the need for enhanced international cooperation. At the same time, geopolitical tensions have increasingly hindered cross-border flows of goods, services, capital and labour, and contributed to food insecurity for many countries. The rise in debt distress among low-income countries makes it particularly urgent that creditor countries and institutions take joint action – building on the initial steps taken under the G20 Common Framework – to ensure that debt burdens are sustainable, and avoid the risk of a lost decade of development for many low-income countries. More generally, in an interconnected world, countries have to find ways to ensure that frictions in some areas do not prevent progress being made on issues of common interest, including climate change mitigation, open markets, economic security, and responding to pandemics.

Table 1.1. Global growth prospects remain modest

	Average 2013-2019	2021	2022	2023	2024	2022 Q4	2023 Q4	2024 Q4
				Per cent				
Real GDP growth[1]								
World[2]	3.4	6.1	3.3	2.7	2.9	2.3	2.9	3.1
G20[2]	3.5	6.5	3.1	2.8	2.9	2.1	3.0	3.0
OECD[2]	2.2	5.7	3.0	1.4	1.4	1.4	1.3	1.6
United States	2.4	5.9	2.1	1.6	1.0	0.9	1.0	1.3
Euro area	1.9	5.2	3.5	0.9	1.5	1.8	1.1	1.5
Japan	0.8	2.2	1.0	1.3	1.1	0.4	1.7	0.8
Non-OECD[2]	4.4	6.5	3.7	3.9	4.1	3.1	4.3	4.3
China	6.8	8.4	3.0	5.4	5.1	3.5	6.2	4.6
India[3]	6.8	9.1	7.2	6.0	7.0			
Brazil	-0.4	5.3	3.0	1.7	1.2			
OECD unemployment rate[4]	6.5	6.2	5.0	5.0	5.2	4.9	5.2	5.2
Inflation[1]								
G20[2,5]	3.0	3.8	7.8	6.1	4.7	7.8	5.2	4.0
OECD[6,7]	1.6	3.8	9.3	6.9	4.3	9.5	5.5	3.8
United States[6]	1.4	4.0	6.2	3.9	2.6	5.7	3.2	2.3
Euro area[8]	0.9	2.6	8.4	5.8	3.2	10.0	3.5	2.9
Japan[9]	0.9	-0.2	2.5	2.8	2.0	3.9	2.0	1.9
OECD fiscal balance[10]	-3.2	-7.5	-3.6	-3.6	-3.1			
World real trade growth[1]	3.4	10.4	5.0	1.6	3.8	0.7	3.4	3.9

1. Per cent; last three columns show the change over a year earlier.
2. Moving nominal GDP weights, using purchasing power parities.
3. Fiscal year.
4. Per cent of labour force.
5. Headline inflation.
6. Personal consumption expenditures deflator.
7. Moving nominal private consumption weights, using purchasing power parities.
8. Harmonised consumer price index.
9. National consumer price index.
10. Per cent of GDP.

Source: OECD Economic Outlook 113 database.

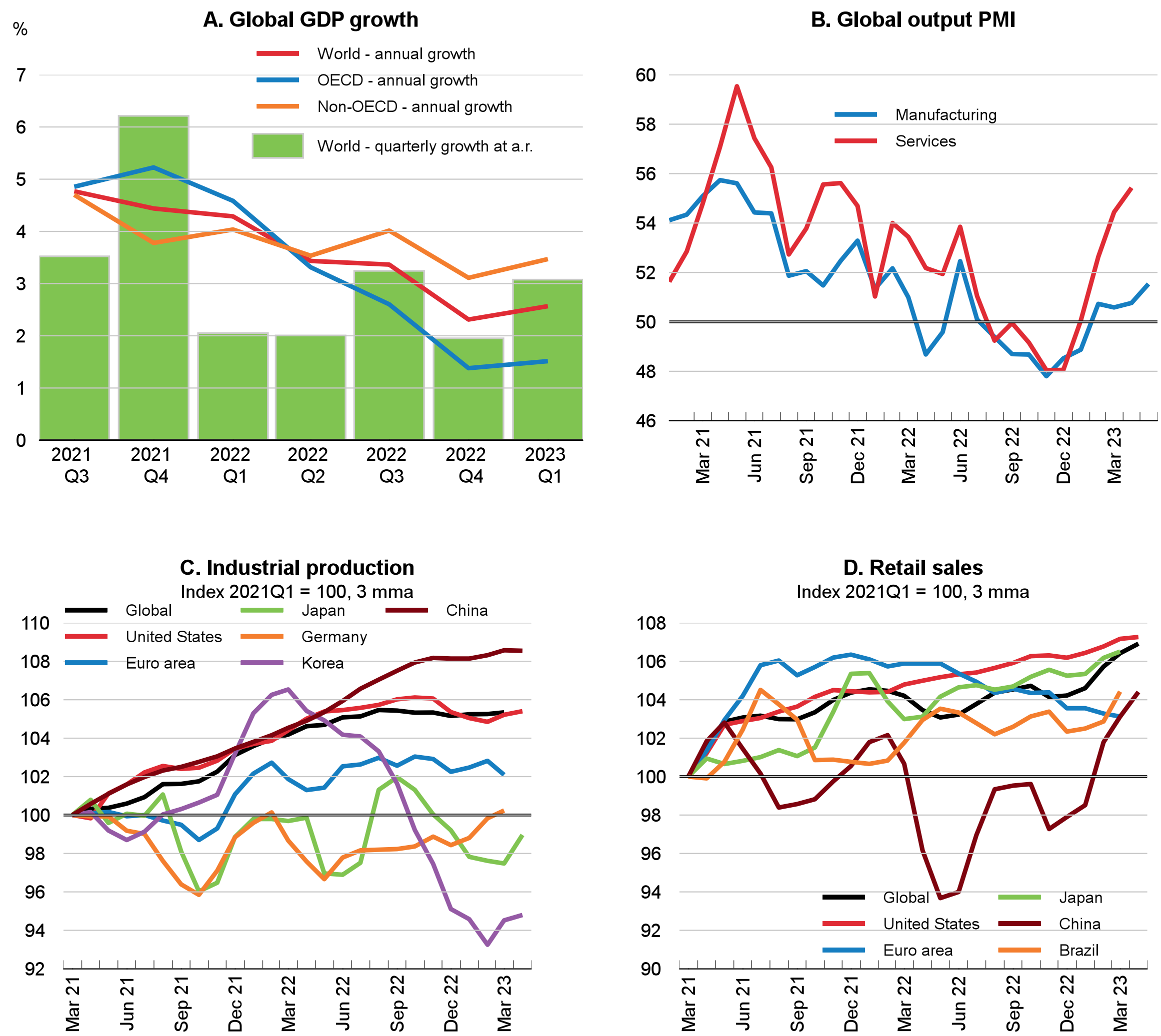
StatLink https://stat.link/nyegbl

Global growth has stabilised, but the improvement is fragile and financial strains have worsened

After weak global growth in 2022, there are signs of improvement in 2023

Global growth slowed substantially over the course of 2022 in both advanced and emerging-market economies (Figure 1.1, Panel A). The large spike in food, fertiliser and energy prices following Russia's invasion of Ukraine added to the already sizeable increases during 2021, pushing up headline inflation considerably in almost all countries and generating declines in household real disposable incomes. The ratio of aggregate OECD end-use energy expenditures to GDP rose sharply in 2022, reaching the highest level since the early 1980s, raising costs for firms and eroding the purchasing power of households (OECD, 2022b). Significant tightening of monetary policy by almost all major central banks pushed up policy interest rates and began to weigh on interest-sensitive components of expenditure. The slowdown in the OECD economies was led by housing investment, which contracted during 2022, but the growth of consumers' expenditure and business investment also eased through the year. By the fourth quarter of 2022, global growth had slowed to an annualised rate of just 2%, with growth over the year falling to 2¼ per cent, just over half the pace seen through 2021. Output declined in 15 OECD economies in the fourth quarter, with most of these in Europe. Outcomes were also relatively weak in the Asia-Pacific economies, with activity in China continuing to be held back by a wave of COVID-19 infections and public health restrictions. China's GDP grew by only 3% in 2022, less than in any year in the past four decades with the exception of 2020, which was even more severely affected by the pandemic.

Figure 1.1. Global growth has slowed and recent activity indicators are mixed

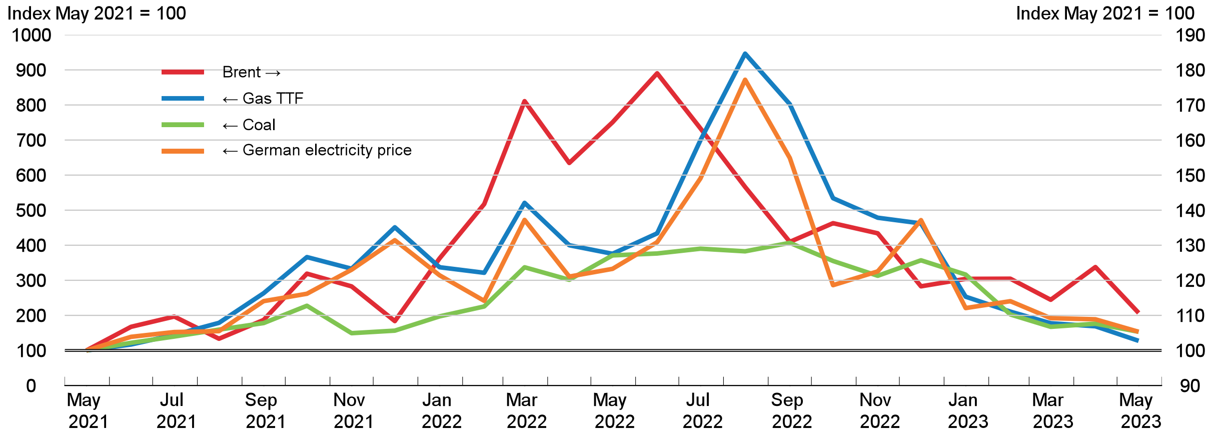


Note: In Panel A, annual growth denotes the change over the year to the quarter shown. Quarterly growth at a.r. denotes quarter-on-quarter growth at an annualised rate. Global aggregates in Panels C and D are PPP-weighted aggregates. The retail sales measure uses monthly household consumption for the United States and the monthly Real Consumption Activity indicator for Japan.

Source: OECD Economic Outlook 113 database; S&P Global; OECD Main Economic Indicators database; Bank of Japan; and OECD calculations.

StatLink https://stat.link/3dljsc

Figure 1.2. Energy prices have fallen back to mid-2021 levels



Note: Gas TTF corresponds to the Dutch Transfer Title Facility and coal to the HWWI coal price.
Source: SMARD, Bundesnetzagentur 2023; Refinitiv; and OECD calculations.

StatLink https://stat.link/26afrk

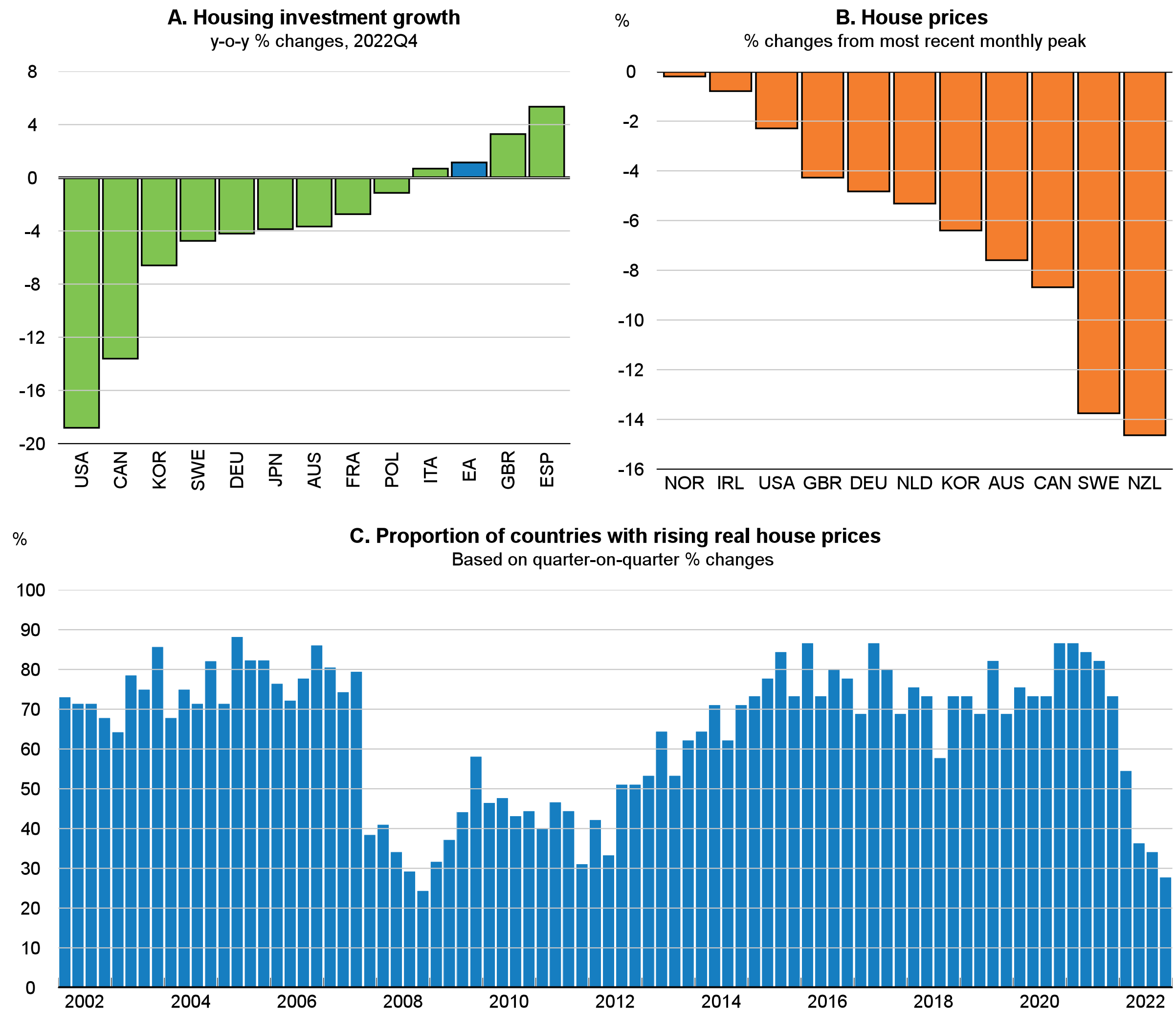
Economic indicators in the first months of 2023 have improved, with global GDP growth picking up to an annualised rate of just over 3% in the first quarter, despite mixed outcomes across countries. Growth rebounded in Brazil, China, India and Japan, but slowed in the United States, and there was only a modest output rise in the euro area and the United Kingdom. Business surveys have improved markedly relative to late 2022, particularly in the services sector (Figure 1.1, Panel B) and consumer confidence indicators in major economies have also begun to recover from the very low levels seen last year.

The improvement in the early part of this year is driven to some extent by declines in energy prices and better prospects for China. Energy commodity prices have fallen sharply since last summer, with a particularly marked decline in the price of natural gas, above all in Europe (Figure 1.2). However, this has yet to be fully reflected in lower retail prices in many countries. The spot prices of oil and coal have also come down a long way from the peaks reached after the invasion of Ukraine last year, easing pressures on households and companies. Even so, prices generally remain higher than seen prior to the pandemic. China's earlier-than-expected reversal of its zero-COVID policy in December 2022, combined with a loosening of both fiscal and monetary policy, has also boosted business sentiment, as stronger growth of the Chinese economy will have positive benefits in the Asia-Pacific region and more widely.

Recent monthly activity indicators have been mixed. The manufacturing sector is still weak (Figure 1.1, Panel C), notably in several Asian economies, in part due to subdued tech sector activity. In most economies, the improvement in early 2023 has been more apparent in services sectors, helped by a rebound in consumer demand in China and solid growth in the United States (Figure 1.1, Panel D). However, demand for durable goods remains soft, in part reflecting the greater sensitivity of such spending to financial conditions.

The impact of tighter monetary policy is becoming increasingly visible in property markets. Housing investment declined in all the large OECD economies in the second half of 2022. In the fourth quarter of 2022, housing investment in the OECD economies with available data was 7½ per cent weaker than a year earlier, with the decline approaching 19% in the United States and exceeding 13% in Canada (Figure 1.3, Panel A). Housing investment continued to contract in the United States and Canada in the first quarter of 2023. House prices have also begun to adjust to policy tightening, with nominal price declines now underway in many economies (Figure 1.3, Panel B), and even larger real price declines given high consumer price inflation. Price adjustments have been relatively quick in countries with elevated price-rent ratios, high household debt, and a sizeable share of adjustable-rate mortgages. Price changes have been less marked in countries with strong population growth and a large share of mortgages at fixed borrowing rates (OECD, 2022b). Even so, many mortgages have rates that float or are fixed for only a few years, and mortgage-holders will increasingly be faced with rising payments if mortgage rates remain at their new higher levels. Past experience has shown that swings in real house prices are often associated with business cycle fluctuations (Hermansen and Röhn, 2017; Cavalleri et al., 2019; Figure 1.4, Panel C), both because of the substantial drag on economic activity from lower investment and pressures on household finances and balance sheets, and because of associated strains in the financial sector.

Figure 1.3. Tighter monetary policy is already affecting housing markets



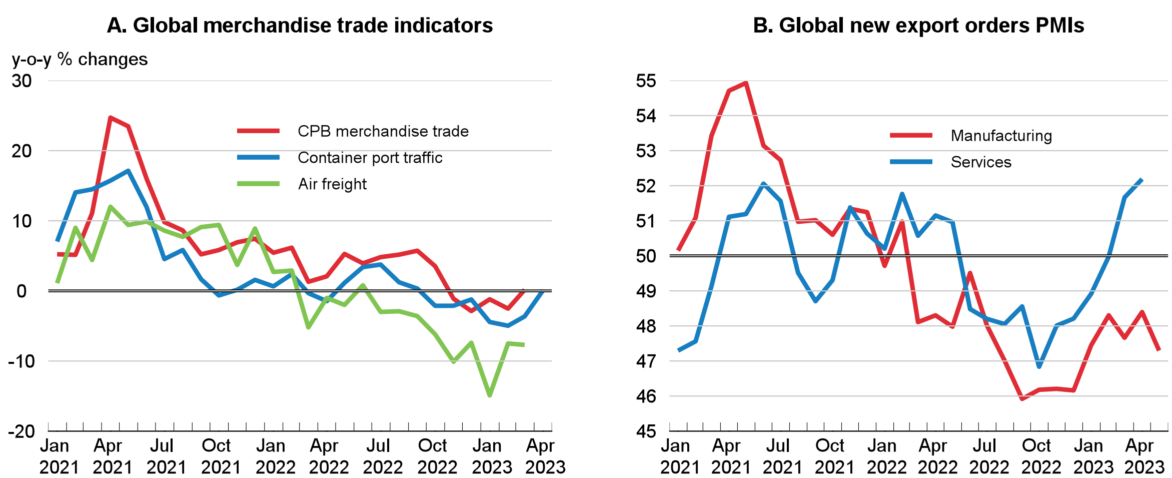
Note: In Panel B, the peak corresponds to November 2021 for New Zealand; January 2022 for Australia; February 2022 for Sweden; May 2022 for Canada and Korea; June 2022 for Germany, the Netherlands and the United States; August 2022 for Norway and the United Kingdom; and December 2022 for Ireland. Latest available information is December 2022 for Sweden; January 2023 for Korea; March 2023 for Ireland and the United States; April 2023 for Canada, Germany, New Zealand, Norway and the Netherlands; and May 2023 for Australia and the United Kingdom. Data are seasonally adjusted. In Panel C, sample based on the OECD economies except Costa Rica, plus Brazil, Bulgaria, China, Croatia, India, Indonesia, Romania and South Africa.
Source: OECD Economic Outlook 113 database; OECD Analytical House Price database; Australia, Core Logic; Canada, Teranet-National Bank; Germany, Europace; Ireland, Central Statistics Office; Statistics Netherlands; New Zealand, REINZ; Real Estate Norway; Sweden, Valueguard; United Kingdom, Nationwide Building Society; United States, Standard and Poor's Case-Shiller Index; and OECD calculations.

StatLink https://stat.link/pag7yr

Global trade growth was relatively robust in 2022, at 5%, despite the war in Ukraine, high geopolitical tensions and commodity prices, and widespread dollar appreciation. Trade was supported by the gradual easing of supply bottlenecks, the continued recovery in consumer demand for travel services, and the gradual lifting of COVID-related travel restrictions, particularly in Asia. Despite the relatively strong annual growth, trade in goods and services faltered in the fourth quarter of 2022, with a 7% annualised quarterly decline in trade volumes. Tighter monetary policy, slowing industrial production, high inventory levels, and a downturn in the semiconductor cycle lowered demand. In addition, a renewed wave of COVID-19 infections in China restricted trade within Asia. Global trade volumes recovered partially in the first quarter of 2023, with an estimated rise of 1.8% (at an annualised rate), but global merchandise trade remained very weak. Transport prices and shipping volumes are weak and survey measures of new manufacturing export orders generally remain at low levels, although services export orders continue to improve (Figure 1.4). With global supply bottlenecks having now largely eased, and China having reopened, subdued demand for manufactured goods and commodities, which make up almost 80% of total trade volumes, will weigh on global trade growth.

Despite war-related trade restrictions and the potential risk to the supply of key agricultural products from Ukraine, global food exports have held up relatively well. Exports of wheat, maize and barley from Ukraine fell by 9.1% in 2022, to 41.3 million tonnes, but the Black Sea Grain Initiative has facilitated over 16 million tonnes of approved food shipments from Ukraine in 2022 and more than 15 million tonnes in the first five months of 2023. Accelerating the food transported through this initiative, by supporting inspection and trade insurance, would increase Ukraine's exports to its traditional markets in the Middle East and Africa and enhance food security in these countries.[1]

Figure 1.4. Global trade indicators generally remain soft



Source: CPB Netherlands Bureau for Economic Policy Analysis; Institute of Shipping Economics and Logistics; IATA; S&P Global; and OECD calculations.

StatLink https://stat.link/lnk9as

[1] Rail, another option to support the diversification of transport channels and consequently markets, could take more time given costs and coordination problems in overcoming differences in rolling stock requirements.

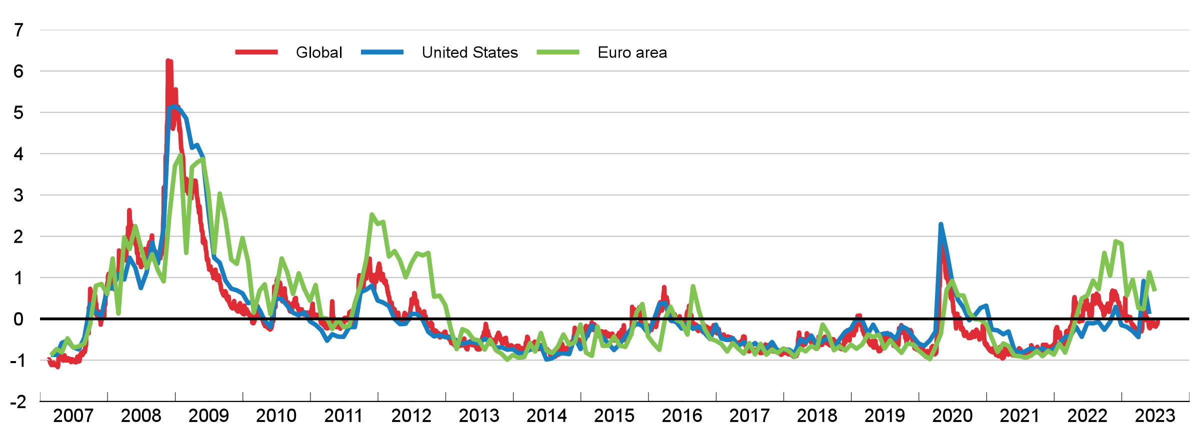
Financial market conditions remain tight and volatile

The impact of monetary policy tightening is increasingly being reflected in financial market developments, particularly credit conditions and the prices of long-term fixed-income assets. Significant stress has also appeared in parts of the banking system, heightening market volatility, though this has not led to a substantial generalised further tightening of financial conditions.

The failure of some regional US banks in recent months and the forced takeover of Credit Suisse, a global systemically-important bank, quickly generated tensions in global banking markets. Bank equity indexes fell sharply, and banks' credit default swap (CDS) spreads soared by some 60 to 80 basis points in the United States and the euro area. While noticeable, the increase was significantly lower than at the peak of the global financial crisis in 2008. Timely policy measures to deal with the failing institutions and address banks' liquidity pressures have helped to stabilise financial conditions (Figure 1.5), but significant liquidity, duration and credit risks remain in segments of financial markets.

The rising cost of funding for banks (Figure 1.8, Panel A) and the need to further strengthen capital and liquidity buffers are likely to result in more restrictive credit conditions. Bank lending standards have already tightened substantially in most major advanced economies, particularly in the United States and in the euro area (Figure 1.8, Panel B), although not in Japan, where monetary policy remains accommodative. In the United States, lending standards have tightened at a faster pace than in previous tightening cycles, but have not yet reached the peaks seen at the height of the global financial crisis. Changes in policy interest rates in other countries have been quickly transmitted to deposit rates and banks have passed through the high cost of funding to lending rates, leading to a slowdown of credit growth in many economies (Box 1.1). New loans for house purchases have been falling sharply in several OECD countries, including the largest European economies.

Figure 1.5. Financial stress has so far remained contained



Note: The chart shows various indicators of systemic stress in financial markets. These summarise disruptions in normal market functioning across a range of market segments, including money markets, equity markets, bond markets, credit markets and foreign exchange markets. Positive and negative values indicate that financial stress is respectively above or below the long-run average. Data are standardised.
Source: European Central Bank; Federal Reserve Bank of Kansas City; Office of Financial Research; and OECD calculations.

StatLink https://stat.link/m6zgrt

Box 1.1. Monetary policy pass-through to household and corporate credit financing conditions: a preliminary assessment

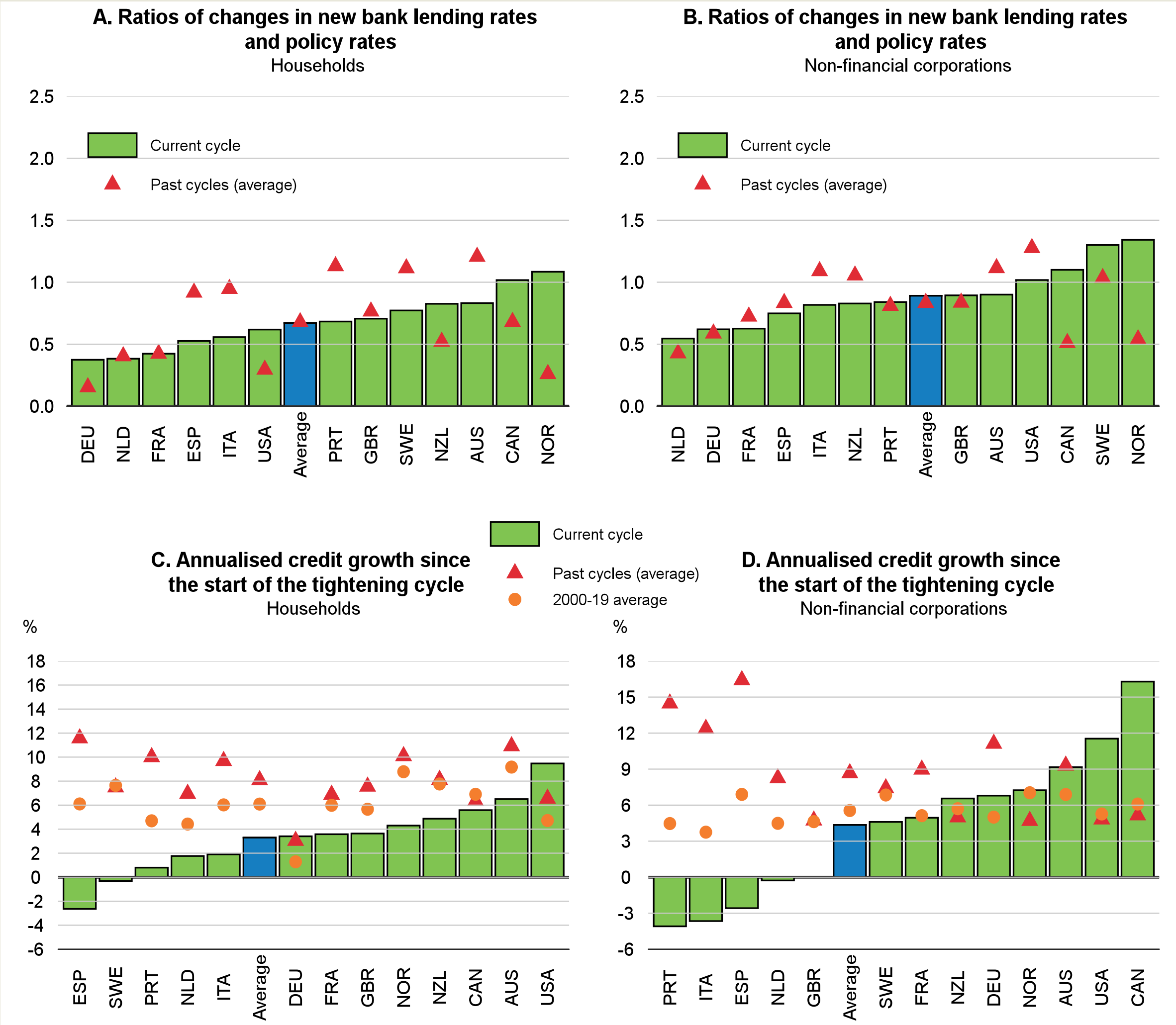
The impact of monetary policy on financing conditions for households and firms is a key channel for the transmission of changes in the policy stance.[1] Ultimately, the effectiveness of monetary policy depends on the speed and extent to which changes in policy rates are passed through to economic agents. Rising policy rates have already been quickly transmitted to money market rates and bank funding costs over the past year, with inter-bank interest rates and deposit rates reaching levels not seen since the peak of the global financial crisis in some countries. This Box assesses the extent to which these developments are affecting financing conditions for households and companies. The analysis suggests that changes in policy rates in the advanced economies are being quickly reflected in bank credit conditions, with transmission occurring at a broadly similar pace to that seen in past tightening cycles. The pass-through of monetary policy to corporate bond yields appears to be taking place more slowly.

Comparing movements in policy rates and the interest rates charged on new bank loans provides one means of assessing the strength and speed of monetary policy pass-through.[2] Banks generally base the lending rates they charge to firms and households on their own funding costs, plus a mark-up.[3] On average, across countries, banks have swiftly passed through the higher cost of funding to economic agents (Figure 1.6, Panels A and B), especially to non-financial corporations, where bank lending rates have on average increased almost one-to-one with policy rates. Transmission is occurring at a similar pace to past tightening cycles on average, but with significant variation across countries. The largest relative changes in new bank lending rates are in Australia, Canada, New Zealand, Norway and Sweden, in some cases reflecting an earlier start to policy tightening.

In some countries, including Germany, Sweden and the United Kingdom, the increase in bank lending rates has outpaced the changes in deposit rates, pointing to a somewhat slower pass-through of monetary policy to savers than borrowers.[4] However, deposit rates have started to rise more rapidly recently, with banks trying to counteract tighter liquidity conditions and an acceleration in deposit outflows by offering higher rates to their customers. Euro area data suggest that bank lending rates charged on short-term loans to non-financial corporations have generally increased faster than these on lending at longer maturities, while lending rates on consumer loans to households have risen less than rates on loans for house purchases.

Fast-rising bank lending rates have been associated with a slowdown in the pace of nominal credit growth (Figure 1.6, Panels C and D). The slowdown has been somewhat more pronounced for credit to households, although credit to firms has contracted in a handful of countries. In the majority of the countries considered, credit growth has been more muted than at similar points in previous tightening cycles, and also lower than on average over 2000-19, particularly in the case of credit to households. The available evidence thus suggests that monetary policy transmission is proving at least as effective as in past tightening cycles. The slowdown in credit growth is even stronger if measured in real terms, as inflation has been higher in most countries than in many previous monetary tightening cycles.

Figure 1.6. Bank credit is slowing and swiftly becoming more expensive

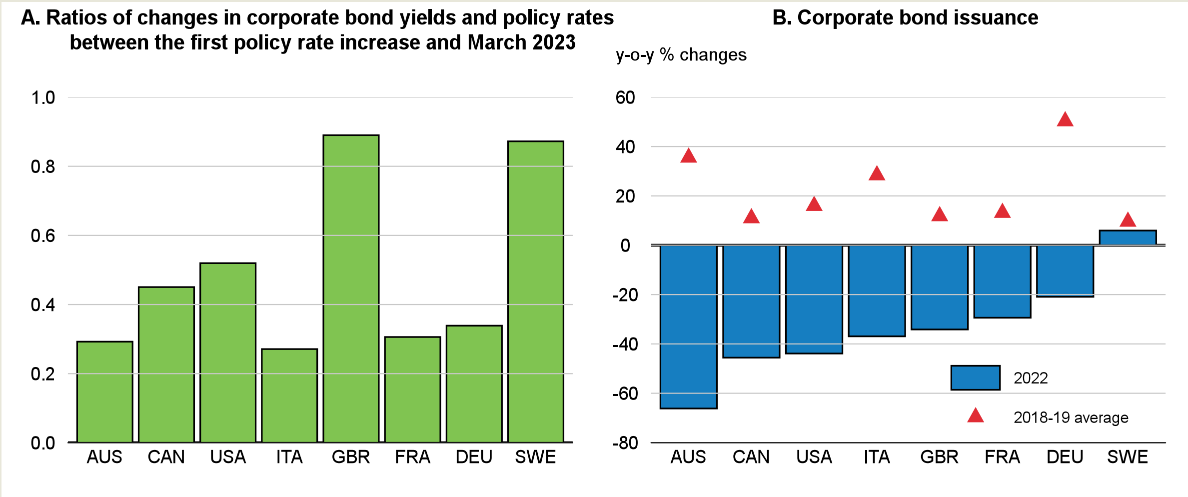


Note: For the current tightening cycle, changes in policy rates, new lending rates and credit growth are computed between the date of the first policy increase and March 2023. Similarly, across past tightening cycles, changes are computed since the first rate increase and over a period matching the one elapsed since the first increase in the current cycle. Changes across past tightening cycles are computed as simple averages of individual country tightening cycles since 2000. “Average” is computed as a simple average across countries. Bank lending rates and credit growth to households are for house purchases.
Source: Central bank statistics; and OECD calculations.

StatLink https://stat.link/431ewz

Bank lending surveys suggest that slowing credit growth and higher lending rates observed in the advanced economies reflect a combination of tighter credit standards and falling credit demand. While data are only available for a few countries, banks overwhelmingly report a tightening of credit standards in recent quarters, especially for mortgage lending in the euro area and for lending to non-financial corporations in the United States. Credit standards for mortgage lending have also tightened in the United Kingdom, albeit by less. Surveys point to a sharp decline in credit demand as well, especially for house purchase in the euro area and in the United States, reflecting a range of factors, including weak income growth. In the euro area, the decline of credit demand for house purchases is similar to that seen during the global financial crisis. Banks expect a further deterioration of credit conditions in the second quarter of 2023, especially for loans to households, again overwhelmingly reflecting tighter credit standards and, in the euro area and in the United States, a further decline of credit demand.

Figure 1.7. Monetary policy tightening has also been transmitted to corporate bond markets



Note: Corporate bond yields for all maturities of Bloomberg fixed income indices.
Source: Bloomberg; Bank for International Settlements; and OECD calculations.

StatLink https://stat.link/qm5d8c

Rising policy rates have also been reflected in the cost and quantity of market-based debt available to firms. Yields on corporate bonds have risen in recent quarters in most advanced economies (Figure 1.7). The pass-through of monetary policy to corporate bond yields appears to be generally slower than for bank lending rates. In addition, corporate bond issuance has recently dried up in most economies. There is also evidence from euro area firm-level data that riskier firms have reduced their bond issuance since June 2022 more vigorously than other firms (Lane, 2023). Due to lags in the transmission of monetary policy, the effect of all of the recent increases in policy rates on financing costs has yet to fully materialise. As banks continue to pass through higher policy rates to households and corporates, financing conditions could tighten further in coming quarters, weighing on economic activity.

---

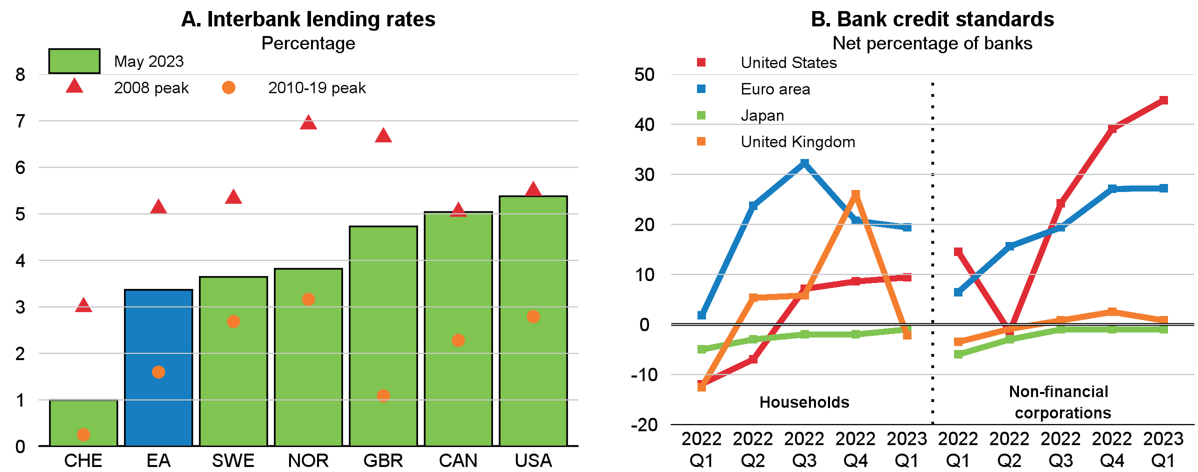
1. The literature emphasises three main transmission channels of monetary policy: the interest rate channel, the asset price channel and the credit channel (Bernanke and Gertler, 1995; Mishkin, 1996). The interest rate channel transmits changes in policy rates to retail lending and deposit rates via money markets, causing adjustments to investment and saving decisions. The asset price channel works through the prices of bonds, stocks and real estate, changing the effective cost of capital and the net worth of households and firms and thus affecting consumption and investment. Finally, the credit channel transmits monetary policy signals by influencing the balance sheets of banks, firms and households, and hence credit supply and demand.

2. In addition to changes in the monetary policy stance, bank lending rates can also reflect other factors, including exogenous changes in demand and supply conditions.

3. The size of the mark-up depends on several factors, including banks' business models, balance sheet and leverage conditions, the degree of competition in the banking system, business cycle conditions and banks' appetite for risk (Maravalle and Gonzalez Pandiella, 2022).

4. Income earned by banks on their activity of maturity transformation increased in 2022, enabling banks to rebuild profit margins after the pandemic. In contrast, data point to a renewed decline in bank profitability across a number of countries at the start of 2023.

Figure 1.8. Bank funding costs have risen sharply, and credit standards have tightened



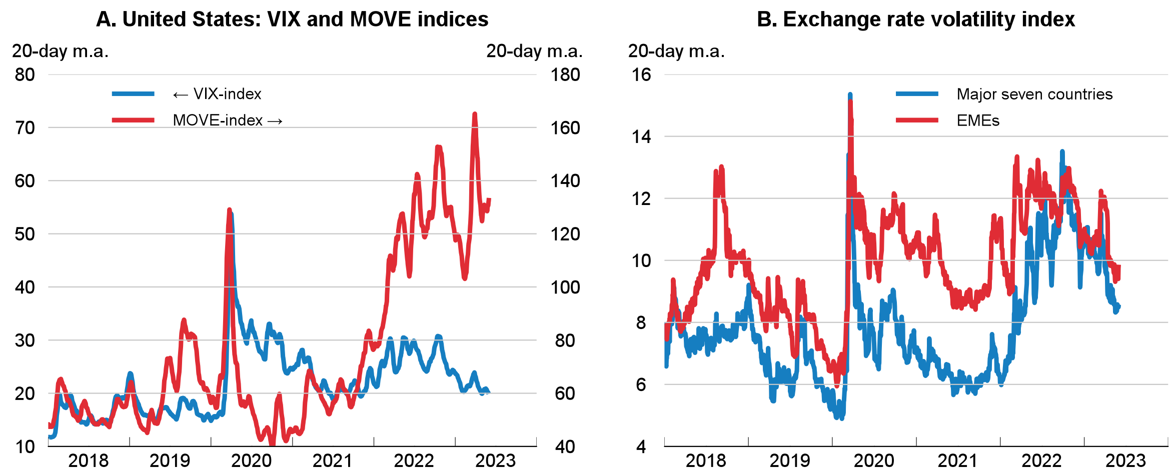
Note: Panel A shows 1-month interbank interest rates, and Panel B shows quarterly net percentages of credit standards from bank lending surveys in 2022 and in 2023Q1. In Panel B, net percentages are defined as the difference between the sum of the share of banks reporting a tightening in credit standards and the sum of the share of banks reporting a loosening of credit standards. A positive (negative) balance indicates tighter (easier) credit standards. For the United Kingdom, credit standards are proxied by inverted loans approved. For the United States, the United Kingdom and Japan, credit standards to non-financial corporations are for large firms.
Source: Refinitiv; European Central Bank; Bank of England; Federal Reserve; Bank of Japan; and OECD calculations.

StatLink https://stat.link/83ynwo

Wider market conditions have been volatile, but the prices of risky assets have regained momentum in recent months. Rapid changes in market expectations about the future path of monetary policy have generated continued volatility in government bond markets (Figure 1.9, Panel A), surpassing the peak observed at the height of the pandemic. Foreign exchange market volatility has declined from its March 2023 peak, but remains elevated (Figure 1.9, Panel B). Aggregate equity price indices have risen in most countries since late 2022, and bank equity prices have recovered in most advanced economies from low levels in March. Ten-year government bond rates have edged down in the United States but have risen in the euro area and in the United Kingdom (Figure 1.10), and term spreads in sovereign bond markets have generally widened. Real long-term rates on government bonds remain lower than typically observed prior to the global financial crisis. Sovereign spreads also remain contained across the euro area, helped by the availability of the ECB's Transmission Protection Instrument and flexibility across countries in Eurosystem bond reinvestments. However, corporate bond spreads have widened, especially on corporate bonds in the advanced economies that are below investment grade.

The US dollar has depreciated against most advanced and emerging-market currencies since November 2022 (Figure 1.10, Panel C), helped by narrowing policy interest differentials between the United States and other countries and market views that US policy rates might be close to a peak. This has helped to limit signs of financial stress in emerging-market economies. Equity price indices have risen a little in China, reflecting the reopening of the economy, but fallen in some energy exporters amid lower commodity prices (Figure 1.10, Panel A). Yields on local-currency government bonds have generally declined in major emerging-market economies (Figure 1.10, Panel B), but spreads over US government bonds remain elevated in countries characterised by high inflation or risk premia. Foreign-currency government bond spreads over US government bonds have also declined in most emerging-market economies, suggesting sovereign credit risk so far remains contained. Investment-grade corporate bond yields in emerging-market economies are still below their peak in 2022, but above their average for that year.

Figure 1.9. Volatility in bond markets has increased sharply

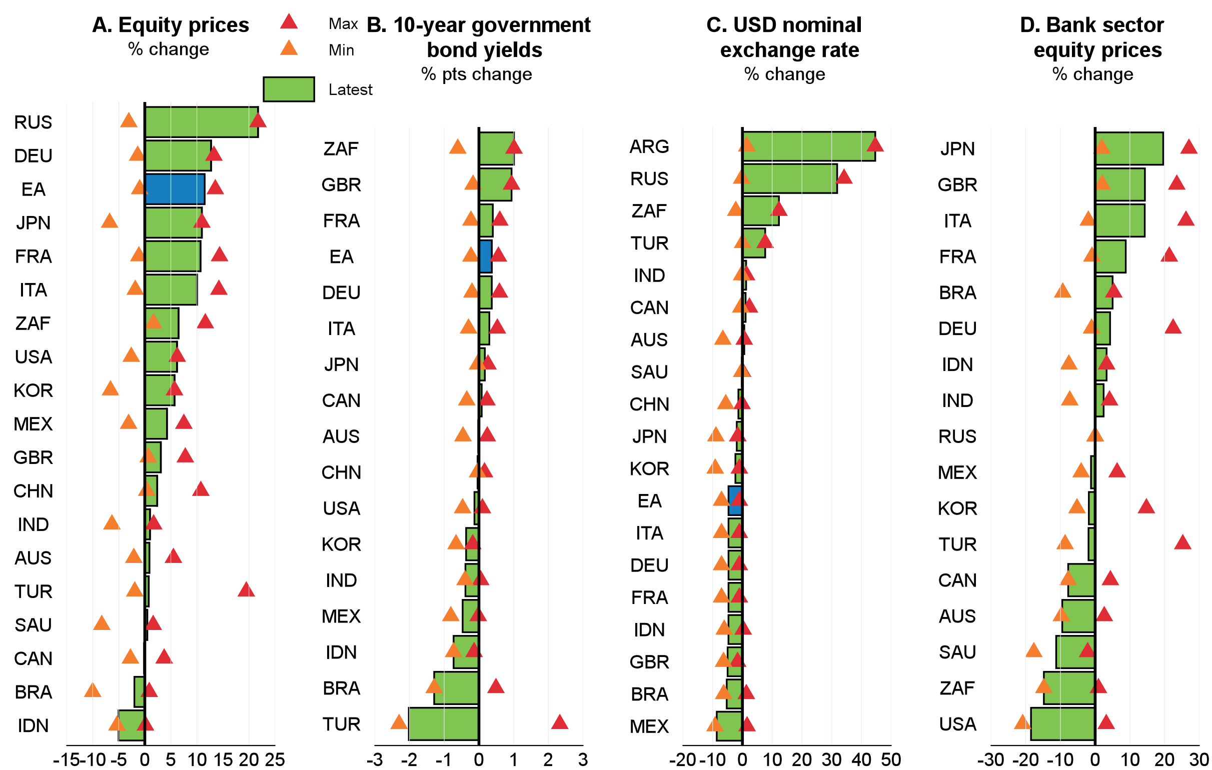


Note: Implied volatility as measured by the VIX index can be interpreted as the market expectation of risk (future volatility). The MOVE index is a yield curve weighted index of the normalised implied volatility on 1-month Treasury options which are weighted on the 2-, 5-, 10- and 30-year contracts.

Source: Refinitiv; and OECD calculations.

StatLink https://stat.link/ou21wn

Figure 1.10. Equity prices and bond yields have rebounded after sharp drops in many countries



Note: "Latest" refers to the change between the average of November 2022 and the latest available data up to 2 June 2023. Maximum and Minimum refer to the biggest increases and falls from the average of November 2022. Based on a 10-day average of daily observations. Panel C: a positive value indicates a depreciation.

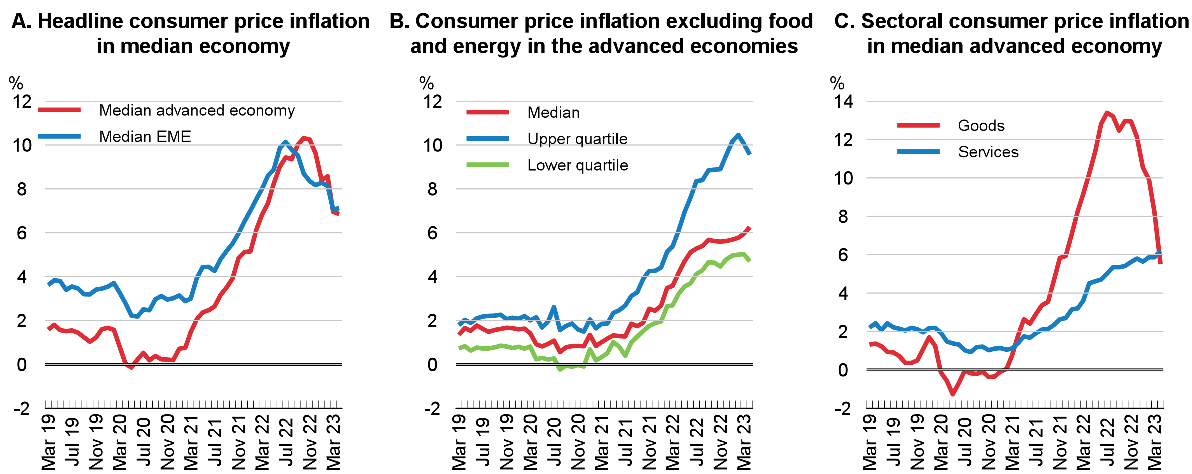
Source: OECD Exchange Rates database; Refinitiv; and OECD calculations.

StatLink https://stat.link/qyrhna

Underlying inflationary pressures remain high

Headline inflation has fallen in most economies in recent months due to the downturn in energy prices, even though food product and services prices have continued to rise rapidly. However, core inflation – excluding food and energy – remains stubbornly high in many countries (Figure 1.11). Core inflation is dominated by services, and services price inflation tends to be less variable than goods price inflation and more dependent on labour costs. Some services prices are also adjusted infrequently. For example, the rental component of consumer prices (including the imputed rents of owner-occupiers in some countries) generally lags the movements in market rents (new rentals), as prices for existing rents are only changed gradually, often once a year.[2] Rising services price inflation also reflects the ongoing normalisation of demand patterns after the sharp shifts seen in the first year of the pandemic. Demand for services has rebounded, converging towards the pre-pandemic path in many countries, while the earlier surge in goods demand, particularly for durable goods, has ebbed.

Figure 1.11. Headline inflation has fallen but core inflation is proving persistent



Note: Calculations using annual inflation rates up to April 2023. EME denotes emerging-market economies. Based on figures for 33 advanced economies and 16 emerging-market economies.
Source: OECD Consumer Price database; Australian Bureau of Statistics; Bureau of Economic Analysis (BEA); Eurostat; Ministry of Statistics and Programme Implementation, India; INEI, Peru; and OECD calculations.

StatLink https://stat.link/r3mfyi

[2] In the United States, market rents have fallen in four of the last seven months, and the year-on-year increase in market rents has slowed for the past 14 months, but the year-on-year change in the rents component of the CPI and the PCE deflator continued to rise until April 2023.

The upsurge in inflation in 2021-22 has led to declines in real wages and, in many countries, household disposable incomes (Figure 1.15, Panel A). However, continued employment growth and fiscal policy support have helped to limit the overall drop in household disposable incomes in some countries, especially in Europe.[3] The weakness of household incomes, and the associated pressures on household purchasing power, have prompted concerns that the high rates of inflation seen in the past year have been due in part to firms raising their profits rather than simply passing on higher input costs. A decomposition of the factors contributing to the rate of growth of the GDP deflator – an indicator of domestically-generated price pressures – suggests that increases in both unit profits and unit labour costs help to account for the upturn in inflation, albeit to a different extent across countries (Box 1.2). A significant part of the unit profits contribution has stemmed from profits in the energy and agriculture sectors, well above their share of the overall economy, but there have also been increases in profit contributions in manufacturing and services.

Despite the slowdown in output growth, labour markets generally remain tight across most OECD economies, with OECD-wide employment and labour participation rates reaching historic highs in the fourth quarter of 2022 and the OECD unemployment rate remaining at a low of 4.8% in March this year. Labour supply shortages, which point to a need for additional well-targeted reforms in some countries, and real wage declines have generated a pick-up in nominal wage agreements, though the pace has remained relatively moderate. Some signs of easing labour market pressures are now emerging in many advanced economies. The number of vacancies has started to decline from elevated levels, layoff rates are increasing, employment of temporary help services has declined, and nominal wage increases have generally levelled off and in some countries even begun to decline (Figure 1.15, Panel B).

Box 1.2. The contribution of unit profits to domestic inflationary pressures

The price of every good or service can be broken down into the unit cost of inputs bought from other firms and value added per unit, with the latter in turn being decomposable into profits per unit, unit labour costs, and unit taxes (net of subsidies). With the upsurge in inflation in 2021-22 creating a cost-of-living crisis in many countries, there has been much interest in whether this is mainly attributable to firms securing higher unit profits, to higher wages (pushing up unit labour costs), or to some combination of the two. This Box explores the contributions from these different components to domestically generated inflation, and also compares recent experience with that seen in the 1970s, an earlier period of high inflation.

The data needed to estimate the impact of changes in unit profits, unit labour costs and unit taxes on consumer prices are not generally available directly. However, this breakdown can be calculated for the GDP deflator using the income measure of GDP (Arce et al., 2023; European Commission, 2023). The change in the GDP deflator (GDP inflation) differs from consumer price inflation, as the composition of household consumption is different from the composition of domestic output. Notably, many OECD economies are net importers of fossil fuels and food, and energy and food prices increased dramatically in 2021-22. Thus, for these countries, consumer prices increased by much more than the GDP deflator over that period. Conversely, for oil and gas exporters, the prices of goods produced domestically and then exported rose rapidly, pushing GDP inflation above headline consumer price inflation.

A decomposition of GDP inflation thus gives only a partial picture of the aggregate contribution of profits and labour costs to headline consumer price inflation.[1] Nevertheless, since the GDP deflator measures the price of domestic value added, GDP inflation is an indicator of domestically generated inflation, and can shed light on the extent to which headline inflation is domestically generated or imported.

Conducting this decomposition for a range of OECD economies yields a number of insights:

[3] On a per capita basis, household disposable incomes rose in the OECD in both the third and fourth quarter of 2022, though incomes remained much weaker than a year earlier (OECD, 2023e).

- The recent period is characterised by more frequent simultaneous increases in the contributions to inflation from unit profits and unit labour costs, a phenomenon last seen in the 1970s.
- A large part of the higher unit profits contribution originates from mining and utilities, even in commodity-importing economies.
- The recent period – so far at least – is unlike the 1970s in that GDP inflation was generally much higher in the 1970s, notably on account of stronger increases in unit labour costs.

The decomposition of GDP inflation since 2019 for three commodity-exporting OECD economies (Australia, Canada and the United States) and six commodity importers is shown in Figure 1.12. As expected, the commodity exporters experienced higher GDP inflation over 2021-22 than the commodity importers.

- The contribution from unit profits was relatively stable in the last four quarters for the United States as well as for Germany, following several quarters of significant positive contributions.
- In contrast, the contribution from unit profits has recently increased in many other European countries, including the aggregate euro area, France, Italy, Spain, and the United Kingdom.
- The contribution from unit labour costs has recently risen in Australia, the euro area (including France, Germany and Italy), the United Kingdom and the United States.
- While it is usually stable and small, the contribution from unit taxes was particularly volatile following the COVID-19 shock, reflecting pandemic-related subsidies that have subsequently been phased out and changes in the composition of expenditure, particularly household consumption.

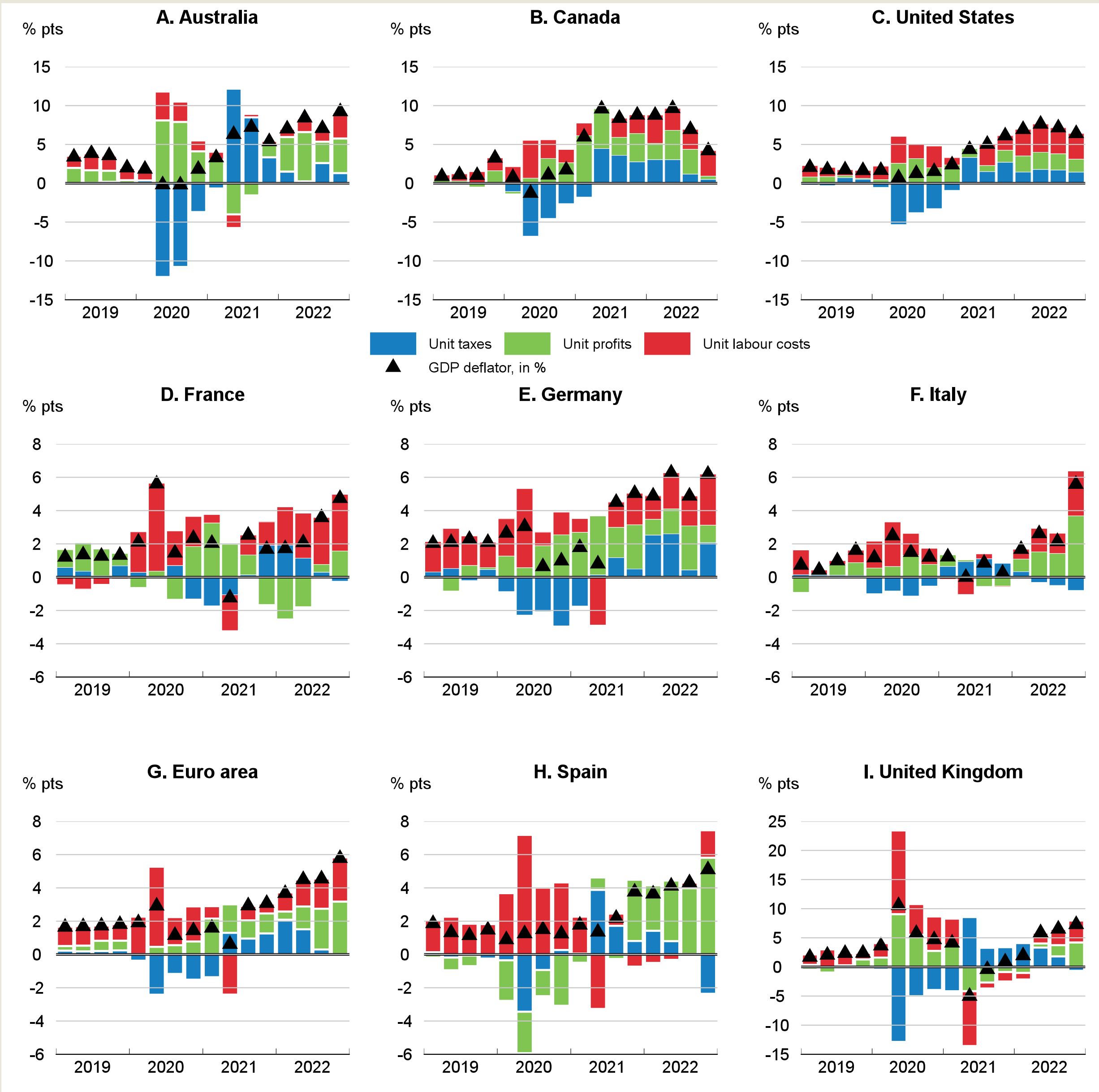
Despite recent increases, the GDP inflation rate remains significantly below the levels seen in the 1970s, especially for commodity importers. In the oil crises of the 1970s, both unit labour costs and unit profits boosted GDP inflation to double-digit rates.[2] In the current inflationary episode, the contribution of unit labour costs and, to a lesser extent, unit profits have been much smaller, especially for commodity importers.

The combination of rising unit labour costs and rising unit profits seen in 2021-22 for many countries, including Australia, Canada, the euro area (including Germany and Italy), the United Kingdom and the United States, is relatively unusual. Over the two decades prior to the pandemic, there was usually a negative correlation between unit profits and unit labour costs, with increases in one being partially absorbed by falls in the other. This relationship has weakened of late, with the median correlation amongst 17 OECD countries shrinking from -0.6 over 2000-19 (using quarterly data) to -0.2 over 2021-22, similar to the value for the decade 1971-81, another period characterised by large energy and food price shocks. This suggests that a period of rising input cost inflation may be conducive to unit profits and unit labour costs rising together, at least in nominal terms.

A key policy issue is whether the observed aggregate increase in unit profits reflects a generalised lack of competitive pressures throughout the economy, or specific factors that have contributed to strong profit growth in a few sectors or in a subset of firms. Moreover, an increase in unit profits (profits per unit of value added) does not necessarily entail higher profit margins (profits as a proportion of sales) as the increase of input costs (including intermediate consumption) can result in profits per unit of value-added moving differently to profits on gross output (or sales) (Colonna et al., 2023).

Figure 1.12. The contribution to inflation from both unit profits and unit labour costs has increased recently in many countries

Contribution to year-on-year GDP inflation



Note: GDP inflation is the rate of change in the GDP deflator at market prices. A small statistical discrepancy between the sum of the components and the GDP deflator is not shown. Unit taxes correspond to taxes on production net of subsidies per unit of real GDP; unit profits to gross operating surplus per unit of real GDP; and unit labour costs to compensation of employees per unit of real GDP. The published gross operating surplus data include mixed income, which incorporates the income of the self-employed. The calculations in this figure adjust the published gross operating surplus data by allocating part of self-employment incomes to unit labour costs, based on the assumption that the self-employed receive on average the same compensation per head as employees, following Schwellnus et al. (2018).
Source: OECD Economic Outlook 113 database; OECD Quarterly National Accounts database; and OECD calculations.

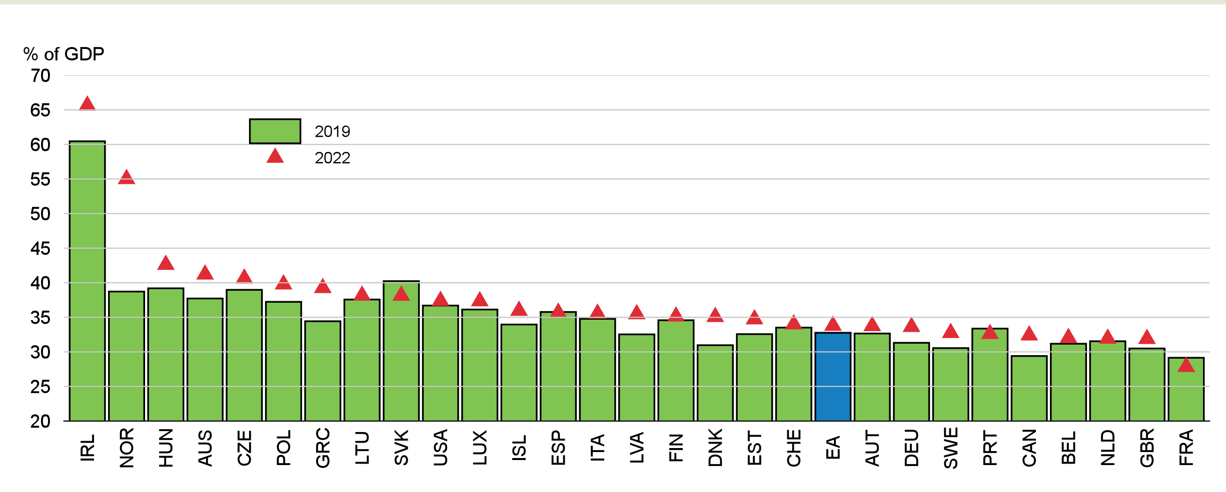
StatLink https://stat.link/hzskal

Evidence on the recent evolution of profit margins is mixed. Colonna et al. (2023) find that margins have risen in the United States and in non-tradeable sectors in Germany, and returned to pre-pandemic levels in Italy after an earlier decline. Weber and Wasner (2023), using firm-level data in the United States, argue that rising prices after COVID-19 were mainly the result of market power and implicit agreements between large firms. In contrast, Glover et al. (2023), suggest that the rise of mark-ups during 2021-22 was due to firms anticipating future cost increases rather than an increase in monopoly power or higher demand. A recent review of competition policy and inflation suggests that weaker competition may have contributed to the observed rise in cost pass-through and corporate profits (OECD, 2022c).

Indirect evidence that aggregate profitability has risen is provided by the evolution of the share of profits in GDP. In most advanced economies, the ratio of the gross operating surplus to GDP in 2022 was higher than in 2019 (Figure 1.13), implying that unit profits have risen faster than GDP inflation over this period.

Figure 1.13. The share of gross profits in GDP increased in most countries since 2019

Gross operating surplus



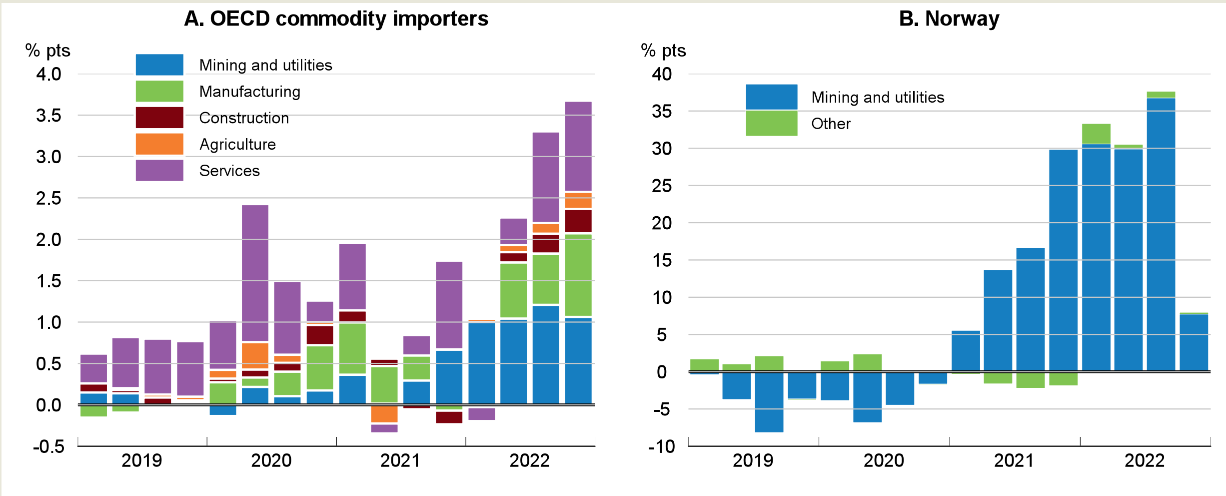
Note: The calculations in this figure adjust the published gross operating surplus data by removing the part of self-employment incomes that is estimated to reflect labour compensation rather than profits. This is done using the assumption that the self-employed receive on average the same labour compensation per head as employees, following Schwellnus et al (2018).
Source: OECD Economic Outlook 113 database; OECD Quarterly National Accounts database; and OECD calculations.

StatLink https://stat.link/mnvghf

One indication of the extent to which rising aggregate unit profits reflects a broad-based increase in pricing power across sectors is to decompose the change in unit profits by sector. Doing this for the 13 OECD commodity-importing economies with an available sectoral breakdown of GDP, and computing unit profit as value added minus labour compensation and taxes, suggests that a disproportionate part of the observed increase of unit profits in 2022 came from mining and utilities: that is, mining and quarrying together with electricity, gas and water supply (Figure 1.14, Panel A). This sector accounts for only about 4% of the average economy but more than 40% of the rise of unit profits in 2022 as a whole. For commodity-importing countries this likely corresponds mainly to electricity and gas supply, including renewable electricity producers, who did not suffer from higher costs but benefited from higher retail prices. On a quarterly basis, the contribution of other sectors to the rise of unit profits gradually increased through 2022, with stronger effects from both manufacturing and services. The relatively small share of agriculture in the economy (less than 2% for the euro area) also masks a relatively large increase of the contribution of unit profits in this sector.

Figure 1.14. Mining and utilities account for a substantial share in the increase in unit profits

Contribution of unit profits to year-on-year GDP inflation



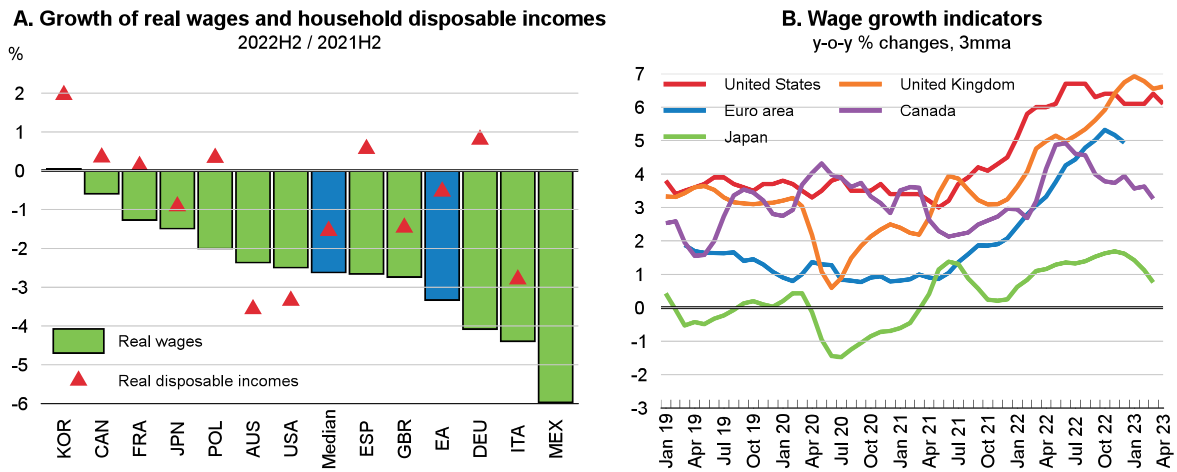
Note: Unit profits based on estimated sectoral gross operating surplus in current values. The latter is computed as sectoral output minus sectoral labour compensation and an estimate of unit taxes (based on the value at the macroeconomic level in per cent of GDP applied to sectoral GDP) and reconciled so that the sum across sectors equals the macroeconomic level. OECD commodity importers correspond to a simple average of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Spain, Sweden and the United Kingdom.
Source: OECD Quarterly National Accounts database; and OECD calculations.

StatLink https://stat.link/cahztd

Due to an absence of compensation data by sector for most OECD commodity exporters, only Norway can shed some light on sectoral developments of unit profits for this group of countries. As expected, the bulk of the large increase in unit profits in Norway in 2022 came from mining and utilities (Figure 1.14, Panel B), with the contribution of unit profits to GDP inflation plummeting in 2022Q4 because of the global fall in energy prices. It is likely that mining similarly accounts for a large share of the rise in unit profits during 2021-22 in other commodity exporters such as Australia and Canada.

1. Diev et al. (2019) use an alternative approach that decomposes core CPI inflation instead of GDP inflation with some additional contributors to inflation (including the terms of trade excluding food and energy) but using the same definition of unit profits and unit labour costs. Haskel (2023) proposes a similar decomposition of headline CPI inflation.
2. There are a few countries in which the GDP deflator growth rate is relatively similar to the 1970s: for example, the average annual growth rate over 1971-81 in Germany was 5%, slightly below the value for 2022 (5.5%).

Figure 1.15. Real incomes and wages have been weak and nominal wage growth is starting to stabilise



Note: Panel A shows compensation per employee deflated by the personal consumption expenditures deflator. The median is the median of all available OECD countries. Comparable data for household disposable income are not available for Mexico. In Panel B, wage indicators vary across countries. United States: median change in hourly wage of individuals observed 12 months apart; euro area: median of the annual change in wages and salaries advertised in job postings on Indeed; Japan: contractual earnings per employee for all establishments with 5 or more employees; Canada: fixed-weighted index of average hourly earnings for all employees; United Kingdom: median of annual pay growth for all individuals.
Source: OECD Economic Outlook 113 database; Federal Reserve Bank of Atlanta; Indeed; Ministry of Health, Labour and Welfare of Japan; Statistics Canada; Office for National Statistics; and OECD calculations.

StatLink https://stat.link/mndpqo

Growth will remain subdued, with inflation declining gradually

Despite the signs of improvement seen in the early months of this year, the outlook is for a period of subdued growth and persisting inflation amidst acute risks. The full effects on output from the quick and synchronised tightening of monetary policy since the start of 2022 are likely to appear over the course of 2023 and early 2024, particularly on private investment. Central banks, faced with persistent above-target inflation, are expected to keep interest rates high, and most countries are set to adopt a tighter fiscal stance to start alleviating debt burdens worsened by the pandemic. However, stronger public investment, supported by NGEU grants, could provide some support to activity in many European countries. Household incomes remain under pressure, with lower energy and food commodity prices yet to be fully reflected in retail prices, although use of additional savings accumulated during the pandemic could help to cushion demand. The disruption from the war in Ukraine is also likely to continue to weigh on the global economy.

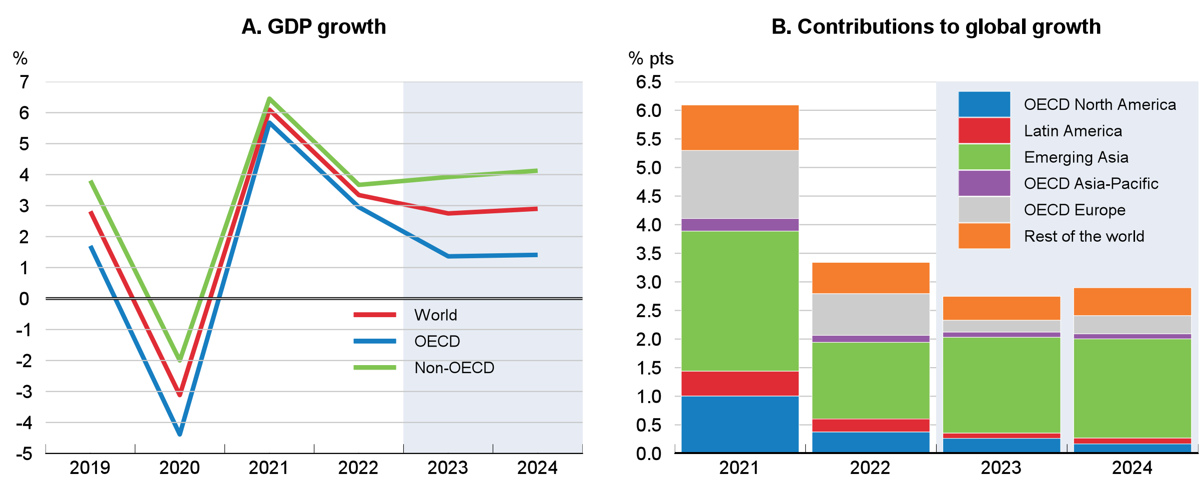
Global GDP growth in 2023 is projected to be 2.7% (Figure 1.16, Panel A), the lowest annual rate since the global financial crisis, with the exception of the pandemic-hit year of 2020. A modest improvement to 2.9% is foreseen for 2024, but this would still be a relatively poor outcome by historical standards. The slowdown in annual growth from 2022 masks a gradual improvement in the year-on-year growth of global activity over the course of 2023. This improvement partly reflects the fall in energy prices, but mainly stems from the emerging-market economies and the positive impetus provided by the rebound in China after fully reopening its economy. In addition, a disproportionate share of global growth in 2023-24 is expected to continue to come from Asia (Figure 1.16, Panel B). If the economic impact of China's reopening is less than expected, a main pillar of global growth this year and next would be weakened.

Annual OECD GDP growth is projected to be below trend at 1.4% in both 2023 and 2024, although it will gradually pick up on a quarterly basis through 2024 as inflation moderates and real income growth strengthens. Business investment is projected to be nearly stagnant in the OECD area in 2023, and housing investment is projected to decline in many economies. Overall GDP growth is sustained by steady increases in private consumption and government final expenditure, the former being supported by continued, albeit modest declines in saving ratios on average across the OECD this year. Real wages, which fell in all major OECD economies in 2022, are projected to stop declining over the course of 2023 in most, and OECD-wide employment is projected to keep expanding in 2023-24, underpinning incomes. Any negative shocks to household sentiment or wealth, or a less benign evolution of the labour market, would yield weaker growth in consumption and output.

The prospects for individual major economies and regions are as follows.

- In North America, the sharp rise in interest rates since late 2021 has been reflected in a slowdown in final domestic demand growth in both the United States and Canada. Housing investment has declined sharply, and business investment is showing signs of weakness. Lower saving rates and robust increases in employment are helping to maintain private consumption growth, but this is set to fade. Annual GDP growth in the United States is projected to be 1.6% this year, helped by strong carryover effects from late 2022, and 1.0% in 2024. Annual growth in Canada is projected to be 1.4% in both 2023 and 2024, supported by strong population growth and a resilient labour market. In both economies, the average annual growth numbers obscure a projected improvement in quarterly growth rates through the course of next year, helped by the moderation of inflation towards 2% by the end of 2024.

Figure 1.16. Global growth is projected to remain subdued and heavily dependent on Asian economies



Note: In Panel B, Emerging Asia comprises China, India, Indonesia and the Dynamic Asian Economies (Hong Kong (China), Malaysia, Chinese Taipei, the Philippines, Singapore, Thailand and Viet Nam). Latin America comprises Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru. Contributions calculated moving PPP shares of global GDP.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/aic0bk

- Although inflation has increased in the major advanced Asian economies, it remains relatively mild. The reopening of China should also provide a boost to demand in the wider region. In Japan, monetary policy remains accommodative, and fiscal policy is set to be largely neutral this year before becoming less supportive in 2024. Policy support, together with signs of stronger wage growth, is projected to help GDP growth pick up to an above-trend pace of 1.3% in 2023 and 1.1% in 2024 and bring underlying inflation up towards 2% by the latter half of 2024. In contrast, macroeconomic policy is already tightening in Korea, and domestic demand growth is expected to remain relatively subdued amidst high debt service burdens. GDP growth is projected to be 1.5% in 2023 and 2.1% in 2024, with exports set to pick up with China's recovery and an upturn in the tech cycle.
- The major European economies have been strongly affected by the war in Ukraine, via elevated energy prices and heightened uncertainty. Macroeconomic policies are now becoming less supportive, with higher policy interest rates and fiscal consolidation underway. In the euro area, GDP growth is projected to be 0.9% in 2023. Tight labour markets, along with further declines in household saving rates should support private consumption, but higher financing costs and tighter credit standards will weigh on investment, despite the boost from higher spending under the NGEU programme. GDP growth is expected to pick up to 1.5% in 2024, helped by rising real incomes as inflation eases. Headline inflation in the euro area will fall quite quickly as food and energy inflation turns negative on a year-on-year basis, but core inflation is projected to be sticky, remaining close to 3% year-on-year in the last quarter of 2024. The current high dispersion of inflation across euro area countries is projected to moderate only gradually. The pattern of growth and inflation during 2023-24 is broadly similar for the United Kingdom, but the fiscal stance is tighter in both years, and export growth is expected to remain very weak. GDP growth is projected to be 0.3% in 2023 and pick up to 1% in 2024 as real income growth starts to improve. Annual headline and core inflation are projected to recede, but to still remain slightly above target at the end of 2024.
- China is expected to see the sharpest positive shift in growth between 2022 and 2023 of any G20 economy, largely on account of the lifting of the government's zero-COVID policy. GDP growth is projected to rise to 5.4% in 2023, and then ease to 5.1% in 2024 as the rebound associated with reopening fades. The shift in the anti-COVID policy has released pent-up demand for in-person services, lifted consumer confidence and alleviated the downturn in the property sector. China is unusual in having experienced little inflationary pressure during 2022, and consumer price inflation is projected to remain benign.
- Over the past year, GDP growth has remained relatively strong, and close to potential, in India and Indonesia, but monetary policy has been tightened to lower inflation and fiscal policy is becoming less supportive. GDP growth in India is projected to ease to 6% in FY 2023-24, as tighter financial conditions hold back domestic demand, before picking up to 7% in FY 2024-25, helped by lower inflation and stronger external demand. Indonesia's average annual growth is projected to remain close to 5% over 2023-24, underpinned by solid business and consumer confidence, and stronger international tourism from China.
- After a strong rebound last year, growth will slow sharply in most Latin American economies in 2023, reflecting generally tight macroeconomic policies to tackle persistently high inflation, soft growth in export markets and lower prices for key export commodities. Output growth is projected to pick up in 2024 as inflation subsides, monetary policy becomes less restrictive and external demand strengthens. After the large boost from agricultural output in the first quarter of 2023, GDP growth in Brazil is projected to moderate, with annual growth of 1.7% in 2023 and 1.2% in 2024, as high real interest rates and weak credit growth hold back domestic demand, despite stronger social transfers.

Global trade growth is projected to slow alongside GDP growth in 2023 to 1.6%, in part due to carryover effects from the weakness in late 2022, before recovering to 3.8% in 2024. Lower commodity prices and the full reopening of China should help to support trade growth over next eighteen months, including in Europe (Figure 1.17, Panel A), although base effects will keep annual growth very low in 2023. The lagged effects of tight monetary policy will continue to be felt into 2024, particularly in the United States. The trade intensity of growth is set to decline in 2023, before recovering in 2024, as rising trade in OECD countries offsets the continued weakness in Chinese trade intensity (Figure 1.17, Panel B). Growth in the trade of services is expected to outperform goods, with the re-opening of the Chinese economy providing a substantial boost to international travel particularly in 2024.

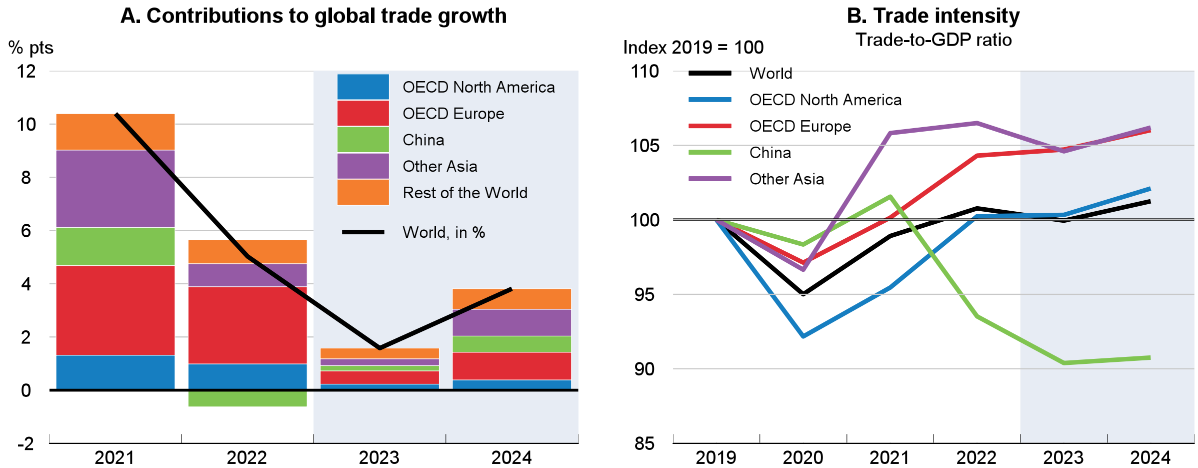
The recovery in trade could be weaker if growth disappoints or possible second-round impacts from trade-related sanctions on Russia limit the pace of the trade rebound. However, if domestic demand picks up faster than expected, trade could recover faster, as supply chain pressures in manufacturing and shipping have mostly abated and estimates of spare capacity are high across most manufacturers. A faster-than-projected normalisation in China's tourism market could also result in higher trade growth. Services import volumes in China in 2022 were still 26% lower than 2019 levels. International tourism estimates are still 20% below 2019 peaks, suggesting room for a full recovery if growth should surprise to the upside in 2023. If global travel services grew sufficiently to return to their share of global trade in 2019 (5.7%), it would boost the value of total trade by just over 1½ per cent in 2023.

A key question for the outlook is the extent to which the slowdown in output growth will push up unemployment rates. So far, despite many advanced economies having already had at least one quarter of negative GDP growth, unemployment has remained low and even continued to fall in some countries. Instead, two margins of adjustment to a weaker demand environment have been the number of job vacancies, which is now declining in many OECD economies, and hours worked, which have begun to move down in some countries. With the projected slowdown in demand growth expected to be relatively mild, unemployment is projected to rise only marginally during 2023-24, especially in the euro area. The OECD-wide unemployment rate is expected to increase from 4.9% at the end of 2022 to 5.2% in the fourth quarter of 2024, though with relatively large rises of around ¾ percentage point or more in Australia, New Zealand, the United Kingdom and the United States. With labour markets generally expected to remain tight, and with workers having experienced falls in real wages in 2022, nominal wage growth is projected to be just over 4% in the overall OECD area in 2023, before moderating to around 3½ per cent in 2024.

Helped by the decline in energy prices over the past few months, average annual headline inflation in the OECD as a whole is now projected to fall relatively quickly from 9.4% in 2022 to 6.6% in 2023 and 4.3% in 2024, with year-on-year inflation in the last quarter of 2024 down to 3.8% (Figure 1.18).[4] In the major advanced economies, annual inflation is projected to be closer to target, at just over 2¼ per cent by the fourth quarter of 2024. The projected fall in OECD core inflation is shallower, reflecting the stickiness of many prices and a slow adjustment of margins and cost pressures. Core inflation is projected to ease from 6.6% in 2022 to 6.5% in 2023 and 4.5% in 2024 on an annual average basis.

[4] The figures for annual OECD headline consumer price inflation differ slightly to the OECD inflation figures in Table 1, which are for the annual inflation rate based on the personal consumption deflator from the national accounts. The latter has a similar definition across countries and may include a broader range of goods and services than the national headline consumer price index.

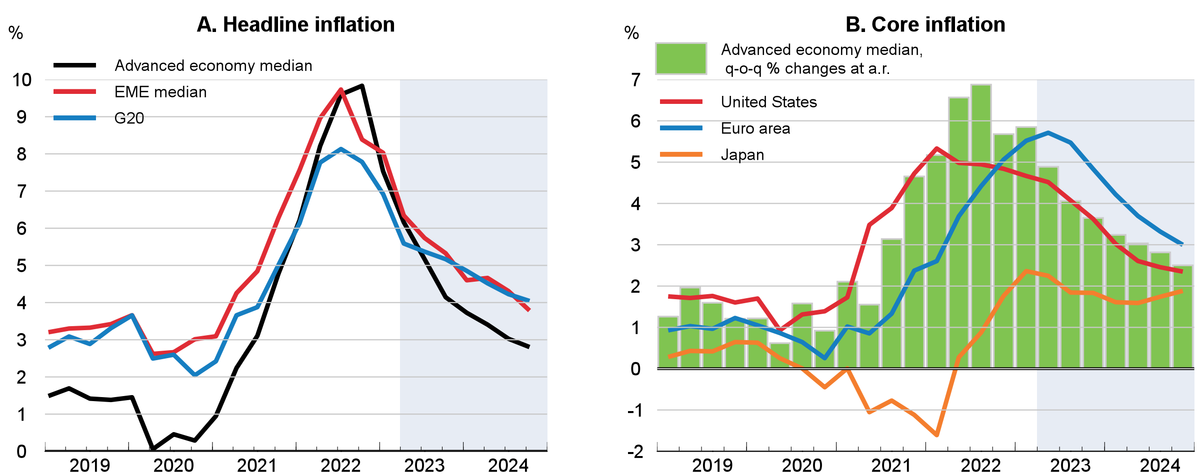
Figure 1.17. Trade growth is projected to remain soft



Note: The OECD North America includes Canada and the United States; Other Asia includes Japan, Korea, the Dynamic Asian Economies (Hong Kong (China), Malaysia, Chinese Taipei, the Philippines, Singapore, Thailand and Viet Nam), India and Indonesia.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/jsyftv

Figure 1.18. Inflation is projected to ease



Note: Advanced Economy median and EME median denote the median inflation rate in the advanced economies and the emerging-market economies respectively. Based on projections for 34 advanced economies and 16 emerging-market economies.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/rp50at

The balance of risks is to the downside

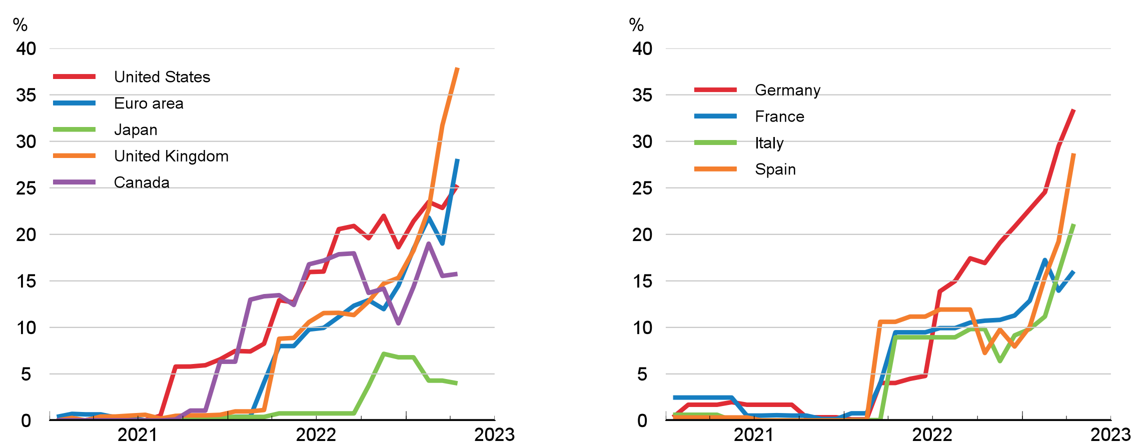
Inflation could be more persistent than expected, with interest rates being higher for longer

Over the past eighteen months or so, underlying inflation has consistently proved to be higher than projected. The large shocks that have affected the global economy and the range of factors contributing to higher inflation, both on the demand and the supply side, have made it difficult to assess the speed at which inflation pressures may recede. Relatedly, after an extended period of low interest rates, there is considerable uncertainty concerning the impact of the monetary tightening that has already occurred. If the rise in interest rates has smaller-than-expected and/or delayed effects, or cost pressures moderate less rapidly than expected, or firms try to raise price-cost markups, inflation will be higher than projected. In such circumstances, monetary policy will have to be tightened further and perhaps kept restrictive for longer, with negative implications for growth and employment and greater risks for financial stability.

The extended period of high inflation has already resulted in a rising share of items in consumer price baskets that have had annual price rises of more than 5% for at least 12 months. This share has gone from near zero at the beginning of 2021 to around a quarter on average by April 2023, and to a third or more in Germany and the United Kingdom (Figure 1.19). Delays in getting inflation down would be likely to raise these shares further, intensifying the challenges of lowering inflation, increasing the risks of market and private sector inflation expectations settling at levels well above inflation objectives, and possibly also prompting a drift towards greater indexation of contracts and financial assets. In these cases, inflation would likely prove more persistent than projected.

Figure 1.19. There is a risk that inflation could persist for longer than expected

Weighted share of items in the consumer price basket for which the year-on-year inflation rate has been above 5% for at least 12 consecutive months



Note: Inflation based on the personal consumption expenditures deflator in the United States, harmonised consumer price indices in the euro area and the United Kingdom, and national consumer price indices elsewhere.
Source: Bureau of Economic Analysis; Eurostat; Statistics Bureau of Japan; Office for National Statistics; Statistics Canada; and OECD calculations.

StatLink https://stat.link/3o1g28

Other factors might also contribute to inflation persistence. Notably, an aggravation or spreading of the conflict in Ukraine could yet give new upward impetus to energy and food prices. Likewise, a stronger-than-expected rebound of the global economy this year could push up a range of commodity prices and hinder the downward move in inflation. Again, policy rates would be likely to be kept higher for longer than projected, with a higher probability of a widespread and harmful economic slowdown and enhanced risks of financial stress.

Tighter financial conditions could trigger stress in financial markets

Tighter financial conditions are to be expected as monetary policy becomes more restrictive, and are a standard channel through which policy affects output and inflation. Nonetheless, there are risks that an abrupt tightening of financing conditions could trigger widespread financial stress and undermine stability as investors rapidly reassess exposures to liquidity, duration and credit risks. Key concerns are that renewed fragilities could appear in the banking sector, resulting in a broader loss of confidence and a sharp contraction of credit, and a heightening of risks from liquidity mismatch and leverage in non-bank financial institutions (NBFIs).

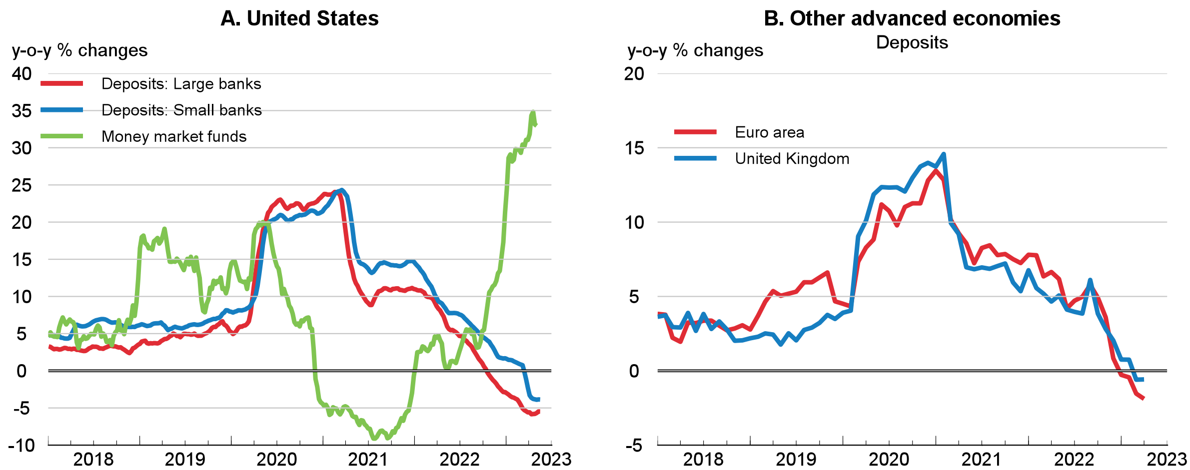
Collectively, the banking system appears more resilient than before the global financial crisis, with post-crisis regulatory reforms strengthening capital and liquidity positions, and the largest banks being subject to more stringent stress tests. Large systemically important banks in advanced economies appear to be liquid and adequately capitalised, although market confidence remains fragile, as shown by the speed at which banking sector pressures spread across countries following bank failures in the United States in March. Moreover, capital ratios stand above regulatory minima, non-performing loans (NPLs) remain low, and recent stress tests suggest that large banks are generally well positioned to cope with fast rising interest rates and a flattening of yield curves (IMF, 2022a; ECB, 2022).

Nonetheless, recent episodes in the United States and Europe suggest that in an environment of fast-rising interest rates, banks can be exposed to severe duration and liquidity risks if large deposit outflows occur. Deposit growth has slowed in the large advanced economies since early 2021 and in many has recently become negative (Figure 1.20). With bond yields rising fast, savers can get higher returns by moving deposits away from banks and towards money market funds (MMFs), as seen in past episodes of policy tightening (Paul, 2022).

Duration risks can arise if the value of fixed-income securities falls as a result of higher interest rates. While losses may only be realised over time, they can materialise rapidly if banks have to sell bonds to meet unexpected deposit outflows. In addition, liquidity risks can become manifest for banks with low liquid assets and large short-term liabilities. While liquidity mismatches vary widely across countries, banks in Mexico and the United States tend to have comparatively high ratios of short-term liabilities to liquid assets and therefore might be more vulnerable to liquidity risks triggered by large deposit outflows (Figure 1.21, Panel A). Banks in Mexico, the United States and some European countries could also be potentially vulnerable to duration risks, given their comparatively high, albeit often declining, share of government bonds in total assets (Figure 1.21, Panel B). The prospect of large losses by banks and poor liquidity conditions can lead to a sharp repricing of bank risk and higher bank funding costs, pushing banks to tighten lending conditions to households and companies.

Banks could also face pressures from rising credit losses if firms and households struggle to repay their debts, which in turn would significantly reduce the supply of new credit available for households and companies. In a number of countries, private sector debt-service ratios in 2022 were already above those in the early 2000s, when interest rates last rose sharply (OECD, 2022b). The share of borrowers unable to service debt payments could increase as rising policy rates are passed through to lending conditions, particularly in countries in which private debt levels are elevated and in which a sizeable share of debt is at variable interest rates.

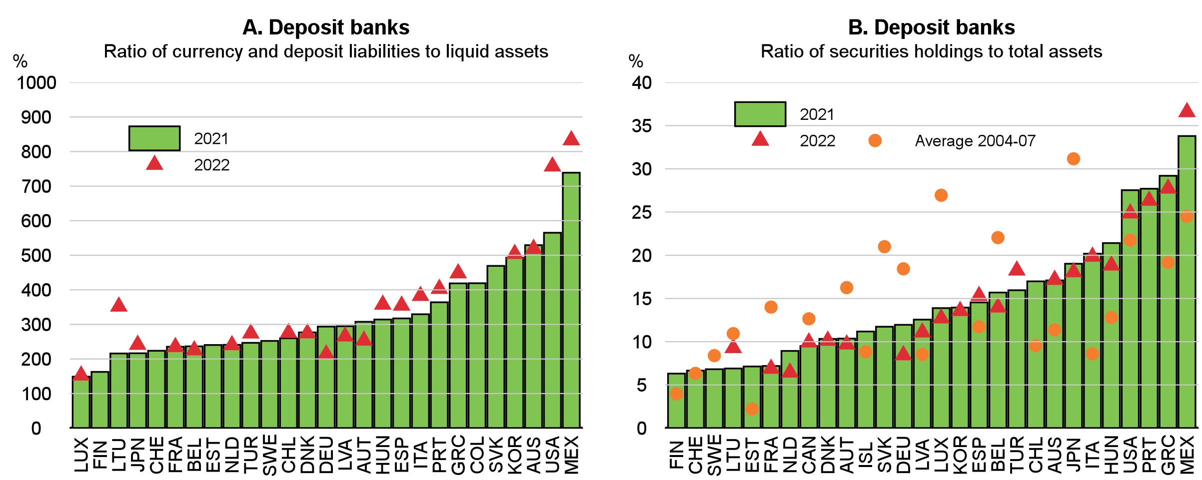
Figure 1.20. Bank deposit growth has slowed, with money flowing into money market funds



Note: Year-on-year growth rates of outstanding deposits at US banks are 4-week moving averages. Money market funds data are for retail money market funds. Large US banks are chartered banks that have consolidated assets of USD 300 million or more**.** Small banks are chartered banks with consolidated assets of less than USD 300 million. Last data point for US deposits is 17 May, and for US money market funds is 3 May. Data for the euro area and the United Kingdom are monthly and for US deposits and money market funds weekly.
Source: US Federal Reserve; European Central Bank; Bank of England; and OECD calculations.

StatLink https://stat.link/tiolr7

Figure 1.21. Banks' vulnerability to liquidity and duration risks varies across countries



Note: For Panel A, the ratio is computed as currency and deposit liabilities (including interbank liabilities) over the sum of liquid assets: currency and deposits, and short-term debt securities. For Panel B, the data are for end-2021 and 2022 Q4 or the latest available quarter in 2022.
Source: OECD National Accounts database; OECD Financial Accounts database; and OECD calculations.

StatLink https://stat.link/l6xq75

A sharp correction in house prices or commercial real estate (CRE) prices could also exacerbate household and corporate solvency risks, leading to large potential losses for banks. CRE transaction activity has declined globally (IMF, 2023), and CRE prices have started to decline in the major advanced economies. By the fourth quarter of 2022, CRE prices were 1.8% and 2.9% below their most recent peaks in the United States and the euro area respectively, and monthly indicators based on Real Estate Investment Fund valuations point to further sharp declines in values this year. In the event of severe stress in property markets, banks could be forced to realise losses on loan portfolios if there were fire sales or foreclosures on a large scale, reducing the value of available collateral. A sharp repricing of CRE could weigh heavily on US regional bank balance sheets, as they account for a sizeable share of lending to the sector (FDIC, 2022). In addition, there have already been some signs of asset quality deterioration, amid rising bankruptcies and delinquency rates for mortgage loans in several countries (FOMC, 2023; Eurostat, 2023; Sverige Riksbank, 2022), which may require higher loss provisions and force banks to take steps to replenish their capital positions.

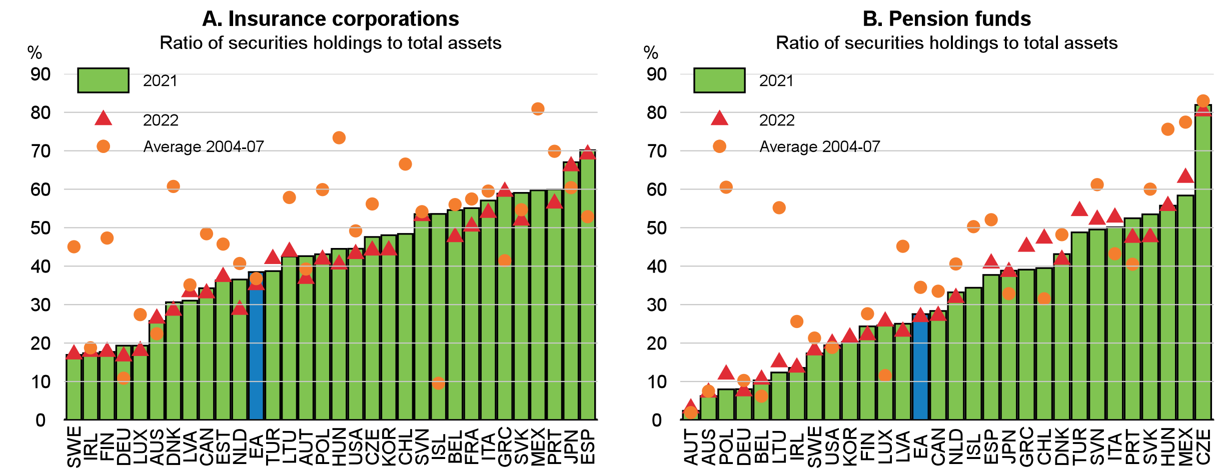
There are also broader indications that corporate bankruptcies have begun to increase in many countries, including in Europe, after a long period when they were at unusually low levels helped by pandemic-related support from governments. While a higher level of business failures is not surprising given the higher energy costs and debt servicing costs that firms face, a sharp acceleration could also place an additional source of stress on the balance sheets of lenders, including NBFIs.

Non-bank financial institutions now account for around 50% of global financial assets (FSB, 2022a), a significantly larger share than before the global financial crisis. Credit to firms by NBFIs in 2022 accounted for 20% of total outstanding loans to non-financial corporations in the euro area and 50% in the United Kingdom (ESRB, 2022; IMF, 2022a). NBFIs' provision of credit to households has also risen. For example, in 2021 more than 70% of mortgages were originated by NBFIs in the United States (Federal Reserve, 2022), NBFIs are particularly exposed to risks from liquidity mismatch and the use of derivatives and other forms of leverage to fund investments in illiquid assets (Bank for International Settlements, 2021). These institutions could come under stress in an environment of rising interest rates and declining asset prices if they are forced to realise large mark-to-market losses on their assets to try and meet sizeable margin calls on leveraged trades (due to the decline in collateral values). Such a scenario would be likely to further destabilise asset markets in the absence of prompt policy action. In addition, if NBFIs are forced to sell assets to accommodate outflows, a negative spiral could kick in, amplifying adverse market dynamics and generating a further tightening of financing conditions for non-financial corporations.

In many OECD countries, holdings of debt securities by MMFs and insurance companies stand at above 50% of total assets (Figure 1.22). Pension funds and financial companies engaged in securitisation could also be vulnerable given their use of leverage (ESRB, 2022). Further efforts are also needed to enhance the resilience of MMFs. Such funds could be vulnerable to large redemption calls and may face challenges in selling assets under stressed conditions (FSB, 2022b; Federal Reserve, 2023). Real estate investment funds could also incur severe losses if housing prices undergo sharp corrections (Daly et al., 2023).[5]

[5] Estimates suggest that a 100 basis points upward shift of the whole yield curve could lead to valuation losses of around 4% in the net asset value for bond funds operating in Europe, with more than one-third of funds facing losses higher than 5% of total assets and around 20% of funds facing losses above 7% (ESRB, 2022).

Figure 1.22. Debt securities are a sizeable share of total financial assets of insurers and pension funds



Note: Data for end-2021 and 2022 Q4 or latest available quarter in 2022.
Source: OECD National Accounts, financial accounts database; and OECD calculations.

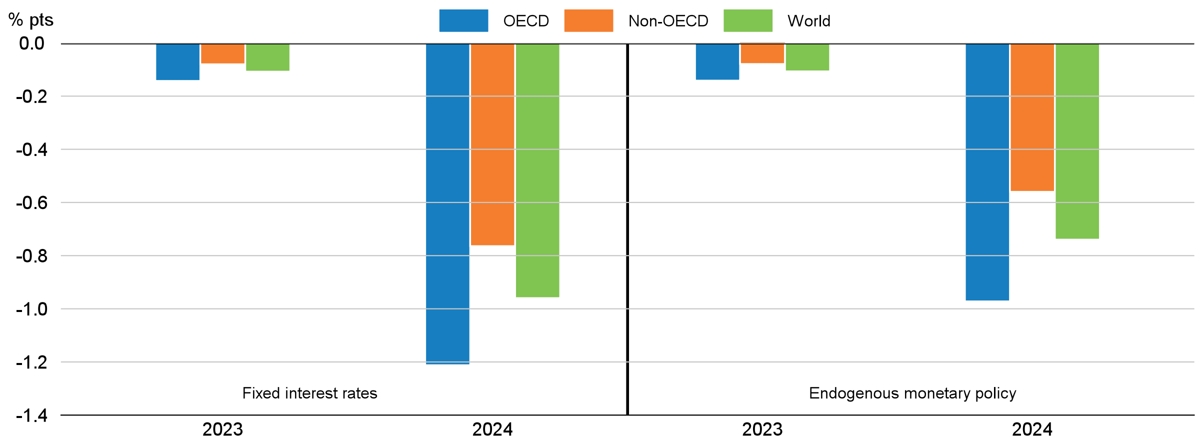
StatLink https://stat.link/1phyv2

Illustrative scenarios, using the NiGEM global macroeconomic model, highlight the potential implications for growth if financial stress were to result in the cost of finance for households and firms rising by more than expected in the advanced economies. The scenarios consider three particular financial shocks, a rise of 1 percentage point in the wedge between household borrowing and lending rates, a rise of 1 percentage point in the user cost of capital due to higher funding costs, and a rise of 50 basis points in equity risk premia. These shocks are largely between one-quarter and one-half of the corresponding changes seen in past stress episodes, although this varies across countries. In contrast to the global financial crisis, the shocks are not assumed to spread directly into financial conditions in the emerging-market economies, and credit remains available to households and firms but at a higher price than before. The illustrative shocks are assumed to apply in the latter half of 2023 and in 2024 before fading, and are treated as unanticipated shocks for firms, households and financial markets.

- In a scenario of this kind, for given policy settings, growth in the OECD economies could be lowered by around 1¼ percentage point in 2024, with global GDP growth reduced by almost 1 percentage point (Figure 1.23). This would push many advanced economies into or close to recession given the baseline projections for 2024. Higher financing costs would hit incomes, asset prices and domestic demand, with private sector investment declining by close to 7% relative to baseline in the advanced economies in 2024, equity prices dropping by close to 10% and unemployment rising by around ½ percentage point in the major economies. Inflationary pressures would also ease, by around 0.4 percentage points in the OECD economies in 2024. The emerging-market economies would be adversely affected due to weaker demand from the advanced economies, with growth in the non-OECD area declining by around 0.7 percentage points in 2024. If tighter financial conditions were to hit confidence, or generate significant stress in particular financial market segments, the adverse effects of the shocks would be stronger.

Figure 1.23. A further unexpected tightening of financial conditions would hit growth

Annual GDP growth, difference from baseline



Note: Illustrative scenarios with a rise of 1 percentage point in the wedge between household borrowing and lending rates, a rise of 1 percentage point in the user cost of capital, and a rise of 50 basis points in equity risk premia in all advanced economies from 2023Q3. Policy interest rates are held unchanged in all countries in the first scenario, but allowed to react in the second scenario.
Source: OECD calculations using the NiGEM macroeconomic model.

StatLink https://stat.link/viwnpj

- Macroeconomic policies can help to cushion part of these shocks. In particular, lower policy interest rates would mitigate the shocks, with the adverse impact on global GDP growth in 2024 reduced by around one-quarter. In the typical economy, policy interest rates are lowered by around 50 basis points in 2024, relative to baseline. An additional offset could be provided by fiscal policy if the automatic fiscal stabilisers were also allowed to operate fully in all countries, with budget deficit-to-GDP ratios rising relative to plans. Even in the absence of such a fiscal adjustment, the government debt-to-GDP ratio is around 2 percentage points higher by the end of 2024 in the median advanced economy (due to the lower level of GDP).

Tighter financial conditions could exacerbate vulnerabilities in emerging-market economies

Since November 2022, financial market conditions in emerging-market economies have been broadly stable. The appreciation of the US dollar has come to a halt, the reopening of China has boosted the growth prospects of some commodity exporters, and the spillovers from the recent banking stress in major advanced economies have been limited, with sovereign and corporate bond yields changing only marginally. However, increased financial market volatility, higher external indebtedness and large bank exposures to domestic sovereign debt are aggravating vulnerabilities in emerging-market and developing economies. Several low-income countries have faced increasingly tight financing conditions, with a rising debt service burden due to higher sovereign spreads and greater reliance on USD-denominated debt. In the medium run, climate-related risks could also dampen growth prospects and increase inflationary pressures in emerging-market and developing economies.

Emerging-market and developing economy sovereign debt issuance declined by about 7% (USD 300 billion) in 2022 (OECD, 2023d). Corporate debt issuance has also declined (World Bank, 2023) and portfolio inflows have slowed, with higher yields available in the advanced economies (Figure 1.24, Panel A).[6] Foreign-currency sovereign bond spreads and corporate bond yields have risen recently in all regions since early March, although they generally remain below the peaks seen in 2022 (Figure 1.24, Panels B and C). The pressures have been strongest in highly indebted low-income countries, many of whom are now in sovereign debt distress. About one-quarter of 62 emerging-market and developing economies now have a foreign-currency sovereign bond spread of more than 10 percentage points (Figure 1.24, Panel D) and more than 40% of sovereign debt is due within the next three years in low-income emerging-market and developing economies (OECD, 2023d).[7]

External debt and the exposure of domestic banking sectors to domestic government bonds have increased in emerging-market economies since the global financial crisis, although the nature of risks differs across economies.

- Among the countries with high external debt (Figure 1.25, Panel A), Argentina, Chile, Colombia, Malaysia, South Africa and Türkiye had short-term financing needs – defined as the sum of short-term debt due on a residual maturity basis and the cumulative current account deficit 12 months ahead – of more than 15 percentage points of GDP in 2022 (IMF, 2022b). The current account deficit widened by 0.8 percentage points of GDP in 2022 in the median emerging-market economy, and by more in commodity importers, with most of this deterioration driven by a worsening of the trade balance.[8]
- In addition, some countries with relatively high external debt, such as Costa Rica, Colombia, Malaysia and Romania, also experienced a sharp decline in their investment income balance. FDI inflows declined by 35% in the G20 emerging-market economies in 2022 (OECD, 2023c) although they have remained large enough to cover a sizeable portion of current account deficits in several Latin American countries, including Brazil, Colombia and Mexico. In other countries, there are risks of greater reliance on short-term external financing, potentially raising exposure to rollover risk.
- In countries where the banking system exposure to the government is large, such as Argentina and Egypt (Figure 1.25, Panel B), a loss of confidence or higher perceived sovereign risk would raise risks of an adverse feedback loop between sovereign and bank balance sheets.[9] This would also hinder private sector financing and growth, given that banks have been the main source of credit in emerging-market economies (Ehlers and Víllar, 2015).

In addition to potential financial tensions, emerging-market and developing economies continue to face medium-term climate-related risks, such as droughts, which could hurt growth prospects and reignite inflationary pressures (Kabundi et al., 2022). In particular, the higher share of food in consumption baskets (OECD, 2022a), continued pressures on food security, and lower resilience to extreme climate events in emerging-market and developing economies could lead to protracted inflationary effects (Faccia et al., 2021).

---

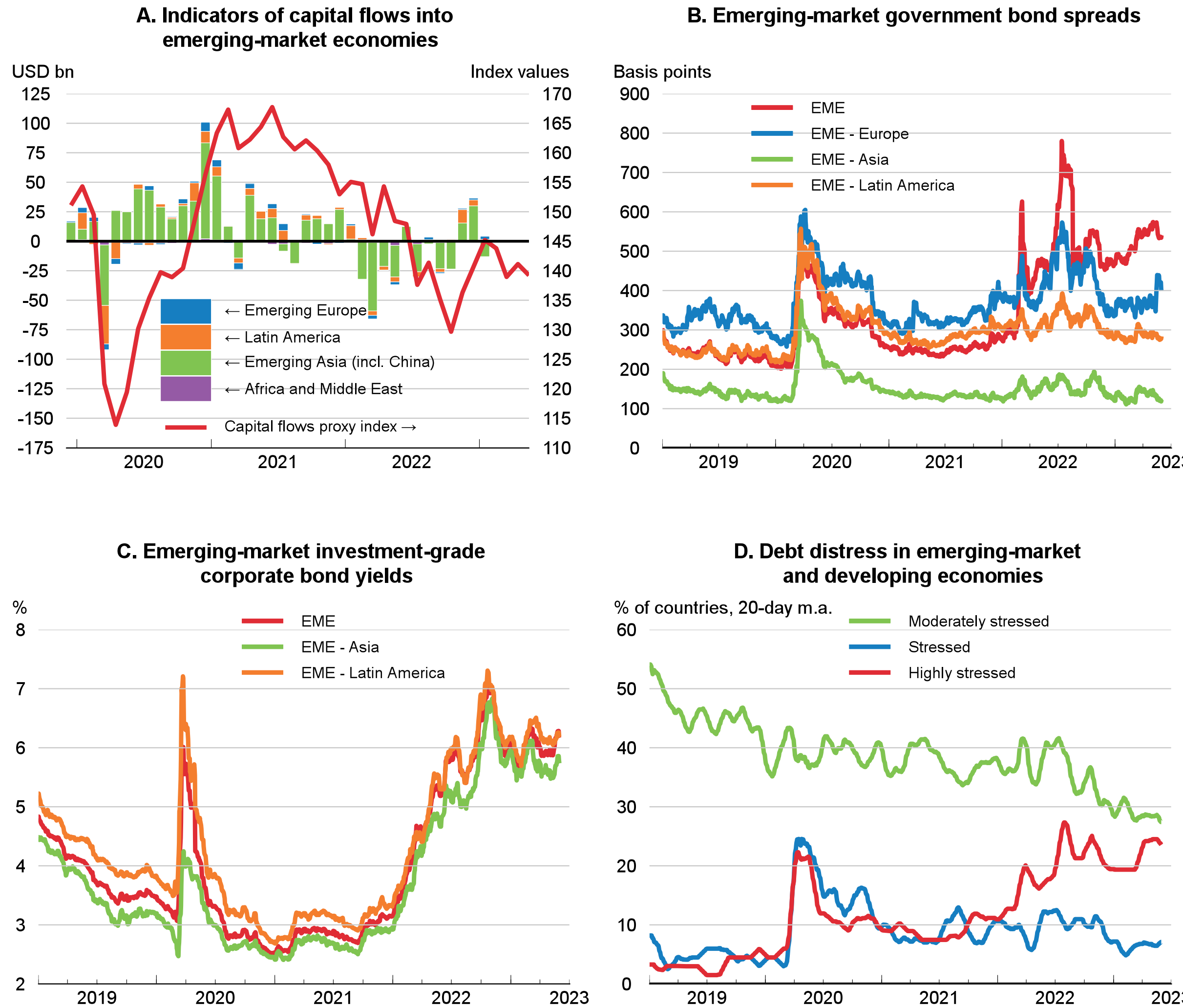
[6] In larger economies with better-than-expected fiscal outcomes, the slowdown in the pace of sovereign debt issuance partly reflects the intention to reduce the debt legacy of the pandemic. In contrast, in low-income countries, the decline in debt issuance is more related to the tightening of financing conditions in international capital markets.

[7] Since November 2022, credit rating agencies have downgraded the sovereign debt ratings of Argentina, Bangladesh, Egypt, Ethiopia, Ghana, Kenya, Nigeria, Pakistan, Sri Lanka, Tunisia and Ukraine. Over the same period, the IMF has approved: an Extended Fund Facility for Bangladesh, Côte d'Ivoire, Egypt, Sri Lanka and Ukraine; an Extended Credit Facility for Bangladesh, Côte d'Ivoire and Ghana; a Resilience and Sustainability Facility for Bangladesh; and a Flexible Credit Line for Morocco.

[8] Countries considered are Argentina, Bulgaria, Brazil, Chile, China, Colombia, Costa Rica, India, Indonesia, Mexico, Malaysia, Peru, the Philippines, Romania, Russia, Saudi Arabia, Thailand, Türkiye, Viet Nam and South Africa.

[9] For the median emerging-market economy shown in Panel B of Figure 1.25, the domestic banking system exposure to the domestic government in 2022Q2 was about 8 percentage points higher than for the median of 25 OECD advanced economies.

Figure 1.24. Financial market volatility has recently increased in emerging-market economies



Note: Panel A shows the gross portfolio inflows data from the OECD Monthly Capital Flow dataset for 21 emerging-market economies grouped by four geographical areas and the Bloomberg proxy index of capital flows. The latter is a monthly composite index, reflecting the performance of commodity, equity, foreign-currency-denominated government bond and currency asset classes. Increasing (decreasing) values of the index indicate capital flows into (out of) emerging-market economies. Panel B shows unweighted regional averages for the JP Morgan EMBI global bond spread, a measure of the sovereign risk spread of USD-denominated emerging-market economy government bonds over US government bonds. 'EME - Europe' covers Romania and Türkiye. 'EME - Asia' covers China, Indonesia, India, Malaysia, the Philippines and Viet Nam. 'EME - Latin America' covers Brazil, Chile, Colombia, Costa Rica, Mexico and Peru. The 'EME' aggregate covers all mentioned countries plus South Africa and Ukraine. Panel C shows unweighted regional averages for the ICE Bank of America Investment Grade Emerging Markets Corporate Plus Issuers yield. 'EME - Asia' covers China, Indonesia, India, Malaysia and Thailand. 'EME - Latin America' covers Brazil, Chile, Colombia, Mexico and Peru. The 'EME' aggregate also includes South Africa and Türkiye. In Panel D, countries are classified as 'Moderately stressed' if the JP Morgan EMBI global bond spread is between 300 and 700 basis points; 'Stressed' if the resulting spread is between 700 and 1000 basis points; and 'Highly stressed' if the resulting spread is greater than or equal to 1000 basis points. Based on 62 emerging-market and developing economies.
Source: OECD Monthly Capital Flow dataset; Bloomberg; Factset; Refinitiv; and OECD calculations.

StatLink https://stat.link/p3vtcj

Figure 1.25. External debt and the linkages between domestic banks and domestic sovereign bonds have risen in emerging-market economies

Note: In Panel A, local-currency denominated GDP figures are converted to USD using market exchange rates. Red triangles show 2015Q1 data for China, 2012Q1 data for Malaysia, 2010Q3 data for the Philippines and 2017Q1 data for Saudi Arabia. In Panel B, total bank assets are defined as the sum of claims of domestic depository corporations on domestic borrowers and non-resident borrowers. Bars show 2022Q1 data for Peru and 2021Q4 data for Russia. Triangle shows 2017Q1 data for Argentina.
Source: OECD Economic Outlook 113 database; World Bank Quarterly External Debt Statistics database; IMF Sovereign Debt Investor Base dataset; IMF International Financial Statistics; and OECD calculations.

StatLink https://stat.link/grflam

Risks from energy markets have not disappeared

In Europe, the risk of a critical shortage of energy supplies has diminished but not disappeared. Gas storage levels are near record levels for the time of year, contrary to earlier fears. Consumption has declined sharply in the face of record high prices, down by 17.7% in the EU in the eight months to March 2023, helped by warm weather during the Northern Hemisphere winter, investments in energy efficiency, and lower output from some energy-intensive industries. Liquefied natural gas (LNG) imports also remain at high levels, helped by new offshore storage capacity in some countries. There are also some residual imports by pipeline from Russia. Nonetheless, some challenges remain in securing sufficient storage levels for the 2023-24 winter. Supply from Russia in 2023 is likely to be minimal, in contrast to the early months of 2022, and a potential rebound in demand in China would increase competition for tight global LNG supply. This could push up energy prices once again, resulting in a renewed spike in consumer prices and further economic dislocation. Risks of higher prices also remain in oil markets, given continued uncertainty as to how output cuts by OPEC producers and Western sanctions on crude oil and oil products from Russia will affect global supply through the course of 2023.

Upside risks

While the balance of risks is skewed towards slower global growth and/or more persistent pressure on inflation, there is also a range of factors that could lead to more favourable macroeconomic outcomes.

- The dynamics of growth, employment and inflation since 2020 have largely reflected forces associated with the pandemic, including the policy responses to it. The exceptional nature of that episode and the reopening of economies means that there is necessarily a great deal of uncertainty about how those dynamics will evolve. In particular, stronger labour force growth than projected would boost output and facilitate disinflation. After a virtual freezing of international migration during the first phase of the pandemic, migration flows to a number of advanced economies have been very large, in part reflecting a catch-up from the interruption in 2020-21. A continuation of similar net inflows would push labour force growth in these countries above what is projected. There are also a number of countries, including the United States and the United Kingdom, where there is scope for more people to enter the labour force as reductions in domestic labour supply resulting from the pandemic are unwound.
- Another feature of pandemic-era labour markets in many economies has been the exceptionally high number of vacancies, often greatly exceeding the number of those looking for work. If labour demand can be cooled by a reduction in the excess of vacancies over jobseekers, with little if any increase in unemployment rates, then a given amount of disinflation can be achieved with more economic growth than otherwise. Relatedly, the ongoing unwinding of the shifts in the composition of demand associated with the pandemic (initially towards goods and subsequently towards services) could proceed more quickly and smoothly than expected, helping to moderate the currently persistent upward pressure on services price inflation.
- Among emerging-market economies, one source of possible upside risks is that better financial conditions could support investment, including foreign direct investment (FDI), and private sector balance sheets. This would boost overall investment and growth prospects and help to reduce the vulnerability of countries to sudden stops or reversals of capital inflows.

In addition, there are a number of possible shocks that could be favourable for growth while worsening the inflation outlook or vice versa. For example, a faltering of China's expected rebound this year, or stronger-than-expected effects from tighter monetary policy would likely help to bring down global inflationary pressures more quickly than projected, but would also weaken global growth. On the other side, if remaining pandemic-era excess savings are greater than estimated or if they are run down faster than projected, that would be positive for growth but would hinder the pace of disinflation.

Policy requirements

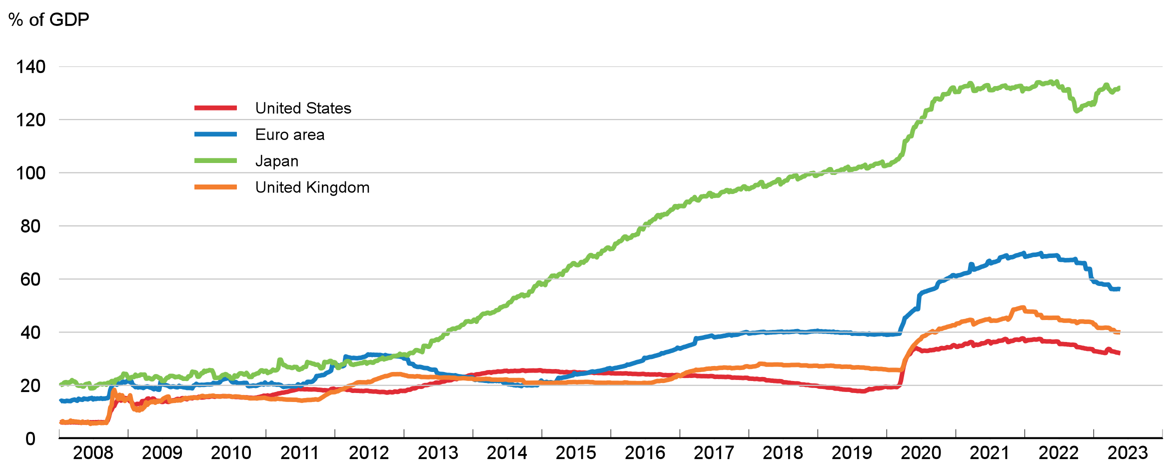
Persisting inflationary pressures, modest growth prospects and significant downside risks generate difficult challenges for policymakers. High interest rates will be needed for some time to come to ensure that inflationary pressures are durably reduced. In the event of additional financial market stress, central banks will need to make full use of the financial policy tools available to ensure adequate liquidity and minimise contagion risks. Lower energy prices and the upgrading of social benefits for past inflation mean that fiscal policy support to mitigate the impact of higher food and energy costs should be targeted only on vulnerable households inadequately covered by the general social protection system. This would reinforce incentives to reduce energy use and provide support to monetary policy in dealing with inflation. With government debt higher than prior to the pandemic in most countries, and governments facing future spending needs due to ageing and the climate transition, greater attention should be paid to ensuring debt sustainability. Rebuilding fiscal space is essential to conserve scarce resources to meet future policy priorities and respond effectively to future shocks. Stronger efforts are needed in all economies to address key structural challenges, including population ageing, climate change and digitalisation. Given the scale and ubiquity of these challenges, bold and sustained reforms will be needed to simultaneously reinvigorate growth and improve the quality of growth.

In advanced economies, monetary policy needs to remain restrictive for some time

Most central banks in advanced economies have continued to tighten monetary policy in recent months, even in the aftermath of the financial market turbulence in March. Policy rate increases have nonetheless tended to become smaller, and some banks have announced a pause to assess the impact of the cumulative tightening already delivered, as forward-looking real short-term interest rates have generally now become positive. Many central banks are also now reducing securities holdings, either by not (or not fully) reinvesting the proceeds of maturing bonds (passive quantitative tightening, QT) or by selling bonds (active QT). This has helped to reduce the size of central bank balance sheets in most advanced economies, although the need for enhanced liquidity provision in the wake of the banking stress in March temporarily pushed up central bank assets in some jurisdictions (Figure 1.26).

Figure 1.26. Most central bank balance sheets have begun to decrease

Central bank assets



Source: OECD Economic Outlook 113 database; Board of Governors of the Federal Reserve System; European Central Bank; Bank of Japan; Bank of England; and OECD calculations.

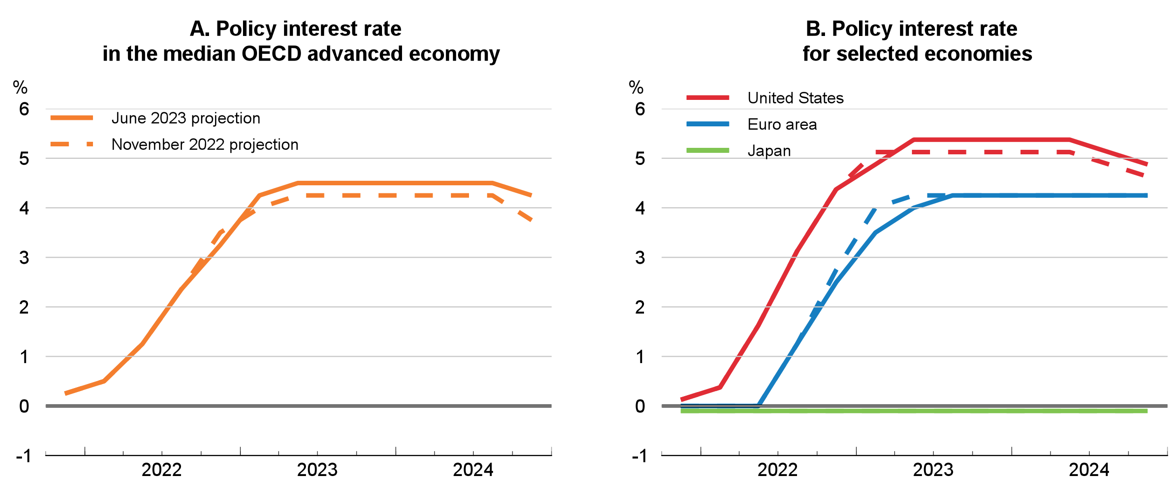
StatLink https://stat.link/k5g28s

Several quarters of positive forward-looking real interest rates and below-trend growth will likely be needed to lower resource pressures durably and achieve sustained disinflation, particularly where demand pressures are an important source of inflation (OECD, 2022b). However, calibrating domestic monetary policy actions is difficult, and policies will need to remain responsive to new data, given the uncertainty about the speed at which higher interest rates take effect, the potential spillovers from restrictive policy in other countries and tightening financial conditions. The impact of monetary policy tightening has started to appear in financial and housing markets, but no clear signs of a persistent decline in core inflation have been observed yet. Simultaneous tightening by many countries makes the transmission mechanism more complex and uncertain, especially for smaller economies, with stronger effects arising from weaker global demand and smaller effects on exchange rates from domestic policy actions. This could potentially increase the period of time needed to return inflation to target. Continuous communication efforts are needed to bridge the gap between central banks' stated intention of maintaining a restrictive policy stance for an extended period and market expectations of an early reduction in policy rates.

Policy interest rates in most countries are projected to have reached their peaks or are expected to do so in the next few months (Figure 1.27). Once inflation eases and converges towards central bank targets, policy rates may start to decrease in 2024 in some jurisdictions.

- In the United States, the federal funds rate is projected to peak at 5¼-5½ per cent from the second quarter of 2023. Two modest rate reductions are projected in the second half of 2024, as core inflation declines towards 2%. Bond holdings have continued to decline following a pre-announced path, and this is expected to persist. In the wake of some bank failures in March, the Federal Reserve introduced a new loan facility, the Bank Term Funding Program, which values eligible collateral at par rather than marked to market. Liquidity provision under this facility has slowed the pace of balance sheet reduction.
- In the euro area, where underlying inflation is still elevated, the main refinancing rate is projected to peak from the third quarter of 2023 and remain unchanged at 4¼ per cent until the end of 2024. With reinvestment of Asset Purchase Programme redemptions expected to cease altogether from July, QT should accelerate, but full reinvestment of maturing Pandemic Emergency Purchase Programme securities is expected to continue to make use of all margins of flexibility to limit financial fragmentation in the euro area.
- The Bank of Japan modified its conduct of yield curve control in December 2022, widening the range of the 10-year Japanese government bond yield fluctuations around the zero per cent target level from between around plus and minus 0.25 percentage points to between around plus and minus 0.5 percentage points. The Bank is projected to maintain an accommodative policy stance, with no increase in the policy rate until end-2024, reflecting still-subdued underlying price inflation. However, the yield curve is projected to gradually steepen over 2023-24 as gradual adjustments occur in the conduct of yield curve control.
- No further policy rate increases are projected in Canada and Korea, while in Australia and the United Kingdom rates are expected to peak from the second quarter of 2023. In all four cases, moderate rate reductions are projected in the second half of 2024. Except for Korea, central bank bond holdings are assumed to decline further.

Figure 1.27. Monetary policy is projected to remain restrictive



Note: Solid lines refer to the OECD June 2023 projections and dashed lines refer to the OECD November 2022 projections. In Panel A, advanced economies include Australia, Canada, the Czech Republic, Denmark, the euro area, Hungary, Iceland, Israel, Japan, Korea, New Zealand, Norway, Poland, Sweden, Switzerland, the United Kingdom, and the United States.
Source: OECD Economic Outlook 113 database; OECD Economic Outlook 112 database; and OECD calculations.

StatLink https://stat.link/r8uxqd

The monetary and financial authorities should continue to take actions to monitor and mitigate risks of financial instability. Clear communication will be necessary to minimise any uncertainty about apparent conflicts between the steps necessary to pursue the separate price stability and financial stability mandates. Key areas for action by supervisors and regulators include steps to ensure that smaller and medium-sized banks have adequate capital and liquidity ratios and formal plans to address any shortfalls and carrying out rigorous stress testing against credit and liquidity risks, particularly from property markets. Data gaps for non-bank financial institutions (NBFIs) also need to be closed and their regulation and supervision strengthened. If further market strains make additional liquidity support necessary, either to banks or non-banks, support should be priced at a relatively high level, have clear criteria, be time limited, and seek to minimise moral hazard. Solvency issues should not be addressed through central bank liquidity provision but be tackled within national resolution regimes that limit the need to resort to public funding (IMF, 2023).

Clear communication about the sizeable financial losses now being reported by many central banks would help to preserve central bank credibility and ensure the effectiveness of monetary policy. These losses arise from the rapid expansion of central bank balance sheets since the global financial crisis, declining prices of the assets held, especially long-term securities purchased under quantitative easing, and the impact of rapid policy rate increases on payments on commercial bank reserves held at the central bank (Box 1.3). The scale of reported losses could intensify further in the coming years. This is having an impact on the public finances by reducing or ending remittances from the central bank to the government. Reported central bank losses should not be taken as evidence of policy failure, as they follow from the pursuit of price stability, and need not entail weakened central bank independence, as central banks can operate effectively even with negative equity.

Box 1.3. Do central bank losses matter?

After recording sizeable gains from quantitative easing (QE) over most of the past decade, several central banks in advanced economies have recently reported financial losses, often likely to persist in the coming years. Losses largely reflect the large balance sheets built up during an extended period of QE and the effects of the recent rises in policy interest rates. This Box analyses the key drivers of those losses and their potential impact on the public finances and on the credibility and policy effectiveness of the central bank.

Increases in policy rates reduce the net interest income of central banks. QE created a sizeable mismatch in the maturity of central bank assets and liabilities. On the liability side, central bank reserves (mainly commercial bank deposits) rose sharply. The remuneration on these is closely linked to policy interest rates, and has thus risen rapidly, to the benefit of commercial banks, as policy rates are raised. In contrast, on the asset side, most of the assets purchased under QE were long-term fixed-rate bonds that generate a relatively stable stream of income. When policy interest rates were at or close to the zero lower bound, the balance of these two sets of payments generated gains for central banks. Even as policy rates were raised through 2022, their impact on whole-year net interest income was still relatively mild (Figure 1.28), especially where most rate increases took place towards the end of the year, as in the euro area. However, larger impacts are likely in 2023 and 2024 (Anderson et al., 2022; De Nederlandsche Bank, 2022).

Increases in interest rates also reduce the market value of securities, and valuation losses may thus arise. However, the timing and magnitude will depend on the accounting frameworks used by central banks and asset sales decisions. For instance, the Federal Reserve and the Bank of Japan account for securities held for monetary policy purposes using amortised cost. Hence valuation changes do not affect profits until securities are sold, which has not been the case so far. Eurosystem accounting guidelines, also followed by Sweden, allow central banks to value securities held for monetary policy purposes at either amortised cost or the current market price (Kjellberg and Åhl, 2022). While euro area national central banks have generally opted to use amortised cost, the Riksbank has adopted market pricing, making a significant loss apparent in 2022. Mark-to-market accounting brings forward loss recognition. Other central banks which use current market prices for securities held for monetary policy purposes, including Australia, Canada, New Zealand, Switzerland and the United Kingdom, also recorded, or are expected to have recorded, significant losses in 2022 (unless indemnified by their governments, see below). In Switzerland, where the central bank loss was unusually large, at 17 per cent of GDP, losses stemmed largely from changes in the domestic currency value of foreign exchange reserves, including foreign securities.

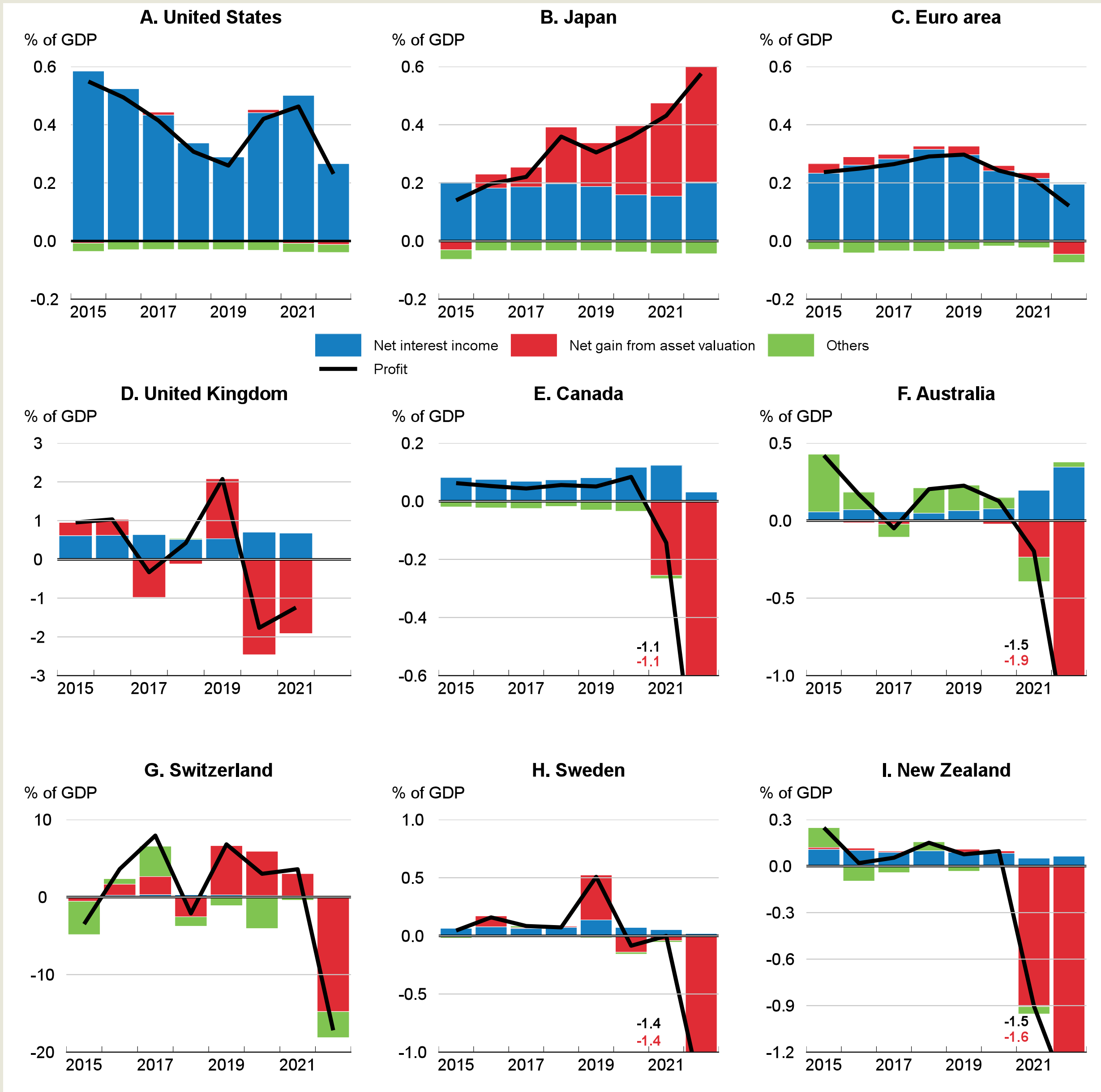
Central bank losses will weigh on the public finances. While institutional arrangements vary widely across countries, losses will in general mean lower or no central bank payments to the Treasury in the form of income taxes or remittances. In addition, reverse cash flows (i.e., payments *from* the Treasury) may occur if central banks are entitled to be compensated by the government for certain losses, such as QE-related losses. For instance, in the United Kingdom, the Bank of England Asset Purchase Facility (APF), through which QE asset purchases were conducted, is fully indemnified by the Treasury. Such indemnified losses are a contingent liability for the government. The annual impact on the general government fiscal balance should in general be modest (Figure 1.29), but potentially protracted, as losses may persist for several years. Even after the central bank returns to profits, some time may elapse before remittances to the Treasury resume.[1]

From a broader public sector perspective, QE has effectively shortened the average maturity of debt. Consolidating the balance sheets of the general government and the central bank, QE has to a large extent replaced long-term fixed-rate bonds by short-term floating-rate bank reserves (OBR, 2022). While this change may ultimately unwind if central banks take their balance sheets back to pre-QE levels, interest rate increases are currently transmitted more rapidly to debt service costs than would otherwise have been the case.

Central bank losses are not an indication of a policy error. The policy mandates of central banks include price stability and financial stability, but not profit maximisation. Their current losses, as well as their earlier gains from QE, are a by-product of policy actions to achieve their mandates and have long been anticipated (in the case of the United Kingdom, at least since November 2012; Bank of England, 2012) Moreover, since central banks are not subject to capital adequacy requirements or bankruptcy procedures, they can operate effectively even with negative equity, as the central banks of Chile, the Czech Republic, Israel and Mexico have done over several years (Bell et al., 2023).

However, losses or negative equity may pose communication challenges. For instance, some policy decisions, such as not pursuing active QT, could be wrongly interpreted as motivated by a desire to contain losses rather than being necessary to pursue specific mandates, reducing central bank credibility. Likewise, financial flows from government, including any decision to strengthen central bank capital positions, could be perceived as endangering central bank independence. This underscores the importance of clear communication about the reasons for losses and of a transparent framework to account for financial flows between the central bank and the government.

Figure 1.28. Several central banks now report negative profits

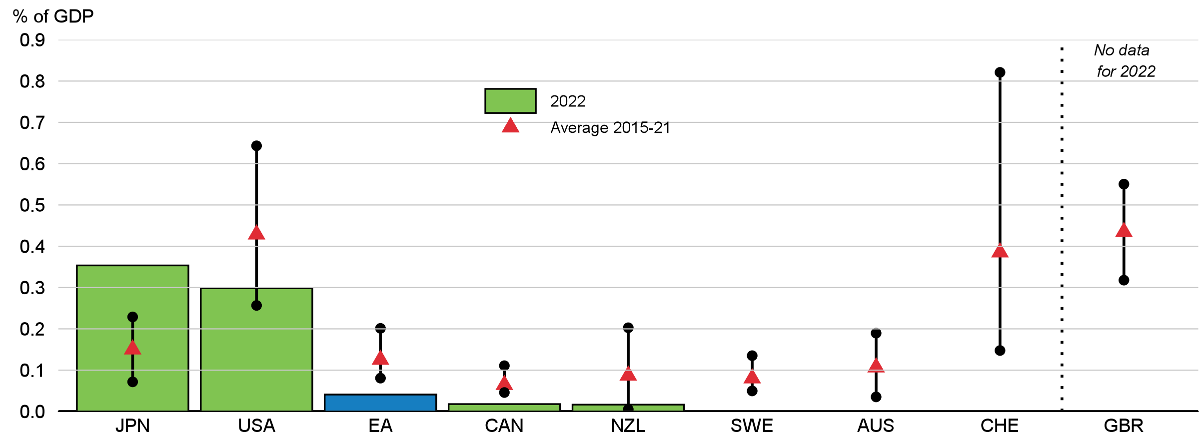


Note: Accounting approaches and financial years differ across countries and data should therefore be compared with caution. 'Net gain from asset valuation' includes realised gains/losses from financial transactions and, depending on accounting frameworks, may also comprise unrealised asset valuation gains/losses. Transfers from/to risk provisions are excluded, as these are often discretionary. 'Profit' excludes income taxes, transfers from/to risk provisions and net indemnities to/from government, and in some countries thus differs from profit as reported by the central bank. For Japan and the United Kingdom, results for the financial year ending in March or February of calendar year *n* are depicted under year *n-1*. For Australia and New Zealand, results for the financial year ending in June of calendar year *n* are depicted under year *n*. In these cases, ratios to GDP are defined taking the quarterly GDP observations that come closest to the financial year. For the euro area, the chart shows the consolidated result of national central banks (for 2022, only those central banks having published their results by 31 May 2023 – twelve altogether, including those of the four largest euro area economies). For the United Kingdom, the chart shows the consolidated result of the Bank of England and the Asset Purchase Facility.

Source: Board of Governors of the Federal Reserve System; Bank of Japan; national central banks in the euro area; Bank of England; Bank of Canada; Reserve Bank of Australia; Swiss National Bank; Sveriges Riksbank; Reserve Bank of New Zealand; OECD Quarterly National Accounts database; and OECD calculations.

StatLink https://stat.link/co75wz

Figure 1.29. Net transfers from the central bank to general government have declined



Note: Accounting approaches and financial years differ across countries and data should therefore be compared with caution. The chart shows net transfers from central bank to government in the form of income tax, dividends or remittances paid to the Treasury and (for Canada, New Zealand and the United Kingdom) indemnities. The range line shows the maximum and minimum values between 2015 and 2021. For the euro area, the chart shows consolidated figures for national central banks (for 2022, only those central banks having published their results by 31 May 2023 – twelve altogether, including those of the four largest euro area economies). For the United Kingdom, the chart shows consolidated figures for the Bank of England and the Asset Purchase Facility. For Japan and the United Kingdom, results for the financial year ending in March or February of calendar year n are depicted under year n-1. For Australia and New Zealand, results for the financial year ending in June of calendar year *n* are depicted under year *n*.
Source: Board of Governors of the Federal Reserve System; Bank of Japan; national central banks in the euro area; Bank of England; Bank of Canada; Reserve Bank of Australia; Swiss National Bank; Sveriges Riksbank; Reserve Bank of New Zealand; OECD Quarterly National Accounts database; and OECD calculations.

StatLink https://stat.link/yjnzqf

1. For instance, the Federal Reserve records losses as a negative liability – a “deferred asset” to be covered by future profits. Remittances to the government will be suspended as long as the “deferred asset” exists.

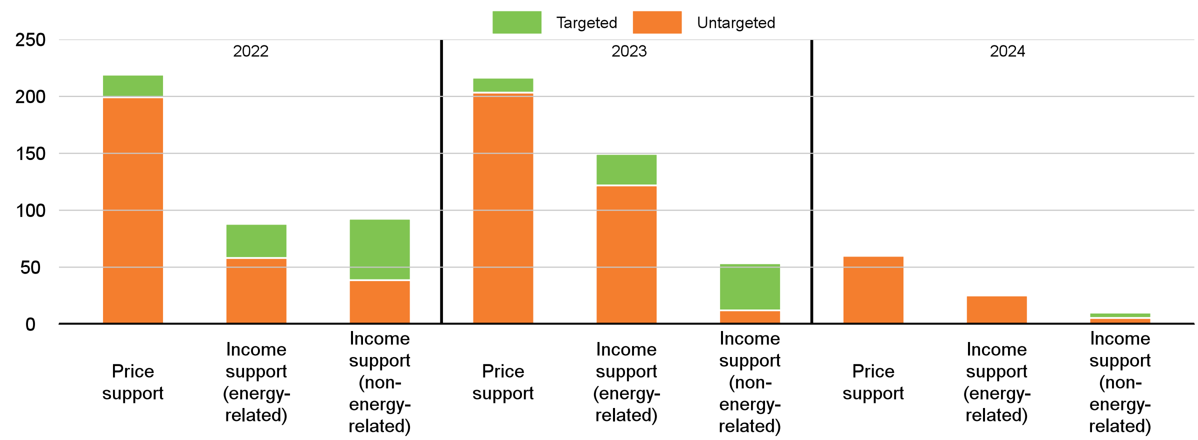
Fiscal support needs to be refocused

Many governments are continuing to provide sizeable support to energy consumers at present. The estimated budget cost of the measures in force this year is about 0.8% of GDP in the median OECD economy, broadly unchanged from 2022, and 2% of GDP or more in several European countries, including Germany and Poland (OECD, 2023a). The eventual fiscal costs will heavily depend on the evolution of energy market prices and energy consumption, and could therefore be lower than originally budgeted because extensive use has been made of measures such as price caps or lower VAT rates on some or all of the energy consumed. A gradual phasing out of energy support is expected over 2023-24 and will likely result in a substantial reduction in fiscal costs in 2024, though considerable uncertainty still surrounds policy plans in many countries (Figure 1.30). At the same time, declining inflation in 2023-24 is likely to weigh on fiscal balances, as the higher-than-expected tax revenues stemming from inflationary surprises in 2022 give way to higher expenditure associated with public wage increases and the indexation of numerous social benefits (and also minimum wages) to past inflation.

Fiscal projections for 2023-24 are conditional on announced government measures and OECD assessments of current plans (Annex 1.A.). Modest fiscal consolidation is expected in many countries, with the underlying primary balance in the median OECD economy improving by 0.2% of potential GDP in 2023 and 0.5% of potential GDP in 2024 (Figure 1.31).

Figure 1.30. Fiscal support to mitigate energy costs remains sizeable and mostly untargeted

Cost of energy-related fiscal support by type of measure, USD billion, calculated using 2022 bilateral exchange rates



Note: Based on an aggregation of support measures in 41 countries, of which 35 are OECD economies (all members except Hungary, Iceland and Switzerland) and 6 are non-OECD economies (Brazil, Bulgaria, Croatia, India, Romania and South Africa). Support measures are taken in gross terms, i.e., not accounting for the effect of possible accompanying energy-related revenue-increasing measures, such as windfall profit taxes on energy companies. Where government plans have been announced but not legislated, they are incorporated if it is deemed clear that they will be implemented in a shape close to that announced. Measures classified as credit and equity support are not included. When a given measure spans more than one year, its total fiscal costs are assumed to be uniformly spread across months. For measures without an officially announced end-date, an expiry date is assumed and the fraction of the gross fiscal cost that pertains to 2022-24 has been retained. For Japan and Spain, it has been assumed that some existing measures will be extended further into 2023 or 2024, even though that extension has not been decided or announced by the authorities.
Source: OECD Energy Support Measures Tracker.

StatLink https://stat.link/2oftjv

- In the United States, the fiscal stance is projected to be moderately contractionary in 2023-24, largely reflecting the full expiry of pandemic-related spending and the phasing-out of energy-related fiscal support at the state level. The increase in public investment under the Infrastructure Investment and Jobs Act will be modest, given the 10-year horizon of the plan.

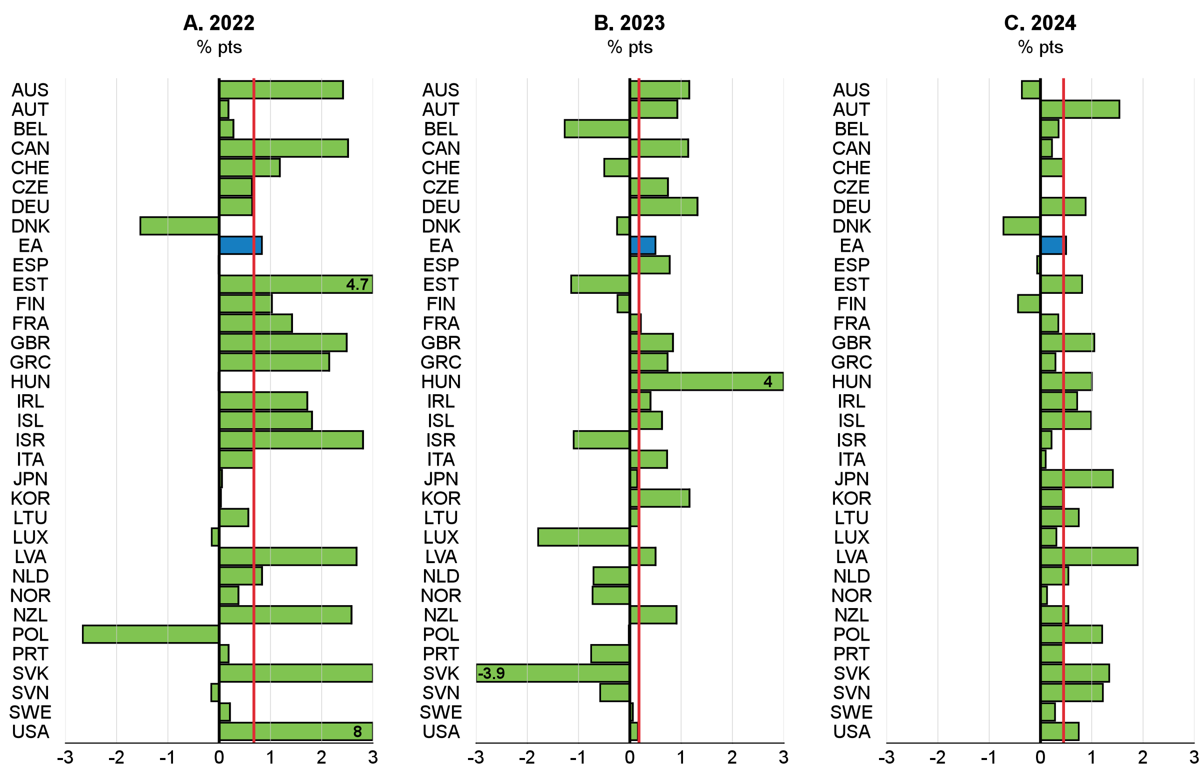
- In the euro area, moderate fiscal consolidation is also expected, mainly reflecting savings in 2023 from the full withdrawal of pandemic support and the gradual phasing out of energy-related support in 2024. In some countries, stimulus from an expected faster implementation of Next Generation EU plans and increased spending on defence, healthcare or inflation-indexed social benefits will moderate the improvement in underlying primary balances.

- In Japan, the fiscal stance is projected to be largely neutral in 2023, as the phasing out of pandemic-related measures broadly cancels out expanded support to vulnerable households against higher energy and food prices and increased defence spending. Measures for moderating energy and food prices are then projected to gradually decline, leading to a more restrictive fiscal stance in 2024, with a sizeable improvement in the underlying primary balance.

- Among other large advanced economies, the United Kingdom has a restrictive fiscal stance, with a cumulative increase in the underlying primary balance of almost 2% of potential GDP over 2023-24. More limited tightening is projected in Australia, Canada and Korea. Among smaller economies, Hungary plans a cumulative consolidation effort of 5% over 2023-24, reflecting efforts to reduce inflationary pressures and rebuild fiscal buffers. In contrast, the Slovak Republic envisages a large discretionary expansion in 2023, only partly reversed in 2024, linked in part to the introduction of temporary measures to mitigate the effects of the energy crisis.

Figure 1.31. Moderate fiscal consolidation is projected in most countries

Change in the ratio of the underlying primary balance to potential GDP



Note: Vertical red lines indicate the medians for OECD advanced economies.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/1s3byc

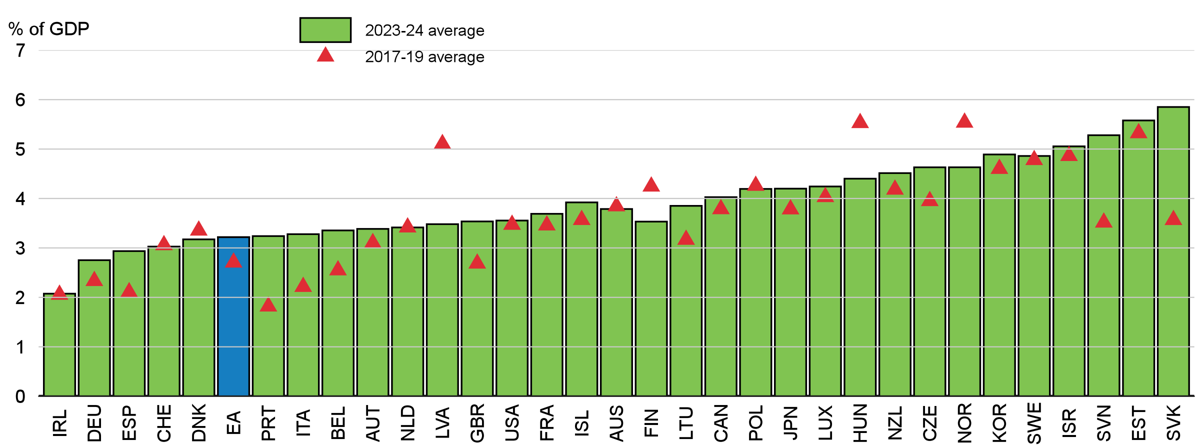
With energy and food commodity prices below their 2022 peaks but generally still above the levels seen only a few years ago, there is a strong case for withdrawing broad policy support but continuing to provide some targeted support for vulnerable households inadequately covered by the general social protection system. In many countries, recent and ongoing increases in minimum wages and welfare benefits, either through discretionary compensation for past inflation or automatic indexation to it, are now an effective mechanism to provide necessary support, with the advantage of not lowering marginal energy prices or weakening incentives to reduce energy use. Preserving untargeted measures to reduce energy prices blurs these incentives, places unwarranted pressure on the public finances, duplicates support to many lower-income households and boosts aggregate demand at a time of high inflation. This adds to the challenges faced by monetary policy in bringing inflation back to target, and raises the risk that high underlying inflation will persist.

However, providing support only to existing welfare recipients may be insufficient, as vulnerability to high energy prices does not depend on income alone. Other sources of vulnerability include the inability to renovate energy-inefficient dwellings and high energy needs due to age, illness or geographical factors. This points to a need to maintain or develop improved targeted measures that go beyond standard welfare benefits by combining indicators from different databases, and also making broader use of digital tools for data collection (such as smart meters) and faster payment delivery (OECD, 2023a). In countries with weaker welfare systems, broader policy support to energy users may be needed for longer, but even in these cases it should become more targeted, incentivise energy efficiency and facilitate adjustment to higher energy costs. These latter considerations should also govern any remaining support to firms.

Reducing vulnerability to future energy crises and the need to accelerate the transition towards carbon neutrality also requires a substantial increase in government investment in many countries, including in the energy efficiency of public buildings, charging infrastructure for electric vehicles, energy grids and interconnections, and public R&D. Encouragingly, public investment as a share of GDP is often projected to increase in 2023-24, rising above pre-pandemic levels, especially in countries where it has been low (Figure 1.32). Still, the contribution of public investment to GDP growth is expected to be modest, at only an average 0.1 percentage points of GDP per year in 2023-24 in the median OECD advanced economy. In Europe, the rise in public investment largely reflects an expected acceleration in the implementation of Next Generation EU investment plans (European Commission, 2022), after delays that have previously held back spending. Those delays, which have long characterised cohesion policy (OECD, 2018), have been exacerbated by high inflation, which has made budgeted amounts for specific projects insufficient or unattractive for tendering.

Ensuring the sustainability of the public finances over the longer term has become more pressing and should become a more prominent policy objective. In the median OECD advanced economy, gross public debt as a per cent of GDP is projected to stay broadly unchanged over 2023-24, and remain 7 percentage points higher in 2024 than in 2019. Despite some consolidation in the next two years, primary budget balances in 2024 are often projected to remain well below pre-pandemic levels (by 1.3% of GDP in the median OECD advanced economy; Figure 1.33) and will be subject in the coming decades to large pressures from factors such as ageing and the climate transition. Government spending on pensions, health and long-term care in the median OECD advanced economy is estimated to rise by around 5% of GDP by 2060 in the absence of policy reforms (Guillemette and Château, 2023). Debt service costs are also rising, with a significant jump in interest payments projected by 2024 (0.5% of GDP higher than in 2022 in the median OECD advanced economy) and subsequent further rises all but certain as low-yielding debt matures. In 2024, the cost of new sovereign borrowing is projected to exceed the average cost of the existing stock of public debt in most countries, often by a large margin. Credible fiscal frameworks with strong national ownership would help to provide clear guidance to citizens and markets about the medium-term trajectory of the public finances needed to ensure a gradual reduction of debt-to-GDP ratios.

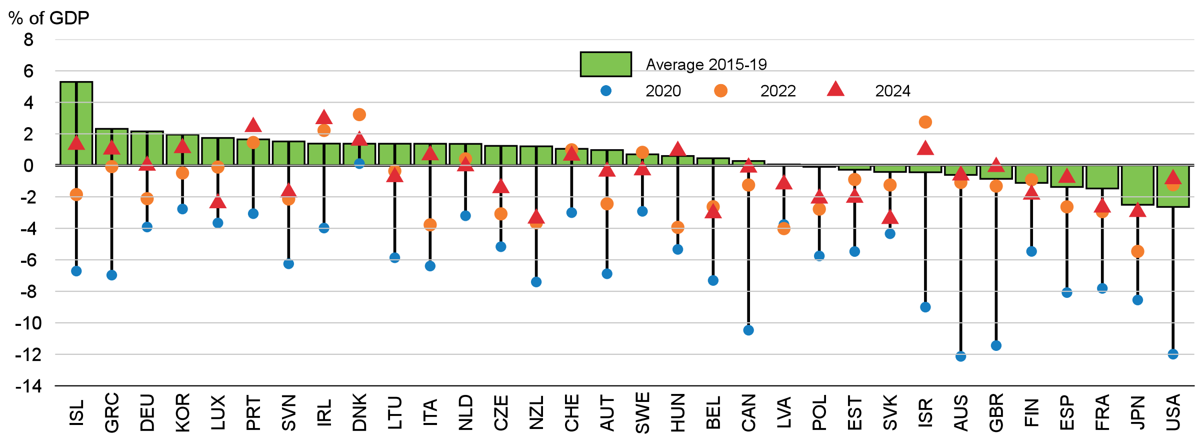
Figure 1.32. Public investment is projected to increase in most countries



Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/eqnir6

Figure 1.33. Primary budget balances are often still below pre-pandemic levels



Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/hb547m

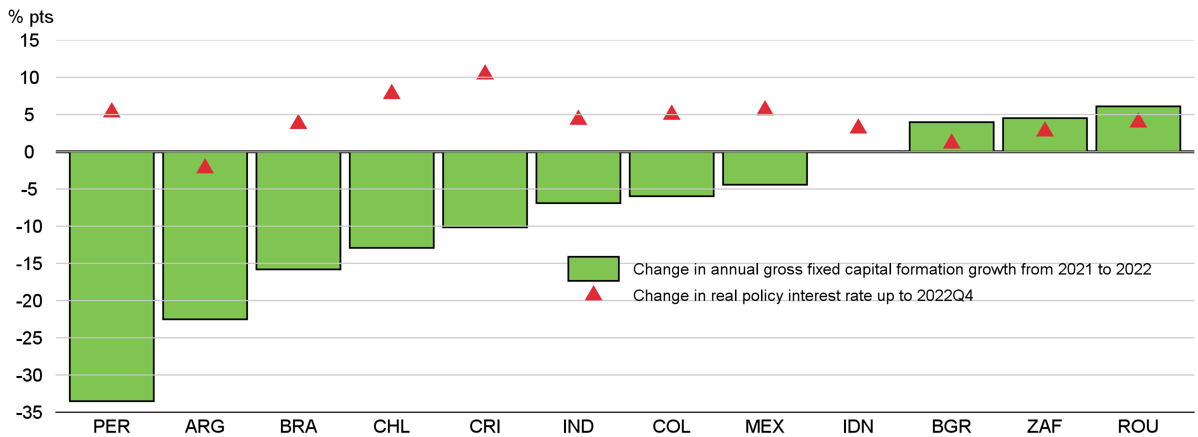
In emerging-market economies, monetary policy should remain focused on inflation and fiscal buffers should be rebuilt

Monetary policy has become restrictive in many emerging-market economies, reflecting persisting inflation pressures and policy tightening in advanced economies. Real policy interest rates are now positive in most economies, particularly ones in which policy rates were raised relatively early, and this has begun to slow investment growth (Figure 1.34) and real GDP growth.

Policy space remains limited by the need to keep inflation expectations anchored and tight global financial conditions. Policy interest rates are generally projected to remain above both headline and core inflation in the remainder of this year (Figure 1.35, Panel A), with headline inflation falling sharply thanks to the easing in food and energy prices, but underlying inflation proving more persistent. In 2024, both headline and underlying inflation are often projected to return to central bank target ranges, providing some scope for policy rate cuts if inflation expectations remain anchored. However, policy rates may need to remain high for longer in economies where large minimum wage increases to cushion the impact of the cost-of-living crisis are adding to underlying inflationary pressures.

Given the recent increase in global risk aversion, and the risks of a renewed appreciation of the US dollar, monetary easing may require careful consideration in countries with sizeable foreign currency denominated debts. In the event of renewed exchange rate pressures, countries should let their currencies adjust as much as possible to reflect underlying economic fundamentals. However, temporary use of foreign exchange interventions, or restrictions on capital flows, could be considered if there are severe risks to domestic financial stability.

Figure 1.34. Tighter monetary policy is slowing investment growth in most emerging-market economies



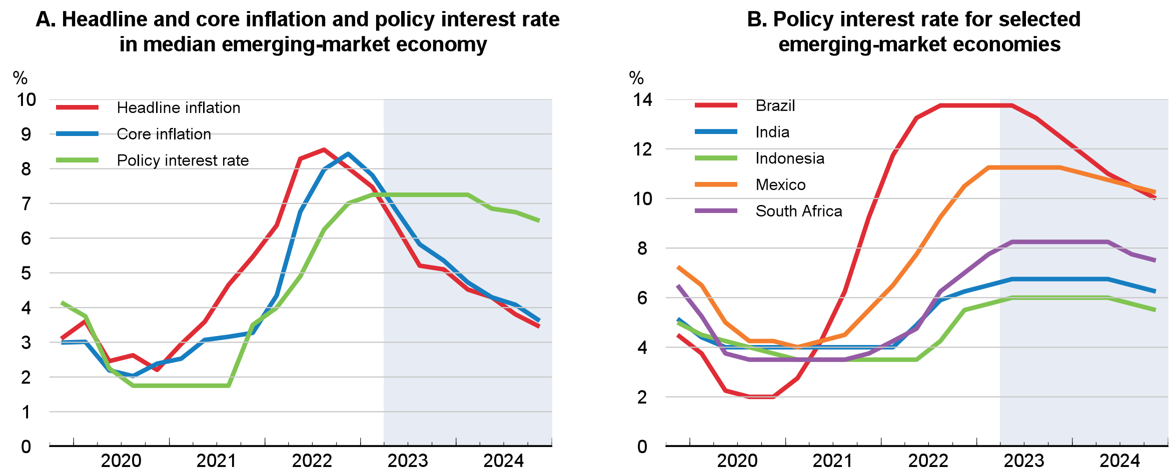
Note: Real policy interest rates in quarter t are obtained from (end-of-quarter) nominal policy rates and annual consumer price inflation from quarter t-2 to quarter t+2. The change in the real policy interest rate is relative to the quarter preceding the first policy rate increase in each country in the current tightening cycle.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/l4qpuv

In Latin America, policy rate reductions are not expected in Chile, Colombia and Mexico before 2024 due to persistent underlying inflation dynamics and minimum wage increases (Figure 1.35, Panel B). In contrast, policy rates in Brazil are projected to start declining in 2023, with tighter credit conditions expected to steadily reduce core inflation. Continuing food price pressures in India, the need to firmly anchor inflation expectations in Indonesia and the broad-based inflationary impact of the projected slow pace of fiscal tightening in South Africa may prevent policy rates in these countries from declining until well into 2024.

Public debt remains well above pre-pandemic levels in most emerging-market economies. However, fiscal deficits declined in 2022 in many countries, helped by elevated inflation and higher commodity-related fiscal revenues in commodity-exporting countries (Figure 1.36, Panel A). The evolution of government fiscal balances over 2023-24 is expected to vary across the major emerging-market economies (Figure 1.36, Panels B and C). Some commodity exporters have used windfall revenues to finance energy-related fiscal support, and there are risks of higher deficits once commodity prices subside. For instance, the exclusion of social spending from the expenditure ceiling in Brazil and meagre growth in South Africa are projected to lead to an increase in the budget deficit in 2023. In such cases, establishing or reinstating credible fiscal rules and decoupling public finances from the commodity-cycle are needed to ensure better macroeconomic stabilisation and a further decline in public debt towards pre-pandemic levels. In India, the fiscal position is projected to improve, helped by greater tax compliance, fewer subsidies and ongoing privatisation of state-owned enterprises. This should be coupled with steps to strengthen revenue mobilisation, further improve public financial management and enhance expenditure efficiency. In Indonesia, fiscal rules are projected to be reinstated, ensuring a significant improvement in fiscal balances.

Figure 1.35. Monetary policy is projected to remain restrictive in many emerging-market economies

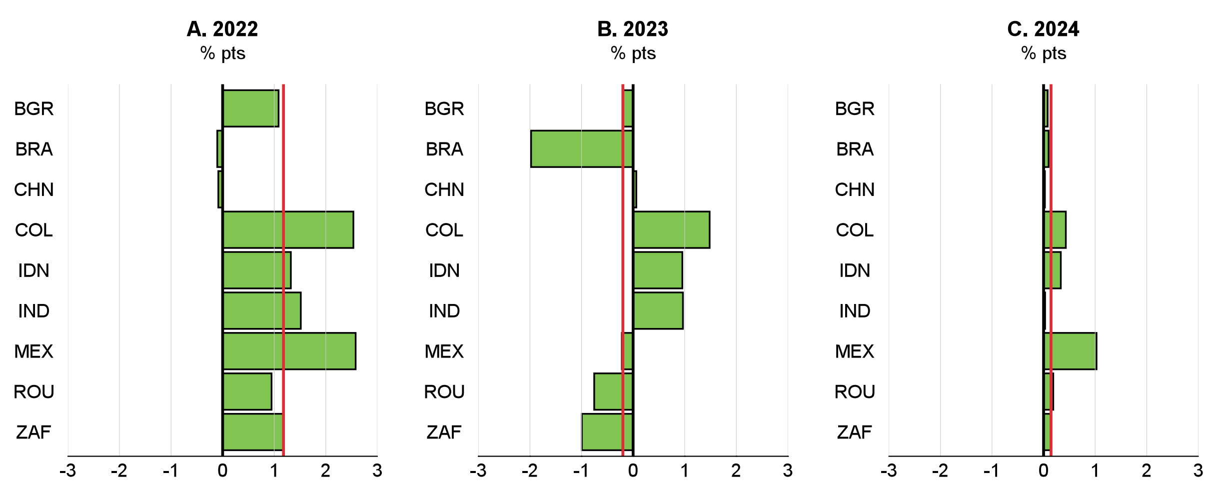


Note: In Panel A, the emerging-market economies considered are Brazil, Bulgaria, Chile, China, Colombia, Costa Rica, India, Indonesia, Mexico, Peru, Romania, Saudi Arabia and South Africa for year-on-year headline inflation and the policy interest rate, and Brazil, Bulgaria, Chile, Colombia, Costa Rica, Mexico, Peru, Romania and South Africa for year-on-year core inflation.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/gxnacz

Figure 1.36. Fiscal balance trajectories are projected to differ across emerging-market economies

Change in the ratio of the general government financial balance to GDP



Note: For India, data refer to fiscal years starting in April. Vertical red lines indicate the medians for the nine emerging-market economies considered.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/3y0p86

Stronger structural reform efforts are needed to reinvigorate growth, bolster resilience and improve equity

Many economies face a dual imperative of reinvigorating underlying trend growth and improving the quality of that growth. The unwinding of the pandemic and energy-price shocks presents an opportunity to refocus attention on these critical longer-term challenges, thus laying the basis for stronger, more inclusive and more sustainable growth. The slow growth being experienced in many countries this year continues a longer period of worsening dynamism. Trend growth since the global financial crisis has been much weaker than previously (Figure 1.37, Panel A), both in advanced and emerging-market economies. The main factor in that deterioration has generally been lower rates of underlying labour productivity growth, augmented by slower growth of the working-age population as population ageing has progressed. The slowdown in labour productivity growth in turn reflects both smaller increases in capital per worker and slower growth of total factor productivity (productive efficiency). Productive capital investment in OECD economies has been much weaker since 2010 than it had been in past decades (Figure 1.37, Panel B), and total factor productivity has also grown more slowly in recent years. This prolonged slowdown highlights the need for supply-boosting structural reforms, especially given that recent experience suggests that interacting adverse supply shocks, such as the pandemic, the war in Ukraine, geoeconomic fragmentation and more frequent extreme weather events, are becoming more common.

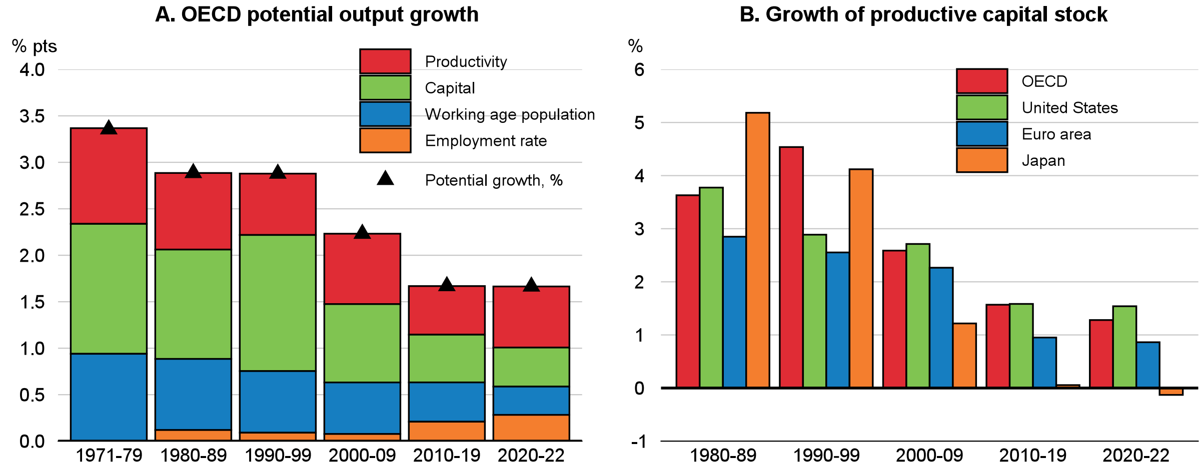
There are many things that policymakers can do to lift investment rates from their currently low levels, with priorities depending on country-specific circumstances (OECD 2023b). A key cross-cutting element is the need to enhance competition to ensure that firms have incentives to undertake investment and improve efficiency. A large body of evidence points to weaker competition in recent years: industry concentration and mark-ups have been rising (De Loecker et al., 2020; Box 2); firm entry and exit rates have been falling (Calvino et al., 2020); and the gap between the best firms (the productivity “frontier”) and others has been growing (Andrews et al., 2016).

In most OECD economies, policy priorities to enhance competitive pressures and investment incentives include reforms to sector-specific and economy-wide regulations, including the streamlining of licensing and permits. Other priorities include tax reforms, to shift from direct to indirect taxation and broaden the tax base, and greater efforts to upgrade physical infrastructure. Insolvency regimes that do not excessively penalise debtors can also have beneficial effects, by facilitating the exit of less productive firms and freeing-up resources for more productive ones. For emerging-market economies, it is often most important to boost business dynamism and knowledge diffusion via measures that reduce the cost of entry, including by lowering barriers to trade and investment, expanding regulatory impact assessments, and strengthening the rule of law.

Making the most of new investments and technologies requires complementary investments in technical and managerial skills. Public policies have a crucial role to play in raising the quality and quantity of human capital by promoting training and by facilitating productive matches of workers to jobs. Labour market regulations should avoid putting a burden on workers who wish to move jobs. Limiting unnecessary differences in the licensing requirements of certain occupations would also ease barriers for workers with relevant skills in finding suitable jobs.

Figure 1.37. Underlying growth prospects and investment have slowed

Per cent, average per annum over period shown



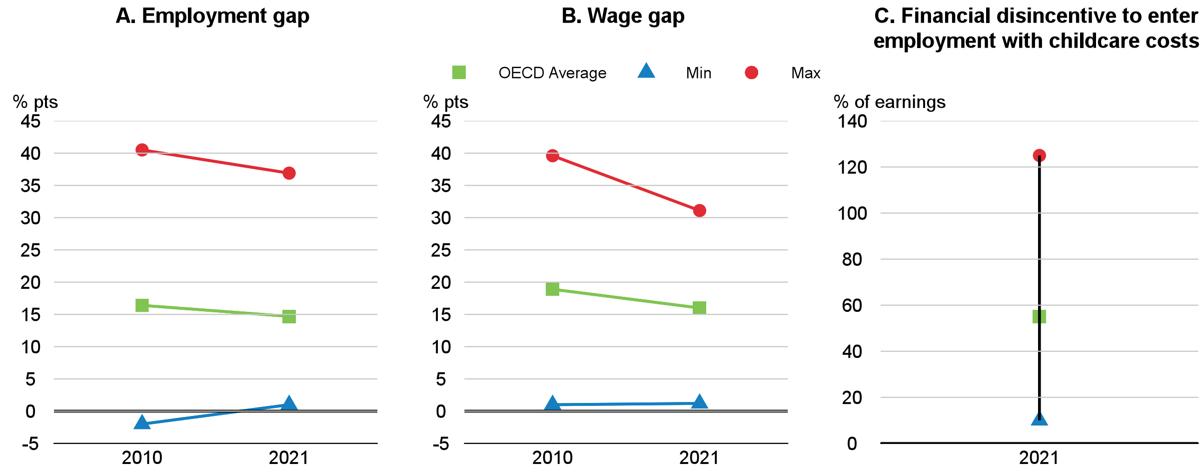
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/3c4phx

The current prolonged period of labour market tightness in some OECD economies, especially for certain sectors (manufacturing and lower-pay sectors), suggests that measures to boost labour market participation are needed to enhance growth and make it more inclusive. Weak aggregate employment rates are often driven by low employment of specific groups, such as younger workers, older workers, women, minorities and the low-skilled.

As discussed in Chapter 2, investments in gender equality are an important means of boosting labour force participation, employment, and output. These require actions across a wide range of policy areas. There have been considerable improvements in women's labour market participation, but gender employment and wage gaps are declining at a slow pace across OECD countries, warranting further policy measures (Figure 1.38, Panel A and B). Improving access to childcare is a priority in many OECD countries. A major obstacle to mothers' employment, especially full-time work, is the lack of affordable high-quality childcare, with the financial disincentive when entering employment sometimes prohibitive when childcare costs are accounted for (Figure 1.38, Panel C). Other key policies to strengthen women's employment and career opportunities include incentivising parents to better share parental leave, schemes to improve skills on return from parental leave, encouraging gender equality within firms, integration programmes for foreign-born women, promotion of entrepreneurship and financial inclusion for women, and levelling taxation for second earners.

Figure 1.38. High childcare costs are slowing the reduction in gender gaps



Note: The employment gap is the difference in the employment rate between men and women aged 15-64; The wage gap is the difference between the median wage of men and women; the financial disincentive to enter employment with childcare costs measures the percentage of earnings lost to either higher taxes or lower benefits when a parent of two children takes up full-time employment and uses centre-based childcare. Calculations refer to a couple with two children aged 2 and 3 where the other parent works full-time at 67% of the average wage.
Source: OECD Employment database; OECD Gender Data Portal; OECD (2023a), Financial disincentive to enter employment with childcare costs (indicator, accessed on 13 April 2023).

StatLink https://stat.link/mi2fsl

Climate policies

Ambitious targets have been set in the wake of the 2015 Paris Agreement, with many countries committing to net-zero emission targets by 2050 to limit global temperature rise to “well below 2°C and as close as possible to 1.5°C relative to pre-industrial levels”. At the global level, however, the policies in place are likely to be insufficient to put greenhouse gas emissions on a downward path before 2030 (IEA, 2022), compromising the goal of achieving net-zero emissions by mid-century.

Attaining that goal requires structural changes in the economy and substantial reallocation of workers and capital from emission-intensive activities towards greener activities. The transition will also require a large increase in green investment (reinforcing the need to boost investment to reinvigorate trend growth), greater use of carbon pricing,[10] and strengthening regulations, institutions and standards to enable emission reductions. Well-targeted regulations can improve energy efficiency, particularly for housing and offices, and encourage the development and adoption of greener technologies. It is also critical that policies are clearly communicated, and sufficiently stable. The necessary increase in long-term clean energy investment will not happen if firms are faced with high uncertainty about future policies (Berestycki et al., 2022).[11]

Another key challenge for the transition is to manage the associated distributional impacts. Major transition costs will emerge or rise in specific sectors that are most vulnerable to the climate transition, such as mining and fossil fuel and energy-intensive industries. This will also have repercussions for firms that are

[10] Strong price signals on greenhouse emissions and a credible future price path are needed to underpin progress towards carbon neutrality but are still lacking in most countries. Currently, 80% of emissions in the OECD and G20 countries are priced below EUR 60/tCO2.

[11] Enhanced investment in clean energy will be needed to meet emission reduction targets: the IEA estimates that investment in clean energy technologies needs to more than double to USD 5 trillion by 2030 (IEA, 2021). While energy investment has been rising recently, this in part reflects higher costs rather than stronger investment volumes.

heavily reliant on these industries. Workers lacking the skills needed in the growing green activities will be at the greatest risk of job losses. Cushioning vulnerable social groups from the adverse effects of transition would help to improve public acceptability of climate change mitigation policies. A key step is to include an element of revenue recycling in any reform package (Dechezleprêtre et al., 2022), such as using revenues from new taxes to reduce existing taxes or make transfer payments to vulnerable households.

Improving the coordination of countries' carbon mitigation efforts is one reason why enhanced international cooperation is needed, together with other pressing global aims such as overcoming food and energy insecurity and ensuring that low-income countries' debt burdens are sustainable. In this context, the new OECD forum, the Inclusive Forum on Carbon Mitigation Approaches (IFCMA), is intended to help its members achieve the common global net zero objective. The first actions of the IFCMA, which aims to improve international collaboration through data sharing, mutual learning and dialogue, are to take stock of the policy instruments in use across members of the Forum and measure their emission-reducing effects. The IFCMA will complement other international efforts on climate policy data, including in the context of the Enhanced Transparency Framework of the United Nations Framework Convention on Climate Change.

Open markets and resilient supply chains help to raise living standards

Open and well-functioning international markets with resilient and efficient supply chains are an important source of long-term prosperity and productivity growth for both advanced and emerging-market economies. The pandemic and the initial stages of the recovery as economies reopened highlighted the benefits of international trade, but also the vulnerabilities from increasingly complex supply chains with distant suppliers and the challenges faced by attempts to improve economic security. Rising geopolitical tensions and the war in Ukraine have further exposed growing tensions over trade and the security of supply, and intensified the risk of value chain fragmentation.

The integration into world markets of large and fast-growing emerging-market economies, particularly in Asia, has expanded global supply, enhanced economic efficiency and helped to keep inflation low in advanced economies. These gains could be foregone if fragmentation were to occur and economic policies became more inward looking, with lower-income households hit hardest (Arriola et al., 2020; Aiyar et al, 2023). The cumulative total of global import restrictions in force has already grown steadily since the global financial crisis, both in value terms and as a percentage of world imports. By 2022, over 9% of world merchandise imports were being affected by these import restrictions, up from around 4% in 2017. So far, this appears to have primarily affected trade patterns in the major economies rather than the overall intensity of trade, though there have been marked changes in bilateral trade at the sector level in both the United States and Europe (Box 1.4). However, trade policy uncertainty has also increased recently and, if sustained, would inhibit the growth of trade (Handley and Limao, 2022; Caldara et al, 2020; Novy and Taylor, 2020). A further move away from multilateral-based rules could also add to uncertainty about future trade policy. The increased emphasis on regional or bilateral trade agreements could potentially exclude smaller and medium-sized economies, limiting the gains from trade.

A key policy challenge is to enhance the resilience of global value chains without eroding their benefits for efficiency. Most actions to improve resilience lie with private firms, who have strong incentives to reduce risks of costly disruptions to production. Governments can nonetheless help to create a favourable trading environment and minimise bottlenecks along supply chains by removing trade and investment barriers, enhancing trade facilitation, modernising digital and physical infrastructures, and reducing heterogeneity in technical standards. Such steps can help to cushion shocks and facilitate easier substitution between suppliers (Arriola et al., 2020).

Box 1.4. Shifting bilateral trade patterns in the major economies

Global trade and investment relations have entered a period of significant change. The COVID-19 pandemic, supply bottlenecks, the war in Ukraine and the re-setting of US and China bilateral trade relations have heightened scrutiny of the potential vulnerabilities in global supply chains. There are also signs that enthusiasm for the further deepening of trade linkages and the multilateral trading system may have started to wane. Average tariff levels have remained broadly unchanged in the world over the last 5 years, excluding US and China bilateral tariffs, but trade costs are increasingly affected by non-tariff measures. The share of global merchandise imports subject to restrictions has risen steadily since the global financial crisis, and export restrictions on critical raw materials and foodstuffs have increased. Such restrictions can prompt importers to switch to less efficient suppliers that are subject to fewer trade barriers, potentially raising costs and lowering trade volumes. More broadly, there is a risk that countries become less open to trade over time, with attendant risks to productivity (Égert and Gal, 2017).

This box looks at selected aspects of trade developments in the major economies in recent years and the extent to which they suggest that trade is being affected by increasing trade frictions for different products and different trade partners. While there are differences across countries, two broad points emerge. First, the global trade system has so far generally absorbed recent trade frictions. Merchandise trade, and within that manufacturing trade, is rising steadily in value terms, and global trade intensity in volume terms (trade openness) has risen in most OECD countries and remained broadly stable for the world as a whole. The resilience of trade is not guaranteed: the strong policy support during the pandemic and the energy crisis and continued trade deepening in Europe have been important offsets for trade fragmentation. Secondly, there are also marked shifts in bilateral trade patterns in the major advanced economies, particularly with China, some of which are attributable in part to higher trade frictions.

Trade intensity

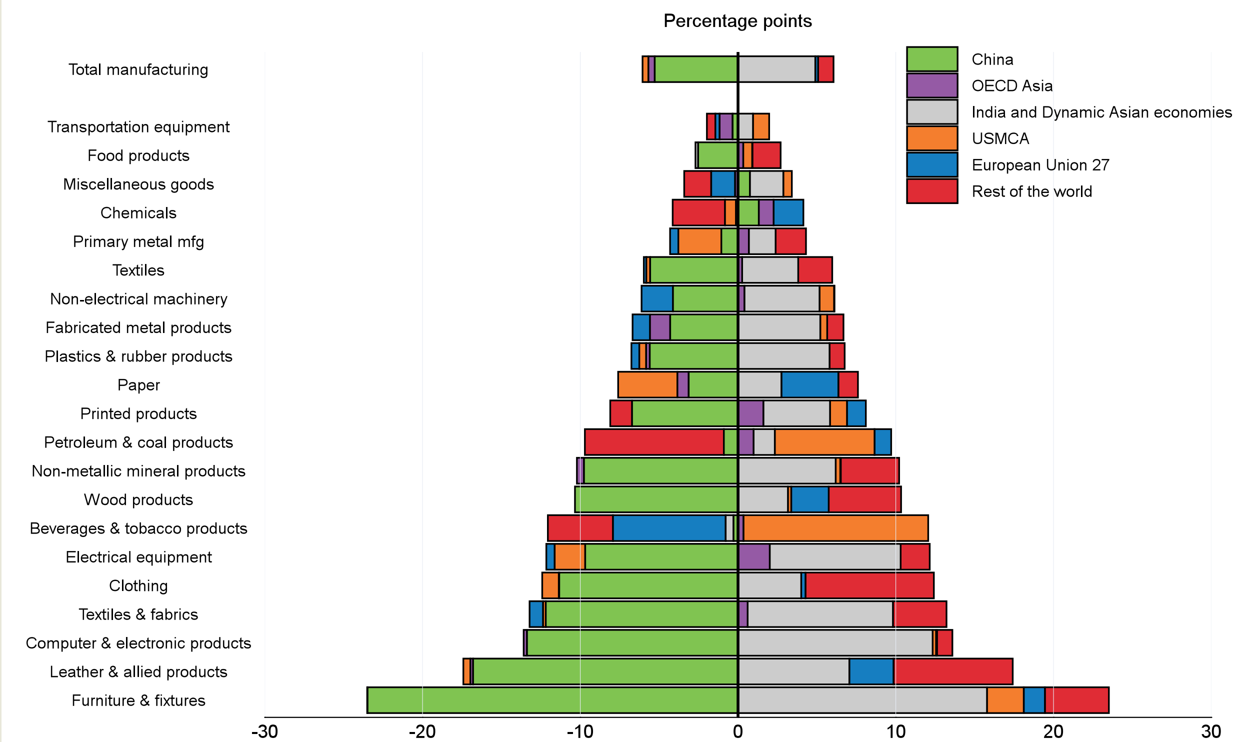
There is little evidence of a global decline in the intensity of merchandise trade over the past decade. Global merchandise trade was about 22% of world GDP in volume terms in 2022, 0.6 percentage points higher than the average for the last 10 years excluding the COVID-19 pandemic. This stability masks significant changes at the country level. In volume terms, merchandise trade intensity (the average of goods imported and exported as a share of GDP) increased by 2.6 percentage points for the OECD, and by much more in many smaller European countries. Amongst the major economies, trade intensity in the EU, Japan and the United States rose by 6.9, 2.5 and 1 percentage points respectively. In contrast, China's merchandise trade intensity fell 3.5 percentage points over the period, driven primarily by a decline in import penetration as reliance on domestic production increased.

Merchandise trade can be further separated into trade in commodities and trade in manufactures. Understanding manufacturing trade trends is of particular interest, given their centrality in US-China trade, concerns about global supply chain vulnerability and the implications for industrial policy. National trade data at the country and manufactured product level, available in value terms, provide insights into how bilateral trade patterns have shifted in the three largest OECD markets in recent years.

The United States

In the United States, China's share of manufactured imports fell from 25% in 2018, when new bilateral tariffs on Chinese exports were introduced by the United States, to 19% in 2022. Particularly large declines occurred in China's share of imports of furniture, textiles and computers and other electronic products (Figure 1.39). These include many products subject to the highest bilateral tariff levels after 2018 (Bown, 2023). For the most part, the declines in the share of China have been offset by gains in the share of imports from other Asian economies.

Figure 1.39. Changes in US manufacturing import shares between 2018 and 2022



Note: Manufacturing import statistics based on the North American Industry Classification System (NAICS). OECD Asia includes Japan and Korea; Dynamic Asian economies include Chinese Taipei, Hong Kong (China), Malaysia, the Philippines, Singapore, Thailand and Viet Nam; USMCA includes the United States, Mexico and Canada; Rest of the world includes all other countries not mentioned elsewhere in the chart. The US manufacturing classification includes food, beverages and fuels.
Source: United States Census Bureau; and OECD calculations.

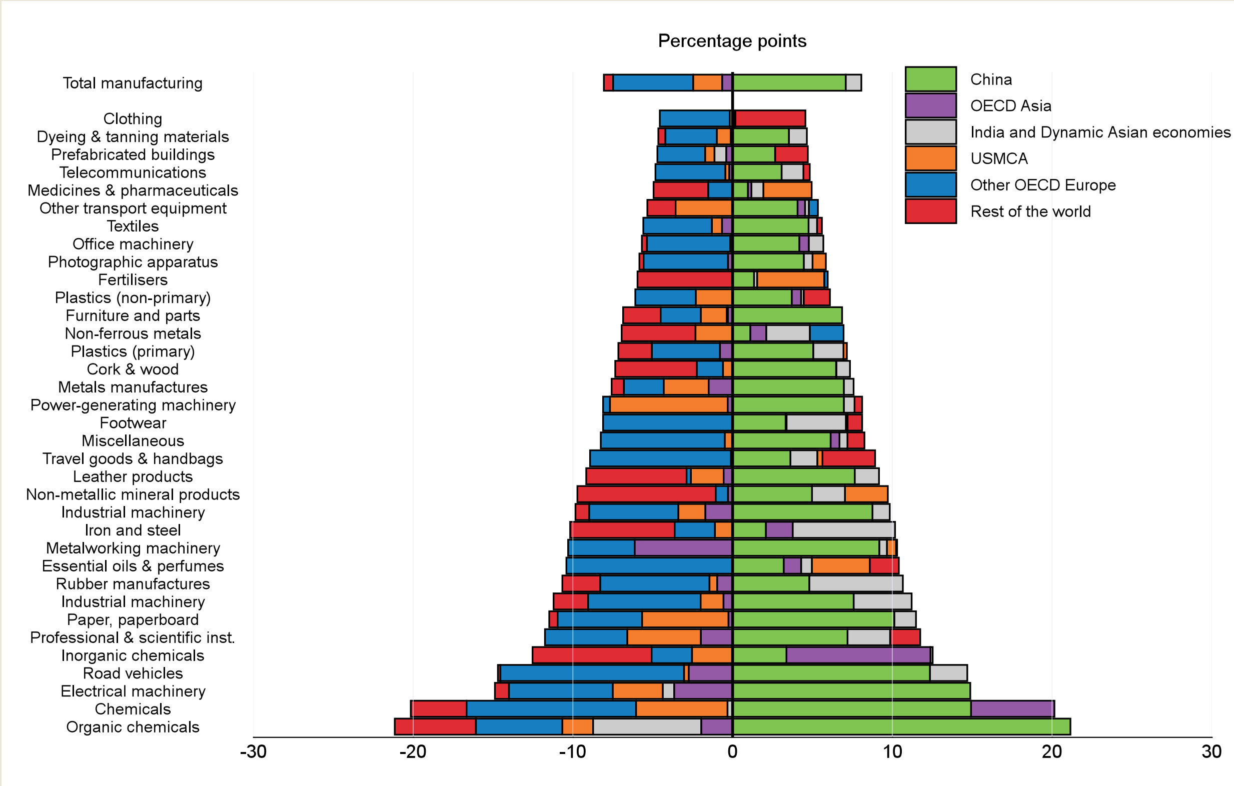
StatLink https://stat.link/hgnykt

There is limited evidence of a move towards the nearshoring of production in the US data. The overall share of Mexico in US imports of manufactures rose by only 0.2 percentage points between 2018 and 2022, despite a rise in the value of trade. At the product level, Mexico and Canada's share of trade rose the most in food, drink and tobacco products, and petroleum products – with China's shares unaffected. By contrast, in the fast-growing electrical equipment category, total US imports grew by 50% between 2018 and 2022, but Mexico's share of trade fell by 1.7 percentage points between 2018 and 2022, alongside the decline in China's market share.

European Union

In contrast to the United States, China's share of extra-EU manufactured goods imports has risen steadily, with the overall share of manufacturing imports rising from 26% in 2018 to 33% in 2022. China accounts for a rising share of EU imports across most product categories, with the largest increases being for electrical machinery, road vehicles and chemical products (Figure 1.40). The share of imports originating from the emerging Asian economies has also generally risen, with the exception of chemicals, suggesting that there has been relatively little switching between imports within Asia for the European market.

Figure 1.40. Changes in extra-EU manufacturing import shares between 2018 and 2022



Note: Manufacturing import statistics based on the Eurostat Standard Industry Trade Classification (SITC). OECD Asia includes Japan and Korea; Dynamic Asian economies include Chinese Taipei, Hong Kong (China), Malaysia, the Philippines, Singapore, Thailand and Viet Nam; USMCA includes the United States, Mexico and Canada; Other OECD Europe includes Iceland, Norway, Switzerland, Türkiye and the United Kingdom; Rest of the world includes all other countries not mentioned elsewhere in the chart. The EU manufacturing classification does not include food, beverages and fuels.
Source: Eurostat; and OECD calculations.

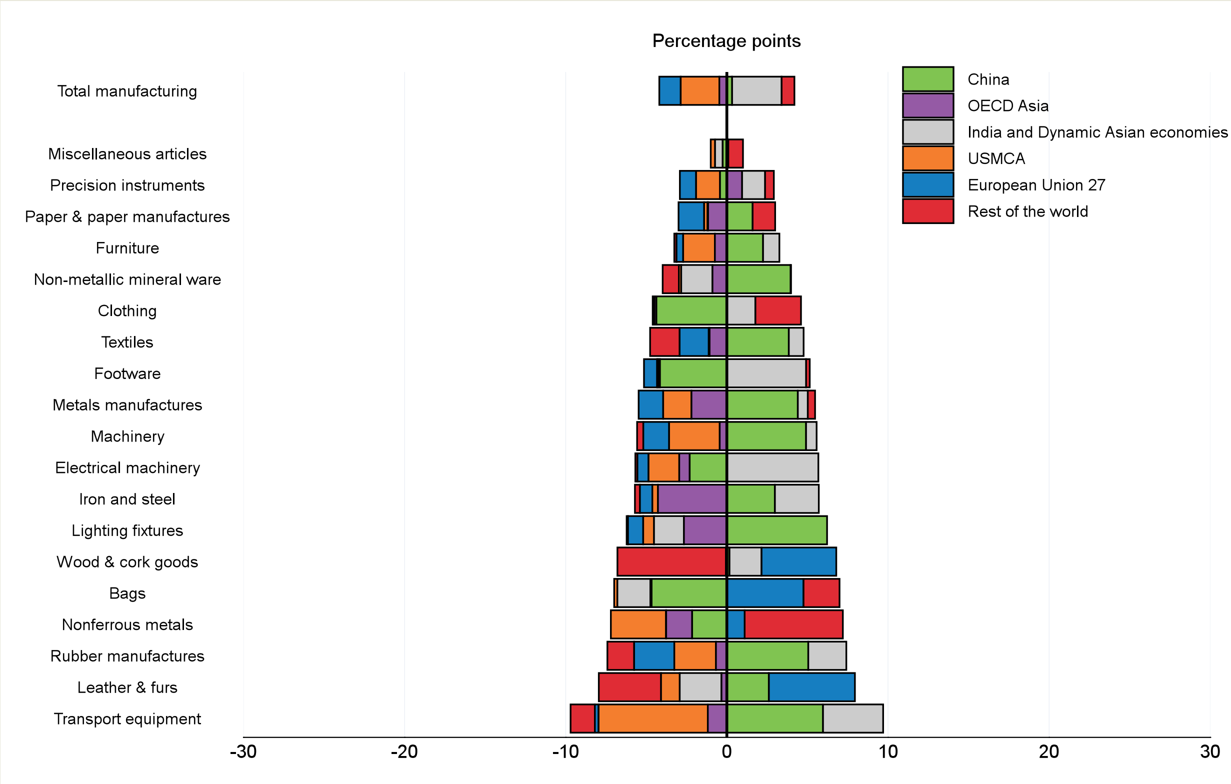
StatLink https://stat.link/74y58g

The share of EU imports from locations outside Asia have collectively declined, with the largest drops occurring for imports from other OECD Europe countries and from North America. More broadly, the share of the advanced economies in EU imports has declined across most product categories, particularly for chemicals, road vehicles and electrical machinery. The share of imports from the United Kingdom has also declined significantly over the past five years. Nonetheless, thanks to strong aggregate trade growth, EU manufactured imports in 2022 from other OECD Europe were 13% higher than in 2018 in value terms, and imports from the United States were 26% higher.

Japan

In Japan, the pattern of trade is much more mixed. The share of China in total manufactured imports has hardly changed between 2018 and 2022 (Figure 1.41). Whilst there have been changes in China's share of a few specific manufactured products, these are proportionately much smaller than the corresponding changes in Europe and the United States. Imports from dynamic Asia are not clearly substituting or complementing Chinese imports: they have risen alongside China for transport equipment, iron and steel products and furniture, but have also risen for footwear and electrical machinery, where China's share has fallen. On aggregate, the share of imports from the EU and from the United States, Mexico and Canada (USMCA) have fallen, although manufactured imports from the EU rose 12% in value terms since 2018, and USMCA imports rose marginally.

Figure 1.41. Changes in Japan's manufacturing import shares between 2018 and 2022



Note: Manufacturing import statistics based on the HS classification applied by custom authorities. OECD Asia includes Korea; Dynamic Asian economies include Chinese Taipei, Hong Kong (China), Malaysia, the Philippines, Singapore, Thailand and Viet Nam; USMCA includes the United States, Mexico and Canada; Rest of the world includes all other countries not mentioned elsewhere in the chart. The Japanese manufacturing classification does not include food, beverages and fuels.
Source: National Statistics Centre of Japan; and OECD calculations.

StatLink https://stat.link/s46zha

Bibliography

Aiyar, S. et al. (2023), "Geoeconomic Fragmentation and the Future of Multilateralism", *IMF Staff Discussion Note*, No. SDN (2023)/001.

Anderson, A., P. Marks, D. Na, B. Schlusche, and Z. Senyuz (2022), "An Analysis of the Interest Rate Risk of the Federal Reserve's Balance Sheet, Part 2: Projections under Alternative Interest Rate Paths," *FEDS Notes*, Washington; Board of Governors of the Federal Reserve System, 15 July.

Andrews, D. C. Criscuolo and P. Gal (2016), "The Best versus the Rest: The Global Productivity Slowdown, Divergence across Firms and the Role of Public Policy", *OECD Productivity Working Papers*, No. 5.

Arce, Ó, E. Hahn and G. Koester (2023), "How tit-for-tat inflation can make everyone poorer", *The ECB Blog*.

Arriola, C., S. Guilloux-Nefussi, S. Koh, P. Kowalski, E. Rusticelli and F. Van Tongeren (2020), “Efficiency and Risks in Global Value Chains in the context of COVID-19”, *OECD Economics Department Working Papers*, No. 1637, OECD Publishing, Paris.

Bank for International Settlements (2021), *Quarterly Review*, December 2021.

Bank of England (2012), "Exchange of letters regarding the transfer of excess cash from the Asset Purchase Facility to HM Treasury – Exchange of letters between the Governor and the Chancellor", November.

Bell, S., M. Chui, T. Gomes, P. Moser-Boehm, and A. P. Tejada (2023), "Why are Central Banks Reporting Losses? Does it Matter?,” *BIS Bulletin* No 68, February.

Bernanke, B., and M. Gertler (1995). "Inside the Black Box: The Credit Channel of Monetary Policy Transmission." *Journal of Economic Perspectives*, Vol. 9.

Berestycki, C., et al. (2022), "Measuring and Assessing the Effects of Climate Policy Uncertainty", *OECD Economics Department Working Papers*, No. 1724, OECD Publishing, Paris.

Bown, C. (2023), “US Imports from China are both Decoupling and Reaching New Highs. Here's How”, Peterson Institute of International Economics, March 2023.

Calvino, F., C. Criscuolo and R. Verlhac (2020), "Declining Business Dynamism: Structural and Policy Determinants", *OECD Science, Technology and Industry Policy Papers*, No. 94, OECD Publishing, Paris.

Caldara, D., Iacoviello, M., Molligo, P., Prestipino, A., Raffo, A. (2020) “The Economic Effects of Trade Policy Uncertainty”, *Journal of Monetary Economics*, Vol. 109.

Cavalleri, M., B. Cournède and V. Ziemann (2019), “Housing Markets and Macroeconomic Risks”, *OECD Economics Department Working Papers*, No. 1555, OECD Publishing, Paris.

Colonna, F., R. Torrini and E. Viviano (2023), “The Profit Share and Firm Mark-up: How to Interpret Them?”, *Occasional Papers*, Banca d’Italia, No. 770.

CBO (2023), *The Budget and Economic Outlook 2023-2033*, Congressional Budget Office, February.

Daly, P., L. Dekker, S. O’Sullivan, E. Ryan and M. Wedow (2023), “The Growing Role of Investment Funds in Euro Area Real Estate Markets: Risks and Policy Considerations”, *ECB Macroprudential Bulletin,* April.

Diev, P., Y. Kalantzis and A. Lalliard (2019), “Why Have Strong Wage Dynamics Not Pushed Up Inflation in the Euro Area?”, *Bulletin de la Banque de France*, 225/6, September-October.

De Loecker J., J. Eeckhout and G. Unger (2020), “The Rise of Market Power and the Macroeconomic Implications”, *The Quarterly Journal of Economics*, Vol. 135 Issue 2.

De Nederlandsche Bank (2022), "Letter regarding DNB’s capital position – September 2022,” 9 September.

Dechezleprêtre, A., et al. (2022), "Fighting Climate Change: International Attitudes Toward Climate Policies", *OECD Economics Department Working Papers*, No. 1714, OECD Publishing, Paris.

Égert, B. and P. Gal (2017), "The Quantification of Structural Reforms in OECD Countries: A New Framework", *OECD Journal: Economic Studies*, Vol. 2016/1.

Ehlers, T. and A. Víllar (2015), “The Role of Banks”, *BIS Papers 83*.

European Central Bank (2022), *Financial Stability Review,* November 2022.

European Commission (2022), *European Economic Forecast Autumn 2022*, November.

European Commission (2023), *European Economic Forecast: Spring 2023*, May.

European Systemic Risk Board (2022), *EU Non-bank Financial Intermediation Risk Monitor 2022*, July.

Eurostat (2023), “’Q4 2022: Business bankruptcies highest since 2015’’, February.

Faccia, D., M. Parker and L. Stracca (2021), “Feeling the Heat: Extreme Temperatures and Price Stability,” *Working Paper Series* 2626, European Central Bank.

FDIC (2022), *Risks Review*, Federal Deposit Insurance Corporation, June 2022.

Federal Reserve (2023), *Financial Stability Report*, May.

FSB (2022a), *Global Monitoring Report on Non-Bank Financial Institutions 2022*, Financial Stability Board.

FSB (2022b), *Enhancing the Resilience of Non-Bank Financial Intermediation*, Progress Report, November 2022.

Guillemette, Y. and J. Château (2023), "Long-term Scenarios Update: Incorporating the Energy Transition", *OECD Economic Policy Paper*, forthcoming.

Glover, A., J. Mustre-del-Rìo and A. von Ende-Becker (2023), "How Much Have Record Corporate Profits Contributed to Recent Inflation?", *Economic Review*, Federal Reserve Bank of Kansas City.

Handley, K. and N. Limão (2022), "Trade Policy Uncertainty", *Annual Review of Economics*, Vol. 14.

Haskel J. (2023), "What's Driving Inflation: Wages, Profits, or Energy Prices?", Bank of England, Speech given at Peterson Institute for International Economics, Washington DC, 25 May.

Hermansen, M. and O. Röhn (2017), "Economic Resilience: The Usefulness of Early Warning Indicators in OECD Countries, *OECD Economic Studies*, Vol. 2016/1.

IEA (2021), *Net Zero by 2050*, International Energy Agency, Paris.

IEA (2022), *World Energy Outlook 2022*, International Energy Agency, Paris.

IMF (2022a), *Global Financial Stability Report*, International Monetary Fund, October.

IMF (2022b), *External Sector Report*, International Monetary Fund, August.

IMF (2023), *Global Financial Stability Report*, International Monetary Fund, April.

Kabundi, A., J. Yao and M. Mlachila, (2022), "How Persistent are Climate-Related Price Shocks? Implications for Monetary Policy," *IMF Working Papers* 2022/207.

Kjellberg, D. and M. Åhl, (2022), "The Riksbank's Financial Result and Capital are Affected by Higher Interest Rates," *Economic Commentary No 8*, Sveriges Riksbank, 4 July.

Lane, P. R. (2023), "The Euro Area Hiking Cycle: An Interim Assessment", speech at the National Institute of Economic and Social Research, 16 February.

Maravalle, A. and A. Gonzalez Pandiella (2022), "The Pass-through of the Monetary Policy Rate into Lending Rates in Mexico," *OECD Economics Department Working Papers* 1734, OECD Publishing.

Mishkin F. (1996), "The Channels of Monetary Transmission: Lessons for Monetary Policy," *NBER Working Papers* 5464.

Novy, D. and A. Taylor (2020) "Trade and Uncertainty", *The Review of Economics and Statistics*, Vol. 102.

OBR (2022), *Economic and Fiscal Outlook, November 2022*, Office for Budget Responsibility, 17 November.

OECD (2022a), *OECD Economic Outlook, Volume 2022 Issue 1*, OECD Publishing, Paris.

OECD (2022b), *OECD Economic Outlook, Volume 2022 Issue 2*, OECD Publishing, Paris.

OECD (2022c), *Competition and Inflation*, OECD Competition Policy Roundtable Background Note.

OECD (2023a), "Aiming Better: Government Support for Households and Firms During the Energy Crisis", *OECD Economic Policy Papers*, No. 32, OECD Publishing, Paris.

OECD (2023b), *Economic Policy Reforms 2023: Going for Growth*, OECD Publishing, Paris, forthcoming.

OECD (2023c), *OECD Foreign Direct Investment in Figures*, April 2023 edition.

OECD (2023d), *OECD Sovereign Borrowing Outlook 2023*, OECD Publishing, Paris.

OECD (2023e), *Growth and Economic Well-Being: Fourth Quarter 2022*, OECD, OECD Publishing, Paris.

OECD (2018), *OECD Economic Surveys: European Union* 2018, OECD Publishing, Paris.

Paul, P. (2022), "When the Fed Raises Rates, Are Banks Less Profitable?", *FRBSF Economic Letter*, December.

Schwellnus, C., M. Pak, P. Pionnier and E. Crivellaro (2018), “Labour Share Developments over the Past Two Decades: The Role of Technological Progress, Globalisation and ‘Winner-takes-most’ Dynamics”, *OECD Economics Department Working Papers*, No. 1503, OECD Publishing, Paris.

Sveriges Riksbank (2022), *Financial Stability Report*, November.

Weber, I. and E. Wasner (2023), “Sellers’ Inflation, Profits and Conflict: Why can Large Firms Hike Prices in an Emergency?”, *Economics Department Working Paper Series*, University of Massachusetts Amherst.

World Bank (2023), *Global Economic Prospects*, January 2023, Washington, DC.

Annex 1.A. Policy and other assumptions underlying the projections

Fiscal policy settings for 2023-24 are based as closely as possible on legislated tax and spending provisions and are consistent with the growth, inflation and wage projections. Where government plans have been announced but not legislated, they are incorporated if it is deemed clear that they will be implemented in a shape close to that announced. Existing energy-related support measures have been assumed to be extended into part or the whole of 2023-24 when that extension is deemed likely, even if it has not yet been announced. When a given energy-related measure spans more than one year, its total fiscal costs are assumed to be uniformly spread across months.

Projections for the EU countries account for spending financed by the Next Generation EU (NGEU) grants and loans, based on expert judgments about the distribution across years and different expenditure categories and informed by officially announced plans where available. NGEU grants are assumed to be budget neutral, i.e. they increase both capital tax and transfers receipts and government expenditure. In addition, positive net one-offs are added in order to reflect the discretionary stimulus associated with those grants, as measured by changes in underlying primary balances.

For monetary policy, the assumed path of policy interest rates and unconventional measures represents the most likely outcome, conditional upon the OECD projections of activity and inflation. This may differ from the stated path of the monetary authorities. In the euro area, 10-year sovereign spreads relative to Germany are assumed to remain constant over the projection period at levels close to those observed in March and April 2023.

The projections assume unchanged exchange rates from those prevailing on 12 May 2023: one US dollar equals JPY 128.8, EUR 0.96 (or equivalently one euro equals USD 1.04) and 6.79 renminbi.

The price of a barrel of Brent crude oil is assumed to remain constant at USD 75 until the end of 2024. The TTF natural gas price is assumed to remain constant at EUR 45 MW/h until the end of 2024. Other commodity prices are assumed to be constant over the projection period at their average levels from April 2023.

The cut-off date for information used in the projections is 1 June 2023.

OECD quarterly projections are on a seasonal and working-day-adjusted basis for selected key variables. This implies that differences between adjusted and unadjusted annual data may occur, though these in general are quite small. In some countries, official forecasts of annual figures do not include working-day adjustments. Even when official forecasts do adjust for working days, the size of the adjustment may in some cases differ from that used by the OECD.

2 Promoting gender equality to strengthen economic growth and resilience

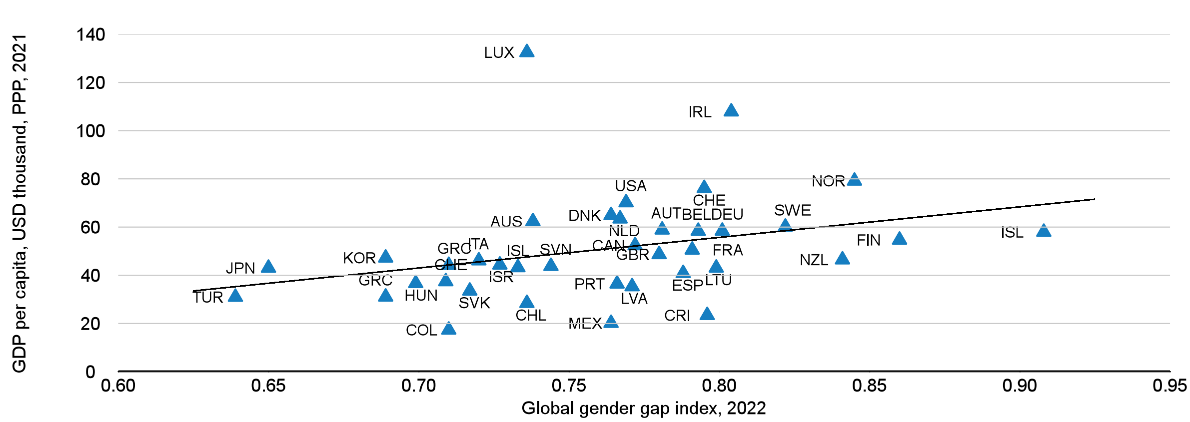
Introduction

The COVID-19 pandemic, Russia's war of aggression against Ukraine, and the current cost-of-living crisis have affected women's incomes, job opportunities and security (OECD, 2020a; European Parliament, 2023; Charlton, 2023). Long-standing factors such as climate change, the digital transition and population ageing also entail risks of widening gender gaps. Women are more vulnerable to economic shocks, may be less well-placed to seize the opportunities associated with the green and digital transitions as they tend to specialise less in scientific knowledge than men, and shoulder a disproportionate share of care for elderly relatives. This chapter draws on a wide range of previous OECD studies on gender equality to document employment and wage gender gaps across OECD countries, and their recent evolutions and underlying factors. It subsequently reviews policies put in place by governments to tackle gender inequality and outlines directions for further action.

Gender employment and wage gaps have generally narrowed at a relatively modest pace over the past decade and remain significant, calling for further policy action. Key areas for progress include: broadening access to quality childcare and early childhood education and making them more affordable; promoting better sharing of parental leave between parents and facilitating return to work through training; supporting gender-balanced career advancements through corporate disclosure; promoting women's access to management positions and entrepreneurship; addressing biases in the tax and pension systems; better integrating foreign-born women through tailored labour-market programmes; enhancing women's financial inclusion; and mainstreaming gender across policy domains.

Lower gender inequality, as measured by the World Economic Forum's Global Gender Gap index, is generally associated with higher income per capita (Figure 2.1). Causality between higher gender equality and higher incomes runs in both directions (Duflo, 2012). High incomes and living standards generate more opportunities for women, including better access to health and education, as well as financial inclusion, which are key to empowering women. Higher levels of economic development are also generally associated with more economic and political rights and opportunities for individuals, especially women. Gender equality contributes to higher well-being primarily by reducing gaps in education, health, labour participation and job quality. Greater equality of opportunities between men and women would enhance social mobility, foster inclusiveness and boost economic growth through better use of talent.

Figure 2.1. Gender equality is associated with high income per capita



Note: A higher score indicates a lower gender gap. The gender gap index is produced by the World Economic Forum to benchmark progress towards gender parity and compare countries' gender gaps across four dimensions: economic opportunities, education, health and political leadership.
Source: World Economic Forum; and OECD Productivity Database.

StatLink https://stat.link/o12kyc

The literature points to a strong effect of gender equality on national income. At the macroeconomic level, in a growth model with endogenous saving, fertility and labour market participation calibrated on the United States, a 50% increase in the gender wage gap eventually leads to a 35% decrease in income per capita in the steady state (Cavalcanti and Tavares, 2016). Gender inequality also explains a large part of some other countries' income gap with the United States. Another study finds that gender gaps cause an average income loss of 15% in the OECD, of which 40% is due to entrepreneurship gaps (Cuberes and Teignier, 2016). Across OECD countries, closing gender gaps in labour force participation and working hours could lift GDP by more than 9% by 2060, adding about a quarter of a percentage point to average annual growth (OECD, 2023a).

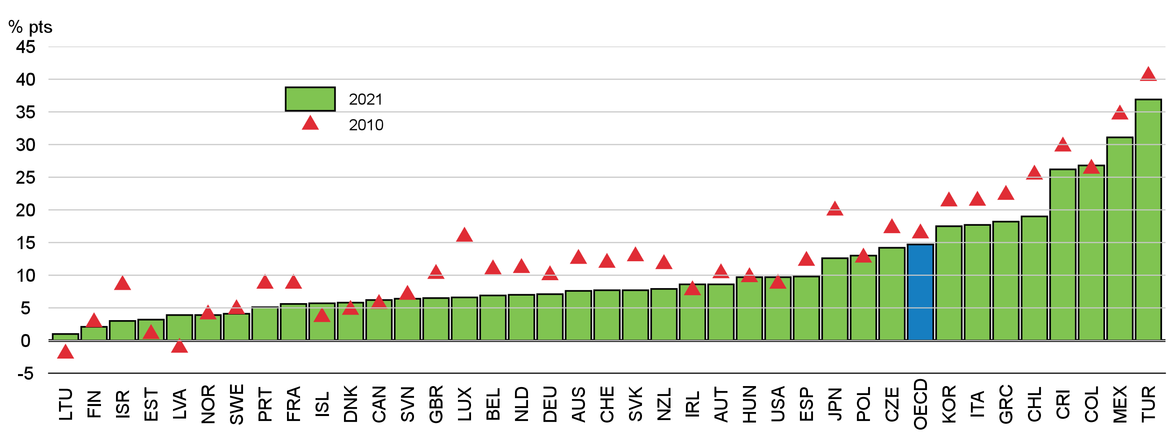
OECD research at the firm level shows that differences in gender diversity contribute significantly to the productivity gap between frontier firms, those with the highest productivity levels, and other firms (Criscuolo et al., 2021). Enhanced equality of opportunities and social mobility can foster more inclusive and stable growth. Given the relationship between parental or socio-economic background and the educational and wage outcomes of their offspring, better opportunities for women can enhance intergenerational social mobility (Causa and Johansson, 2010). This is crucial, as in an average OECD country it can take around four to five generations for children from the bottom earnings decile to attain the level of mean earnings (OECD, 2018a). Gender diversity can also help economies recover faster from shocks and more broadly strengthen economic and financial resilience. Public policy has a role to play in supporting more inclusive outcomes.

Women's employment is still lagging in many countries

A gender employment gap persists in all OECD countries, although it has narrowed in most of them since 2010. Differences across countries are large, with the employment gap ranging from one percentage point in Lithuania to nearly 37 percentage points in Türkiye in 2021 (Figure 2.2). Employment gaps tend to be wide in Latin America, Southern Europe and Asia, and small in Eastern and Northern Europe. Such gaps are the result of various factors, including cultural and social norms. However, a lack of equal opportunities, which is partly related to policy, contributes in many cases to women's lower employment rate.

Figure 2.2. Gender employment gaps vary widely across countries

Difference in employment rates between men and women aged 15-64



Source: OECD Employment database; and OECD calculations.

StatLink https://stat.link/d53vfb

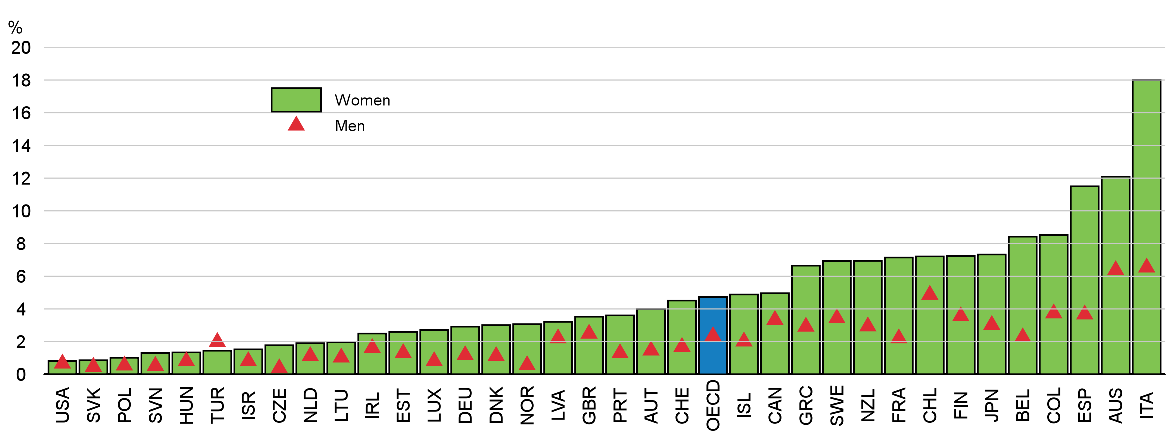
The prevalence of part-time work is also higher among women. On average, about one in four women in the OECD works part-time, with lower rates in most of Eastern Europe and higher rates in the Netherlands, Switzerland and Japan. In many cases, part-time work may reflect work-life balance considerations. Nevertheless, involuntary part-time employment represents a larger share of female than of male employment in most OECD countries and exceeds 10% in Australia, Italy and Spain (Figure 2.3). The over-representation of women in involuntary part-time work makes them vulnerable to reductions in working time (OECD, 2020b).

Employment of foreign-born women is particularly low in some countries (Figure 2.4). Differences in the gap with natives partly reflect differences in the skills of migrants across countries. The gap is especially wide where the employment rate of native women is high. One obstacle to the employment of foreign-born women in countries with a highly-skilled workforce is the lower average level of education among immigrants and the difficulty of getting foreign qualifications recognised.

The unequal burden of family-related work contributes to a higher propensity of women to drop out of the labour force than men. On average across European countries, around 1.7% of employed and 4.6% of unemployed women in a given year move to inactivity to fulfil domestic tasks, compared to less than 0.2% of employed and 1% of unemployed men (Causa et al., 2021). Long hours of unpaid work also reduce women's well-being disproportionately compared to men, who are relatively more likely to have long hours of paid work (OECD, 2020c). However, the COVID-19 pandemic has triggered a reassessment of career objectives and work-life balance, both for men and women, which could lead to a better sharing of family tasks and greater life satisfaction (Stevenson, 2021).

Figure 2.3. Involuntary part-time is more prevalent among women

Percentage of involuntary part-timers in total employment, 2021 or latest

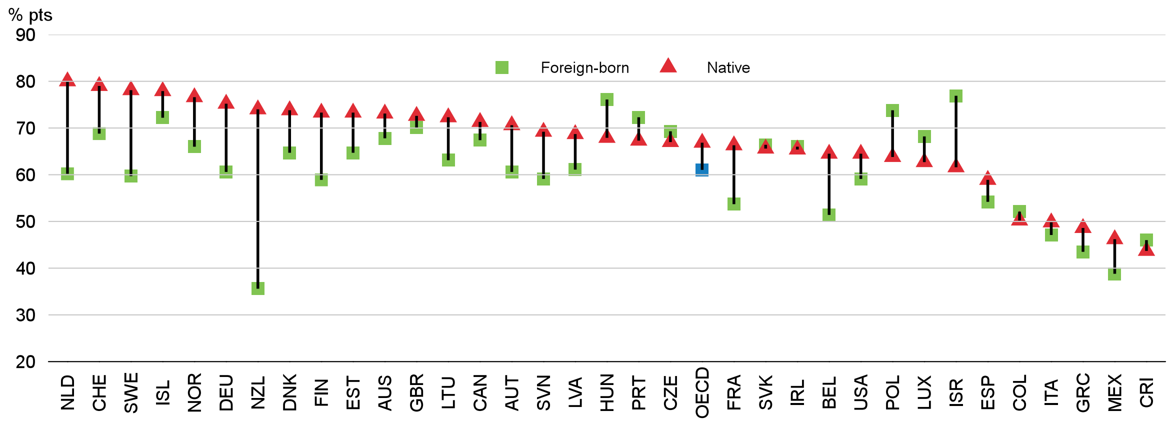


Note: Part-time employment is defined as people in employment (whether employees or self-employed) who usually work less than 30 hours per week in their main job. Employed people are those aged 15 and over who report that they have worked in gainful employment for at least one hour in the previous week or who had a job but were absent from work during the reference week while having a formal job attachment.
Source: OECD Labour Force Statistics.

StatLink https://stat.link/jfd3ze

Figure 2.4. Foreign-born women tend to have lower employment rates than natives

Women aged 15-64, 2021 or latest



Source: OECD Migration Statistics.

StatLink https://stat.link/lgyfpb

Gender wage gaps and glass ceilings persist

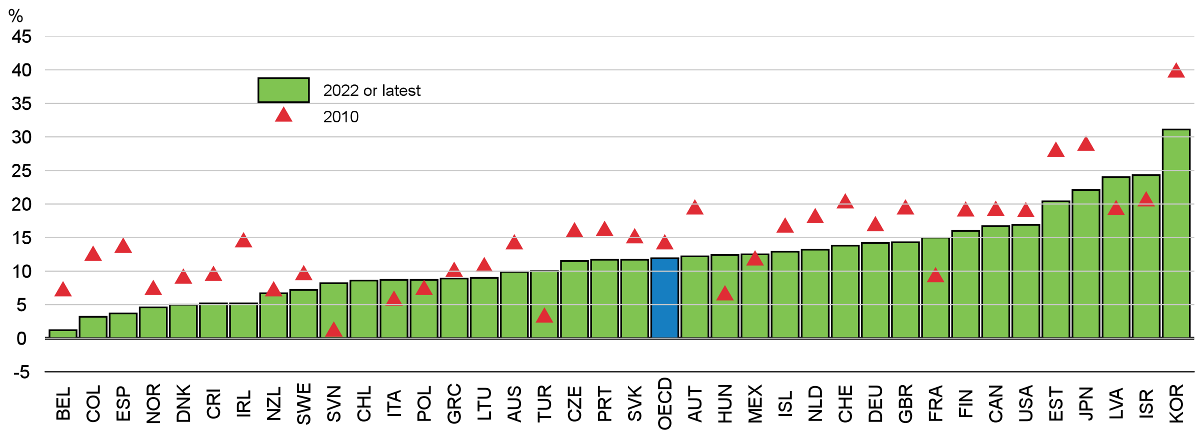
Wage gaps remain wide, even though they have narrowed in seven out of ten OECD countries since 2010 (Figure 2.5). On average, the gender wage gap was close to 12% in the OECD in 2022, but differences across countries were large. While the wage gap was around 1% in Belgium, it still exceeded 30% in Korea, despite significant progress over the past decade. Part of the wage gaps reflects factors like age, education, occupation, sector of employment and hours worked. However, they may also reflect discrimination against women.

Recent studies suggest that factors unrelated to skills and work experience account for a substantial share of the gender wage gap. About three-quarters of the gender wage gap results from the same firm paying men more than women with similar skills, mainly due to differences in task and responsibility assignments. The remaining quarter of the gender wage gap results from the concentration of women in low-wage firms and industries (OECD, 2022a). However, the relative impact of objective and subjective factors in wage differences is still insufficiently documented in many countries, which hinders corrective action.

Recent OECD research using individual-level data on 25 European countries suggests that factors related to social norms, gender stereotypes and discrimination, account for 40% of the gender wage gap on average, while a motherhood penalty hindering women's career and wage progression accounts for around 60% (Ciminelli et al., 2021). The first set of factors is predominant in most Northern and Western European countries, while the motherhood penalty dominates in most Central and Eastern European countries. This calls for policy action tailored to countries' specific challenges.

Wage and employment gaps translate into pension gaps, as career interruptions lower women's lifetime contributions to pension schemes. Women's longer life expectancy can also expose them to erosion in the real value of pensions. Pension payments to women aged 65 and over in the 34 OECD countries for which data are available are on average about 25% lower than for men and gaps vary widely across countries, ranging from 3% in Estonia to 47% in Japan (OECD, 2021a).

Figure 2.5. Gender wage gaps remain wide in most countries



Note: The gender wage gap is defined as the difference between the median earnings of men and women relative to the median earnings of men. Data refer to full-time employees.
Source: OECD Gender Data Portal.

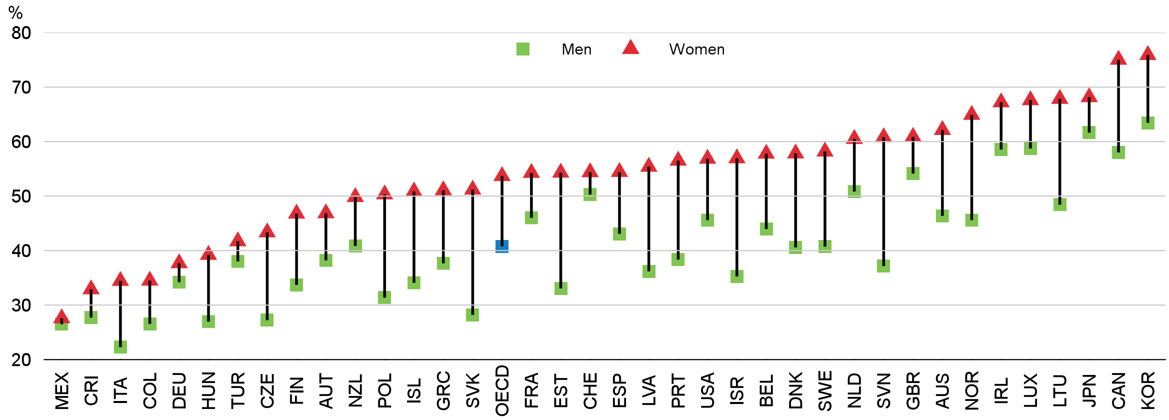
StatLink https://stat.link/9jqzuc

Girls' educational achievements in OECD countries are now generally better than those of boys (Figure 2.6). On average, 54% of 25-34-year-old women have attained tertiary education in 2021, compared to only 41% of men in the same age group (OECD, 2022b). However, girls are under-represented in some fields, such as science, ICT and engineering, that often lead to highly rewarding career opportunities (Figure 2.7). This is likely to reflect preferences, but also stereotypes. The specific impact of cultural norms is difficult to assess but studies have shown that girls, especially high-achieving ones, tend to underperform in mathematics because they generally have lower self-confidence in their ability to solve mathematics or science problems than boys. They are also more likely to express strong feelings of anxiety towards mathematics. This fear of failure and lack of confidence in their abilities is often exacerbated by the gender stereotypes that girls face at home, in school and within their communities (Carlana, 2019; Encinas-Martín and Cherian, 2023). Children and youth are affected by gender stereotypes from an early age, with parental, school, teacher and peer factors influencing the way students internalise their gender identities. This results in expectations that girls will follow career paths to become nurses or teachers, while boys will pursue goals involving science, engineering or business and will occupy positions of leadership (Brussino and McBrien, 2022).

Women may also be less well-placed than men to benefit from the opportunities offered by the green transition, although they will also be less affected by the disappearance of jobs in polluting activities. Fewer than one-third (28%) of green jobs in OECD countries are held by women (OECD, 2023b).

Figure 2.6. Girls perform better than boys in education

Per cent of 25-34-year-old population with tertiary education

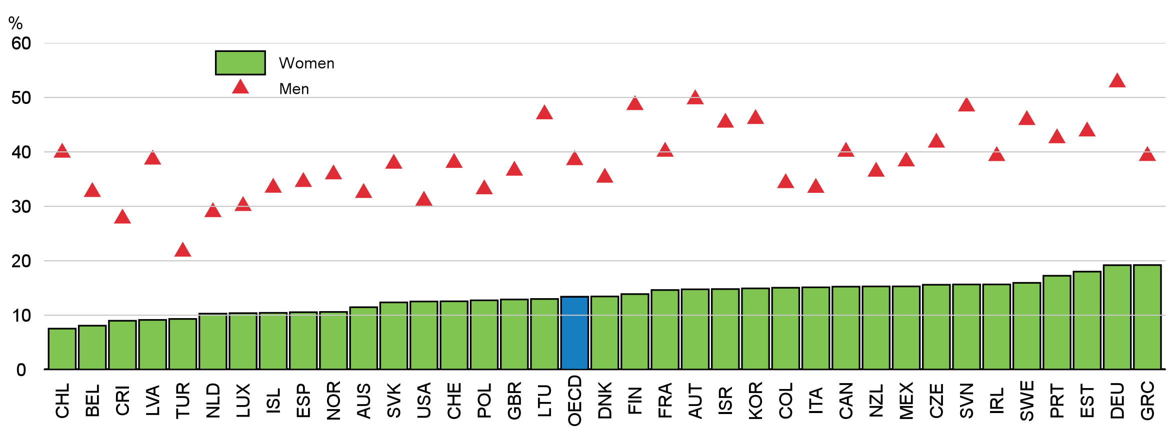


Source: OECD, Education at a Glance.

StatLink https://stat.link/7atxm8

Figure 2.7. Fewer women graduate in Science, ICT and engineering

Per cent of graduate gender group



Note: Includes natural sciences, mathematics and statistics, Information and Communication Technologies (ICTs) and engineering.
Reading note: In Greece, around 40% of tertiary graduate men graduate in Science, ICT and engineering, which contrasts with less than 20% of tertiary graduates' women.
Source: OECD Gender Data Portal.

StatLink https://stat.link/solctz

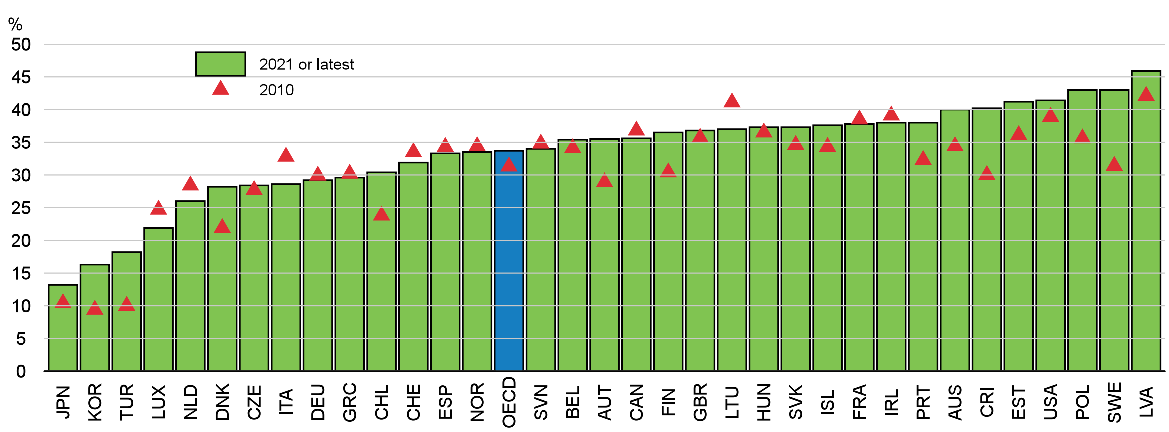
Women are generally over-represented in relatively low-pay activities, especially in the public sector. Wages also tend to be lower in professions with a high proportion of women than in male-dominated occupations. To some extent, lower pay may result from lower productivity in some female-dominated sectors, notably in services, than in male-dominated sectors. However, evidence from European countries and the United States suggests that lower wages in female-dominated professions could also result from undervaluation of the work done by women (Bettio and Verashchagina, 2009; Levanon et al., 2009). To the extent that lower wages in female-dominated professions make them relatively unattractive to men, gender imbalances may be perpetuated.

Women are still facing a glass ceiling. Even though it has increased in most countries over recent years, the average share of women on boards of listed companies in the OECD was only 28% in 2021. While this share is coming close to parity in countries like Iceland and France, it remains below 10% in Estonia, Hungary and Korea. Moreover, executive positions within boards are still rarely filled by women (Denis, 2022). Women also occupy less than a third of managerial positions on average (Figure 2.8). The under-representation of women in senior management warrants special attention not only from an equity point of view, but also because women in executive positions can have more of an impact on firm performance than as board members (Noland et al., 2016). Achieving parity in management positions, especially at the most senior levels, may be more challenging and take more time than parity for company board members. Many managers are promoted internally, and maintaining a balance between internal and external promotions is often necessary to preserve experience and staff motivation.

The slow progress in gender equality within businesses runs against evidence that greater diversity, in terms of gender, ethnicity, and culture, can enhance firm performance. In a fast-moving business environment, more diverse groups are likely to be better at rapidly finding responses to problems and at spotting new opportunities. Woolley et al. (2010) find that collective intelligence, defined as the general ability to perform a wide variety of tasks, increases with the proportion of women in a group. Homogenous groups can suffer from narrowmindedness, groupthink – the tendency to agree with a group's consensus without critical thinking – and over-confidence, whereas diversity fosters creativity and innovation through enhanced information processing and complex thinking (Galinsky et al., 2015). In addition to improved group decision-making, gender diversity can offer access to a larger pool of talent, a wider span of management skills, a better understanding of customer preferences, and improved corporate governance (Curtis et al., 2012).

Figure 2.8. Women remain under-represented in management

Female share of employment in managerial positions



Source: OECD Gender Data Portal.

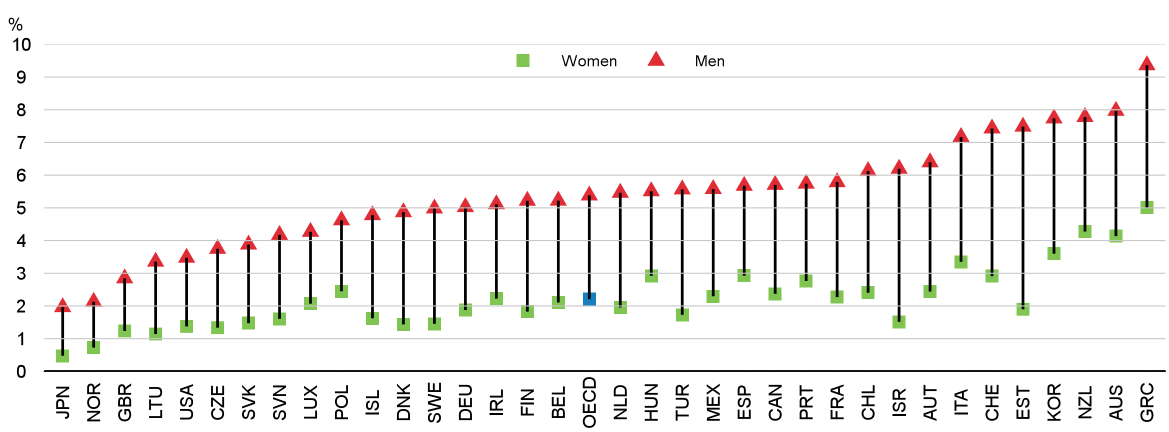
StatLink https://stat.link/51xum9

Women are less likely than men to become entrepreneurs. Self-employed women who are employers account on average for slightly over 2% of total female employment in the OECD, while the corresponding figure for men is around 5½ per cent. The gap is wide in all OECD countries (Figure 2.9). Women in OECD countries are also 1.5 times less likely than men to be working on setting-up a business start-up. Even though this gap varies greatly across countries, there are no OECD countries in which women are more active than men in business creation. Women also operate different types of businesses than men. In particular, women-run businesses are less likely to export and to introduce new products and services, and are often in personal service sectors, retail, tourism, health care and education (OECD, 2021c).

Many factors may contribute to the gender gap in entrepreneurship, including institutional barriers, such as family and tax policies that discourage labour market participation and entrepreneurship; negative social attitudes towards women's entrepreneurship; market failures; and personal choices (OECD, 2021c). Female entrepreneurs face higher barriers to access private finance compared to male colleagues, with the gap being particularly steep for high-potential innovative start-ups (Lassebie et al, 2019).

Figure 2.9. Fewer women than men are entrepreneurs

Percentage of self-employed who are employers in total employment



Source: OECD Gender Data Portal.

StatLink https://stat.link/qkmn41

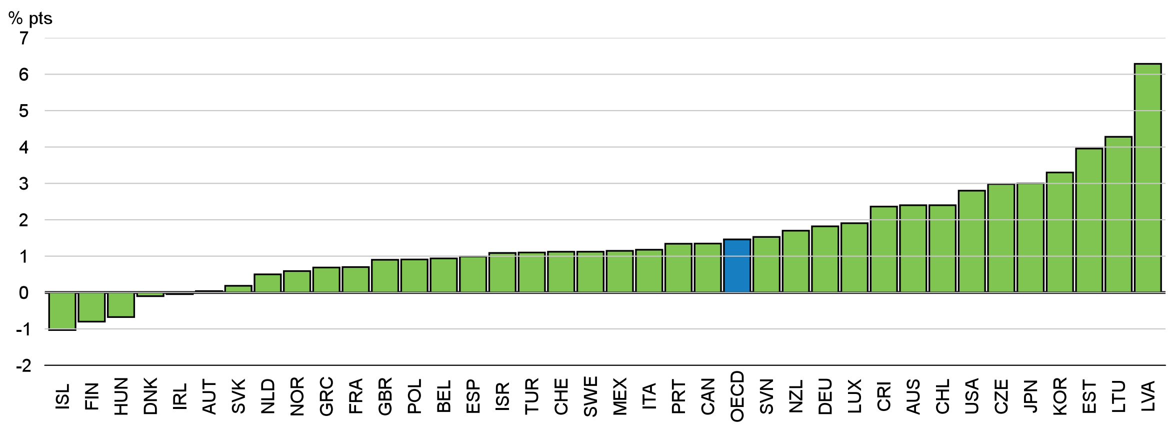
Women tend to be more vulnerable to economic shocks and poverty

Women are often more vulnerable to economic shocks than men, although this depends on the type of shock and the sectoral composition of employment (Périvier, 2014). In general, shocks primarily affecting industrial sectors tend to hit male employment, whereas shocks to service activities tend to hit women disproportionately. The COVID-19 pandemic is a case in point. Although women were at the core of the fight against COVID 19, as they account for about three quarters and two-thirds of health care and education employment respectively, they were also overrepresented in hard-hit industries that relied on travel and physical interaction. In addition, women tend to engage in involuntary part-time work more often than men, making them vulnerable to reductions in working time in period of economic duress (OECD, 2020d). Women also face increased risks of violence, exploitation, abuse or harassment during times of crisis (OECD, 2020a).

Women are at higher risk of poverty than men in most countries, especially in Asia and some Eastern European countries (Figure 2.10). This is particularly the case for single mothers, as just under one-third of single-parent families are income-poor, which is three times higher than the poverty rate for two-parent families (Adema et al., 2020), and for older women with low pensions (OECD, 2021a, b). The cost-of-living crisis is also affecting women disproportionately, as their financial buffers are reduced by the gender pay gap, the gender pension gap and more limited possibilities to work because of a higher burden of caring for children and other close relatives. Single mothers are particularly at risk of poverty resulting from higher energy and food prices. Older women, who generally live longer than men and on average receive lower pensions, are particularly at risk of energy poverty and health damage due to insufficient heating (European Parliament, 2023).

Figure 2.10. Women are at higher risk of poverty than men in most countries

Gender poverty gap



Note: Difference between the share of women and the share of men living with less than 50% of the median income.
Source: OECD Income Distribution Database and OECD calculations.

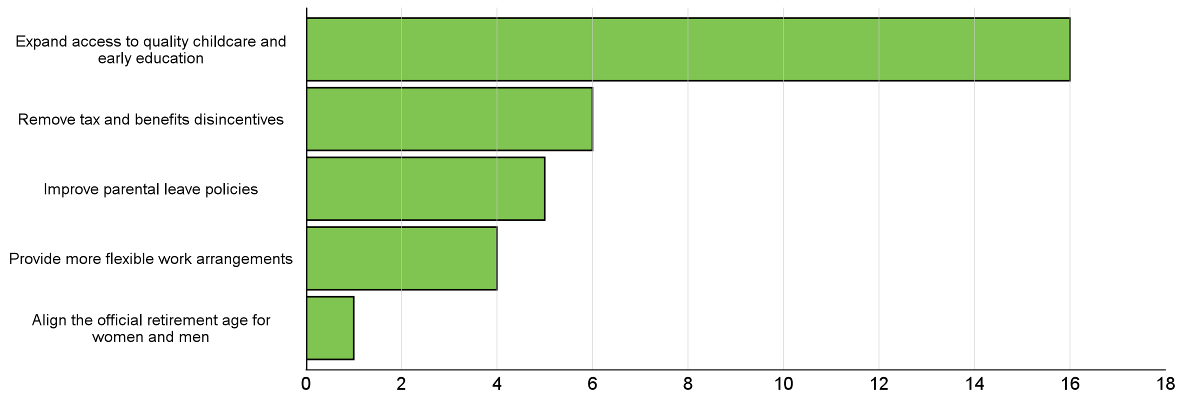
StatLink https://stat.link/46jsyp

Policies can support female employment and foster equal opportunities

A wide range of institutional and societal factors contribute to gender-related inequalities. These need to be tackled through a wide range of policies, including labour, family, childcare, pension, taxation, education, integration and entrepreneurship policies. Making the labour market more gender-inclusive is stated as a policy priority for about 20 OECD countries in the forthcoming edition of *OECD Going for Growth* (OECD, 2023c), with expanding access to quality childcare and early education, removing tax and benefits disincentives, improving parental leave policies and providing more flexible work arrangements identified as the main areas for action (Figure 2.11). Alongside such policies, mainstreaming gender into all policy fields is necessary to achieve gender equality. Specific policy recommendations to reduce gender imbalances are also made in the relevant country notes in Chapter 3.

Figure 2.11. More gender-inclusive labour markets is a priority for many countries

Number of OECD countries where given reforms are among top priorities



Source: Economic Policy Reforms 2023: Going for Growth, OECD Publishing, Paris, forthcoming.

StatLink https://stat.link/1kfsmh

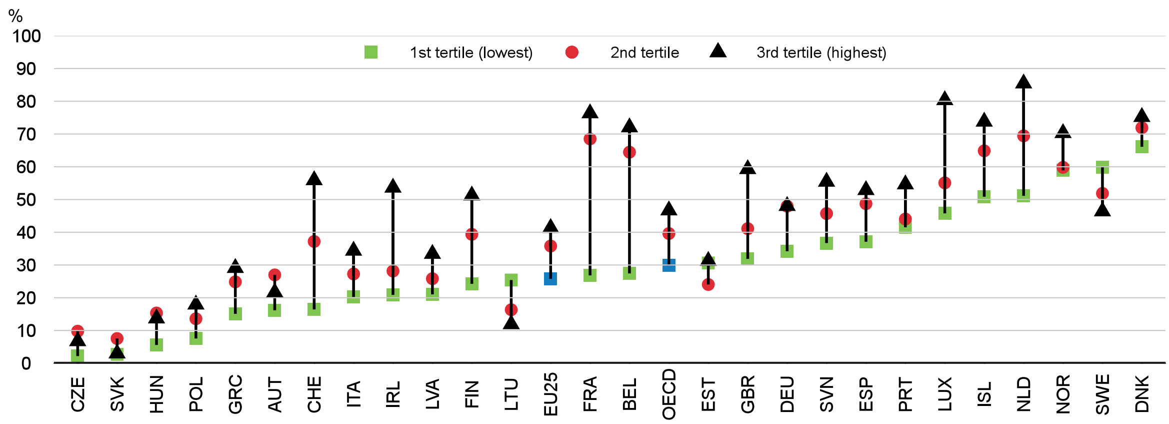
Broad and affordable access to childcare and early childhood education is crucial

Combining work and child-raising is often challenging. Low quality or unaffordable childcare can be a significant hindrance to women's labour market participation. Adequate childcare supply facilitates an earlier return to work after childbirth and provides the option for both parents to take on full-time work (OECD, 2022a). Although participation is not compulsory in all OECD countries, school enrolment between age 3 and 5 is significantly below 80% in only five countries (Costa Rica, Greece, Switzerland, Türkiye and United States). Conversely, on average only slightly over one in three children aged between 0 and 2 years participates in early childhood education and care services. The average hides large differences across countries, with extremely-low enrolment rates in some Eastern European countries and high rates in Scandinavia, and across income groups, with lower participation of children from less affluent families in most countries (Figure 2.12).

High childcare costs can make work financially unattractive, particularly for low-wage earners. On average, a parent of two children taking up full-time employment and using centre-based childcare loses about half of his/her earnings to either higher taxes or lower benefits. The loss is especially high for low-income earners and varies widely across countries (Figure 2.13). The United Kingdom has recently announced new policies to tackle barriers to parents working (Box 2.1). Beyond facilitating mothers' employment, access to affordable high-quality early childhood education can be decisive for children's development, especially for those from lower socio-economic background (OECD, 2018b). Well-developed elderly care can also favour female employment, as women are more likely than men to interrupt their careers or work part-time to care for family members (OECD, 2017).

Figure 2.12. Enrolment in early education varies widely across countries and income groups

Participation rates in early childhood education and care, 0- to 2-year-olds, by equivalised disposable income tertiles 2020 or latest

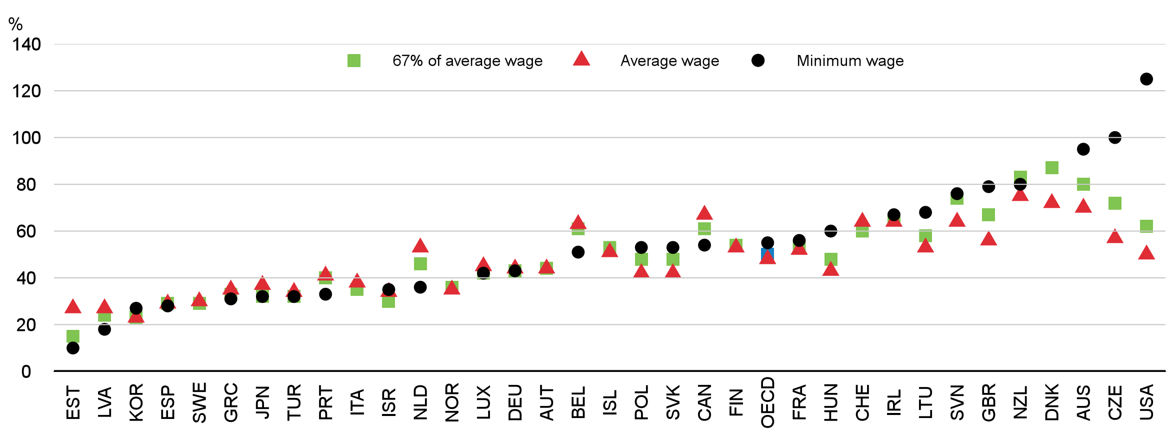


Note: OECD estimates based on information from EU-SILC. Data refer to children using centre-based services (e.g. nurseries or day care centres and pre-schools, both public and private), organised family day care, and care services provided by (paid) professional childminders, regardless of whether or not the service is registered or ISCED-recognised. Equivalised disposable income tertiles are calculated using the disposable (post tax and transfer) income of the household in which the child lives, and are based on the equivalised disposable incomes of children aged less than or equal to 12.
Source: OECD Family Database.

StatLink https://stat.link/zt5yq8

Figure 2.13. High childcare costs can generate high financial disincentives to enter employment

Per cent of earnings lost when entering employment and using childcare, 2021 or latest



Note: This indicator measures the percentage of earnings lost to either higher taxes or lower benefits when a parent of two children takes up full-time employment and uses centre-based childcare. Calculations refer to a couple with two children aged 2 and 3 where the other parent works full-time at 67% of the average wage.
Source: OECD (2023), Financial disincentive to enter employment with childcare costs (indicator, accessed on 13 April 2023).

StatLink https://stat.link/fm2j8y

Box 2.1. Addressing barriers to parents working in the United Kingdom

Although British women are highly educated, their skills are not fully utilised in the labour market and inequalities in earnings persist. Women adjust working hours to take over care responsibilities. Parental leave pay rates are low, providing little incentive to shift leave to fathers (OECD, 2022d).

The 2023 spring budget includes ambitious measures to remove barriers to parents working, to be fully implemented by September 2025. It substantially increases the amount of free childcare that working families can access. The government will provide over GBP 4.1 billion by 2027-28 to fund 30 free hours per week for working parents with children aged from 9 months to 3 years in England, matching the current eligibility for 3 to 4 year-olds.

The government is also providing additional funding to childcare providers, to help them provide sufficient capacity to deliver the free hours offered, manage cost pressures, and raise the quality of provision. Further flexibility in childcare provision will be introduced, notably by changing staff-to-child ratios from one-to-four to one-to-five for 2 years-olds in England and providing start-up grants for new child carers.

New policies will also aim to provide access to care in school from 8am to 6pm, to ensure that working parents are not forced to reduce their hours due to caring responsibilities.

Support for parents on Universal Credit (means-tested social benefit) who face the highest childcare costs will be increased and payments related to childcare costs will be brought forward to alleviate liquidity constraints faced by low-income households.

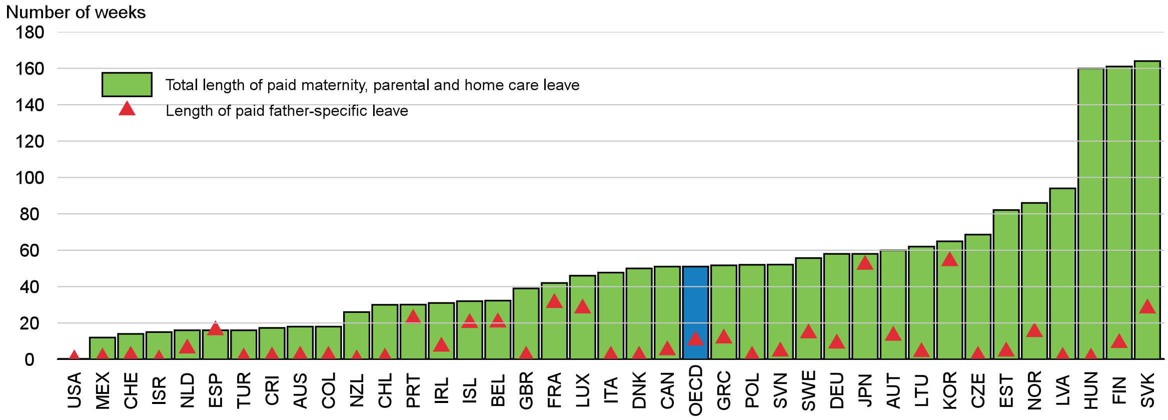
Source: *OECD Economic Surveys: United Kingdom 2022*, OECD Publishing, Paris; HM Treasury, Spring Budget 2023, Policy Paper.

Promoting work-life balance for both men and women through parental leave arrangements

Promoting work-life balance, which is an essential dimension of well-being, supports gender equality by making work more compatible with family care and allowing a better sharing of domestic tasks between men and women. Potential actions include: incorporating part-time and other time flexibility options in career patterns; ensuring that employees who use workplace flexibilities are not penalised for doing so; promoting part-time as a temporary rather than a permanent solution for employees with family obligations; and developing policies and transition paths supporting the move from part-time to full-time work (OECD, 2015). Although teleworking provides welcome flexibility, it has mixed effects on work-life balance inequalities, the gender wage gap, and gender disparities in career progression (Touzet, 2023).

Parental leave, which is still very unevenly split between parents, even where institutional settings encourage sharing, tends to slow women's career progression. While opportunities for young women have generally increased in OECD countries, mothers tend to lose ground after having children, sometimes even moving into lower quality jobs or exiting the labour market altogether. The "child penalty" associated with motherhood, defined as the long-run loss in gross labour earnings excluding taxes and transfers, that results from lower employment, hours worked and wage rates, has been estimated from around 20% in Denmark and Sweden to more than 50% in Austria and Germany, with the United Kingdom and the United States in between (Kleven et al., 2019). In recent years, policy reforms in many OECD countries have aimed to encourage fathers to take up parental leave through earmarked months or bonus systems. The number of OECD countries offering some parental leave reserved for fathers rose from seven in 1995 to 34 in 2020 (OECD, 2022a). Nevertheless, parental leave entitlements are still very uneven between parents in most countries (Figure 2.14), calling for further progress to encourage a more equal use of parental leave. For example, extending parental leave and making it more flexible is part of the broader Australian National Strategy for gender equality (Box 2.2).

Figure 2.14. Parental leave entitlements are still very uneven between parents



Note: Maternity leave refers to the number of weeks of job-protected leave available for mothers just before and after childbirth. For countries where there is no separate legislation for maternity leave, the weeks of parental leave reserved for the exclusive use of mothers around childbirth are reported. Parental leave with job protection refers to the number of weeks after maternity leave which a woman can take as parental leave with her job protected, disregarding payment conditions. Total duration of paid maternity and parental leave refers to the total number of weeks which a women can be on paid leave after the birth of a child combining both maternity, parental and home care leave. Paid father-specific leave refers to the number of paid weeks reserved for the exclusive use of fathers, including entitlements to paid paternity leave, 'father quotas' or periods of paid parental leave that can be used only by the father and cannot be transferred to the mother, and any weeks of paid sharable leave that must be taken by the father in order for the family to qualify for 'bonus' weeks of parental leave.
Source: OECD Family Database.

StatLink https://stat.link/p8d5hu

Box 2.2. The Australian National Strategy for gender equality

Improving gender equality is a key objective for the Australian government. A National Strategy to Achieve Gender Equality has been articulated that will be partly informed by the newly established Women's Economic Equality Taskforce.

Some reforms are already underway:

- The government paid parental leave schemes for mothers and fathers are being combined and the total amount of paid parental leave will increase from 20 weeks to 26 weeks by July 2026. In addition, increased flexibility is being introduced, with parents able to take leave concurrently and in blocks as small as one day at a time. Two weeks of leave will be reserved for each parent as a dedicated "use it or lose it" portion.
- The Child Care Subsidy was increased in the October 2022 Budget. However, an additional 39 000 early childhood care workers will be needed by 2023 to meet needs. The government has tasked the Australian Competition and Consumer Commission to undertake a 12-month inquiry into the cost of childcare (first report to be released in June 2023) and the Productivity Commission to conduct a comprehensive review of the childcare sector (to commence in July 2023).

The government's Employment White Paper (to be released by the end of September 2023), which will explore the policies needed for Australia's future labour market, will also put a strong emphasis on improving women's economic participation and equality.

Recent changes to industrial relations laws embed the principle of gender equality in the Fair Work Commission's decision-making processes. In addition, various changes have been made to labour market regulations to promote gender equity. These include provisions to increase pay transparency, the ability to request flexible work arrangements and punishment of employers when sexual harassment occurs in their workplace.

Source: OECD (2023d), *OECD Economic Surveys: Australia 2023*, forthcoming.

Facilitating the return to work after an extended parental leave through training

Mothers often face challenges upon returning from long parental leave. This is especially true in times when work practices and tools evolve rapidly. Training, re-skilling and upskilling schemes can help women re-engage in their careers and assist them in transitioning to new jobs. Digital skills can be decisive in that respect, as hurdles to access, affordability, lack of education and inherent biases and socio-cultural norms often curtail women and girls' ability to benefit from the opportunities offered by the digital transformation (OECD, 2018c, 2019). The green transition requires broadening the access of women to emerging green-task jobs, notably by encouraging early engagement in science, technology, engineering and mathematics, as well as providing career guidance, while offering retraining and upskilling opportunities to workers in polluting jobs, which are mainly held by men (OECD, 2023b; Causa et al., 2023).

Supporting gender-balanced career advancements through corporate disclosure

Female employment is often held back by a lack of opportunities to access sufficiently rewarding and well-paid jobs. As the bulk of the gender wage gap is concentrated within firms, i.e. the same firm pays men more than women with similar skills (OECD, 2022a), policies targeted at firms are key to promoting women's access to better jobs and reducing gender wage gaps. They include pay transparency measures, such as disclosure requirements, gender equality audits, job-classification systems, voluntary target setting and mandatory quotas for women in higher-level positions or company boards (OECD, 2022a). More than half of OECD countries now require private sector firms to systematically report their gender pay gaps. Many of the reporting schemes are embedded in extensive equal-pay audit systems. Governments should ensure that reporting schemes do not exclude SMEs and workers in precarious work arrangements, effectively enforce reporting rules, conduct more frequent and rigorous evaluations of their effects, and raise awareness of pay gap reporting rules and results among firms, employees, their representatives and the public (OECD, 2023e).

Addressing biases in the tax and pension systems

Wage disadvantages can be compounded by the tax and benefit system. The role of taxation of second earners, who are often women, in creating work disincentives has long been recognised. Empirical evidence points to a strong responsiveness of second earners to these disincentives (OECD, 2011). The progressivity of the tax system eases the burden on part-time workers, among which women are over-represented. However, when coupled with the removal of tax credits and allowances once a part-time worker enters full-time work, progressivity creates disincentives for part-time workers to move to full-time work (Harding et al., 2022). Moving from household-based towards individual taxation would help to remove negative work incentives for second earners. Among the OECD countries that responded to the OECD Tax & Gender Stocktaking Questionnaire 2021, 18 reported applying individual taxation, five household-level taxation and six providing an option between the two (OECD, 2022c). In the same survey, countries identified the gender impact of tax credits and allowances, tax system progressivity and social security contributions as key areas for future work to improve tax systems and enhance gender equality.

Lower wages and career breaks translate into lower pensions for women. While addressing the root causes is key, some adjustments to retirement savings arrangements could ensure that they do not compound existing inequalities in women's retirement benefits and could even help reduce them. In some cases, particular features of retirement plans disadvantage women, for instance when eligibility criteria are based on working hours or earnings, or when contributions stop during periods of maternity leave, or when women do not get their share of retirement benefit entitlements upon divorce (OECD, 2021a).

Better integrating foreign-born women through tailored labour-market programmes

Effective integration of foreign-born women is crucial to achieve broader equality objectives, including the reduction of gender gaps and the successful inclusion of children of migrants. Many women come to OECD countries via family migration and have a weak connection to the labour market. They often struggle to have foreign qualifications and skills recognised in the host country. Programmes to reach out to migrant women, integration courses, and participation of migrant women in training and other active labour market policies can enhance economic and social integration (OECD, 2020e). For example, initiatives such as the Swedish *Establishment Programme* for recently arrived immigrants and the pilot project *Equal Establishment,* which aims to improve job matching for foreign-born women, show that well-tailored active labour policy measures can have a significant impact on immigrant women's employment (OECD, 2021d, 2023f).

Promoting women's access to management positions and entrepreneurship

Many countries have put in place policies to increase the proportion of women on company boards and management, including quotas, targets and disclosure requirements. For example, quotas are in place in Austria, Belgium, France, Germany, Greece, Iceland, Israel, Italy, Korea, Netherlands, Norway and Portugal. Countries that have initiated quotas or targets for board composition in listed companies have on average achieved a greater level of board gender diversity than other countries. However, such measures have often led to a small group of women serving on multiple boards or an increase in family-related appointments. Moreover, there seems to be no strong link between the share of women on company boards and the proportion of women in management positions. This calls for complementary initiatives to strengthen the pipeline for leadership positions, such as programmes to strengthen the professional and leadership skills of women, and advocacy and awareness-raising initiatives (Denis, 2022).

Policies to support women's entrepreneurship need to be strengthened. Recent OECD analysis suggests that mainstream entrepreneurship policies and programmes are not gender-neutral (OECD, 2021c). Explicit approaches are therefore needed to address barriers to entrepreneurship that are experienced differently by men and women, and to ensure that women have equal access to policy support for entrepreneurs. Widely-used policies to enhance gender equality include actions on entrepreneurship culture, skills development, access to finance, and the promotion of entrepreneurship networks and ecosystems. However, measures supporting women's entrepreneurship are often insufficient, calling for further action on three priorities: introducing overarching policy frameworks for women's entrepreneurship; better adapting women's entrepreneurship policy interventions to institutional, cultural and social contexts; and reinforcing policy evaluation as a foundation for scaling policy initiatives. Creating targeted financial instruments for female entrepreneurs is one concrete action that would support women-owned businesses.

Enhancing women's financial inclusion

Financial literacy is essential to improve women's financial empowerment, opportunities, and well-being. In many countries, women have less financial knowledge than men, are less confident in their financial knowledge and skills, and enjoy lower access to formal financial products (Lusardi and Mitchell, 2008; Maravalle and González Pandiella, 2022). They are more likely to experience difficulties in making ends meet, saving, and choosing financial products (OECD, 2013a, b). Gender differences are driven by several potentially interrelated factors, including differences in socio-economic conditions, skills, attitudes, and opportunities (Hung et al., 2012). Policies to enhance women's financial literacy generally target sub-groups, such as low-income women or micro and small entrepreneurs, and aim at improving women's financial inclusion and use of formal saving products, preventing over-indebtedness, helping women planning for retirement, and supporting female entrepreneurship. Programmes need to be tailored according to the specific needs of women and girls with respect to their financial knowledge, confidence and financial strategies, with a particular focus on their ability to make ends meet, save, choose and use financial products, and seek information and advice. They need to involve all stakeholders and the results should be systematically monitored and evaluated (OECD, 2013b). It is also necessary to ensure that women are not unduly denied access to credit or charged higher interest rates than men for the same risk level. Evidence from the US mortgage market points to better performance of loans to women, compared to men with similar credit profiles, which are not reflected in pricing and acceptance rates (Goodman et al., 2016).

Mainstreaming gender across policies

The multiple dimensions and root causes of gender inequality underscore the benefits of mainstreaming gender across policy domains. Gender mainstreaming can involve the introduction of laws or requirements for public servants to promote gender equality. Between 2017 and 2022, nine OECD countries introduced new legislation or regulation underpinning gender mainstreaming in at least one policy area. Strategic planning, as reflected in documents, formal government commitments and dedicated programmes, is another powerful avenue for gender mainstreaming. Countries such as Austria, Denmark, Iceland, Lithuania, Luxembourg and the Netherlands have introduced requirements to advance gender equality priorities in government programmes. Gender budgeting, which is now used in over 60% of OECD countries, is also a powerful tool to guide gender equality policies (OECD, 2023g). The OECD has developed a comprehensive Toolkit on Mainstreaming and Implementing Gender Equality, designed to help policymakers identify weaknesses and opportunities in their country and work contexts, and highlight approaches available to advance gender equality (OECD, 2015).

Gender-disaggregated data are key to raising awareness of gender issues and designing adequate, evidence-based policies to fight inequality. For example, gaps have been identified in data needed to assess the gender impact of taxation (OECD, 2022c). The sources of gender wage gaps are often difficult to assess. Detailed and timely information, such as that provided by the Swedish National Mediation Office annual report, which separates differences related to age, education, occupation, sector of employment and hours worked from gender discrimination, can facilitate corrective action (Swedish National Mediation Office, 2021). Such examples illustrate the benefits of expanding gender-related data collection and dissemination. Civil society organisations, including NGOs and women’s groups, can help to gather information about the potential or actual impact of government policies, and should be consulted regularly. Surveys, interviews, reviews, opinion polls, focus group discussions and benchmarking are also effective methods for obtaining and analysing data on diversity policies. Actions to be considered include ensuring wide access to gender-disaggregated data at national and sub-national levels, using public consultations to collect missing information, and enhancing public officials and statisticians’ awareness of gender issues through information campaigns and trainings (OECD, 2015).

Bibliography

Adema, W., Clarke, C., Thévenon, O. (2020), “Family Policies and Family Outcomes in OECD Countries”, In: Nieuwenhuis, R. and W. Van Lancker (eds), *The Palgrave Handbook of Family Policy,* Palgrave Macmillan, Cham.

Bettio, F. and A. Verashchagina (2009), Gender Segregation in the Labour Market, Root Causes, Implications and Policy Responses in the EU, European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities.

Brussino, O. and J. McBrien (2022), “Gender stereotypes in education: Policies and practices to address gender stereotyping across OECD education systems”, *OECD Education Working Papers*, No. 271, OECD Publishing, Paris.

Carlana, M. (2019), “Implicit Stereotypes: Evidence from Teachers’ Gender Bias”, *The Quarterly Journal of Economics*, 134(3), 1163-1224.

Causa, O. et al. (2023), “Lost in the green transition? From measurement to stylized facts”, *OECD Economics Department Working Papers*, OECD Publishing, Paris, forthcoming.

Causa, O., N. Luu and M. Abendschein (2021), "Labour market transitions across OECD countries: Stylised facts", *OECD Economics Department Working Papers*, No. 1692, OECD Publishing, Paris.

Causa, O. and Å. Johansson (2010), "Intergenerational Social Mobility in OECD Countries", OECD Journal: Economic Studies, vol. 2010/1.

Cavalcanti, T. and J. Tavares (2016), “The Output Cost of Gender Discrimination: A Model-Based Macroeconomics Estimate, *The Economic Journal*, 126, 109-134.

Charlton, E. (2023), “This is why women are bearing the brunt of the cost of living crisis, according to research”, World Economic Forum.

Ciminelli, G., C. Schwellnus and B. Stadler (2021), “Sticky floors or glass ceilings? The role of human capital, working time flexibility and discrimination in the gender wage gap”, *OECD Economics Department Working Papers*, No. 1668, OECD Publishing, Paris,

Criscuolo, C, P Gal, T Leidecker and G Nicoletti (2021), "The human side of productivity: Uncovering the role of skills and diversity for firm productivity", *OECD Productivity Working Papers* No. 29, OECD Publishing, Paris.

Cuberes, D., and M. Teignier (2016). “Aggregate Effects of Gender Gaps in the Labor Market: A Quantitative Estimate”. *Journal of Human Capital*, 10(1), 1-32.

Curtis, M., C. Schmid and M. Struber (2012), “Gender diversity and corporate performance”, Credit Suisse Research Institute, Zurich.

Denis, E. (2022), “Enhancing gender diversity on boards and in senior management of listed companies”, *OECD Corporate Governance Working Papers*, No. 28, OECD Publishing, Paris.

Duflo, E. (2012), “Women empowerment and economic development”, *Journal of Economic Literature*, 50(4), 1051-79.

Encinas-Martín, M. and M. Cherian (2023), Gender, Education and Skills: The Persistence of Gender Gaps in Education and Skills, OECD Skills Studies, OECD Publishing, Paris.

European Parliament (2023), “Gender aspects of energy poverty”.

Galinsky, A. et al. (2015), “Maximizing the gains and minimizing the pains of diversity: a policy perspective”, *Perspectives on Psychological Science*, 10(6).

Goodman, L., J. Zhu and B. Bai (2016), “Women Are Better than Men at Paying Their Mortgages”, *Urban Institute Research Report*, Washington, DC.

Harding, M., D. Paturot and H. Simon (2022), "Taxation of part-time work in the OECD", *OECD Taxation Working Papers*, No. 57, OECD Publishing, Paris.

HM Treasury (2023), Spring Budget 2023, Policy Paper, London.

Hung, A., J. Yoong and E. Brown (2012), "Empowering Women Through Financial Awareness and Education", *OECD Working Papers on Finance, Insurance and Private Pensions*, No. 14, OECD Publishing, Paris.

Kleven, H., C. Landais, J. Posch, A. Steinhauer and J. Zweimüller (2019), “Child Penalties across Countries: Evidence and Explanations”, *AEA Papers and Proceedings*, 109, 122-26.

Lassébie, J., et al. (2019), “Levelling the playing field: Dissecting the gender gap in the funding of start-ups”, *OECD Science, Technology and Industry Policy Papers*, No. 73, OECD Publishing, Paris.

Levanon, A., P. England and P. Allison (2009), “Occupational feminization and pay: assessing causal dynamics using 1950-2000 U.S. Census data”, *Social Forces,* 88(2), 865-892.

Lusardi, A. and O.S. Mitchell (2008), “Planning and Financial Literacy: How Do Women Fare?”, *American Economic Review*, 98 (2), 413-17.

Maravalle, A. and A. González Pandiella (2022), "Expanding access to finance to boost growth and reduce inequalities in Mexico", *OECD Economics Department Working Papers*, No. 1717, OECD Publishing, Paris.

Noland, M., T. Moran and B. Kotschwar (2016), "Is gender diversity profitable? Evidence from a global survey", Peterson Institute for International Economics Working Paper Series, No. 16-3, Washington DC.

OECD (2023a), Joining Forces for Gender Equality: What is Holding us Back?, OECD Publishing, Paris.

OECD (2023b), Job Creation and Local Economic Development 2023: Bridging the Great Green Divide, OECD Publishing, Paris.

OECD (2023c), *Economic Policy Reforms 2023: Going for Growth*, OECD Publishing, Paris, forthcoming.

OECD (2023d), *OECD Economic Surveys: Australia 2023*, OECD Publishing, Paris, forthcoming.

OECD (2023e), Gender pay gap reporting in OECD countries: Guidance for implementation and monitoring, OECD Publishing, Paris, forthcoming.

OECD (2023f), *OECD Economic Surveys: Sweden 2023*, OECD Publishing, Paris, forthcoming.

OECD (2023g), "OECD Best Practices for Gender Budgeting", *OECD Journal on Budgeting*, Vol. 23/1.

OECD (2022a), "Same skills, different pay: Tackling Gender Inequalities at firm level", OECD, Paris.

OECD (2022b), Education at a Glance 2022: OECD Indicators, OECD Publishing, Paris.

OECD (2022c), Tax Policy and Gender Equality: A Stocktake of Country Approaches, OECD Publishing, Paris.

OECD (2022d), OECD Economic Surveys: United Kingdom 2022, OECD Publishing, Paris.

OECD (2021a), Towards Improved Retirement Savings Outcomes for Women, OECD Publishing, Paris.

OECD (2021b), Pensions at a Glance 2021: OECD and G20 Indicators, OECD Publishing, Paris.

OECD (2021c), Entrepreneurship Policies through a Gender Lens, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris.

OECD (2021d), OECD Economic Surveys: Sweden 2021, OECD Publishing, Paris.

OECD (2020a), "Women at the core of the fight against COVID-19 crisis", *OECD Policy Responses to Coronavirus (COVID-19)*, OECD, Paris.

OECD (2020b), OECD Employment Outlook 2020: Worker Security and the COVID-19 Crisis, OECD Publishing, Paris.

OECD (2020c), How's Life? 2020: Measuring Well-being, OECD Publishing, Paris.

OECD (2020d), "Distributional risks associated with non-standard work: Stylised facts and policy considerations", *Tackling Coronavirus Series*, OECD, Paris.

OECD (2020e), "How to strengthen the integration of migrant women?", Migration Policy Debates, N°25, OECD, Paris.

OECD (2019), The Role of Education and Skills in Bridging the Digital Gender Divide, Evidence from APEC Economies, OECD, Paris.

OECD (2018a), A Broken Social Elevator? How to Promote Social Mobility, OECD Publishing, Paris.

OECD (2018b), Early Learning Matters, OECD, Paris.

OECD (2018c), Bridging the Digital Gender Divide, Include, Upskill, Innovate, OECD, Paris.

OECD (2017), The Pursuit of Gender Equality: An Uphill Battle, OECD Publishing, Paris.

OECD (2015), OECD Toolkit for Mainstreaming and Implementing Gender Equality, Implementing the 2015 OECD Recommendation on Gender Equality in Public Life, OECD, Paris.

OECD (2013a), Women and Financial Education: Evidence, Policy Responses and Guidance, OECD Publishing, Paris.

OECD (2013b), Addressing women's needs for financial education*,* International Network on Financial Education (INFE), OECD, Paris.

OECD (2011), Taxation and Employment, OECD Tax Policy Studies, No. 21, OECD Publishing, Paris.

Périvier, H. (2014), "Men and women during the economic crisis. Employment trends in eight European countries", *Revue de l'OFCE*, 133(2), 41-84.

Stevenson, B. (2021), "Women, work, and families: recovering from the pandemic-induced recession", Economic analysis, Hamilton Project, Washington DC.

Swedish National Mediation Office (2021), Wage Differences Between Women and Men 2020, Stockholm.

Touzet, C. (2023), "Teleworking through the gender looking glass: Facts and gaps", *OECD Social, Employment and Migration Working Papers*, No. 285, OECD Publishing, Paris.

Woolley, A. et al. (2010), "Evidence for a collective intelligence factor in the performance of human groups", *Science*, Vol. 330(6004).

3 Developments in individual OECD and selected non-member economies

Argentina

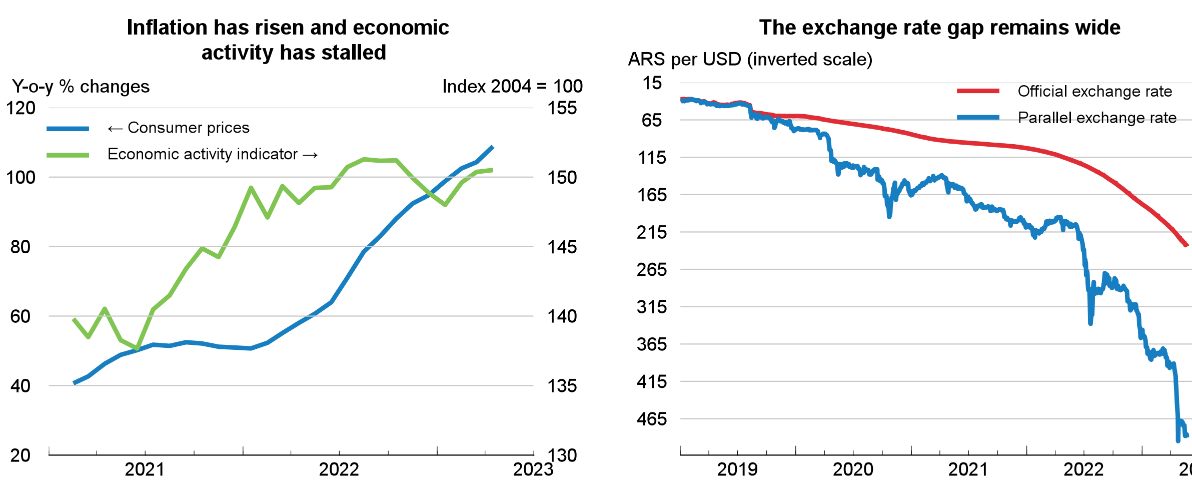
Following an economic slowdown at the end of 2022, GDP is expected to contract by 1.6% in 2023 and then recover by 1.1% in 2024. The labour market has improved, but the coming recession is expected to bring a drop in employment. Exports are suffering from a severe crop drought in 2023 but will recover in 2024. Inflation surpassed 100% and will remain high in the short term, despite a slightly less expansionary fiscal stance. Tight capital controls and policy uncertainty ahead of the October 2023 elections will hold back investment and consumption in 2023.

Public spending will rightly fall during 2023, as energy subsidies are scaled back and compliance with fiscal targets requires further spending restraint. A continued reduction in transfers from the central bank to the treasury should reduce inflationary pressures in the medium term, narrow the gap between the official and the parallel exchange rates and lower the risk of a sudden devaluation. Stabilising the macroeconomic situation and lowering inflation will be crucial to reduce high poverty and address mounting social pressures.

Growth is weakening

Output contracted in the last quarter of 2022, mainly driven by a decline in investment and private consumption. Short-term indicators point to a further contraction during the first half of 2023, as agricultural production is affected by a severe drought. Unemployment has returned to pre-pandemic levels, reaching 6.3% in the fourth quarter of 2022, although informality has increased sharply, approaching 40% of the labour force. Consumer confidence has declined. Headline inflation rose to 108.8% in the year to April, the highest level in over 30 years, amid a widening gap between the managed official and the parallel exchange rates. With no formal anchor for inflation expectations, inflation is broad-based, and core inflation is at 105%.

Argentina



Source: CEIC; Instituto Nacional de Estadísticas y Censos; OECD Exchange rate database; Central Bank of Argentina; and Ambito.com.

StatLink https://stat.link/7lbwkr

Argentina: Demand, output and prices

Argentina	2019	2020	2021	2022	2023	2024
	Current prices ARS billion	Percentage changes, volume (2004 prices)				
GDP at market prices	21 558.4	-9.9	10.4	5.2	-1.6	1.1
Private consumption	14 256.1	-13.7	10.0	9.4	-1.8	1.2
Government consumption	3 544.9	-1.9	7.1	1.8	-1.8	0.6
Gross fixed capital formation	3 061.1	-13.0	33.4	10.9	-6.7	0.9
Final domestic demand	20 862.1	-11.8	12.8	8.4	-2.6	1.1
Stockbuilding[1]	2.4	1.6	0.2	-0.4	-1.4	0.0
Total domestic demand	20 864.4	-10.2	13.2	8.0	-4.2	1.1
Exports of goods and services	3 864.3	-17.7	9.2	5.7	3.5	2.4
Imports of goods and services	3 170.3	-18.5	22.0	17.4	-7.9	2.2
Net exports[1]	694.0	-0.5	-1.5	-1.6	1.8	0.1
Memorandum items						
GDP deflator	_	40.1	54.2	69.7	100.8	86.8
Consumer price index	_	40.4	48.0	72.4	106.9	88.3
Current account balance (% of GDP)	_	0.7	1.4	-0.5	0.0	0.2

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/g5sjub

As a net energy importer, Argentina has been exposed to high and volatile energy prices, particularly of LNG. To soften the impact of higher energy costs, the government has extended price controls into 2023, which also cover some food and beverage items. Lower export revenues and low foreign currency reserves are increasingly putting pressure on public finances, external accounts, and the overall economy.

Fiscal and monetary policy will remain tight

Fiscal policy targets imply a less expansionary fiscal stance in the future but meeting the primary deficit target of 1.9% of GDP in 2023 will be challenging, despite continued reductions of energy subsidies. In the coming months, the drought will lead to a sharp drop in export tax revenues, which could raise the fiscal deficit. The central bank has raised the policy interest rate thirteen times since early 2022, to reach 97%, which has improved the incentives for holding domestic currency balances and relieved exchange rate pressures. Given the recent increase in inflation, further increases are warranted during 2023. Continuous reductions in transfers from the central bank to the treasury will be key to stabilise the economy, and this will also require further fiscal restraint.

Output will contract in 2023 amid increasing risks

The economy will contract by 1.6% in 2023 and then gradually recover, with growth of 1.1% in 2024. Higher inflation, fiscal moderation and tighter capital controls will all weigh on consumption during 2023, while low confidence levels and import restrictions will continue to hold back investment. The drought and the bringing forward of some exports in 2022 due to exchange rate incentives imply weaker exports in 2023. Inflation is projected to remain high in 2023 amid high food inflation and emerging wage pressures. A gradual upturn is projected for 2024 as macroeconomic vulnerabilities are gradually reduced and exports recover. The opening of a newly built gas pipeline from gas fields in the country's south is expected to reduce dependence on gas imports and could reduce external vulnerabilities.

Risks appear tilted to the downside. Low foreign exchange reserves, tight currency restrictions and large volumes of outstanding central-bank bonds in a context of rising inflation and interest rates could lead to currency devaluation, spiralling inflation, and an inability to comply with current fiscal targets. Recently introduced preferential exchange rate arrangements for agricultural exporters managed to anticipate currency inflows and provide temporary relief, while shifting some of the underlying risks into the near future. Political pressures for higher spending in the face of a deteriorating economic situation could also jeopardise the planned fiscal adjustment. On the upside, stronger global demand for Argentina's exports could lead to stronger growth and currency inflows, reducing pressure on the exchange rate.

More targeted reforms could reduce poverty and strengthen growth

More effective social spending could help to reduce poverty and inequalities, as poverty has risen to 39% and more than 50% of children live below the poverty line. Current attempts to improve the targeting of utility subsidies go into the direction of improving public spending efficiency. However, further reforms to subsidies are still pending and remain politically challenging. Reducing barriers to competition and trade, raising female participation in the labour market including through better access to early childhood education, and investing more in the quality of primary and secondary education would foster stronger productivity and improve equity.

Australia

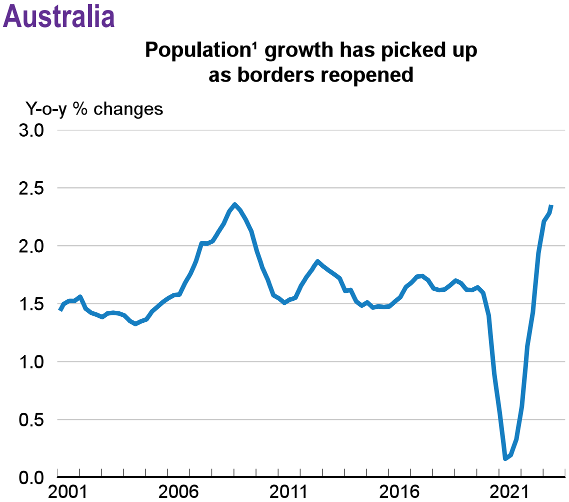
Real GDP is projected to grow by 1.8% in 2023 and 1.4% in 2024. Tightening financial conditions and a weaker outlook for real incomes will weigh on growth. Labour market pressures will ease, with the unemployment rate rising to 4.6% by the end of 2024. Inflation, which likely peaked in late 2022, is projected to continue declining in 2023 as supply chain and commodity related cost pressures wane. A downside risk is a stronger-than-projected cutback in household consumption amid falling house prices.

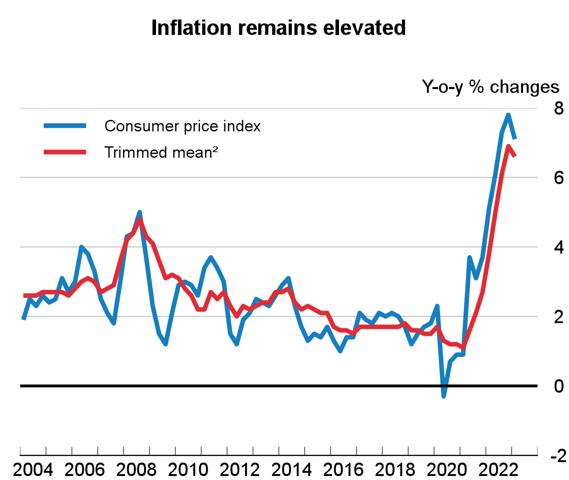
Further monetary policy tightening will be necessary to bring inflation down to the 2-3% target range. Fiscal policy is expected to remain broadly neutral over the projection period. Further fiscal reforms should be considered to improve the sustainability of public finances, including redesigning the National Disability Insurance Scheme and improving the governance of infrastructure project selection and implementation. Reforms that improve the integration of women in the labour market and reduce the gender wage gap are also a priority. In this context, changes to tax and transfer policy settings, measures that improve childcare availability and adjustments to the parental leave system should be considered.

Economic activity slowed further

Real GDP growth in Australia slowed further in the last quarter of 2022, as strong inflation and tightening financial conditions weighed on demand. Population growth has picked up, partly due to border reopening and the return of international students following the pandemic, sustaining economic growth and providing some relief to the tight labour market. Inflation, although still high, appears to have peaked, with yearly growth in the CPI slowing to 7% in Q1 2023, driven by slowing goods and tradables inflation, although services inflation remains elevated. Quarterly wage growth appears to be gradually easing despite ongoing tightness in the labour market, with the unemployment rate at 3.7% near historic lows. High-frequency indicators suggest that consumption has slowed amid tightening financial conditions, with mortgage rates on outstanding loans reaching 5.9% in March, up from a low of 2.9% in April 2022.

Australia





1. Civilian population aged 15 years and over.
2. Trimmed mean is the average rate of inflation after 'trimming' away the items with the largest price changes (positive or negative). It is the weighted average of the middle 70% of items.
Source: Australian Bureau of Statistics.

StatLink https://stat.link/7prgbz

Australia: Demand, output and prices

Australia	2019	2020	2021	2022	2023	2024
	Current prices AUD billion	Percentage changes, volume (2020/2021 prices)				
GDP at market prices	1 993.7	-1.9	5.2	3.6	1.8	1.4
Private consumption	1 064.4	-5.8	5.1	6.5	2.1	1.3
Government consumption	411.6	7.8	5.4	5.2	1.0	1.3
Gross fixed capital formation	453.1	-2.8	10.6	0.9	0.6	1.0
Final domestic demand	1 929.1	-2.2	6.4	4.8	1.5	1.2
Stockbuilding[1]	- 2.0	-0.2	0.7	0.3	-0.6	0.0
Total domestic demand	1 927.2	-2.4	7.1	5.1	0.8	1.2
Exports of goods and services	492.1	-9.4	-2.1	3.2	5.6	3.9
Imports of goods and services	425.5	-12.7	5.6	12.7	1.3	3.9
Net exports[1]	66.5	0.4	-1.5	-1.6	1.3	0.2
Memorandum items						
GDP deflator	_	0.8	5.5	8.0	4.6	2.8
Consumer price index	_	0.9	2.8	6.6	5.4	3.2
Core inflation index[2]	_	1.3	2.4	5.9	5.5	3.2
Unemployment rate (% of labour force)	_	6.5	5.1	3.7	3.8	4.4
Household saving ratio, net (% of disposable income)	_	17.4	14.8	7.9	4.7	5.0
General government financial balance (% of GDP)	_	-12.2	-4.8	-1.8	-0.8	-1.5
General government gross debt (% of GDP)	_	66.3	63.3	64.5	64.9	66.2
Current account balance (% of GDP)	_	2.3	3.0	1.1	2.0	1.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/1t67x3

After COVID-19 restrictions were lifted in China, the return of tourism and education-related travel to Australia has boosted services exports. The upturn in China has also raised the price of Australian bulk commodities, particularly iron ore. Nevertheless, overall commodity prices have continued to normalise in recent months, although they remain elevated.

Further tightening of monetary policy is likely required

The Reserve Bank of Australia has continued to tighten monetary policy in response to rising inflation, raising its cash rate from 0.1% to 3.85% in a year. Further monetary policy tightening is likely to be necessary to bring inflation back to the target range of 2-3%, with the projections assuming that the cash rate will peak at 4.1% in mid-2023 and remain there until well into 2024. The underlying budget deficit is projected to widen slightly over the projection period as rising cost pressures offset falling spending on fiscal support measures introduced during the pandemic and the cost-of-living crisis. The growth impulse from fiscal policy is therefore expected to be broadly neutral over the projection period.

Economic growth will slow further

Economic growth is projected to slow further, to 1.8% in 2023 and 1.4% in 2024. High interest rates and rising costs of living will dampen spending by households with fewer accumulated savings. Past falls in house prices will exert a further drag on consumption through their effect on household wealth, and together with tight financial conditions will weigh on housing investment. Continued strong population growth and higher exports as travel recovers will partly offset these headwinds. As GDP growth slows, the unemployment rate is projected to start rising, reaching 4.6% by late 2024. Inflation will moderate, aided by lessening global inflationary pressures particularly for goods, and is expected to fall to the top of the target band by the end of 2024. There are both upside and downside risks to economic growth. A quicker than expected fall in inflation, which could arise if goods prices normalise to a greater extent than currently projected, could require less policy tightening by the Reserve Bank of Australia. However, further declines in house prices and persistent inflation could cause households to cut back on spending more than expected.

Making economic growth more equal and sustainable

Further fiscal reforms are needed to improve the sustainability of the public finances. Ageing-related spending pressures will intensify, leading to persistent fiscal deficits under current policy settings. Raising further revenue, such as through reducing private pension tax breaks and increasing receipts from the goods and services tax, should be considered. At the same time, spending pressures need to be kept in check by redesigning aspects of the National Disability Insurance Scheme and improving the governance of infrastructure project selection and implementation. Growth and living standards would also be supported by greater gender equity. Further progress needs to be made to better integrate women into the labour market and reduce the gender wage gap. The Australian government is currently developing a National Strategy to Achieve Gender Equality. Areas to consider will include the impact of tax and transfer policies on women’s work incentives, access to childcare and the extent to which the parental leave system encourages gender equity in childcaring responsibilities.

Austria

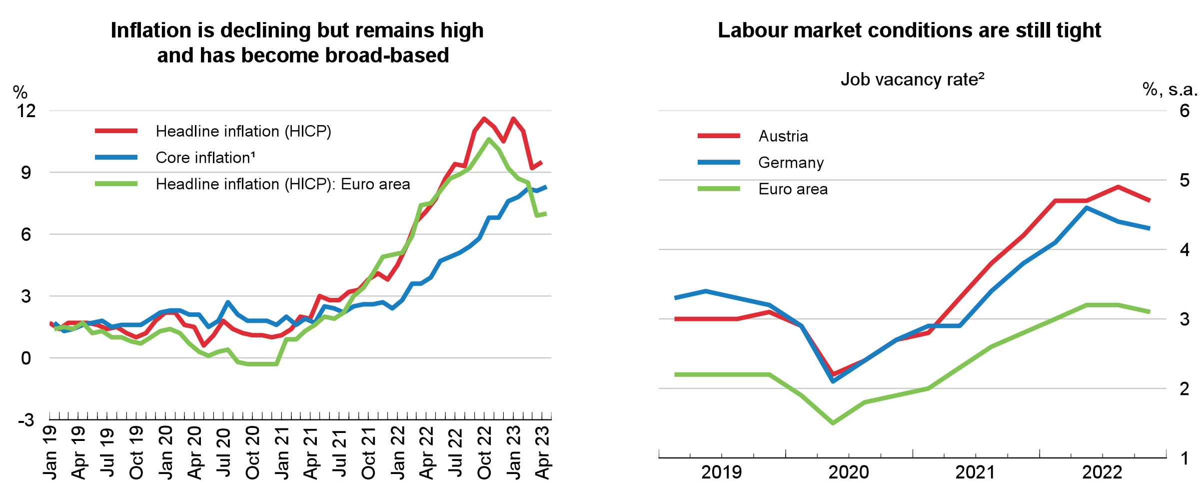
Economic activity is projected to slowly recover from the current downturn, with GDP rising by 0.2% in 2023 and 1.6% in 2024, supported by stronger domestic demand. Headline inflation will gradually decrease and rising real wages will support household incomes from the second half of 2023. Tight labour market conditions will loosen slightly over the projection period, bringing a small increase in unemployment. Business investment will be damped by elevated interest rates and labour costs.

The fiscal stance will tighten over the projection period with the phasing out of pandemic-related support in 2023 and of anti-inflation measures in 2024. Some of these measures will be substituted by welcome structural fiscal changes aimed at lifting growth by reducing labour costs. Other temporary measures compensating for high energy prices that are still in place over the next two years need to be better targeted to avoid weakening price signals and to reduce inflation pressures. Activating existing labour reserves would help remedy persistent labour shortages.

Economic growth has slowed

A contraction of 0.1% in the fourth quarter of 2022 was reversed in the first quarter of 2023. High-frequency indicators suggest that output growth will remain weak until the second half of 2023. High inflation is weighing on private consumption. Elevated uncertainty and tighter financial conditions have slowed private investment. Headline inflation fell over the first quarter to 9.5% in April 2023. However, core inflation continued to rise, predominantly driven by services sectors. Labour market conditions are tight but have started to cool with the unemployment rate increasing slightly from a low level and the job vacancy rate trending down since the third quarter of 2022.

Austria



1. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
2. The job vacancy rate is the number of vacancies divided by the number of occupied posts plus the number of vacancies.
Source: OECD Main Economic Indicators database; and Eurostat.

StatLink https://stat.link/pq2b5g

Austria: Demand, output and prices

Austria	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices*	397.0	-6.5	4.7	4.9	0.2	1.6
Private consumption	204.7	-7.9	3.4	4.9	-0.2	2.3
Government consumption	77.2	-0.5	7.9	3.6	-0.2	0.6
Gross fixed capital formation	98.5	-5.0	8.8	0.4	0.3	1.1
Final domestic demand	380.5	-5.6	5.7	3.4	-0.1	1.7
Stockbuilding[1]	1.4	0.1	0.7	-0.9	0.0	0.0
Total domestic demand	381.9	-5.5	6.4	2.5	-0.1	1.6
Exports of goods and services	222.0	-11.4	10.2	13.0	3.2	2.7
Imports of goods and services	207.0	-9.2	13.5	7.8	2.8	2.7
Net exports[1]	15.1	-1.6	-1.4	2.9	0.3	0.0
Memorandum items						
GDP deflator	_	2.5	2.0	4.9	7.5	3.5
Harmonised index of consumer prices	_	1.4	2.8	8.6	8.0	3.9
Harmonised index of core inflation[2]	_	2.0	2.3	5.1	7.7	4.2
Unemployment rate (% of labour force)	_	5.4	6.2	4.7	5.0	5.1
Household saving ratio, net (% of disposable income)	_	13.3	12.0	8.8	8.3	7.7
General government financial balance (% of GDP)	_	-8.0	-5.8	-3.2	-3.2	-1.6
General government gross debt (% of GDP)	_	111.6	105.3	86.4	86.3	85.6
General government debt, Maastricht definition[3] (% of GDP)	_	83.1	82.3	78.5	78.3	77.7
Current account balance (% of GDP)	_	3.0	0.4	0.7	1.4	1.3

* Based on seasonal and working-day adjusted quarterly data; may differ from official non-working-day adjusted annual data.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/6nc0wq

The Austrian economy is vulnerable to a further tightening of financial conditions. Higher interest rates are passing quickly through to corporations and households due to a prevalence of variable-interest loans. Evidence of this is seen in the housing sector: new lending for residential construction halved in the second half of 2022, and real estate prices have started falling. Austria remains vulnerable to additional disruptions in gas supply even though the country has reduced its dependence on Russian gas imports and gas reserves stood at 72% of average annual consumption as of early May 2023.

Fiscal support will steadily decline

The budget deficit is expected to narrow over the projection period from 3.2% to 1.6% of GDP. A large part of crises-related support, including most expenditure items which amounted to 3.9% of GDP in 2022, will be phased out. Meanwhile, income taxes will be reduced and interest expenditure is set to rise. The remaining pandemic-related expenses, amounting to around 1.7% of GDP in 2022, will continue to be phased out over the next two years. Discretionary fiscal support against high inflation represented around 1.5% of GDP in 2022. Much of this support will continue throughout 2023 and partly into 2024, in particular, through an electricity-price brake. The fiscal effect of these measures will be partially substituted by structural measures including the inflation indexation of tax brackets and the eco-social tax reform. The latter will increase the deficit by 0.5 percentage point of annual GDP between 2022 and 2024. Higher revenues from carbon pricing will contribute to reductions in income taxes and income support via the regional climate bonus for households. Grants from the European Recovery and Resilience Facility will finance investment in renewable energy and digitalisation for 0.2% of GDP per year in 2022-2024.

The economy will gradually expand

Output will recover gradually and grow by 0.2% in 2023 and 1.6% in 2024. High inflation, tighter financial conditions, and the withdrawal of pandemic-related expenditures will weigh on domestic demand during 2023 while weaker growth in trading partners will damp export growth. The tight labour market will loosen only gradually, with a small increase in unemployment. Higher nominal wages and a decrease in inflation will support private consumption in 2024. Higher interest rates will weigh on investment in 2023 but growth will resume in 2024. Inflation has peaked and will steadily decrease, but will remain high over the projection driven by stickier inflation in core services. Risks to the projections are skewed to the downside. As a small open economy, Austria is particularly susceptible in the event of weakening global demand or further supply disruptions.

Structural reforms could support sustainable and inclusive growth

Reducing regulatory barriers in certain service sectors that have been sheltered from competition, and pursuing efforts on digitalisation, could strengthen productivity. Broadening access to labour markets and reducing skill shortages would also support inclusive growth. Improving the availability and quality of early child and elderly care services, and encouraging a balanced use of parental leave, would address the low full-time employment of women. Better incentives to continue working at an older age and ensuring good working conditions would support the employment of older workers. Pursuing the reduction in labour tax wedges included in the support measures against high inflation and the eco-social tax reform would help raise the employment of low-skilled workers. Support measures to mitigate the impact of high inflation need to be better targeted to preserve incentives to lower energy use, and ensure fiscal sustainability in light of rising future long-term spending pressures related to ageing and climate change.

Belgium

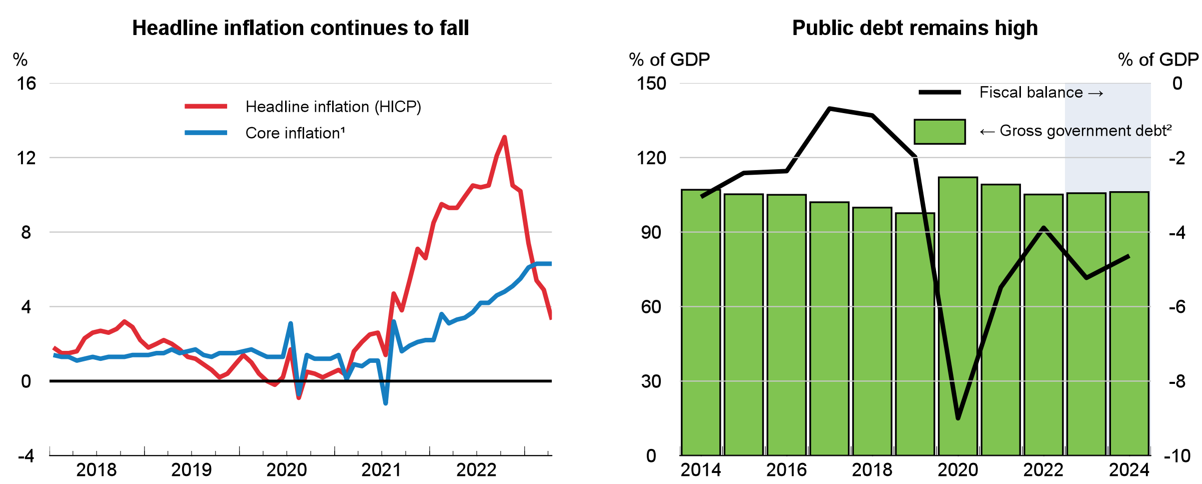
Real GDP growth is projected to slow to 0.9% in 2023, before picking up to 1.4% in 2024. Inflation, tighter financing conditions, and high uncertainty will drag on domestic growth, while weak global trade prospects will weigh on net exports. By contrast, public investment, solid labour demand and automatic wage indexation will sustain activity. Headline inflation is projected to fall to 4% in 2023, due to falling energy prices, and 3.7% in 2024. The main risks to the outlook include more persistent inflation due to wage indexation and a consequent loss of export competitiveness.

The fiscal deficit will increase in 2023 and remain large in 2024. In the longer term, measures to ensure the sustainability of public finances will be necessary given high public debt. The level of debt poses macro-financial risks and limits the scope for public investment. Policies reducing the gender gap in labour market participation could sustain stronger and more inclusive growth.

Economic growth is slowing

Economic growth has slowed significantly in the wake of high energy prices, rising borrowing costs, and weakening international trade. Weak confidence has weighed on economic activity, but consumer and business confidence indicators are now improving. GDP rose by 0.5% in the first quarter of 2023 (at an annualised rate), after 0.2% in the previous quarter. Sharply-higher interest rates have dampened housing market activity. Mortgages granted in January fell to their lowest level in 17 years, and credit demand is lower than during the 2008-09 financial crisis. Annual headline inflation is falling fast due to declining energy prices, reaching 3.3% in April. Labour market tensions are easing as the number of jobseekers rises, but wages are increasing faster than in major trading partner economies. Second-round effects from automatic wage indexation are being felt more broadly, with core inflation at 6.3% in April.

Belgium



1. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
2. Maastricht definition.
Source: OECD Economic Outlook 113 database; and Eurostat.

StatLink https://stat.link/3mvtld

Belgium: Demand, output and prices

Belgium	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	478.7	-5.4	6.3	3.2	0.9	1.4
Private consumption	245.7	-8.3	5.5	4.1	1.7	1.9
Government consumption	110.3	0.1	5.0	3.2	1.5	1.1
Gross fixed capital formation	116.2	-5.3	5.1	-0.8	0.6	1.7
Final domestic demand	472.2	-5.6	5.3	2.7	1.4	1.6
Stockbuilding[1]	3.4	-0.3	0.3	0.6	-0.1	0.0
Total domestic demand	475.7	-5.8	5.5	3.2	1.2	1.6
Exports of goods and services	394.4	-5.0	11.3	5.1	0.8	1.8
Imports of goods and services	391.4	-5.6	10.7	4.9	1.1	2.0
Net exports[1]	3.0	0.4	0.7	0.2	-0.3	-0.2
Memorandum items						
GDP deflator	_	1.5	2.8	5.9	5.9	4.5
Harmonised index of consumer prices	_	0.4	3.2	10.3	4.0	3.7
Harmonised index of core inflation[2]	_	1.4	1.3	4.0	6.8	4.1
Unemployment rate (% of labour force)	_	5.6	6.2	5.6	5.8	5.8
Household saving ratio, net (% of disposable income)	_	14.2	10.3	7.7	7.0	6.7
General government financial balance (% of GDP)	_	-9.0	-5.5	-3.9	-5.2	-4.6
General government gross debt (% of GDP)	_	140.9	129.9	104.1	104.6	105.0
General government debt, Maastricht definition[3] (% of GDP)	_	112.0	109.1	105.1	105.6	106.1
Current account balance (% of GDP)	_	1.1	0.4	-3.6	-2.3	-1.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/5g2paf

As a small, open economy, Belgium is highly exposed to an international trade slowdown. Exports were at a 13-month low in February as high energy and commodity prices dragged down export growth. Energy support measures have been extensive, and with electricity and gas prices falling, the average electricity (gas) bill in April 2023 was 19% (45%) lower than in April 2022. Risks of energy shortages are limited. Belgium has a central location in Europe's energy grids, hosts a large LNG terminal and has domestic nuclear energy facilities that cover about 40% of electricity consumption.

Financing conditions have tightened, energy support continues

Financial conditions will continue to tighten, with higher interest rates and stricter credit standards. The fiscal deficit will widen by 1.3 percentage points of GDP in 2023, and will remain large in 2024. Sovereign bond yield spreads widened recently amid international financial market turmoil, but are still contained. Energy support measures are already starting to end. The widening of customers who qualify for the social tariff on electricity and gas introduced in 2021 will be maintained until July 2023. The VAT reduction on electricity and gas will be made permanent, with a new excise duty to partly compensate the revenue loss. The fiscal cost of the measures is estimated at EUR 4.7 billion (around 0.9% of GDP) for 2023. Other fiscal measures include a budget-neutral tax reform that reduces the tax burden on labour, which should help to foster labour supply growth, and increases taxes on wealth and consumption.

Economic activity will cool

GDP growth is projected to slow significantly to 0.9% in 2023, before recovering to 1.4% in 2024. High inflation, uncertainty, and interest rates will hold back business and residential investment. Weak global trade growth, and higher energy and wage costs, will exert a drag on exports. Private consumption should help drive GDP growth as household disposable incomes improve in real terms due to receding inflationary pressures and automatic indexation mechanisms. Public investment will continue to be supported by Next Generation EU funding (Belgium has an allocation of almost EUR 5 billion, equivalent to around 0.9% of 2022 GDP). Headline inflation is projected to decline to 4% in 2023 and 3.7% in 2024. Falling energy prices are quickly feeding through, and growing economic slack due to tighter monetary policy should also alleviate underlying inflationary pressures. A larger loss of export competitiveness due to more persistent inflation from second-round effects is a risk, while a sharper slowdown in house prices could weigh on economic activity.

Ensuring fiscal sustainability and competitiveness

Belgium has the sixth highest gross government debt to GDP ratio in the European Union. New fiscal measures are necessary to reduce any negative effects of government debt on the economy, and to avoid correction being driven by pressure from an adverse change in market sentiment. Belgium faces rising future spending pressures from an ageing population, the climate transition, and high interest rates. High debt is limiting scope for public investment, including for public infrastructure needed to reduce fossil fuel dependence. Further removing barriers to female labour market participation, such as high taxation of second earners, would promote gender equality, foster labour supply, and raise tax revenues. Strengthening the links between wage developments and productivity at the firm-level could attenuate any negative impacts from wage setting on international competitiveness.

Brazil

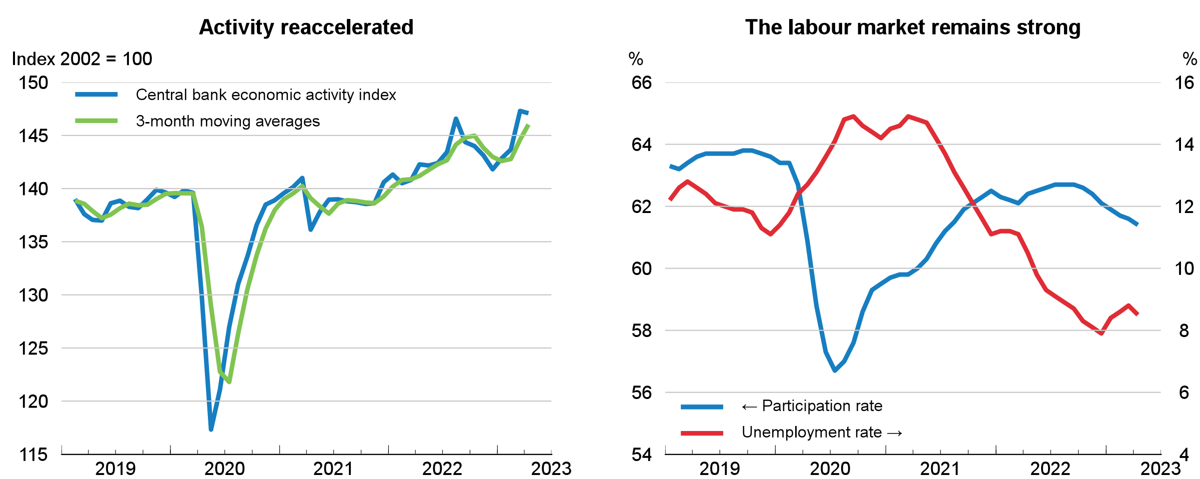
Economic activity is slowing due to weaker private consumption and exports. Real GDP is projected to grow by 1.7% in 2023 and 1.2% in 2024. Lower employment growth, still high inflation and tighter credit conditions will limit household spending capacity despite higher social transfers. Private investment will continue to rise but at a slower pace. Exports will be affected by lower commodity prices and subdued global demand. Inflation has declined markedly over 2022 but will remain above the target band during 2023.

Monetary policy is expected to remain restrictive, with the policy rate staying at 13.75% until at least the third quarter of 2023, after which room for monetary easing may emerge. Fiscal policy remains expansionary for now, but gradual consolidation should start in 2024. Implementing a credible medium-term fiscal framework will help to restore confidence and achieve a more consistent macro-economic policy mix. Better managing public infrastructure investment, simplifying indirect taxes and more effective social transfers could boost potential growth and social inclusion while improving public finances. Stronger sustainability incentives for the agricultural sector and an end to illegal deforestation would make growth more sustainable.

Economic activity rebounded in the first quarter

Economic activity increased by 2% in the first quarter of 2023, supported by services and a large expansion of agricultural production. Retail sales grew by 3.8% in January 2023, including in some sectors that had been in decline for months, such as clothing and footwear, or food and beverages. Agricultural production is expected to reach a new record in 2023, driven by favourable weather conditions on average. This has more than offset localised drought-related declines in agricultural production in the south of the country. However, industrial production continues to stagnate and is still 2.2% below pre-pandemic levels, owing to weak demand and supply constraints for raw materials, electronic components, and other inputs. Investment declined by 3.4% in the first quarter of 2023 on the back of rising financing costs. Job creation also dropped, contributing to a slight increase in unemployment.

Brazil 1



Source: IBGE; and Banco Central do Brasil.

StatLink https://stat.link/3gl7zb

Brazil: Demand, output and prices

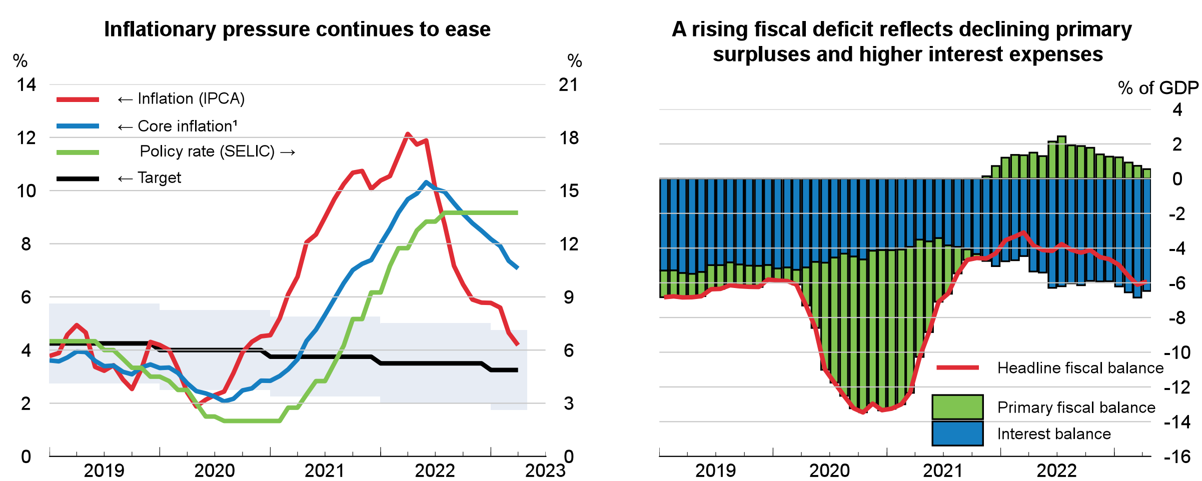
Brazil	2019	2020	2021	2022	2023	2024
	Current prices BRL billion	Percentage changes, volume (2000 prices)				
GDP at market prices	7 389.1	-3.6	5.3	3.0	1.7	1.2
Private consumption	4 813.6	-4.6	3.7	4.3	2.2	1.4
Government consumption	1 476.6	-3.7	3.5	1.5	2.0	1.1
Gross fixed capital formation	1 143.2	-1.7	16.6	0.8	2.5	1.4
Final domestic demand	7 433.4	-4.0	5.8	3.1	2.2	1.3
Stockbuilding[1]	3.4	-0.6	0.9	-0.9	-1.2	0.0
Total domestic demand	7 436.7	-4.6	6.6	2.1	1.0	1.3
Exports of goods and services	1 043.6	-2.7	6.4	6.0	8.0	4.8
Imports of goods and services	1 091.2	-9.9	12.6	1.3	4.6	5.6
Net exports[1]	- 47.6	1.1	-1.0	0.9	0.7	-0.1
Memorandum items						
GDP deflator	_	6.8	11.0	8.2	8.2	5.5
Consumer price index	_	3.2	8.3	9.3	5.6	4.7
Private consumption deflator	_	4.6	8.9	10.4	6.3	5.5
General government financial balance (% of GDP)	_	-13.3	-4.6	-4.7	-6.7	-6.6
Current account balance (% of GDP)	_	-1.8	-2.8	-2.9	-2.0	-1.8

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/k87er3

Annual inflation fell to 4.2% in April 2023, down from 5.6% in February. Broad-based declines in inflation across sectors outweighed stronger increases in electricity and gasoline prices, which were partly related to the withdrawal of temporary tax exemptions on energy. Steadily declining core inflation measures, both for goods and services, confirm that gradual disinflation is underway.

Brazil 2



1. Core inflation excludes energy and food products. The shaded area corresponds to the inflation tolerance band.
Source: OECD Economic Outlook 113 database; and Banco Central do Brasil.

StatLink https://stat.link/aydjoq

Monetary policy will remain restrictive in the near term

Despite recent declines, inflation will remain significantly above the 1.75-3.75% target band in 2023 and the central bank is expected to maintain the policy rate at 13.75% until the third quarter of 2023. Moreover, higher rates in advanced countries are still exercising pressures on the exchange rate. Starting from late 2023, policy rates are expected to be gradually reduced, reaching 10% by the end of 2024.

Fiscal policy will remain expansionary in 2023, in line with a fiscal package voted in December that exempts new social measures from the current expenditure ceiling. The measures include maintaining a 50% increase in conditional cash transfer benefits on a permanent basis and wage increases for civil servants. However, tax exemptions for fuel have been partially withdrawn. The government has proposed a new fiscal framework intended to contain public spending growth while maintaining some flexibility with respect to investment outlays, with annual targets for the primary fiscal deficit. The framework also contains provisions to enhance the efficiency of tax collection and integrate regular spending reviews into the budgeting process to increase the effectiveness of public spending.

Growth will remain moderate

Despite an expansionary fiscal policy, GDP growth is projected to slow to 1.7% in 2023 and 1.2% in 2024, driven by lower domestic demand growth. Household consumption and investment will continue to slow over 2023 as tighter monetary conditions gradually raise lending rates. On the supply side, a record agricultural harvest will provide a visible boost to GDP growth, while the services sector is continuing to rebound from the pandemic shock. As external demand for Brazil's exports is expected to be modest and commodity prices have fallen, net exports will not be able to contribute much to growth. Diminishing credit to the economy and slightly higher unemployment will reduce household disposable incomes and contribute to lower inflation, which is expected to decrease to 5.6% in 2023 and 4.7% in 2024, down from an annual average of 9.3% in 2022.

Risks to economic activity are balanced. On the upside, stronger growth in China, Brazil's main trading partner, could boost exports, while the successful implementation of the new fiscal framework could lift confidence in the public finances and sustain stronger investment. A successful adoption of the tax reform in 2023 would raise productivity, and these effects could turn out stronger than expected. On the downside, a failure to implement key reform plans such as the tax reform or the new fiscal framework could erode confidence, leading to lower growth. Moreover, a slower decrease in inflation would delay policy rate reductions, which would lower investment and consumption. Further increases in advanced economies' policy rates would add to pressures on the exchange rate.

Adopting the fiscal framework and tax reforms is key to boost confidence and control debt

Reforming the complex system of taxing goods and services would drastically reduce the current high administrative burdens on firms and has strong long-term potential to boost productivity and growth, which is particularly important at a time when population growth is declining. Further progress on addressing large infrastructure gaps in transport, water and sanitation would reinforce these effects. These reforms would also boost the competitiveness of Brazilian firms, allowing them to reap greater benefits from international trade. Continued efforts to harness Brazil's strong potential in the generation of electricity from renewable sources would make growth more sustainable. This could be supported by rapid progress in reining in illegal deforestation and better sustainability incentives for the agricultural sector. For instance, increasingly shifting current directed lending programmes for agriculture towards low-carbon practices would help to mitigate carbon emissions and soil degradation. This could build on existing pilot programmes that have successfully strengthened incentives for the recovery of degraded pastures, no-tillage practices, fixation of nitrogen, crop-livestock-forestry integration, expanding the treatment of animal waste, and planted forest. Recently increased benefit levels for conditional cash transfers are well-targeted to those most in need and will reduce poverty and inequality. At the same time, further efforts to strengthen the effectiveness of other social benefits and improve their targeting to low-income households would allow more rapid social progress. Further expanding access to early childhood education, especially for low-income households, could improve equalities of opportunity and allow more women to join the labour market.

Bulgaria

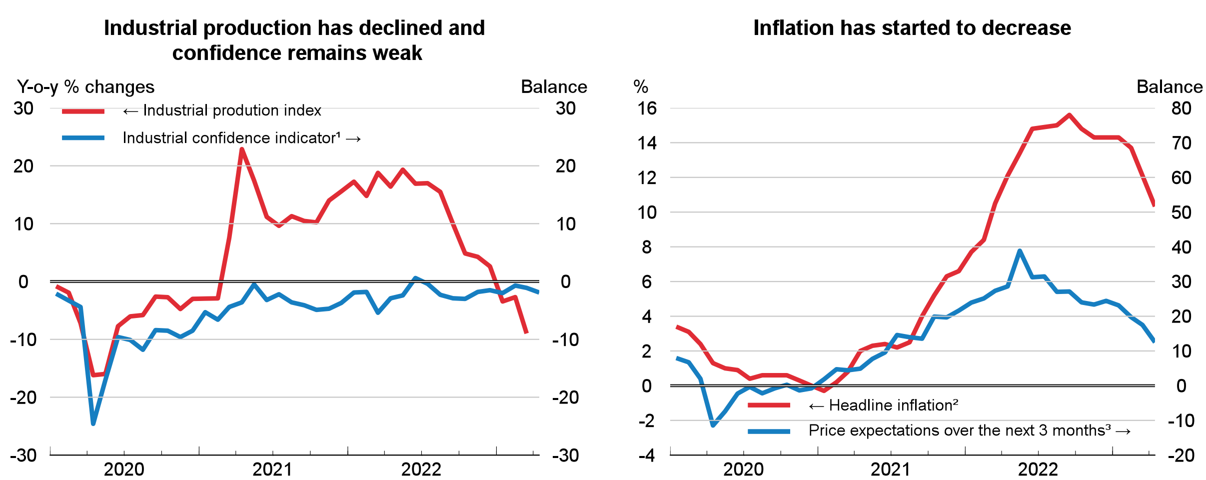
Growth is projected to slow to 1.9% in 2023 due to global headwinds, including the slowdown in Bulgaria's main trading partners, but then rebound to 3.2% in 2024. Private consumption growth will slow in line with lower employment growth. The disbursement of EU funds was delayed in 2022, but is expected to catch up to a large extent in 2023. Inflation is expected to moderate in 2023 and in 2024, but there are risks from high wage increases.

Due to high inflation and political instability, which delayed several important legislative packages, Bulgaria postponed the target date for euro area entry to 2025. Most energy-related fiscal measures will continue, financed from large windfall revenues of the large electricity companies but should be better targeted and designed. The unemployment rate is low, but there are persistent labour shortages. Migration and activation policies need to be stepped up to encourage emigrants to return and to ensure that those with work capacity join the labour market. Upskilling the population is crucial to foster growth and further improve living standards.

Bulgaria's robust recovery has slowed

Bulgaria's economy performed well in 2022 with real GDP growth reaching 3.4% on the back of increased household consumption and exports including electricity, while gross fixed capital formation remained subdued. In the first quarter of 2023 annual growth slowed to 2% due to a moderation in final consumption and exports. The impact from Russia's war of aggression against Ukraine came mainly through the surge of global energy and commodity prices. Even though most of the energy supply comes from domestically

Bulgaria



1. The industrial confidence indicator is an arithmetic average of balances to replies on production expectations in the business surveys in industry.
2. Headline inflation measured by the harmonised index of consumer prices (HICP).
3. Price expectations based on average balance of opinions in the business surveys in industry, retail trade and services concerning selling prices expectations.
Source: National Statistical Institute.

StatLink https://stat.link/v36hq0

Bulgaria: Demand, output and prices

Bulgaria	2019	2020	2021	2022	2023	2024
	Current prices BGN billion	Percentage changes, volume (2015 prices)				
GDP at market prices	120.4	-4.0	7.6	3.4	1.9	3.2
Private consumption	71.1	-0.6	8.8	4.8	2.7	3.2
Government consumption	10.0	9.8	4.3	4.9	0.9	1.5
Gross fixed capital formation	22.4	0.6	-8.3	-4.3	10.5	9.0
Final domestic demand	103.5	0.7	4.4	3.0	3.9	4.2
Stockbuilding[1]	13.0	-1.5	4.8	1.5	0.0	0.0
Total domestic demand	116.5	-0.9	8.7	4.0	3.2	3.6
Exports of goods and services	77.0	-10.4	11.0	8.3	2.9	5.8
Imports of goods and services	73.1	-4.3	10.9	10.5	5.1	6.3
Net exports[1]	3.9	-4.0	0.2	-1.2	-1.4	-0.4
Memorandum items						
GDP deflator	_	4.3	7.1	15.1	7.8	4.3
Consumer price index	_	1.7	3.3	15.3	9.5	4.4
Core consumer price index[2]	_	1.2	1.4	7.6	7.8	4.3
Unemployment rate (% of labour force)	_	5.1	5.3	4.3	4.5	4.2
Household saving ratio, net (% of disposable income)	_	7.6	5.5	5.0	6.4	5.9
General government financial balance (% of GDP)	_	-3.8	-3.9	-2.8	-3.0	-2.9
General government gross debt (% of GDP)	_	34.8	35.1	32.4	35.0	37.4
General government debt, Maastricht definition[3] (% of GDP)	_	24.5	23.9	22.9	25.5	27.8
Current account balance (% of GDP)	_	0.0	-1.9	-0.7	-1.3	-1.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/zhkyqf

produced coal and nuclear energy, interconnection with neighbouring countries drove up electricity prices. Reliance on Russian gas was more limited than in many other countries. With the exception of nuclear fuel and oil, Bulgaria had modest trade links with Russia. Headline inflation started to come down in late 2022 following moderation of international energy and commodity prices, and eased to 10.3% in April. Labour markets have remained resilient with rising employment and a low unemployment rate, and nominal wages have increased at a rapid pace. Industrial production began to slow in August 2022 and in the first quarter of 2023 was lower than a year earlier. The decline in production was broad-based, including in mining and quarrying, electricity and gas supply, and manufacturing of food, textiles, basic metals and chemical products.

As a small open economy trading mainly with other EU countries, Bulgaria is being affected by the slower growth of export demand. Prolonged political instability has delayed key policy reforms. More effective management and roll-out of EU funds would support activity going forward. Currently Bulgaria is under a specific derogation from the EU ban on the import of Russian crude oil, and the export of oil products has not yet been affected. Migrant flows from Ukraine remain small and difficult to retain in the country and integrate in the labour market.

Policy support measures are continuing

The global surge in energy and food prices in 2022 has pushed inflation to levels not seen in decades. Interest rates have increased in line with those in the euro area as part of the currency board arrangement. Broad-based fiscal support measures are continuing in 2023. These include compensation to companies that are electricity end-users and to electricity distribution companies for technological costs, as well as a lower VAT rate for natural gas and central heating and a zero rate for bread and flour. Significant increases in pensions, child allowances and the minimum wage last year continue to support spending. A new government has yet to be formed and new budget policies have not yet been set out, but the aim is to keep the deficit in 2023 below the 3% ceiling in the EU fiscal rules. The projections assume that the overall fiscal stance is broadly neutral in both 2023 and 2024.

A rebound is expected after the slowdown in 2023

Growth will regain speed in 2024 driven by a projected pick-up in export demand, and by public and private investments supported by EU funds. The disbursement of EU funds has been delayed, but is expected to accelerate in 2023 and 2024, lifting GDP growth to 3.2% in 2024. Higher long-term interest rate on government bonds will weigh on activity. Headline inflation will slow to around 9.5% in 2023 and 4.4% in 2024. The labour market will remain resilient with only a marginal increase in unemployment in 2023, while nominal wage growth is expected to decline gradually in line with the inflation rate. A further deterioration in financing conditions would hold back private investment, including from abroad. Political uncertainty still places planned reforms and investments at risk.

Structural reforms need to be stepped up

Effective management of EU funds is key for sustaining activity and boosting potential growth. Strengthening the convergence process requires pursuing and deepening reforms to encourage and intensify investments in infrastructure, reduce administrative burdens and strengthen efforts to fight corruption. Rising spending pressures related to ageing, infrastructure and skills will need to be financed while energy support measures should be more targeted and gradually phased out. Better policies are needed to encourage people to stay in Bulgaria and encourage emigrants to return. While the share of women in management positions is high and the measured gender wage gap is low, many women are engaged in caregiving of children or the elderly and are out of the labour force. Childcare and elderly care should be expanded, including through enhanced training of professionals, to allow family members to participate in the labour market and to meet demand from the rapid ageing of the population. Energy security is currently ensured, but the decarbonisation of the economy will require considerable efforts going forward.

Canada

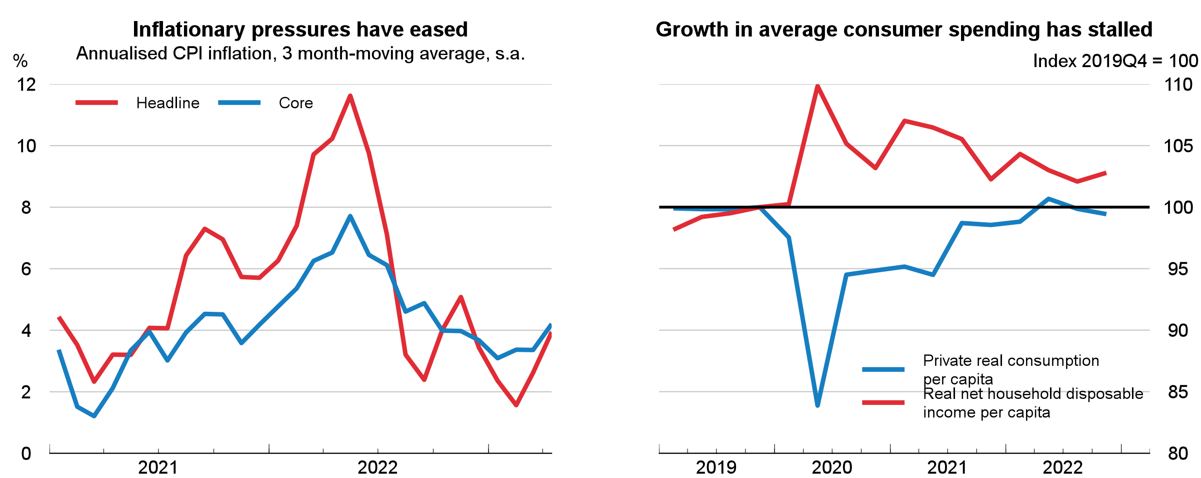
Real GDP growth will decline to 1.4% in 2023. Higher borrowing costs will weigh on activity. Lower commodity prices have unwound last year's terms of trade gains. Demand will strengthen through 2024, but annual output growth will remain below the economy's long-run potential rate at 1.4%. Exports will benefit from improved global conditions, while immigration boosts private spending and labour supply. Price pressures will ebb as the jobless rate rises from recent lows. An investment recovery next year could be upended if credit conditions worsen, a risk that has increased with volatility abroad.

Monetary policy should remain tight, with the policy interest rate kept at its current level until inflation nears target in 2024. Reduced fiscal support should help cool demand as living-cost relief is withdrawn. Reversing provincial fuel tax concessions would complement incentives for green investment, which the federal government is scaling up. In parallel to efforts to remove internal trade barriers, more can be done to facilitate labour mobility. Paring back stringent limits on densification could allow more housing in cities. This would head off future housing price pressures as population inflows increase.

Inflation has fallen despite solid output and employment gains

Economic growth was stronger than expected in the first quarter of 2023. Growth in manufacturing, construction and services more than offset production declines in natural resources industries. Higher borrowing costs continue to weigh on housing-market activity. Metropolitan housing prices and home sales are lower than a year ago but seem to be stabilising. Market expectations of lower interest rates next year are yet to translate into a sustained rise in building approvals, which should precede a residential construction recovery. Higher credit costs and weak sales growth expectations are weighing on business investment intentions. Retail activity has defied expectations of a downturn despite high inflation eroding purchasing power. Population growth is supporting total consumers' expenditure, but average spending per person is little changed from pre-pandemic levels in real terms. Consumer surveys report heightened uncertainty about the economic outlook, consistent with still-high household saving rates.

Canada 1



Source: OECD Economic Outlook 113 database; Statistics Canada.

StatLink https://stat.link/nrug1l

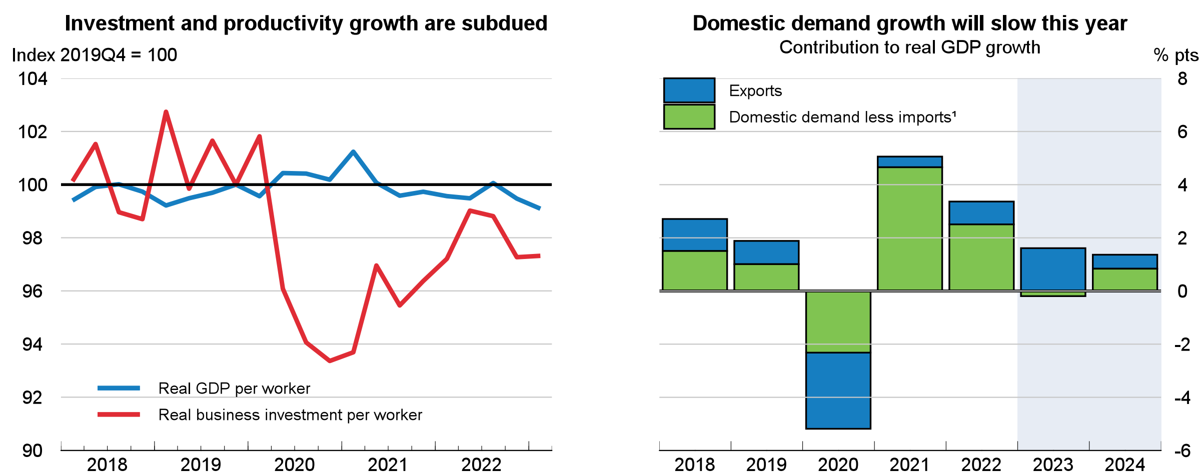
Canada: Demand, output and prices

Canada	2019	2020	2021	2022	2023	2024
	Current prices CAD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	2 313.6	-5.1	5.0	3.4	1.4	1.4
Private consumption	1 336.2	-6.1	5.0	4.8	2.4	1.3
Government consumption	478.1	1.3	6.4	2.0	0.8	1.3
Gross fixed capital formation	522.4	-2.4	7.4	-1.5	-2.6	1.3
Final domestic demand	2 336.7	-3.8	5.8	2.7	0.9	1.3
Stockbuilding[1]	10.8	-1.6	1.1	2.1	-1.0	0.1
Total domestic demand	2 347.5	-5.4	7.0	4.8	-0.1	1.4
Exports of goods and services	748.5	-8.9	1.4	2.8	4.8	1.6
Imports of goods and services	782.4	-9.3	7.8	7.5	0.2	1.7
Net exports[1]	- 33.9	0.3	-2.1	-1.5	1.6	-0.1
Memorandum items						
GDP deflator	_	0.6	8.2	7.2	0.9	2.3
Consumer price index	_	0.7	3.4	6.8	3.5	2.3
Core consumer price index[2]	_	1.1	2.4	5.0	3.7	2.3
Unemployment rate (% of labour force)	_	9.7	7.5	5.3	5.2	5.7
Household saving ratio, net (% of disposable income)	_	13.9	10.7	5.9	4.7	4.8
General government financial balance (% of GDP)	_	-10.9	-4.4	-0.8	-0.4	-0.3
General government gross debt (% of GDP)	_	129.2	120.9	100.9	101.0	101.1
Current account balance (% of GDP)	_	-2.2	-0.3	-0.3	-1.4	-1.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/pn54au

Canada 2



1. Total consumption and investment (including inventory variations) less total imports of goods and services. National accounts data do not disaggregate imports by expenditure component of GDP and intermediate inputs. In practice, imported value added forms part of consumption, investment and also exported goods and services.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/fzmydw

The labour market remains tight. Recent job gains have broadly matched growth in the labour force, keeping the unemployment rate near record lows. Large numbers of new arrivals to Canada appear to be helping relieve skill shortages. Reduced job vacancies point to future moderation in labour demand. Consumer price growth has dropped rapidly with lower energy prices, reduced food price inflation, and lower input costs being passed through to the price of finished goods. In April, year-on-year growth in the headline consumer price index was 4.4%, well below the peak of 8.1% in June 2022. Underlying price pressures have also declined, but more gradually. Wage growth is elevated and now exceeds consumer price growth.

Crude oil price falls have left Canada's commodity export prices well below peaks attained in mid-2022. The terms-of-trade decline has caused a negative income shock, reflected in a lower non-financial corporate operating surplus. Farm output volumes have declined from highs recorded last year amid good growing conditions. Volatility in US and European financial markets prompted comparatively modest tightening in financial conditions in Canada. Still, credit growth has slowed, particularly loans to households.

Macroeconomic policies are helping rein in excess demand

Contractionary monetary policy is cooling demand – which currently exceeds the economy's sustainable productive capacity – and helping to re-anchor inflation expectations. To durably return inflation to target, the policy rate will need to remain at its current level of 4.5% until mid-2024. With output expected to be close to potential in the second half of next year, the policy rate should be lowered towards more neutral levels. The projections factor in a 50-basis-point decline in the benchmark interest rate by the end of 2024. Gradual quantitative tightening is assumed to continue through 2023-24, putting some upward pressure on borrowing costs.

Fiscal deficits will narrow over the next two years. Revenue growth will decline with weaker growth in nominal GDP and business profits. The federal budget announced new spending on healthcare and incentives to spur green investment. Separately, some federal and provincial measures continue to cushion household balance sheets from living cost pressures. In March, the federal government announced a further increase in goods and services tax credits targeting lower-income households hit hard by high food prices. Provinces including Alberta and Ontario have kept in place measures reducing or suspending fuel taxes, despite energy cost falls. A withdrawal of remaining inflation relief initiatives by the end of 2023 is assumed to contribute to improving fiscal balances in 2024, reducing support to economic activity.

Slowing domestic activity will weigh on GDP this year

Real GDP growth is projected to moderate to 1.4% in 2023. The slowing US economy will weigh on Canada's exports after a strong first quarter outcome. Higher credit costs and a subdued demand outlook will cause businesses to postpone capital expenditure plans. Further declines in housing investment in the first half of the year will also contribute to lower private gross fixed capital formation. Private consumption growth will slow, but is expected to remain positive. High rates of household formation will help to offset the impact of higher borrowing costs and weak growth in real incomes. Economic activity will strengthen through 2024 but annual growth will remain below potential at 1.4%. Job creation will slow relative to population growth and the unemployment rate will rise. Wage growth will moderate but remain higher than consumer price inflation, which is projected to return to target by the end of next year. Improved purchasing power will support consumer spending while increased housing demand drives a recovery in residential investment. Exports and business investment will pick up with strengthening foreign demand.

Considerable uncertainty surrounds the outlook. High household debt levels and increased mortgage servicing costs could cause private consumption to contract, particularly if job creation slows more than expected. Increased volatility in major financial markets might translate into tighter credit conditions in Canada, risking deeper falls in business investment. In contrast, high levels of immigration should, in the near term, slow population ageing and could push GDP growth above projections. Beyond direct payoffs from a larger working-age population, newcomers' skills and higher workforce participation might further expand the economy’s productive capacity. This could enable stronger demand without accelerating inflation.

Lower inflation has removed the need for extraordinary living-cost relief

With inflation returning to moderate levels, federal and provincial governments should withdraw remaining living-cost relief amid broader efforts to reduce fiscal stimulus to the economy. Reversing provincial utility bills and fuel tax subsidies would support energy saving and complement measures aimed at boosting investment in green industries. Progress in lowering childcare costs will reduce employment disincentives for second earners, more often women than men. Broader improvements in the business climate will require policy progress at all levels of government towards making markets more efficient. Alongside efforts to shrink barriers to internal trade in goods and services, more can be done to remove obstacles to labour mobility. High costs of housing can make it hard for people to pursue jobs in high-wage, high-productivity cities. Paring back constraints on densification in urban areas, while investing in infrastructure, would help accommodate new residents and limit future growth in housing costs.

Chile

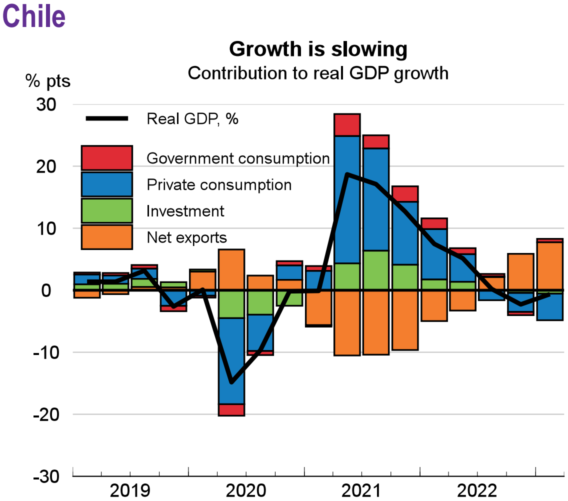
Economic activity will drop by 0.1% in 2023 and increase by 1.9% in 2024. Tighter financial conditions and the withdrawal of pandemic-related support will reduce household consumption during the first half of this year. Higher interest rates and uncertainty will also hit investment during 2023. As the effects of the monetary policy tightening are passed to activity, inflation will continue to abate throughout 2023, and return to target in late 2024.

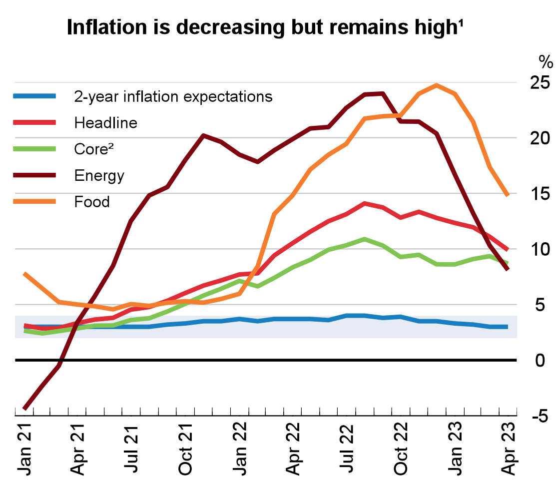
Monetary policy will remain tight, but the budget balance will move back into deficit. Higher investment in social programmes and infrastructure to meet social demands and boost productivity requires a more progressive tax system that allows for additional revenue. Increasing productivity will also require reducing barriers to competition and ensuring proper funding of the competition authority, as well as focusing research and development support on the most effective programmes.

Activity continues to decelerate

GDP grew by 0.8% in the first quarter of 2023, but economic activity decreased in March and April, as measured by the monthly indicator of economic activity (IMACEC), and weak retail and car sales suggest an ongoing downward adjustment in consumption levels after the withdrawal of support measures to face the pandemic. Despite subdued demand, inflation has been persistent, with headline and core decreasing slightly but remaining around 10%. However, one-year-ahead inflation expectations are decreasing, and two-year inflation expectations remain anchored within the central bank's tolerance band. Real wages started to recover in the first months of 2023.

Chile





1. The shaded area represents the central bank's inflation target range.
2. Consumer price index excluding energy and food products.
Source: Central Bank of Chile; and INE.

StatLink https://stat.link/iu81ge

Chile: Demand, output and prices

Chile	2019	2020	2021	2022	2023	2024
	Current prices CLP billion	Percentage changes, volume (2018 prices)				
GDP at market prices*	195 903.2	-6.3	11.9	2.5	-0.1	1.9
Private consumption	120 491.4	-7.4	20.9	2.8	-5.2	1.7
Government consumption	29 826.3	-3.4	13.7	4.1	2.1	1.2
Gross fixed capital formation	47 965.9	-10.9	15.7	2.8	-2.7	1.2
Final domestic demand	198 283.6	-7.7	18.5	3.0	-3.6	1.5
Stockbuilding[1]	1 243.5	-1.9	2.9	-0.6	-0.2	0.8
Total domestic demand	199 527.1	-9.5	21.8	2.3	-3.9	2.3
Exports of goods and services	54 490.4	-1.0	-1.3	1.4	2.5	3.1
Imports of goods and services	58 114.3	-12.3	31.8	0.9	-7.1	4.3
Net exports[1]	-3 623.9	3.4	-8.9	0.1	3.7	-0.3
Memorandum items						
GDP deflator	_	9.5	6.9	6.6	6.7	2.1
Consumer price index	_	3.0	4.5	11.6	8.1	4.1
Private consumption deflator	_	5.3	4.3	10.0	6.5	3.9
Unemployment rate (% of labour force)	_	10.7	8.8	7.9	8.5	7.8
Central government financial balance (% of GDP)	_	-7.3	-7.7	1.1	-2.0	-2.1
Current account balance (% of GDP)	_	-2.2	-7.3	-9.0	-3.9	-4.4

* Based on seasonal and working-day adjusted quarterly data; may differ from official non-working-day adjusted annual data.
1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/27uh93

Tightening monetary policy in trading partners slowed export growth in 2022, but China's reopening should increase demand for inputs for the tech industry, among them minerals exported by Chile. The Government mitigated the impact of higher energy prices stemming from Russia's war of aggression against Ukraine by raising minimum wages, granting subsidies to the vulnerable population, freezing public transport fares, and implementing measures to stabilise the prices of fossil fuels and electricity. The freeze in transport fares was extended until June and in some cases until December 2023, and a rebate of taxes paid on diesel for land freight was introduced in January 2023, expiring in December.

Tight monetary policy is set to continue, fiscal deficits will return

Public expenditure will grow slightly in real terms, focused on social expenditure and investment amid a negative output gap, while revenue will moderate with the downturn in activity during 2023. The central government deficit will be 2.0% of GDP in 2023 and 2.1% of GDP in 2024, which will not threaten debt sustainability. The central bank has continued to tighten policy to curb inflation and control inflation expectations, taking the policy rate to 11.25% and vowing to keep it at that level until there is clear convergence of inflation towards target. As these increases are transmitted to other interest rates, their effects on consumption and investment, and ultimately inflation, will be felt mostly during 2023 and early 2024. The projection assumes moderate declines in the policy rate in the second half of 2024.

Following a downturn in 2023, the economy will rebound in 2024

Real GDP will contract by 0.1% in 2023 but rebound by 1.9% in 2024. The withdrawal of pandemic-related support measures and tight monetary conditions will hold back consumption and investment during 2023, but these effects should abate by early 2024. Stronger external demand, notably from China, should sustain export growth. Risks are tilted to the downside. Russia's war of aggression against Ukraine could lead to further energy price pressures, delaying policy easing. A stalling of the recovery in China, Chile's main trading partner, would decrease exports and investment, thus lowering growth. A worsening drought would impact copper mining and agriculture. Failure to pass a new Constitution, and lack of clarity on the future of the tax reform could heighten policy uncertainty, hurting business and consumer confidence and leading to sluggish consumption and investment.

Reforms are needed to increase productivity and enhance social expenditure

Improvements in social programmes and infrastructure would require raising more revenues, from their low levels compared to the OECD countries, through a more progressive tax system. Productivity would be boosted by strengthening competition through lower barriers to entrepreneurship and proper funding of the competition authority, and higher investment in efficient research and development initiatives. Expanding access to early childhood care and increasing funding of pre-school education can improve educational outcomes for children in low-income families and boost female labour market participation.

China

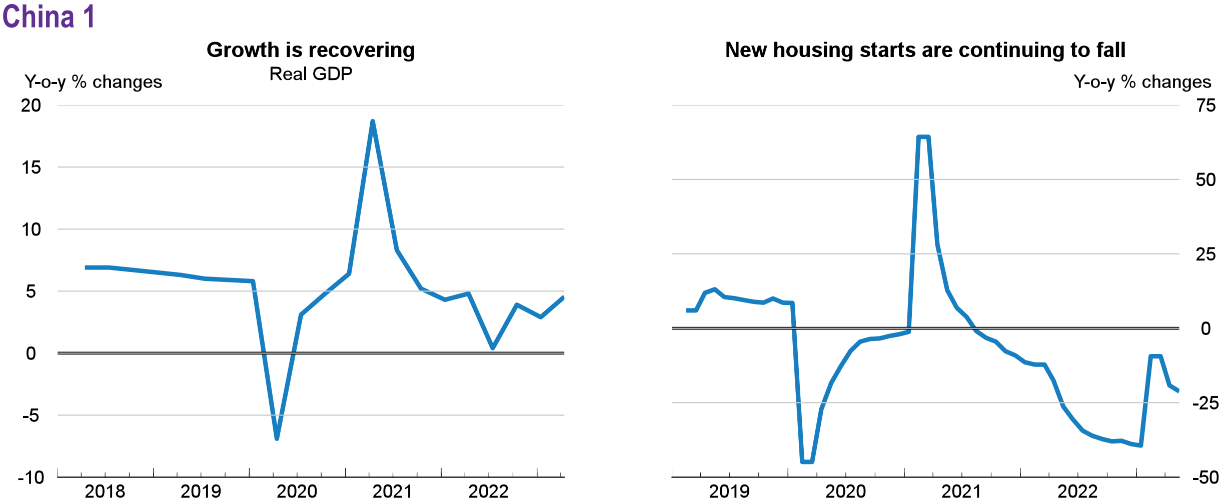
Economic growth will rebound to 5.4% in 2023 and 5.1% in 2024. Lifting zero-COVID restrictions has released pent-up demand for in-person services, increasing revenues in services industries hard hit by lockdowns such as tourism or entertainment. Easing of housing-related prudential regulations and lower mortgage costs have stabilised property sales. Carryover of sizeable infrastructure projects from the previous year will fuel a construction boom. Export growth will be tempered by weak global demand. Consumer price inflation will remain benign due to a moderate recovery of domestic demand.

Monetary policy has become more supportive with a series of interest rate and reserve requirement cuts. The capital outflows and significant currency depreciation seen in 2022, have started to reverse since the reopening of the economy. Tax and user charge deductions and exemptions for targeted groups will provide some support, in particular for small and micro firms. The recovery in the housing sector will boost budgetary revenues. While demand support is needed until the recovery firms, measures should be subject to cost-benefit analysis. Structural reforms to ensure a level playing field should be stepped up to foster the recovery of private firms. Strict implementation of equal pay laws and affirmative action where needed would reduce the gender wage gap and allow women to realise their potential.

Lifting zero-COVID19 restrictions has released pent-up demand for services and ended supply-chain disruptions

GDP growth rebounded in the first quarter of 2023 to 4.5% year-on-year. The rebound reflects the lifting of COVID-19-related restrictions. In-person services, including catering, accommodation, tourism and entertainment, which were restricted during lockdowns, rebounded strongly. In contrast, consumption of goods, which continued even during lockdowns, remains weak. Despite the current momentum in services consumption, overall consumption is constrained by relatively high unemployment rates and a large number of graduate students entering the labour market this year. Investment growth is firming as infrastructure investment is picking up and new support measures contain the contraction of real estate investment.

China 1



Source: CEIC database.

StatLink https://stat.link/u58alw

China: Demand, output and prices

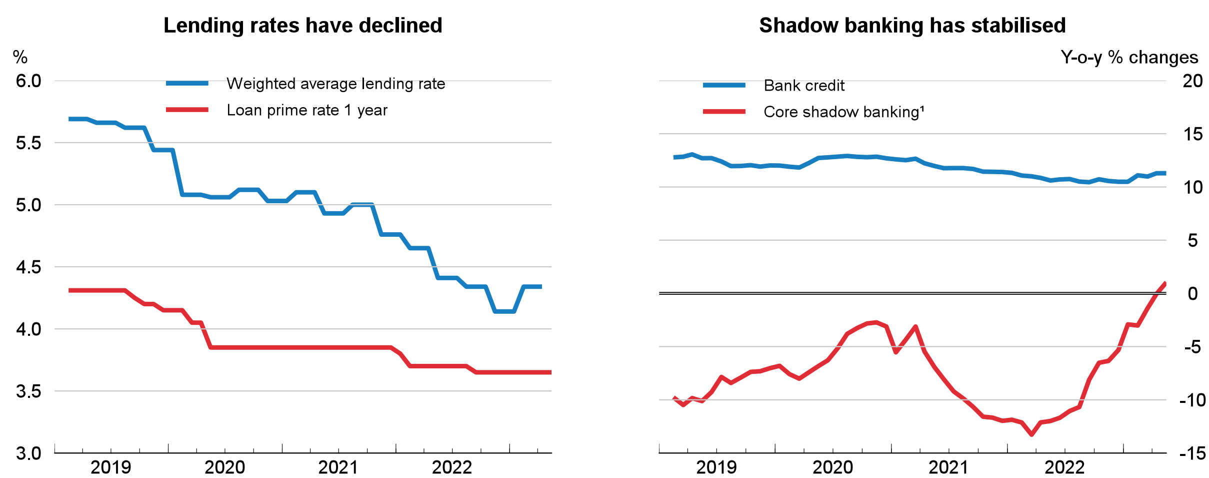
China	2019	2020	2021	2022	2023	2024
	Current prices CNY trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	98.7	2.2	8.4	3.0	5.4	5.1
Total domestic demand	97.7	2.1	6.8	2.8	6.2	5.0
Exports of goods and services	18.2	1.1	15.7	-4.0	0.2	5.8
Imports of goods and services	17.3	-0.1	7.6	-6.7	3.9	5.3
Net exports[1]	0.9	0.2	1.8	0.3	-0.6	0.3
Memorandum items						
GDP deflator	_	0.5	4.6	2.2	2.5	2.2
Consumer price index	_	2.5	0.8	1.9	2.1	2.0
General government financial balance[2] (% of GDP)	_	-7.0	-6.6	-6.7	-6.7	-6.6
Headline government financial balance[3] (% of GDP)	_	-3.7	-3.0	-2.8	-3.0	-2.8
Current account balance (% of GDP)	_	1.7	2.0	2.2	2.5	2.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Encompasses the balances of all four budget accounts (general account, government managed funds, social security funds and the state-owned capital management account).
3. The headline fiscal balance is the official balance defined as the difference between revenues and outlays. Revenues include: general budget revenue, revenue from the central stabilisation fund and sub-national budget adjustment. Outlays include: general budget spending, replenishment of the central stabilisation fund and repayment of principal on sub-national debt.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/4zkbio

China is relatively well insulated from global food and energy market shocks. China has a large share of food in its consumption, but this has limited import content. Large grain reserves and export restrictions in the form of quotas will continue to mitigate the impact of rising global grain prices on domestic inflation and reduce the risk of shortages. Domestically produced coal is used for heating, which is not affected by higher prices in global markets. However, China is more dependent on oil and gas imports. Replacing part of crude oil imports by discounted Urals oil from Russia is containing inflationary pressure and LNG reserves are being refilled from Russian sources. The revival of demand may increase price pressures, but the overall inflation environment remains benign.

China 2



1. Core shadow banking items include entrusted loans, trusted loans and undiscounted bankers' acceptance.
Source: CEIC database.

StatLink https://stat.link/awptc4

Monetary and fiscal policy will continue to support the recovery

Monetary policy continues to support the recovery and ensure adequate liquidity. While the benchmark lending rate remained stable in recent months, the required reserve ratio has recently been cut slightly. Capital outflows and currency depreciation during 2022 were halted by revived confidence following the opening of the economy. Market rates have fallen more than the benchmark rate. Following the coordinated cut of the deposit rate by major state lenders in September 2022, a new mortgage rate adjustment mechanism for first mortgages was introduced in early 2023. This allows local authorities to decide whether to remove the mortgage interest floor in cities in which new housing prices decrease for three consecutive months. More stringent implementation of credit quotas for pre-sold housing, lower provident fund lending rates for first-time buyers, and other measures have helped the property market bottom out, and will support the recovery of the property sector. The rebound, however, will be moderate as restrictions, including on eligibility to purchase real estate, continue to suppress demand. Shadow banking appears to have stabilised and credit supply is ample, but demand is rebounding only gradually. Savings accumulated during the lockdowns may be used partially in the real estate market if it recovers more strongly, and partially for household consumption.

Fiscal policy will continue to provide support through tax cuts and exemptions, but tax and charge deferrals have mostly ended. Some proceeds from special local bonds issued in 2022 are being spent this year. New policies are being announced to boost the recovery, including tax exemptions for small and micro enterprises and accelerated deduction of research costs. Development banks are providing funds financed by bonds to support investment, as a lack of funds has constrained the roll-out of infrastructure projects. Sizeable interest subsidies continue to support re-lending for manufacturing, social services, small and medium-sized companies, and individual businesses.

Activity will recover gradually

Following the lifting of COVID-19 restrictions, GDP growth will gradually return to its estimated potential rate. Infrastructure investment will remain robust and real estate investment will stabilise due to lower mortgage rates and improving consumer confidence. Exports will recover as global demand rebounds. Export growth will be driven by the global need for equipment for the energy transition. Reopening will boost tourism imports but import growth may be contained by an increasing reliance on domestic inputs. Raw material demand will be kept high by infrastructure investment. Longer-term growth prospects have diminished as the population ages, constraining the strength of the recovery. A further rise in corporate defaults will improve risk pricing, but may adversely affect the financial sector and private investors. A stable supply of energy and grains will continue to contain price increases, keeping headline inflation benign.

Relatively high unemployment, especially for youth, slow job creation and a more gradual recovery of consumption remain a key downside risk. Continued credit events and disorderly deleveraging in the overstretched property sector may trigger failures of smaller banks and shadow banking institutions. By contrast, relaxing prudential measures and encouraging investment in real estate would likely create another bubble and subsequently cause greater future disruptions. A stronger rebound of housing prices could divert savings to the real estate sector and revive housing-related consumption.

Structural reforms are needed to reinvigorate the economy

Reforms to enhance competition would sustain the economic recovery from the pandemic. Administrative monopolies, often with exclusive rights to provide certain goods and services, should be dismantled. Recent measures aimed at creating a single domestic market are a welcome step. Stronger consumer protection could boost competitive pressures. Levelling the playing field would support private sector investment and underlying growth. Fundamental reforms to strengthen the social safety net would help to reduce precautionary saving and rebalance demand from investment to consumption. Pension and unemployment insurance coverage should be extended to all. The list of treatments and medicines covered by health insurance should be widened. The extension of the pensionable age is urgent and a target age should be reached within a short time span given relatively long life expectancy. Women should not be allowed to retire 5-10 years earlier than men. China has a large imbalance in the population due to the long-term favouring of boys over girls, in particular in rural areas. While this is changing with urbanisation and rising living standards, there is ample room for policies to ensure greater gender equality. Girls' tertiary enrolment is high and so is female employment, but there is a persistent wage gap, and few women are in managerial positions. Strict implementation of equal pay laws and where needed, affirmative action could help.

Colombia

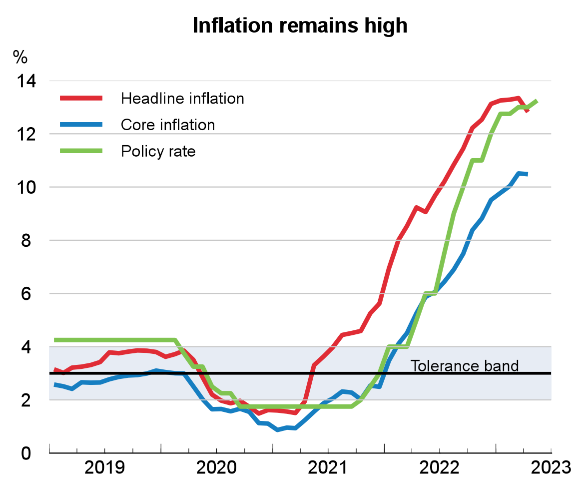
GDP is expected to grow at moderate rates of 1.5% in 2023 and 1.8% in 2024, after a prolonged recovery that lifted output above its potential. Consumption and investment will remain subdued given tight macroeconomic policies and a fragile global economy, especially in 2023. Headline inflation started to decline in April and is projected to continue to decrease to the target by 2025. The main downside risk is tighter global financial conditions combined with pre-existing external imbalances.

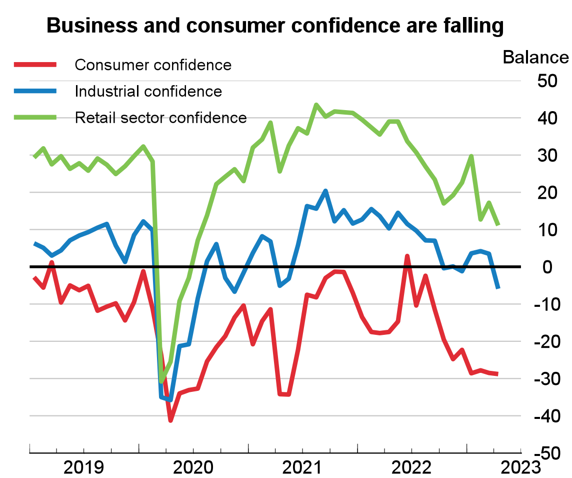
Monetary policy will remain tight to bring down inflation and re-anchor inflation expectations. The planned fiscal consolidation is necessary to ensure compliance with fiscal rules. Building additional fiscal buffers would be prudent given risks. Meanwhile, recent tax reforms provide fiscal space for proposed pension and health reforms that address long-standing inequalities and low social protection coverage. Decreasing informality and promoting gender equality would put Colombia on a path towards more inclusive growth.

High inflation and macroeconomic tightening are slowing growth

Fiscal and monetary policy tightening have started to slow growth, with average year-on-year growth rates slowing to around 2.6% in the last two quarters from more than 10% in early 2022, and consumer and business confidence continuing to decrease. In April, inflation started to recede after having reached a plateau during the first three months of 2023, but still stands at 12.8%. Inflation expectations are already past their peak – at the policy-relevant horizon of two years ahead they stand at around 4%, the upper limit of the 2-4% target range – suggesting a re-anchoring of expectations is gradually taking place. High wage growth, including the 16% minimum wage increase in January 2023, and a still-resilient labour market cushion the effect of high inflation on purchasing power.

Colombia





Source: DANE; BanRep; CEIC; and FEDESARROLLO.

StatLink https://stat.link/7h3zju

Colombia: Demand, output and prices

Colombia	2019	2020	2021	2022	2023	2024
	Current prices COP trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 060.1	-7.3	11.0	7.3	1.5	1.8
Private consumption	727.9	-4.9	14.5	9.5	0.8	0.8
Government consumption	167.2	-0.8	9.8	0.3	2.6	3.8
Gross fixed capital formation	225.5	-24.0	17.3	11.4	-1.5	0.7
Final domestic demand	1 120.6	-8.0	14.4	8.6	0.6	1.2
Stockbuilding[1]	1.2	0.6	-0.8	1.0	-2.3	-0.3
Total domestic demand	1 121.8	-7.5	13.4	9.4	-2.4	1.0
Exports of goods and services	168.2	-22.7	15.9	14.8	3.8	3.6
Imports of goods and services	229.9	-19.9	26.7	22.3	-9.3	-0.9
Net exports[1]	- 61.7	0.7	-3.4	-2.9	3.4	0.9
Memorandum items						
GDP deflator	_	1.5	7.7	14.3	8.2	6.4
Consumer price index	_	2.5	3.5	10.2	11.8	6.1
Core inflation index[2]	_	2.0	1.8	6.4	10.0	6.2
Unemployment rate (% of labour force)	_	16.5	13.8	11.2	10.6	10.5
Current account balance (% of GDP)	_	-3.5	-5.7	-6.2	-4.1	-4.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding primary food, utilities and fuels.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/7tdn43

Tighter external financial conditions have increased pressure on and volatility in Colombian asset prices. However, the strong depreciation of the peso in the second half of 2022 has now been reversed. Colombia relies heavily on foreign direct investment to finance its large current account deficit. High interest rates following policy tightening have contributed to rising debt service costs. Higher global oil prices would increase external and fiscal revenues, but fuel subsidies attenuate the net fiscal gains.

Fiscal and monetary policy will remain tight

The central bank is expected to have reached the end of its tightening cycle, in which it increased the policy rate to 13.25%. The policy rate is projected to start coming down in early 2024. After two successive years of significant fiscal tightening, the budget deficit is projected to reach 3.8% of GDP in 2023, slightly below the limit stipulated by the debt-reduction path of the fiscal rule. Accumulated liabilities from untargeted fuel subsidies weigh on the deficit. The welcome ongoing gradual increase of regulated fuel prices will preserve scarce budget resources for future policy priorities while improving incentives to reduce energy use. Further fiscal buffers should be built in 2024 given downside risks. Meanwhile, two successive tax reforms are expected to permanently increase fiscal revenue from 16% in 2021 to 19% of GDP from 2023 onwards and provide space to finance additional social spending.

After a weak 2023, growth will partially recover in 2024

Growth will moderate considerably in 2023. Fiscal tightening, high interest rates, tighter credit standards, and still high inflation will weigh on investment and consumption. Exports will prop up growth and the current account balance, but goods exports are capped by a fragile global outlook. From early 2024, lower inflation, slower fiscal tightening, and the start of monetary easing will improve domestic demand. Employment is expected to remain relatively resilient, as firms were cautious in re-building their workforces after the pandemic. Colombia's large dual fiscal and current account deficits make the economy particularly vulnerable to tighter global financial conditions; planned deficit reductions would lower such risks. Additional financial tightening in advanced economies could put more pressure on the already volatile exchange rate. Higher global uncertainty or a resumption of domestic policy uncertainty could weigh on demand, especially private investment. Domestic financial risks seem contained as banks are well-capitalised, especially following the adoption of Basel III standards.

Proposed reforms reduce inequalities but are insufficient to tackle informality

Proposed ambitious health, pensions, labour, and energy reforms will help reduce high inequalities, amplify social protection coverage, improve working conditions, and steer the Colombian economy into the green transition. Careful sequencing of reform implementation, ensuring long-term fiscal sustainability, and a continued demonstrated commitment to the strong macroeconomic policy framework are needed. Labour, pension, and health reforms should bear in mind high informality, which has high non-wage labour costs and strict employment regulations among its causes. Further improving incentives for formal job creation together with increasing women's opportunities in the labour market through affordable, good-quality childcare and shared parental leave could foster both productivity and equity. Defining the details, explicit milestones, and actions of the outlined energy transition strategy would accelerate investments in green technologies.

Costa Rica

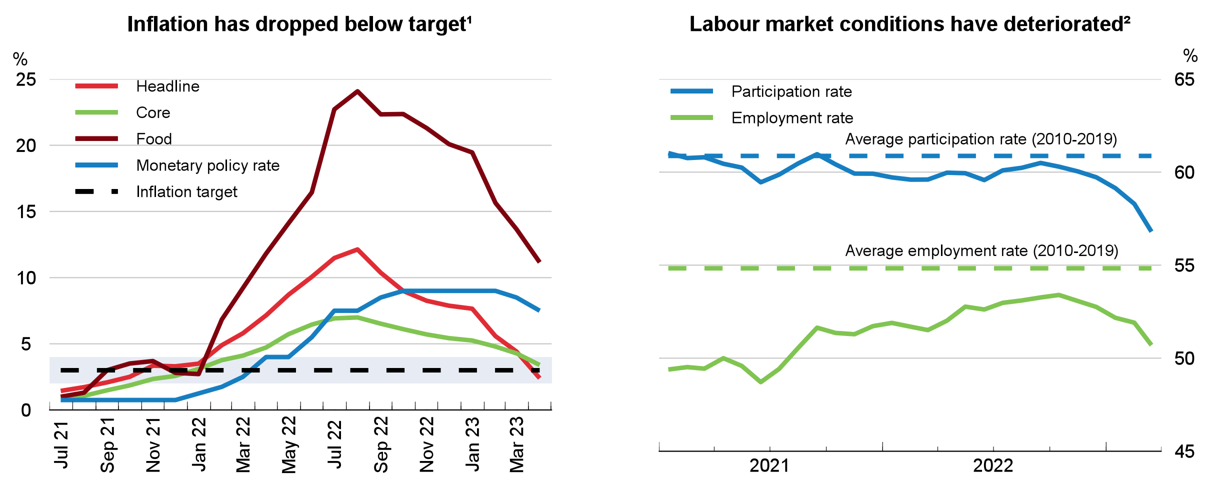
GDP will grow by 2.8% in 2023 and 3.0% in 2024. The contribution of domestic demand to growth will moderate in 2023 due to monetary policy tightening and weak labour market conditions. External inflationary pressures are expected to fade due to the easing of commodity and transportation prices and the appreciation of the exchange rate, with inflation projected to fall to 2.4% in 2023 and be at the target rate of 3.0% in 2024.

The fiscal stance will continue to be restrictive over the projection period as the fiscal rule contains public spending. Monetary policy is expected to ease further, with a gradual decline in the monetary policy rate, as inflation is already within the tolerance band. Increasing female labour participation, by expanding the coverage of early childcare and education, and establishing virtual one-stop shops to reduce the cost to start a company, would support higher growth and equity.

Economic activity is slowing down amid decreasing inflation

Economic activity kept softening in 2022 and early 2023 with the Monthly Index of Economic Activity recording an increase of 4.0% (year-on-year) in March 2023 (+10.2% in March 2022). Private consumption has suffered from high inflation, monetary policy tightening and softer labour market conditions in the second part of 2022. Lower investment in the construction sector, due to the rise in interest rates and the postponement of public investment in infrastructure, weighed on gross fixed capital formation.

Costa Rica



1. The horizontal dashed black line indicates the target inflation rate of monetary policy, and the shaded area the tolerance band around the target (2-4%). Headline and core indicate, respectively, the headline consumer price inflation rate and the core consumer price inflation rate. The core consumer price inflation rate measures consumer price inflation excluding food and energy components.
2. The horizontal blue and green dashed lines indicate the average participation and employment rates computed over the period January 2010 - December 2019.
Source: Banco Central de Costa Rica.

StatLink https://stat.link/ulkaxm

Costa Rica: Demand, output and prices

Costa Rica	2019	2020	2021	2022	2023	2024
	Current prices CRC trillion	Percentage changes, volume (2017 prices)				
GDP at market prices	37.8	-4.3	7.8	4.3	2.8	3.0
Private consumption	24.3	-6.9	7.0	3.3	1.9	3.2
Government consumption	6.3	0.8	1.7	1.9	-0.1	0.8
Gross fixed capital formation	6.1	-3.4	11.0	0.8	1.8	3.6
Final domestic demand	36.8	-5.0	6.7	2.6	1.6	2.9
Stockbuilding[1]	- 0.1	0.2	1.1	-1.3	0.9	0.0
Total domestic demand	36.7	-4.8	7.8	1.2	2.2	2.8
Exports of goods and services	13.0	-10.6	15.9	12.2	5.7	5.3
Imports of goods and services	11.9	-12.9	16.9	3.5	4.4	5.2
Net exports[1]	1.1	0.4	0.3	3.1	0.8	0.4
Memorandum items						
GDP deflator	_	0.8	2.0	5.8	1.3	3.0
Consumer price index	_	0.7	1.7	8.3	2.4	3.0
Core inflation index[2]	_	1.3	0.9	4.2	2.8	3.3
Unemployment rate (% of labour force)	_	19.5	16.4	12.2	10.6	10.4
Current account balance (% of GDP)	_	-1.2	-2.5	-3.9	-1.5	-1.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/z45hma

The appreciation of the exchange rate to the US dollar in the second half of 2022 (+10% between 2022Q2 and 2022Q4) slowed exports, which nonetheless remained solid for industries operating in the free trade area (medical devices, business services). Headline and core inflation have decreased rapidly from their peaks in August 2022, reaching 2.4% and 3.4%, respectively, in April 2023, due to the reduction in imported commodity prices and the appreciation of the exchange rate. The increase in the price of the basic food basket also continues to slow but remains elevated at 11.2%. One-year ahead household inflation expectations fell to 4.1% in April 2023.

Recent financial tensions originating in the United States have not had a tangible impact on domestic financial conditions. Costa Rica's banking system appears solid, with banks exceeding the minimum regulatory capital requirements and country risk, as measured by the Emerging Market Bond Index, decreased recently on account of an improved fiscal outlook.

Monetary policy will continue to ease while fiscal policy will remain prudent

Monetary policy is projected to continue to ease, with further policy rate reductions as inflation remains within the 2-4% tolerance band. The policy rate is expected to be cut by 150 basis points between 2023Q2 and the end of 2024. The fiscal stance will remain restrictive as the fiscal rule contains public spending. The central government primary surplus will reach 1.6% of GDP in 2023 and 1.9% of GDP in 2024. The central government deficit will increase to 3.5% of GDP in 2023, from 2.5% of GDP in 2022, as interest rate increases drive up public debt servicing costs, and then fall to 3% of GDP in 2024. Public debt should come down to 64% of GDP by 2024, from a 70% peak in mid-2021.

Growth will slow in 2023 and then recover slowly

Growth will slow to 2.8% in 2023 and edge up to 3.0% in 2024 as global and domestic economic conditions gradually improve. Falling real wages and weaker labour market conditions will hold back household real disposable income in 2023, softening private consumption. Gross fixed capital formation will be held back by high interest rates and the lack of fiscal space in the first half of 2023, and then start recovering. The improvement in the terms of trade will weigh on exports in both 2023 and 2024 but along with contained domestic cost pressures and lower external inflationary pressures will hasten disinflation. A reform of the fiscal rule, reducing its ability to contain public spending, could generate concern about debt sustainability and increase debt servicing costs. On the upside, the renewed efforts to deepen trade integration might strengthen exports.

Continuing structural reforms to boost growth and equity

Persevering with the implementation of structural reforms would strengthen growth and economic resilience and reduce inequalities. Increasing female labour market participation by expanding the coverage of early education and care for children below four years and improving the quality and efficiency of education by providing support to students with learning gaps and increasing the number of science graduates, would support higher growth and equity. Establishing virtual one-stop shops could reduce the high administrative burden when starting a company. To achieve net carbon neutrality by 2050, Costa Rica should maintain its 100% share of electricity produced from renewable sources, reduce emissions in the transport sector by strengthening the public transport network and expand the fleet of zero-emission vehicles.

Croatia

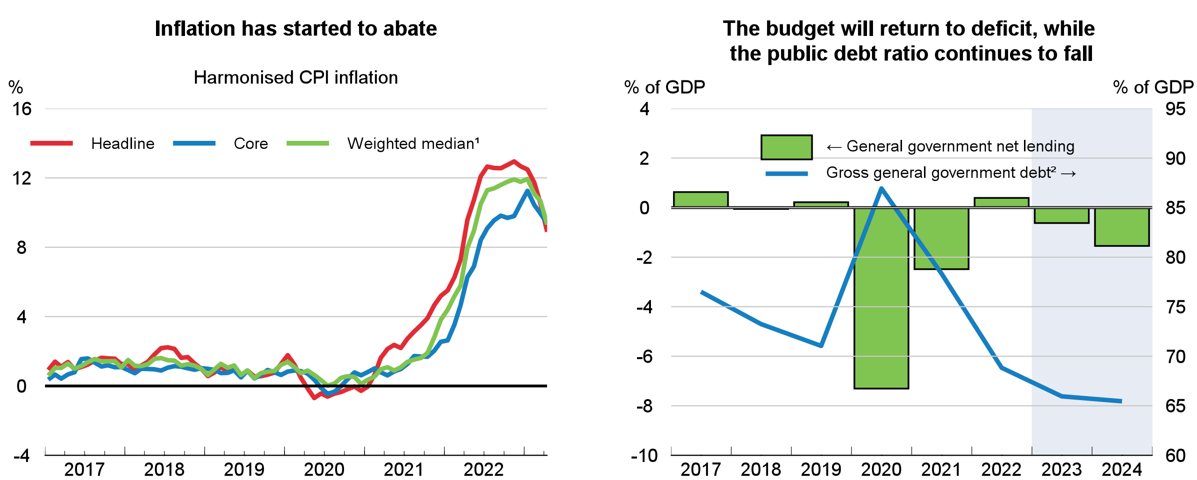
Output growth is expected to moderate to 2.1% in 2023 and 2.5% in 2024. Rising wages and jobs growth will support households' real spending. Croatia's integration in the euro and Schengen areas plus higher disbursement of European funds are expected to bolster investment and exports. Inflation will gradually abate from current high rates following the retreat in energy and other international prices.

The government plans to shift the budget balance from a small surplus in 2022 to a modest deficit in 2023 and a larger deficit in 2024. It has extended substantial energy price subsidies, alongside more modest support for incomes and expanded energy efficiency investments. Curtailing spending on untargeted energy price subsidies sooner, while further addressing Croatia's structural challenges, such as by boosting adult education, family support and investments in energy efficiency, would help make the recovery more sustainable and inclusive.

The surge in prices slowed Croatia's recovery

GDP growth slowed following the surge in energy prices and uncertainty following Russia's war of aggression in Ukraine, although the mild and late winter supported construction activity and reduced the drag from high energy prices, moderating the slowdown. Harmonised consumer price inflation peaked at 13.0% in the year to November 2022, before gradually abating to 8.9% in the year to April 2023 as energy prices fell by 6.6% from their 2022 peak. However, inflationary pressures have broadened. Price growth has lowered households' purchasing power, especially those with low incomes. Households are reducing their savings while maintaining consumption. Employment continued to expand, reducing the unemployment rate to 6.5% in April 2023. This, and the government's 12% minimum wage rise for 2023, are contributing to rising wages. Exports of both goods and services grew robustly in late 2022 and early 2023. Early indicators point to a strong start to the 2023 tourism season.

Croatia



1. Weighted median harmonised inflation has been computed using harmonised consumer prices of 222 products.
2. Maastricht definition.
Source: OECD Economic Outlook 113 database; Eurostat; and OECD calculations.

StatLink https://stat.link/a0g1jz

Croatia: Demand, output and prices

Croatia	2019	2020	2021	2022	2023	2024
	Current prices HRK billion	Percentage changes, volume (2015 prices)				
GDP at market prices	54.8	-8.5	13.1	6.2	2.1	2.5
Private consumption	31.1	-5.1	9.9	5.1	0.3	2.0
Government consumption	11.3	4.3	3.0	3.2	4.7	1.3
Gross fixed capital formation	11.7	-5.0	4.7	5.8	3.6	3.8
Final domestic demand	54.1	-3.1	7.4	4.8	1.9	2.2
Stockbuilding[1]	0.9	0.0	-1.1	1.6	-0.5	0.0
Total domestic demand	55.0	-0.8	9.8	5.6	1.6	2.2
Exports of goods and services	27.7	-23.3	36.4	25.4	4.0	2.7
Imports of goods and services	27.9	-12.4	17.6	25.0	1.9	2.3
Net exports[1]	- 0.2	-5.4	6.6	-0.2	1.2	0.3
Memorandum items						
GDP deflator	_	0.7	2.0	8.2	8.3	3.8
Harmonised index of consumer prices	_	0.0	2.7	10.7	7.5	3.7
Harmonised index of core inflation[2]	_	0.4	1.3	7.6	7.9	3.8
Unemployment rate (% of labour force)	_	7.5	7.6	7.0	6.1	6.0
Household saving ratio, net (% of disposable income)	_	9.2	7.6	-0.4	3.8	4.3
General government financial balance (% of GDP)	_	-7.3	-2.5	0.4	-0.6	-1.5
General government gross debt (% of GDP)	_	107.0	98.3	89.6	86.7	86.2
General government debt, Maastricht definition[3] (% of GDP)	_	86.9	78.3	68.8	66.0	65.5
Current account balance (% of GDP)	_	-0.5	1.8	-1.6	3.9	4.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/ucbj2q

Lower international energy prices have benefited Croatia. Croatia’s gas import and storage capacity and its large share of electricity generated from renewable sources have protected it from supply disruptions. The integration into the euro, which has expanded access to finance and banks’ liquidity, has reduced the pass-through of higher global interest rates, although rates have risen in some markets and conditions have tightened for some loans, slowing lending growth. Croatia is participating in supporting Ukraine and has provided over 21 000 temporary protection visas to refugees.

Fiscal and monetary conditions will remain supportive

Growth in activity and prices in 2022 buoyed government revenues while public spending fell short of plans, notably for public investment, leading to a small budget surplus and lowering the public debt ratio. The government plans a modest deficit in 2023, and a larger deficit in 2024, implying a fiscal stimulus. The government’s fourth energy response package, announced in March, accounts for much of the return to deficit. The EUR 1.7 billion package (2.3% of 2023 GDP) extends price subsidies, including largely non-targeted energy bill subsidies (EUR 1.2 billion), and support for renewable energies, energy efficiency investments and for vulnerable households. Most of the measures are scheduled to apply until October 2023, April 2024 or are one-off transfers. The transmission of tighter euro area monetary policy to Croatia is expected to gradually strengthen as Croatia integrates into the euro area.

Rising incomes, moderating inflation and higher investment will lift growth

As real incomes recover through increasing wages and continued employment growth, household consumption is projected to strengthen, lifting overall GDP growth. Reduced energy prices and global supply disruptions should allow inflation to further abate, although headline inflation will temporarily lift with the expiry of energy support measures. Investment, supported by higher public spending and foreign investment, and exports, supported by gradually improving demand in trading partners, are also projected to add to demand. Improving competitiveness, maintaining fiscal credibility by achieving budgeted spending and fiscal balances, and the full implementation of Croatia's Recovery and Resilience Plan are central to raising investment, productivity and living standards. A new surge in energy prices would likely weaken private consumption, public finances, and international competitiveness. A large rise in low-quality domestic lending or a deterioration in banks' health internationally would imperil the supply of credit for business investment or new housing and commercial building supply.

Investing in more accessible education can boost opportunities

As household consumption recovers, and integration into the euro and Schengen areas bolsters demand, more counter-cyclical fiscal policy would support competitiveness and alleviate capacity constraints. Key needs include ensuring any unplanned revenues build fiscal buffers, shifting from subsidising energy costs to targeted help for households, and investing in reducing energy needs – such as renovating buildings or upgrading transport equipment – to reduce the country's energy exposure and improve air quality. Boosting the supply of quality adult and vocational education programmes and improving their accessibility, for example by expanding vouchers and making programmes' hours and teaching modes more flexible, can raise skills and allow carers to combine work, study and family. Adding places for younger children in education and care, pursuing the shift to standardised school hours and after-school support, and encouraging workplaces to adopt more flexible arrangements can improve human capital and help women especially realise more productive careers.

Czech Republic

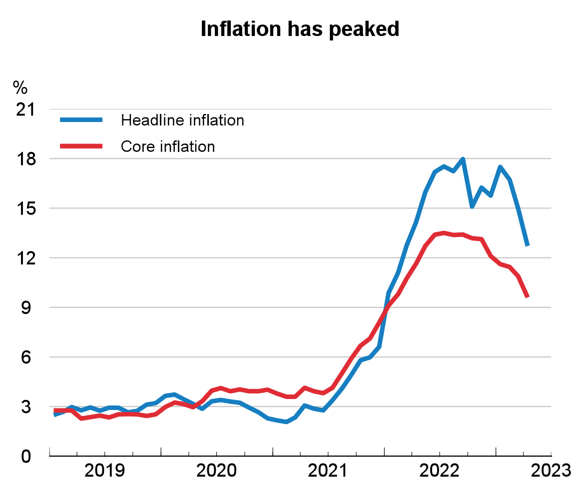
GDP growth will slow to 0.3% in 2023, before picking up to 2.4% in 2024. In 2023, high energy prices, tight financing conditions and weak sentiment will hold back private investment, and still elevated inflation will constrain private consumption. Private consumption will pick up in 2024, underpinned by growing real wages. Inflation will start falling from currently high levels but will only approach the 2% target towards the end of 2024. The unemployment rate will remain low, close to 3%.

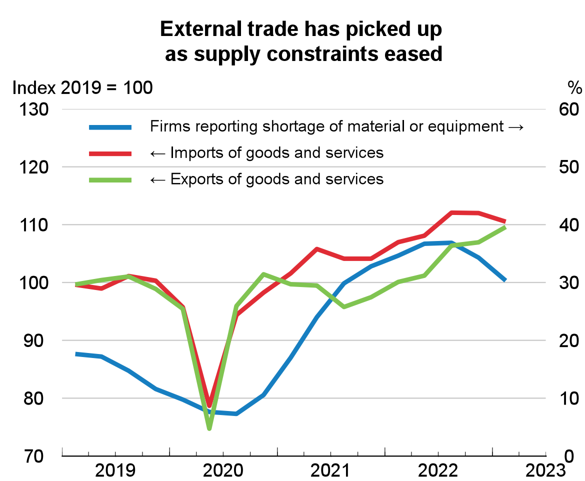
Macroeconomic policy needs to maintain a tight stance until inflation expectations are firmly under control, while monitoring risks to financial stability. Fiscal consolidation should be pursued to rebuild fiscal buffers. Measures to counter high energy prices should become increasingly targeted at those who are not sufficiently protected by the general social protection system, while preserving incentives for energy savings. Unleashing labour supply and accelerating the green transition would support sustainable growth.

The economy has gone through a mild recession

GDP stagnated (0% quarterly growth) in the first quarter of 2023. This followed a shallow recession in the second half of 2022, on the back of high energy prices, tighter financing conditions, and continued high uncertainty. Consumer price inflation has risen to levels not seen in almost 30 years and stood at 12.7% in April 2023. Economic sentiment dropped sharply, dampening household consumption and private investment. Elevated inflation squeezed real household incomes. However, inflation pressures have started abating and core inflation dropped from high levels. Exports rebounded, as supply bottlenecks started easing. Consumer sentiment started to recover. The labour market remains tight and the unemployment rate very low, at 2.7% in the first quarter of 2023.

Czech Republic





Source: Czech Statistical Office; and Czech National Bank.

StatLink https://stat.link/o5tulv

Czech Republic: Demand, output and prices

Czech Republic	2019	2020	2021	2022	2023	2024
	Current prices CZK billion	Percentage changes, volume (2015 prices)				
GDP at market prices	5 793.9	-5.5	3.5	2.5	0.3	2.4
Private consumption	2 712.0	-7.2	4.1	-0.9	-2.7	2.4
Government consumption	1 134.5	4.2	1.4	0.6	3.0	1.2
Gross fixed capital formation	1 568.2	-6.0	0.8	6.2	1.3	0.9
Final domestic demand	5 414.7	-4.5	2.5	1.4	-0.3	1.7
Stockbuilding[1]	29.8	-0.9	4.8	0.9	-0.7	0.0
Total domestic demand	5 444.5	-5.4	7.6	2.3	-1.0	1.6
Exports of goods and services	4 284.6	-8.1	6.8	5.7	4.4	4.1
Imports of goods and services	3 935.2	-8.2	13.2	5.7	2.9	3.0
Net exports[1]	349.4	-0.4	-3.6	0.2	1.1	0.8
Memorandum items						
GDP deflator	_	4.3	3.3	8.6	9.3	3.7
Consumer price index	_	3.2	3.8	15.1	12.2	3.4
Core inflation index[2]	_	3.6	5.0	12.2	9.0	4.1
Unemployment rate (% of labour force)	_	2.5	2.8	2.3	2.8	3.0
Household saving ratio, net (% of disposable income)	_	14.7	14.8	12.5	12.2	11.9
General government financial balance (% of GDP)	_	-5.8	-5.1	-3.6	-3.8	-2.7
General government gross debt (% of GDP)	_	47.0	48.5	48.1	50.8	52.6
General government debt, Maastricht definition[3] (% of GDP)	_	37.6	42.0	44.1	46.8	48.7
Current account balance (% of GDP)	_	2.0	-2.8	-6.1	-2.9	-3.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/ixo6lw

Prior to Russia's war of aggression against Ukraine, Russia accounted for more than half of crude oil imports and virtually all gas consumption. In 2022, gas consumption was roughly 20% lower than in 2021 and total domestic gas reserves at end-2022 were high. The projections assume no major supply issues next winter. The government has introduced measures to cushion the impact of high energy prices, including support to households and companies and price caps on energy, partly financed by a newly introduced tax on the excess profits of energy producers, traders and banks. The Czech Republic has welcomed a large number of Ukrainian refugees. By early May, around 330 000 refugees were registered for Temporary Protection. About 40% of refugees of working age were employed as of late April 2023.

Macroeconomic policy has been tightened

The Czech National Bank (CNB) has tightened monetary policy significantly to counter rapid increases in core inflation and rising inflation expectations. Between June 2021 and June 2022, the CNB raised the policy interest rate from 0.25% to 7%, after which it paused its tightening cycle. Property and mortgage markets have started to slow significantly. A gradual easing cycle is projected to start in the first quarter of 2024. In hindsight, macroeconomic policy provided too much stimulus in 2020 and 2021. Fiscal policy has introduced too many untargeted measures. The fiscal situation has deteriorated and the fiscal rules have been loosened. Recently introduced measures to cushion the impact of high energy prices are assumed to stay in place until the end of 2023, contingent on the evolution of market prices. In May 2023, the government announced a package of spending and revenue measures to undertake structural fiscal consolidation of 1.2 percentage points of GDP in 2023 and a further 0.6 percentage points in 2024. The consolidation package has yet to be adopted by parliament and is not incorporated in the projections.

GDP growth will remain subdued in 2023, before picking up in 2024

Private consumption will remain weak in 2023 due to elevated inflation and falling real incomes. Private investment will pick up only gradually due to tighter financing conditions. On the other hand, public investment will grow rapidly in 2023, due to the end of the EU 2014-2020 programming period. In 2024, stronger growth in trading partners will support exports and trade. Inflation will slowly approach the 2% target and real wage growth will turn positive, boosting private consumption. The unemployment rate will remain close to 3%. The outlook is uncertain. Energy supply disruptions could restrict economic activity. Unexpected further rises in commodity and energy prices, a steep depreciation of the koruna or derailed inflation expectations could make high inflation more persistent and delay monetary easing. Spillovers from banking crises abroad or a sharp correction in housing prices could threaten financial stability.

Unleashing labour supply and accelerating the green transition would support growth

Interest rates will have to remain elevated until inflationary pressures are well controlled. The authorities need to continue closely monitoring risks in the housing market. Fiscal policy should avoid stimulating aggregate demand in order not to undermine monetary policy. Fiscal support measures to cushion elevated energy prices should be well-targeted and maintain incentives for energy savings. Incentives to boost energy efficiency, including for heating and insulation in housing, should be strengthened to reduce reliance on coal and help households cope with high energy prices. Stepping up investment in renewable energy would make the recovery more sustainable. Boosting labour supply of mothers, by boosting the supply of childcare and shortening the maximum length of parental leave, and also older workers, together with improvements to skills provision and redesigning immigration policy, would help attract and retain skilled labour.

Denmark

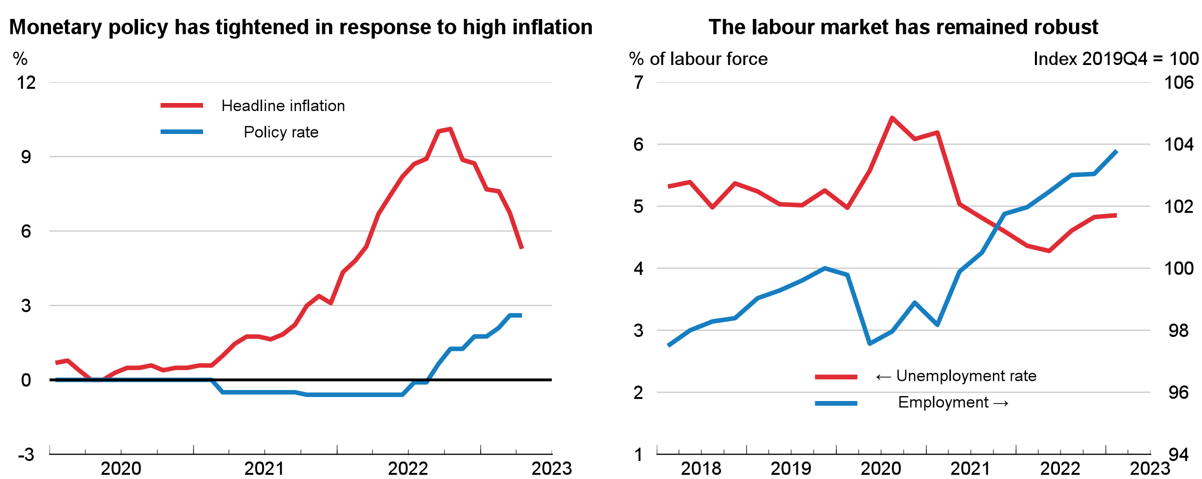
After slowing to 0.7% in 2023, economic growth is projected to recover to 1.4% in 2024. A strong labour market and large excess savings will support private consumption. By contrast, increasing borrowing costs and high uncertainty will weigh on housing and business investment. Inflation will recede from 4.9% in 2023 to 3.2% in 2024 on the back of falling commodity prices. The main risks to the outlook include stronger price and wage growth than projected. By contrast, a steeper fall in house prices would negatively affect economic activity.

Raising interest rates in line with the euro area to support the currency peg will help to stabilise inflation by dampening domestic demand. Fiscal policy will remain prudent with government budget surpluses in 2023 and 2024. Nevertheless, if inflationary pressures turn out stronger than expected, some fiscal tightening would be required next year. Structural policies facilitating international recruitment and reducing effective labour taxation would help to support labour supply. Moving ahead with plans to strengthen emissions pricing and accelerating the implementation of infrastructure projects would help to sustain investment and the green transition.

Growth momentum has weakened

The economy has slowed since the second half of 2022, except in the buoyant pharmaceutical sector. GDP growth slowed to 0.2% in the first quarter of 2023. Industrial production has weakened since the beginning of this year. The energy price shock, increasing borrowing costs, and low confidence have hit private consumption and housing investment. Rising interest rates have slowed transactions in the housing market and house prices have fallen by around 8% from their peak in mid-2022. Tensions in the labour market have started to ease, with growing unemployment and contained wage growth, but recruitment difficulties have remained pronounced. Headline inflation declined to 5.3% in April amid falling energy prices. Core inflation remains high, reflecting the progressive pass-through of higher production costs to consumer prices.

Denmark



Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/co5ql4

Denmark: Demand, output and prices

Denmark	2019 Current prices DKK billion	2020	2021	2022	2023	2024
		Percentage changes, volume (2010 prices)				
GDP at market prices	2 311.0	-2.0	4.9	3.8	0.7	1.4
Private consumption	1 085.0	-1.4	4.2	-2.3	0.0	1.3
Government consumption	557.6	-1.4	4.2	-3.5	-1.0	1.2
Gross fixed capital formation	490.9	5.1	6.2	8.6	-2.7	-1.8
Final domestic demand	2 133.4	0.1	4.6	0.1	-1.0	0.5
Stockbuilding[1]	14.1	-0.2	0.0	0.8	0.6	0.0
Total domestic demand	2 147.6	-0.2	4.5	1.1	-0.3	0.5
Exports of goods and services	1 355.3	-6.3	8.0	8.6	2.1	3.1
Imports of goods and services	1 191.9	-3.6	8.0	4.2	1.4	1.8
Net exports[1]	163.4	-1.9	0.5	2.9	0.6	1.0
Memorandum items						
GDP deflator	_	2.6	2.8	7.6	1.7	3.4
Consumer price index	_	0.4	1.9	7.7	4.9	3.2
Core inflation index[2]	_	1.0	1.2	4.0	4.8	3.2
Unemployment rate (% of labour force)	_	5.8	5.2	4.5	5.4	5.8
Household saving ratio, net (% of disposable income)	_	5.7	3.2	8.4	7.4	6.3
General government financial balance (% of GDP)	_	0.2	3.6	3.3	2.4	1.6
General government gross debt (% of GDP)	_	58.9	50.6	37.6	38.6	37.9
General government debt, Maastricht definition[3] (% of GDP)	_	42.2	36.6	29.8	30.8	30.1
Current account balance (% of GDP)	_	7.9	9.0	13.1	10.3	10.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/mljnr8

Strong price signals, investments in energy savings and mild weather during the winter have triggered a significant reduction in electricity and gas consumption. Energy support measures have been modest compared to other OECD countries (around 0.4% of GDP for 2022 and 2023). They mostly consist of tax-free cheques to low-income pensioners, lump sum payments to vulnerable families, support for the rollout of district heating and a 6-month cut in the electricity tax rate to the EU minimum until June 2023. Risks of energy shortages for the next winter are limited given the low dependence to gas supply and the reopening of gas fields in the North Sea in winter 2023-24.

Sound macroeconomic policies will help to anchor inflation

Monetary and fiscal policies will help to reduce inflationary pressures. The policy interest rate is projected to increase in line with euro area policy rates to maintain the peg to the euro and to reach 3.35% in the second quarter of 2023 and then stay at that level until the end of the projection horizon. Financial conditions will tighten with rising interest rates and stricter credit standards. The fiscal stance is expected to be broadly neutral in 2023 and mildly expansionary in 2024. The budget balance should remain in a surplus over the next two years. Support measures in response to high inflation and additional defence spending will be fully funded by the EU solidarity contribution, a reprioritisation in spending and the use of reserves. Additional support to Ukraine will amount to 0.2% of GDP but will not boost domestic activity.

Inflation will moderate as growth slows

GDP growth is projected to moderate to 0.7% in 2023 before recovering to 1.4% in 2024. Investment will slow amidst tightening financial conditions and weak external demand. Normalisation in the freight and pharmaceutical sectors will temper exports in 2023. Private consumption will drive the recovery as disposable incomes improve in real terms. Wages will continue to adjust to higher prices, but job retention by employers should limit the rise in unemployment. Inflation is expected to fall to 2.8% at the end of 2024 due to declining commodity prices and increasing spare capacity. Risks to the outlook include stronger inflation if wages increase above negotiated rates. A sharper decline in housing prices could weigh on households purchasing power and domestic demand.

Fostering the green transition is priority

Because monetary policy is bound by the peg to the euro, fiscal policy has a significant role to play to reduce inflationary pressures and should tighten if prices do not fall as expected. Structural reforms could limit the risk of labour shortages in key sectors. Removing barriers to the allocation of women into high-skilled occupations and to the recruitment of foreign workers can expand the talent pool. Introducing in--work benefits to lower the high labour taxation of middle-income families receiving social benefits and tackling the motherhood penalty in earnings can also sustain labour supply. Reaching the emission-reduction targets requires reducing reliance on fossil fuels further by speeding up infrastructure investment for the deployment of renewable energy sources. Establishing clear and credible price signals is also key for the green transition. The green tax reform is a step in the right direction and should be complemented by pricing emissions in the agriculture sector, while compensating measures should be in place to limit possible adverse socio-economic consequences.

Estonia

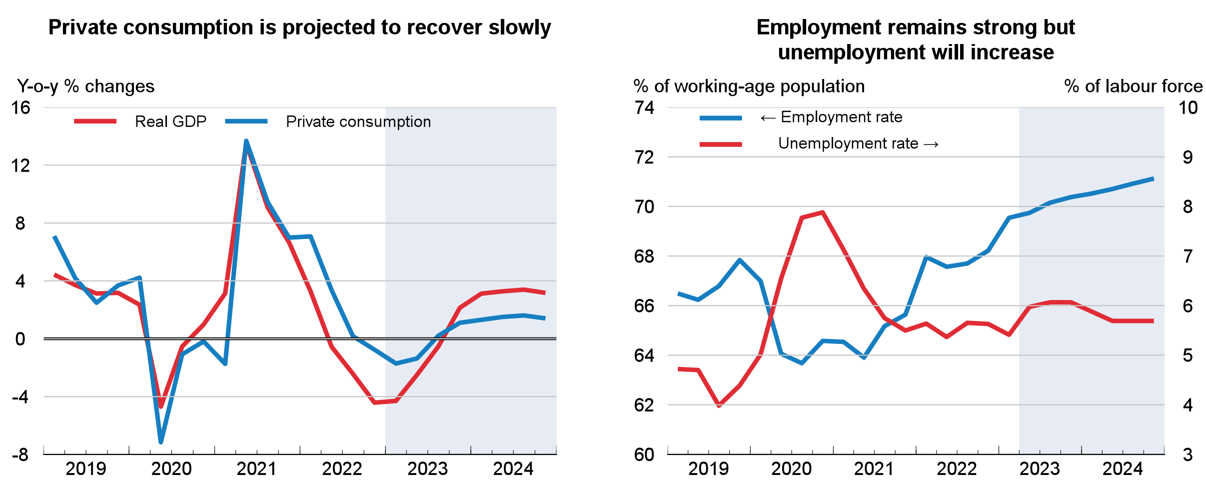
The Estonian economy is expected to contract by 1.3% in 2023 before expanding by 3.2% in 2024, helped by lower energy prices. Inflation will fall to around 5% by the end of this year and continue to ease in 2024. Private consumption will remain subdued as real incomes remain under pressure. With higher interest rates, house prices are declining and housing investment is weak. Stronger external demand will support the initial recovery. The main risks are instability in energy prices and the uncertain impact of Russia's war of aggression against Ukraine.

While support for vulnerable households inadequately covered by the general social protection and investment in energy efficiency and security is warranted, fiscal policy should not add to inflationary pressures. The government should also focus on the distributional impact of planned consolidation measures, as well as on upgrading skills to facilitate continued convergence and the green transition.

High inflation and uncertainty have taken a toll on the economy

The Estonian economy contracted in the second half of last year and decreased overall by around 1% in 2022. The decline was driven by a considerable contraction in exports, notably outside of the euro area, as the war in Ukraine took its toll on trade. Private consumption fell due to higher energy prices and tighter financial conditions are becoming visible in weaker housing investment. Headline inflation peaked at 25.2% in August last year and has been easing since, down to 11.2% by May. The economic contraction continued in the first quarter of 2023, albeit at a slower pace, with GDP decreasing by 0.6% from the last quarter of 2022. While consumer and business confidence have improved this spring, industrial production in March and retail sales in April were lower than a year ago.

Estonia



Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/qmju92

Estonia: Demand, output and prices

Estonia	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	27.7	-0.5	8.0	-1.1	-1.3	3.2
Private consumption	13.9	-1.1	6.9	2.4	-0.5	1.5
Government consumption	5.4	2.9	3.9	-0.1	1.4	2.2
Gross fixed capital formation	6.9	20.5	7.0	-12.7	9.6	7.5
Final domestic demand	26.3	5.8	6.9	-2.7	2.6	3.3
Stockbuilding[1]	0.3	0.3	0.9	3.5	-0.6	0.0
Total domestic demand	26.6	5.1	6.6	0.6	1.9	3.1
Exports of goods and services	20.5	-5.3	20.0	5.0	-1.8	2.6
Imports of goods and services	19.4	0.2	21.3	5.9	-3.9	2.5
Net exports[1]	1.1	-4.1	-0.9	-0.7	1.8	0.2
Memorandum items						
GDP deflator	_	-0.6	5.8	16.4	13.3	5.1
Harmonised index of consumer prices	_	-0.6	4.5	19.4	9.2	3.4
Harmonised index of core inflation[2]	_	0.0	2.8	10.3	9.9	3.3
Unemployment rate (% of labour force)	_	6.8	6.2	5.6	5.9	5.7
Household saving ratio, net (% of disposable income)	_	10.5	8.3	2.1	3.3	3.2
General government financial balance (% of GDP)	_	-5.5	-2.4	-0.9	-3.2	-2.1
General government gross debt (% of GDP)	_	24.8	24.4	25.3	31.1	34.9
General government debt, Maastricht definition[3] (% of GDP)	_	18.6	17.7	18.4	19.1	19.2
Current account balance (% of GDP)	_	-1.0	-2.3	-2.6	-0.2	1.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/p1k5h8

The labour market has held up well with the unemployment rate at 5.3% in the first quarter of 2023 even though the country has welcomed a significant number of Ukrainian refugees and economic activity declined last year. Many of the refugees integrated quickly into the labour market, finding jobs in industry, trade and hospitality. Structural labour shortages pre-dating the COVID-19 pandemic have contributed to reluctance of businesses to lay off staff, even with the temporary weakening of activity.

Fiscal policy continues to contribute to demand

Fiscal policy measures over the past year have supported the economy through temporary decreases in excise duties on fuels and the regulated electricity price, together with permanent increases in family and social benefits, higher defence spending, strong public investment and higher public sector wages. A new government that took office this April aims to keep the budget deficit below 3% in the medium term. The forecast incorporates a planned sizeable fiscal consolidation that includes increasing the VAT rate by 2 percentage points next year and raising personal and corporate income taxes in 2025. The design and distributional impact of these tax increases and other planned measures should be assessed carefully, as well as the impact on inflationary pressures.

Growth to recover gradually in the course of this year and strengthen in 2024

Activity will remain weak during the first half of the year before recovering as the impact of high inflation fades with the economy contracting by 1.3% this year before rebounding by 3.2% in 2024. Inflation will fall to around 5% by the end of the year, but the planned VAT increase is expected to raise it again moderately early next year. Consumption and housing investment will remain weak, with the initial recovery driven by trade and public investment. The unemployment rate is projected to rise to 5.9% this year. As household disposable income recovers, with wage rises throughout this year and next, private consumption will strengthen. The main risk to Estonia's recovery lies in regional and global developments that could weaken economic prospects. Inflationary pressures could be stronger than anticipated given strong nominal demand and the relatively tight labour market. Energy security remains a risk, although the country now has access to gas storage capacity and is investing to align its energy grid with European standards.

Strengthening growth requires sustainable and inclusive policies

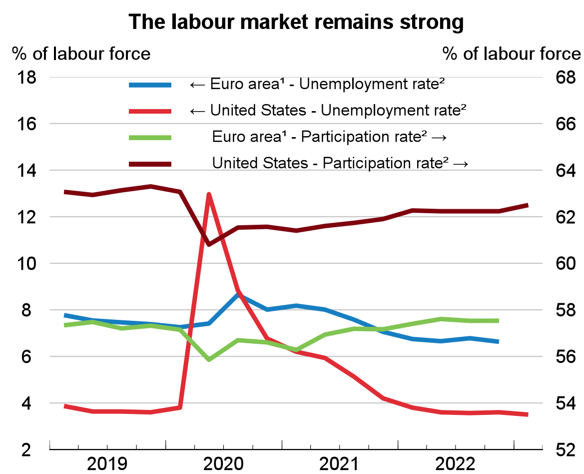
Fiscal policy should continue to support vulnerable households and speed up investment in energy efficiency and security, but needs to avoid adding to inflationary pressures. Planned consolidation should balance the need for new revenues with significant investments and policies to tackle persisting inequalities. In this context, the proposed comprehensive spending review is welcome, as is ongoing policy debate about medium-term financing of healthcare and education systems. In the near term, policy should focus on the distributional impact of planned consolidation measures. Labour market policies should continue to address skills shortages, upgrading weak basic skills and improving participation of the low skilled in lifelong training, as well as on integration of the refugees. To continue narrowing the sizeable gender pay gap, the authorities should strengthen data collection and transparency and give the labour inspectorate a right to supervise implementation of legislation on gender equality.

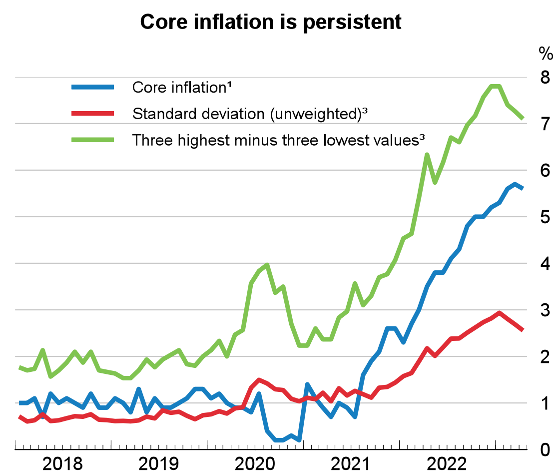
Euro area

GDP growth is projected to slow to 0.9% in 2023 and then gradually strengthen to 1.5% in 2024. Private consumption will be supported by strong labour markets, but higher costs of financing and uncertainty will weigh on private investment. The tight labour market will continue to fuel wage growth in 2023, before wages start gradually easing in 2024. Lower energy and food prices will help reduce headline inflation in 2023, but core inflation will remain elevated. Risks remain tilted to the downside as another spike in energy prices could reignite the energy crisis, and restrictive monetary policy could expose existing financial sector vulnerabilities.

Persistent inflation, declining incomes and elevated uncertainty following recent turmoil in the banking sector call for coordinated and resolute policy actions. Fiscal measures adopted during the energy crisis need to be gradually withdrawn to rein in public debt and avoid providing fiscal stimulus at a time of high inflation. Monetary conditions need to remain tight to durably lower inflation.

Euro area 1





1. Data refer to the euro area including 20 member countries.
2. Age group 15 and over.
3. Dispersion measures refer to the individual euro area countries.
Source: OECD Short-term Labour Statistics database; Eurostat Harmonised index of consumer prices (HICP) database; and OECD calculations.

StatLink https://stat.link/d1kg2h

Euro area: Demand, output and prices

Euro area	2019 Current prices EUR billion	2020	2021	2022	2023	2024
		Percentage changes, volume (2015 prices)				
GDP at market prices	11 955.9	-6.2	5.2	3.5	0.9	1.5
Private consumption	6 363.2	-7.8	3.7	4.4	0.2	1.5
Government consumption	2 450.2	0.9	4.4	1.4	-0.2	0.9
Gross fixed capital formation	2 653.3	-6.2	3.5	3.8	0.6	1.4
Final domestic demand	11 466.7	-5.6	3.8	3.6	0.2	1.4
Stockbuilding[1]	83.4	-0.3	0.3	0.3	-0.1	0.0
Total domestic demand	11 550.1	-5.8	4.1	3.9	0.0	1.4
Net exports[1]	405.8	-0.6	1.3	-0.2	0.7	0.2
Memorandum items						
GDP deflator	_	1.8	2.1	4.6	5.7	3.0
Harmonised index of consumer prices	_	0.3	2.6	8.4	5.8	3.2
Harmonised index of core inflation[2]	_	0.7	1.4	4.0	5.4	3.6
Unemployment rate (% of labour force)	_	7.9	7.7	6.7	6.7	6.6
Household saving ratio, net (% of disposable income)	_	13.6	11.5	7.7	7.4	6.7
General government financial balance (% of GDP)	_	-7.1	-5.3	-3.6	-2.9	-2.2
General government gross debt (% of GDP)	_	121.9	116.3	96.9	95.9	95.6
General government debt, Maastricht definition[3] (% of GDP)	_	99.3	97.5	93.4	92.3	92.0
Current account balance (% of GDP)	_	2.6	3.7	0.7	2.4	2.6

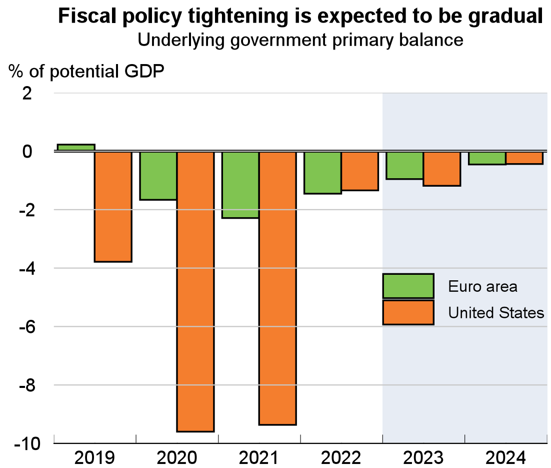
Note: Aggregation based on euro area countries that are members of the OECD, and on seasonally-adjusted and calendar-days-adjusted basis.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

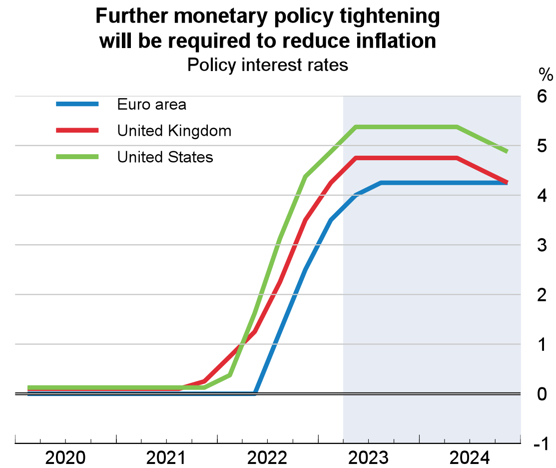
StatLink https://stat.link/nl7ez5

Persistent core inflation and elevated uncertainty are weighing on the outlook

GDP growth in the first quarter of 2023 was 0.1% quarter on quarter. Uncertainty remains elevated and the signals from forward-looking indicators of sentiment are mixed. Improvements in output Purchasing Managers' Indices have moderated in the second quarter of 2023, as strong service sector growth contrasted with weakening demand for goods. Stronger activity levels are also reflected in robust job creation and solid employment growth. At the same time, consumer and, to a lesser extent, business confidence remain well below their long-term averages. Headline inflation has continued to moderate, to 6.1% in May from its peak of 10.6% last October, but core inflation has increased further. Underlying inflation remains broad-based geographically and across consumption items, although inflation dispersion has recently stabilised. Inflation expectations have increased even at longer-term horizons. Bank lending has moderated across euro area countries, reflecting weaker supply and demand of credit. Declining real incomes have been partly protected by fiscal measures that compensate for higher energy prices, albeit at the cost of weakening the incentives to reduce energy consumption. Labour markets remain tight, with the euro area seasonally adjusted unemployment rate at 6.5% in April 2023, and rising wage growth and increasing wage demands in many countries.

Euro area 2





Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/2xf8e4

Recent US banking sector turmoil did not spill over directly into the euro area. However, market strains led to a large fall in bank equity prices, increasing the cost of capital. The economic fallout in the euro area from Russia's war of aggression against Ukraine has been contained. Direct trade with Russia is low and has been reduced further by the ban on Russian seaborn crude and oil imports. The energy crisis has abated, reflecting both stronger supply, such as the inflows of liquified natural gas into Europe, and reduced demand driven by a steep drop in consumption, partly due to mild weather conditions during the winter. At the same time, in the most energy-intensive industries, high prices have led to production cuts or curtailments. Loans to energy-intensive firms have, since Russia's invasion of Ukraine, seen higher probabilities of default than loans to other firms. The war in Ukraine also continues to have substantial effects on the euro area economy through persisting supply chain disruptions and elevated costs for some agricultural commodities. EU countries are providing temporary protection to about 4 million Ukrainian refugees. To help Member States meet related costs, the EU has made available EUR 27 billion (0.23% of euro area GDP) from the cohesion and pandemic recovery funds.

Macroeconomic policies need to be tightened further to reduce inflation

While starkly different across countries in the euro area, the fiscal stance is projected to remain restrictive for the euro area as a whole in 2023 and even more so in 2024. Fiscal support to cushion the impact of high energy costs in 2022 was high and mostly untargeted, amounting to more than 2% of GDP in some euro area countries. A gradual withdrawal of support, with income support targeted only on vulnerable households, is particularly important to curb the deterioration of public finances and provide the needed macroeconomic policy tightening. In addition, the war in Ukraine has triggered a rise in military spending and investments to secure energy supply in many countries, which need to be delivered without overstimulating the economy.

The ECB has continued to tighten monetary policy, but further policy rate increases are needed to durably reduce the underlying inflationary pressures that are pushing up core inflation. A period of below-trend growth is likely to be needed to help lower resource pressures, including the short-term effects of additional public expenditure associated with the Next Generation EU (NGEU) programme. The main refinancing rate is projected to rise to 4.25% in the third quarter of 2023 and to remain unchanged through the rest of the projection period.

Growth will rebound in 2024 as real incomes gradually recover

Quarterly growth is projected to slow in 2023, driven by still-elevated energy and commodity prices, continuing supply bottlenecks and tighter financing conditions. Despite robust wage growth, consumer price inflation of 5.8% in 2023 will mean negligible growth of real disposable income and weigh on private consumption. Investment will be held back by high uncertainty and tighter financing conditions, although additional spending of just below 1% of GDP a year under the NGEU programme will moderate the slowdown. Headline inflation is projected to moderate perceptibly in 2023, with declining energy prices and subdued domestic growth helping to contain price and cost pressures. Core inflation, however, is projected to still remain above the ECB inflation target at the end of 2024.

The risks to the projections are to the downside. The energy crisis may be rekindled by higher demand for liquified natural gas by China or unintended effects of Western sanctions on Russian oil, especially close to or during the next winter. Trade related tensions remain a concern. Further fragmentation of global supply chains and barriers to trade would weigh on external demand in the euro area and contribute to inflationary pressures. Financial stability risks are also increasing. Strains from tighter monetary policy could intensify, especially among nonbank financial intermediaries. A much tighter monetary policy could also heighten the risk of a recession. On the upside, a durable conclusion of the war in Ukraine could alleviate upward pressure on energy and food prices. A stronger recovery in China could also add to external demand.

Expanding productive capacity and supporting the green transition

The war in Ukraine has strengthened the link between the twin goals of energy security and climate change mitigation. An effective disbursement of the Next Generation EU funds will help accelerate both the diversification of energy supplies and the green transition. Careful design and monitoring at the EU level would help to maximise effectiveness of such policies, while ensuring a level playing field. Fiscal measures to cushion the impact of high energy prices should be gradually withdrawn to preserve incentives to reduce energy consumption and limit adverse effects on debt sustainability. Investment in clean energy and energy infrastructure will need to increase substantially by 2030. A clear policy framework to support early-stage green investment should combine price signals with regulatory and fiscal tools at the European level. Continued monetary policy tightening should be complemented, as needed, by macroprudential policy and the use of targeted instruments to address vulnerabilities in the financial sector.

Finland

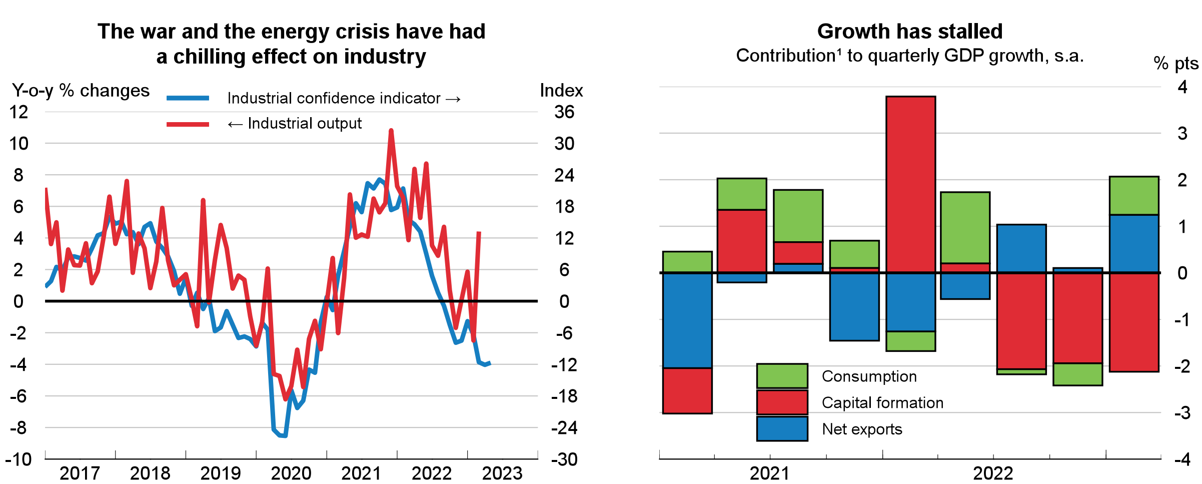
Growth is projected to stall in 2023, before picking up to 1.2% in 2024. As energy prices ease, private consumption is set to recover moderately despite the drag from higher interest rates, which together with declining house prices will weigh on residential investment. Unemployment is expected to increase modestly. Lower energy prices and weak demand should help bring headline inflation down from 7.2% in 2022 to 5.7% in 2023 and 3.0% in 2024, though elevated wage growth and cost increases could keep inflation high.

The fiscal stance is currently projected to be expansionary but is likely to be revised once the new coalition agreement is reached. Implementing a moderate fiscal consolidation is warranted to help fight inflation, and to stabilise the public debt ratio and set it on a downward path. Addressing labour shortages through immigration and improved female labour force participation, investing in R&D and skills, and furthering the diversification of energy sources are key to shared prosperity.

The economy is recovering from the energy crisis

Consumer confidence – which plunged because of Russia's war of aggression against Ukraine and the risk of energy shortages – is gradually improving as the risk of shortages has faded and energy prices have decreased. After two consecutive quarters of negative growth, GDP increased by +0.2% in the first quarter of 2023. Industrial output also increased in the first quarter of 2023 (+2.1% on a year earlier), but industrial confidence has trended down since the war broke out. Annual (harmonised) headline and core inflation have recently decreased, to 6.3% and 4.9% respectively in April 2023, but remain high. The labour market is robust and tight, with the harmonised unemployment rate remaining broadly constant at a low level over the past few months. However, nominal wages have not kept up with inflation and real wages fell by 3.6% in 2022.

Finland



1. Consumption refers to government and private consumption; growth contributions add up to quarterly real GDP growth up to a statistical discrepancy.

Source: Statistics Finland; European Commission; and Economic Outlook 113 database.

StatLink https://stat.link/tqelv2

Finland: Demand, output and prices

Finland	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	239.9	-2.4	3.0	2.1	0.0	1.2
Private consumption	126.1	-3.8	3.6	2.0	0.1	1.4
Government consumption	55.6	1.2	3.9	2.9	4.3	0.2
Gross fixed capital formation	57.1	-1.0	0.9	5.0	-4.7	0.2
Final domestic demand	238.8	-1.9	3.0	2.9	-0.1	0.8
Stockbuilding[1,2]	0.6	0.2	0.0	1.9	-3.4	0.0
Total domestic demand	239.5	-1.6	3.1	5.0	-3.4	0.8
Exports of goods and services	95.7	-7.8	6.0	1.7	-0.5	3.0
Imports of goods and services	95.3	-6.2	6.0	7.5	-4.0	2.1
Net exports[1]	0.4	-0.7	0.0	-2.3	1.7	0.4
Memorandum items						
GDP deflator	_	1.6	2.2	4.2	5.5	3.5
Harmonised index of consumer prices	_	0.4	2.1	7.2	5.7	3.0
Harmonised index of core inflation[3]	_	0.5	1.2	3.6	4.5	3.2
Unemployment rate (% of labour force)	_	7.8	7.6	6.8	7.0	6.9
Household saving ratio, net (% of disposable income)	_	4.9	2.8	-1.3	0.4	1.3
General government financial balance (% of GDP)	_	-5.6	-2.8	-0.9	-1.6	-1.6
General government gross debt (% of GDP)	_	90.8	85.3	80.7	85.4	89.6
General government debt, Maastricht definition[4] (% of GDP)	_	74.7	72.6	73.0	77.7	81.8
Current account balance (% of GDP)	_	0.3	0.0	-3.8	-0.7	0.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/s73gw0

A mild winter and demand reductions have helped Finland avoid energy shortages. Energy prices have come down but remain elevated. Finland has diversified its sourcing away from Russia, in particular through more wind power investments and the commissioning of an additional nuclear unit. While food commodity prices have declined, retail food prices are still rising sharply.

Monetary policy is tightening, while fiscal policy uncertainty is high

The continued tightening of monetary policy by the European Central Bank is affecting lending conditions for households and businesses in Finland. House prices declined 4.6% between 2022Q2 and 2022Q4. Given the high share of variable- or adjustable-rate mortgages, interest rate increases will make it harder to service household debt and could put additional pressure on house prices and consumption. The bulk of remaining energy support measures that were provided from January to April have been wound down. The support included a VAT reduction on electricity and passenger transport as well as targeted support for households facing high energy bills. However, utilities will benefit from emergency loans and credit guarantees until the end of 2023. No support measures are assumed in 2024, and it is probable that the next Budget will implement fiscal consolidation through reduced spending, which would help fight inflation and stabilise the public debt ratio. However, as there is no coalition agreement so far, this likely fiscal consolidation is not incorporated in these projections.

Following a mild recession, a moderate pick-up in growth is expected

Following the decline in GDP in the second half of 2022, activity is expected to remain weak in the first half of 2023, before consumption growth picks up as the energy shock fades, and foreign trade improves. Unemployment will increase modestly in 2023, and slowly decline to 7.1% in 2024. Higher interest rates, the contraction in GDP and increased unemployment are expected to help ease inflationary pressures over 2023-24. The recent fall in energy prices will also help reduce inflation pressures, but the expiration of value added tax cuts at the end of April will delay the decline in retail prices. The pass-through of energy prices into prices and wages is projected to keep core inflation higher for slightly longer than headline inflation. Given the high share of mortgages with variable or adjustable rates, and high household debt (156% of disposable income in 2022), house prices could decline markedly further amid interest rate increases. A renewed spike in energy prices would also undermine confidence and purchasing power, putting a drag on private consumption and growth.

Boosting productivity, employment and energy security is key

Investing in R&D, digitalisation and tertiary education are key to boosting productivity growth and innovation. Enhancing female labour force participation by improving work incentives and addressing shortages of childcare workers, as well as skill-based immigration, can help increase employment and help ease labour shortages. Finally, accelerating the transition towards decarbonised energy sources (wind, solar, nuclear) is also crucial for increased energy security and meeting Finland's greenhouse gas emissions reduction goals.

France

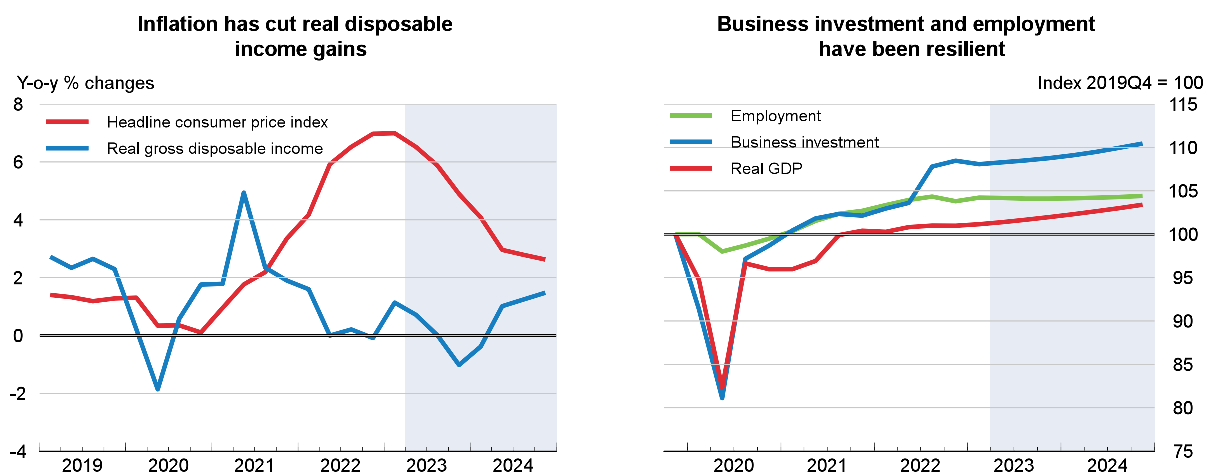
Real GDP is projected to grow by 0.8% in 2023 and 1.3% in 2024. Russia’s war of aggression against Ukraine, supply chain disruptions and elevated energy prices have dented economic prospects. Inflation is expected to remain high at 6.1% in 2023 and to decline to 3.1% in 2024, lowering household purchasing power and consumption growth. Low business and household confidence, modest global growth and high uncertainty will hold back investment and exports. Wages are accelerating, owing to the strong labour market. With slowing job creation, the unemployment rate will broadly stabilise at 7.2% in 2024.

Fiscal policy will become less supportive. The combination of a temporary freeze of regulated energy prices, subsidies and cash transfers have smoothed energy price shocks. These measures are expected to be phased out by the end of 2024. As wholesale energy prices decline, it is crucial to improve the targeting of support measures to avoid impeding the green transition. Changes to unemployment insurance and the pension reform will lower public expenditure in these areas, but be partially offset by the effects of population ageing and higher interest rates, calling for improvements in spending efficiency.

Growth has slowed

Rising energy prices, the war in Ukraine and supply-chain disruptions slowed the rapid rebound in GDP in 2022. Robust business investment and a resilient labour market supported growth over the 2022-23 winter, but GDP stagnated in 2022Q4 and rose by just 0.2% in 2023Q1. Despite historically high employment rates, high energy prices, tighter financial conditions and declining real wages have held back private consumption and residential investment. Goods consumption was down by 4.3% in the year to April, services consumption has slowed, and manufacturing production in energy-intensive sectors has plunged. Consumer prices were up 6.0% in the year to May, as food price inflation reached 13.6% and core inflation rose to 4.3%, with wages accelerating. Nonetheless, business and consumer confidence have been broadly stable in early 2023, as wholesale energy and food prices and supply-chain tensions eased.

France 1



Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/8k2gv1

France: Demand, output and prices

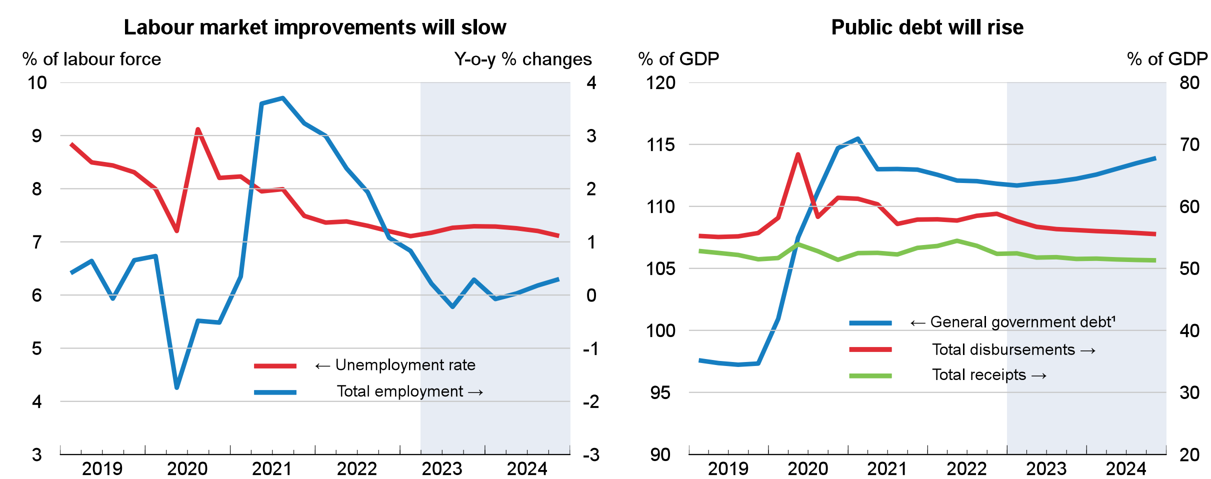
France	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2014 prices)				
GDP at market prices	2 440.2	-7.7	6.4	2.5	0.8	1.3
Private consumption	1 307.4	-6.7	5.2	2.2	0.3	1.4
Government consumption	560.6	-4.2	6.5	2.6	0.8	0.9
Gross fixed capital formation	573.5	-7.1	10.2	2.3	0.8	0.9
Final domestic demand	2 441.5	-6.2	6.6	2.3	0.5	1.2
Stockbuilding[1]	22.4	-0.2	-0.6	0.8	-0.4	0.0
Total domestic demand	2 463.9	-6.3	6.0	3.1	0.2	1.2
Exports of goods and services	771.4	-17.1	10.9	7.2	1.3	3.3
Imports of goods and services	795.0	-12.6	9.2	8.7	-0.5	2.4
Net exports[1]	- 23.7	-1.3	0.2	-0.6	0.6	0.2
Memorandum items						
GDP deflator	_	2.8	1.4	2.9	5.3	2.6
Harmonised index of consumer prices	_	0.5	2.1	5.9	6.1	3.1
Harmonised index of core inflation[2]	_	0.6	1.3	3.4	4.5	3.3
Unemployment rate[3] (% of labour force)	_	8.1	7.9	7.3	7.2	7.2
Household saving ratio, gross (% of disposable income)	_	20.5	18.6	17.2	17.1	16.6
General government financial balance (% of GDP)	_	-9.0	-6.5	-4.7	-4.8	-4.4
General government gross debt (% of GDP)	_	146.0	138.7	117.7	118.1	119.7
General government debt, Maastricht definition[4] (% of GDP)	_	114.7	113.0	111.8	112.2	113.9
Current account balance (% of GDP)	_	-1.8	0.4	-2.2	-1.6	-1.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. National unemployment rate, includes overseas departments.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.

Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/lnakeg

France 2



1. Maastricht definition.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/efpd2g

Despite strong services growth, the trade deficit widened to 4.2% of GDP in 2022 due to rising energy import costs, persistent difficulties in the aeronautical and automotive sectors, as well as constrained nuclear energy production capacity. The gross fiscal costs of energy price caps and support measures will amount to 1.6% of GDP in 2023, despite a 15% increase in regulated electricity and gas prices in early 2023. At the same time, euro area monetary tightening is progressively curbing domestic demand, including through a slowdown in new mortgage loans.

Fiscal measures are partly cushioning external shocks

Fiscal policy is assumed to result in a moderate consolidation in 2023 and 2024. Despite broad energy support measures, the budget deficit narrowed to 4.7% of GDP in 2022, due to strong revenue growth and the phasing-out of COVID-19-related spending. For 2023, the government has maintained capped gas and electricity tariffs, increased a voucher scheme to subsidise low-income households' energy consumption, but abolished road fuel tax cuts. Social benefits and public wages were raised and rent increases capped. In addition, one-off taxes on electricity producers and oil refineries are helping to finance additional temporary energy support measures for firms. The direct energy support measures are estimated to amount to EUR 45.3 billion (1.6% of GDP) in 2023. Energy-support policies are assumed to be largely phased out in 2024, including through a further 15% increase in regulated electricity prices. Additional measures to support economic activity include spending from the recovery plan worth EUR 15 billion in 2023-24 and further housing and business tax cuts in 2023-24. However, the 2022 reform of unemployment insurance and the planned pension reform will bring some fiscal savings.

Monetary and financial conditions are becoming less supportive for investment in the euro area. However, the implementation of the Next Generation EU plan is supporting investment in France, with EUR 37.5 billion of grants, and in its main trading partners. The 2022 resilience plan has pushed forward funding for housing renovation and insulation, while the energy saving plan aims for a 10% decline in energy consumption by 2024. Government-guaranteed loans and subsidies for highly affected firms will support business investment. Vehicle and energy investment subsidies for households are targeted towards green alternatives and will raise housing investment and durable goods consumption. Greater public investment in infrastructure and digitalisation, as well as additional financing for training programmes, are expected to improve productivity and long-term growth.

Domestic demand is projected to pick up slowly

GDP growth is projected to slow to 0.8% in 2023 and increase to 1.3% in 2024. Inflation is weighing on household purchasing power and pent-up demand is slowing. The progressive pass-through of past increases in wholesale energy prices and the indexation of the minimum wage will fuel core inflation and wage growth in 2023, despite caps on regulated energy prices and rent increases, and easing pressures on wholesale energy and food prices. Tighter financing conditions and a weakening labour market will eventually curb core inflation and wage growth and limit housing investment. As demand from trading partners strengthens only gradually, exports will rise only slowly from their current low levels. Business investment is set to remain resilient, as the support from the EU recovery and resilience plan will partly compensate the effects of increasing financing costs, reduced profit margins and high uncertainty. The budget deficit and public debt are projected to remain high relative to GDP, with debt rising above 113% of GDP in 2024 (Maastricht definition).

Worsening geopolitical tensions and further energy-market and supply-chain disruptions could particularly affect sectors such as transport equipment, travel and tourism services in France. With sizeable debt, in part due to government loan guarantees, some companies will face liquidity and solvency concerns, which could lead to bankruptcies and dent growth prospects. The extent to which large, accumulated household saving is spent is particularly uncertain and a higher or lower-than-projected saving rate would either lower or raise domestic demand and growth.

Supporting more sustainable growth

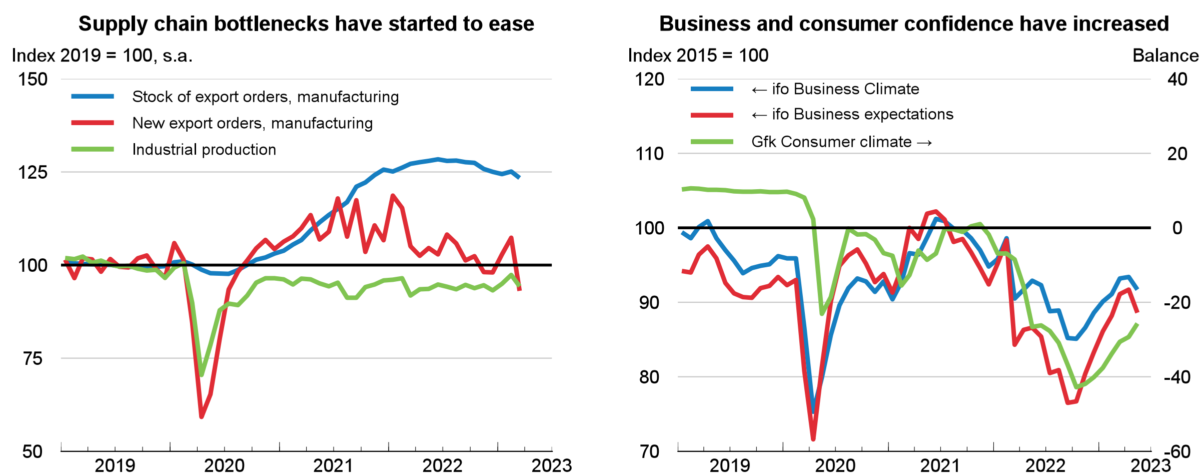
Unconditional energy price support measures, notably price caps, should be phased out, as they have high fiscal costs and create economic distortions. Support measures meant to dampen the effects of persistently high energy prices should remain temporary and become targeted on the most vulnerable households. As uncertainty and price pressures abate and growth becomes more firmly based, a medium-term fiscal strategy to gradually lower public expenditures and increase their efficiency should be firmly implemented to raise long-term growth prospects and improve medium-term fiscal sustainability. This strategy should build on a more efficient and transparent allocation of public spending through spending reviews. Policy efforts to broaden progress towards green alternatives and energy savings, and ensure a fair transition, should also continue. Speeding up housing renovation and energy savings would help the longer-term energy transition and should build on regular evaluations of relevant support schemes. Ensuring broad access to lifelong learning for low-skilled and long-term unemployed people, as well as an efficient implementation of quality standards for these programmes, will support growth and help bring about longer working lives, as foreseen in the planned pension reform. In addition, continuing to strengthen access to high-quality education from an early age will be key to ensure greater equity and further reduce gender imbalances.

Germany

The economy is projected stagnate in 2023 and grow by 1.3% in 2024. High inflation is reducing real incomes and savings, damping private consumption. Export growth will recover through 2023 due to easing supply chain bottlenecks and a record-high order backlog. Investor and consumer confidence have improved due to strong energy price support, swift substitution of energy imports from Russia and declining energy prices. Investment will pick up, despite rising interest rates, mainly due to high corporate savings and investment needs related to the relocation of supply chains and renewable energy expansion, rising public investment and strong fiscal incentives for green investments.

The fiscal deficit will be reduced in 2023 and 2024. To contain inflationary pressures, it is essential to avoid an expansionary fiscal stance. Improving infrastructure planning, approval processes and capacity, particularly at the municipal level, would accelerate the energy transition and digitalisation. Skilled labour shortages should be addressed by raising the labour supply of women, older and low-skilled workers, improving training and adult learning, and facilitating the recognition of the qualifications of migrants and refugees.

Germany 1



Source: Federal Statistical Office; ifo business surveys; and GfK.

StatLink https://stat.link/ivl7jw

Germany: Demand, output and prices

Germany	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	3 479.4	-4.1	2.6	1.9	0.0	1.3
Private consumption	1 807.4	-5.9	0.4	4.9	-1.4	1.6
Government consumption	703.2	4.0	3.8	1.2	-3.9	1.4
Gross fixed capital formation	745.4	-3.0	1.0	0.5	0.8	0.6
Final domestic demand	3 256.0	-3.1	1.3	3.0	-1.4	1.3
Stockbuilding[1]	24.9	-0.2	0.5	0.4	0.6	0.0
Total domestic demand	3 280.9	-3.2	2.0	3.4	-0.8	1.3
Exports of goods and services	1 627.6	-10.1	9.5	3.5	1.1	2.4
Imports of goods and services	1 429.1	-9.1	8.9	7.0	-0.5	2.5
Net exports[1]	198.5	-1.0	0.8	-1.3	0.8	0.1
Memorandum items						
GDP without working day adjustments	3473.3	-3.7	2.6	1.8	-0.1	1.2
GDP deflator	_	1.8	3.1	5.5	5.8	3.0
Harmonised index of consumer prices	_	0.4	3.2	8.7	6.3	3.0
Harmonised index of core inflation[2]	_	0.7	2.2	3.9	5.5	3.4
Unemployment rate (% of labour force)	_	3.7	3.6	3.1	2.9	2.8
Household saving ratio, net (% of disposable income)	_	16.4	15.1	11.2	11.9	11.0
General government financial balance (% of GDP)	_	-4.3	-3.7	-2.6	-1.8	-0.8
General government gross debt (% of GDP)	_	81.7	79.8	65.4	65.0	64.7
General government debt, Maastricht definition[3] (% of GDP)	_	68.9	69.4	66.3	65.9	65.6
Current account balance (% of GDP)	_	6.8	7.4	3.7	5.4	5.9

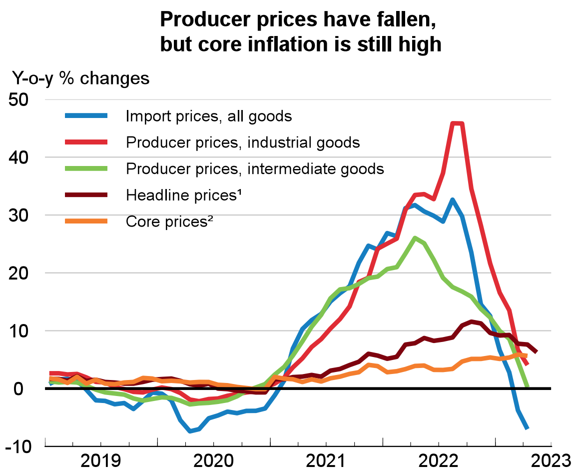
1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

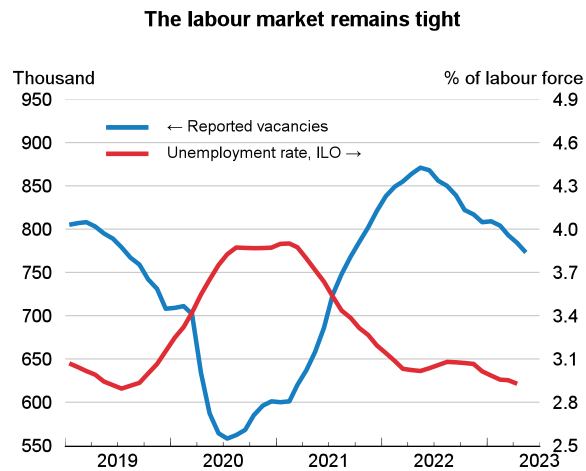
StatLink https://stat.link/f0spvu

High inflation weighs on private consumption

The economy entered a recession over the winter. GDP declined by 2.1% (seasonal adjusted annual rate) in the fourth quarter of 2022 and 1.2% in the first quarter of 2023, mainly due to a drop in private consumption. High inflation has reduced real wages, which were down by 5.4% in the fourth quarter of 2022 compared to a year earlier. Heightened uncertainty, high energy prices and material shortages weighed on manufacturing and investment. However, since early 2023, easing supply chain bottlenecks and a large export order backlog have led to a pick-up in industrial production, investment and exports. Business investment increased by 12.7% (seasonally adjusted annual rate) in the first quarter of 2023. Reduced energy prices have particularly benefitted energy-intensive industries, with production rising by 3.3% from January to March. After picking up strongly in January and February, export orders have slumped in March, but the export order backlog is still at an equivalent of about 7.4 months of production at full capacity. Investor and consumer confidence have recovered since late 2022, but business expectations deteriorated in May. However, real retail sales have increased by 0.8% in April compared to March. Headline inflation decreased to 6.3% in May compared to a year earlier, down from 7.6% in April, but core inflation is still on the rise. The unemployment rate fell to 2.8% in March.

Germany 2





1. Harmonised index of consumer prices.
2. Harmonised index of consumer prices excluding food, energy, alcohol, and tobacco.
Source: Federal Statistical Office; and Eurostat.

StatLink https://stat.link/p8efqt

Before the start of Russia's war of aggression against Ukraine, Germany was highly dependent on Russian gas, oil and coal, with around one-third of primary energy supply coming from Russia. Since then, energy imports from Russia have strongly declined due to the EU coal and oil embargo, the destruction of gas pipelines, and the rapid diversification of energy suppliers. In February 2023, less than 1% of German energy imports still came from Russia. Despite high gas storage levels and the opening of three LNG terminals since December 2022, gas consumption will need to be reduced by around 20% to prevent significantly higher gas prices or shortages if temperatures are below average next winter. The war has led to a net inflow of about 1 million refugees from Ukraine by February 2023 (1.3% of the population).

Energy price measures and public investment will support the recovery

Electricity and gas price subsidies, which have maintained energy saving incentives, and the rapid construction of LNG terminals have helped to lower wholesale energy prices and increased investor and consumer confidence. Three relief packages estimated at EUR 95 billion (2.6% of GDP) and an energy support fund of EUR 200 billion (5.5% of GDP) were put in place. Besides some permanent policy changes in line with earlier government plans, the relief packages include various temporary measures to support real incomes. The debt-financed energy support fund will finance liquidity support, equity injections and grants for firms as well as the subsidy of electricity and gas bills until December 2023, with an option to prolong it until April 2024. Excluding permanent policy measures that are not related to the energy crisis as well as equity injections, total energy price support was planned at about 2.4% in 2023, and 0.6% in 2024. However, falling retail energy prices resulting from lower wholesale prices, as observed since December 2022, will likely reduce the fiscal costs by about 1% in 2023 and 0.5% in 2024. This will lead to a contractionary fiscal stance in 2023 and 2024.

To reach its ambitious climate targets, the government plans to spend around EUR 200 billion (5.5% of GDP) until 2026, with fiscal incentives to crowd in private investments playing a major role. It also envisages a significant increase in military spending of EUR 100 billion over the next few years to upgrade military equipment. Most of these investments as well as the energy support fund will be financed through extra-budgetary funds, the spending of which is excluded from the national debt brake that is planned to be reinstated from 2023. Capacity constraints in the construction sector and long and complex planning and approval procedures will likely slow the disbursement of funds.

The economy will slowly recover

The economy is projected to stagnate in 2023 and grow by 1.3% in 2024. GDP growth will be subdued in 2023 as high inflation reduces real incomes and savings and holds back private consumption. The recovery will be driven by exports due to easing supply chain bottlenecks and a large export order backlog. Rising interest rates and uncertainty amidst energy price volatility will weigh on investment, particularly in housing, but strong government support and lower energy prices will further improve investor confidence. Investment will pick up due to high corporate savings and investment needs related to the relocation of supply chains and the renewable energy expansion, rising public investment and fiscal incentives for green investments. Inflation is projected to remain high in 2023 due to the pass-through of energy and producer prices to consumers and rising wage pressures. Tighter monetary conditions, fading energy price pressures and fiscal tightening will help to bring down inflation to 3.0% in 2024. Real wages will rise in 2024, supporting a recovery of private consumption.

A major downside risk arises from gas prices and potential gas rationing next winter. This would imply severe production disruptions if planned fiscal support measures do not sufficiently preserve price incentives for gas savings, weather conditions are unfavourable, and delays occur in building up the LNG infrastructure. Geopolitical tensions could lead to further trade disruptions and the need to relocate supply chains. Moreover, rising interest rates could cause strong corrections in housing markets, affecting financial markets, as well as lower export demand for investment goods. On the upside, a quicker end to the war in Ukraine could restore investor and consumer confidence and lower energy prices.

Expand renewables to raise energy security

To expand renewable energy supply, it is crucial to continue accelerating complex planning and approval procedures at the municipal and Länder level. Speeding up the digitalisation of the economy requires more investments in digital infrastructure, a more rapid modernisation of the public sector and better coordination of policies and administrative procedures across levels of government. Increasing the efficiency of public spending by effective use of spending reviews, reducing regressive and environmentally harmful subsidies and tax exemptions, and improving tax enforcement could free up additional resources for necessary public investment. To address rising labour shortages, which also risk derailing private and public renewable energy investment, the labour market participation of women, low-skilled and elderly workers need to be raised by setting the right tax incentives and improving training and adult learning policies. Reforming the current joint income taxation of couples would help to raise female labour supply and reduce gender imbalances.

Greece

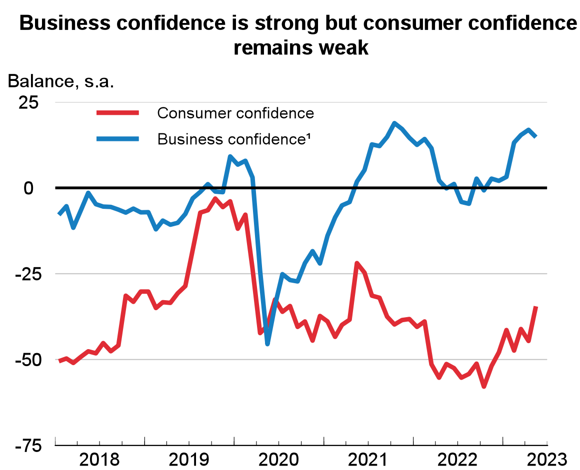
Economic growth will remain robust, with real GDP projected to increase by 2.2% in 2023 and 1.9% in 2024. Consumption growth is projected to slow in the near term following the erosion by high inflation of households' purchasing power. Real investment growth is projected to remain strong in the face of rising borrowing costs as spending related to Recovery and Resilience Funds increases. Headline inflation has been moderating since September 2022 but has become more broad-based with continuing labour shortages contributing to wage growth.

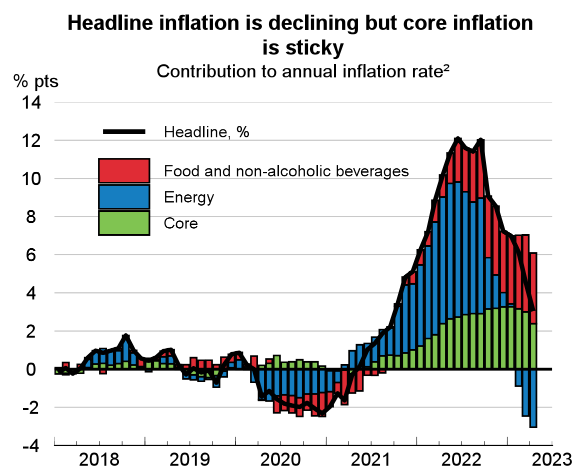
Energy price subsidies are gradually being reduced as energy prices recede. Achieving and maintaining the planned return to a primary surplus will help Greece manage inflationary pressures and reach an investment-grade sovereign debt rating. Further increases in labour market participation especially among women and youth would improve equality of outcomes and help address labour shortages.

Greece's economic growth remains robust in the face of headwinds

Greece's economy has continued to grow robustly in spite of headwinds. Investment growth remained strong in 2022Q4 despite rising investment costs and growing labour shortages. Business confidence rose from October 2022 to be near its pre-pandemic highs in April, while purchasing managers' expectations in April pointed towards expanding demand. Real consumption continued to grow in 2022Q4 and early 2023, reflecting strong employment growth, and despite households' falling purchasing power and low consumer confidence. Job creation has slowed in 2023, however, as the economy hits capacity constraints. The harmonised headline inflation rate abated to 4.5% year-on-year in April as energy prices declined, while broadening price pressures raised annual core inflation to 6.1%. Wage rates have accelerated, and in April 2023 the minimum wage has been increased by 9.4%, following increases of about 10% in the first half of 2022.

Greece





1. Business confidence is an unweighted average of confidence indicators in industry, construction, retail trade and services.
2. National CPI decomposition by energy, food and core inflation.
Source: Eurostat; and OECD Consumer Prices database.

StatLink https://stat.link/imceyj

Greece: Demand, output and prices

Greece	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	183.3	-9.0	8.3	6.1	2.2	1.9
Private consumption	126.6	-7.9	7.8	8.0	1.7	1.6
Government consumption	36.7	2.6	3.7	-0.9	-0.4	0.8
Gross fixed capital formation	19.4	-0.3	19.6	11.7	8.9	4.4
Final domestic demand	182.7	-5.0	8.3	6.7	2.3	1.8
Stockbuilding[1,2]	3.7	1.4	-0.9	1.9	2.2	0.0
Total domestic demand	186.4	-3.4	7.2	8.2	4.1	1.7
Exports of goods and services	73.5	-21.5	21.9	4.5	-0.2	4.2
Imports of goods and services	76.7	-7.6	16.1	10.2	6.7	3.4
Net exports[1]	- 3.2	-5.5	0.7	-3.1	-4.0	0.1
Memorandum items						
GDP deflator	_	-0.8	2.1	7.6	4.5	3.5
Harmonised index of consumer prices	_	-1.3	0.6	9.3	3.9	3.2
Harmonised index of core inflation[3]	_	-1.2	-1.1	4.6	5.5	3.3
Unemployment rate (% of labour force)	_	16.3	14.7	12.4	11.2	10.4
General government financial balance[4] (% of GDP)	_	-9.7	-7.1	-2.3	-1.5	-1.3
General government gross debt (% of GDP)	_	242.3	225.7	191.4	184.1	178.6
General government debt, Maastricht definition[5] (% of GDP)	_	206.4	193.3	170.7	163.4	157.9
Current account balance[6] (% of GDP)	_	-5.1	-6.7	-9.7	-9.5	-8.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. National Accounts basis. Data also include Eurosystem profits on Greek government bonds remitted back to Greece, and the estimated government support to financial institutions and privatisation proceeds.
5. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
6. On settlement basis.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/9anvq2

Energy and other global supply disruptions, amplified by Russia's war of aggression against Ukraine, are easing. Households' electricity, gas and heating prices fell by 27.9% from their peak in September 2022 to April 2023. To address potential energy disruptions next winter, Greece has continued to increase storage capacity through agreements with neighbouring countries, for example Bulgaria, and is expanding its liquified natural gas import capacity. Government-bond spreads have fallen: spreads to German 10-year government bonds were down by nearly 130 basis points in late May 2023 from their October 2022 peak.

Borrowing costs are rising

Electricity price subsidies have been protecting households and businesses from high energy prices. Subsidies introduced for the recent energy price shock are declining as energy prices recede and are planned to be phased out by the second half of 2023, limiting their fiscal cost for 2023 to 0.5% of GDP. In April 2023, pensioners received lump sum payments worth 0.4% of GDP linked to rising living costs. Other fiscal measures in 2023 amount to 1.8% of GDP, including for example a fiscal subsidy for home loan interest costs. The government targets returning the primary budget balance to a surplus near 1% of GDP in 2023 and near 2% of GDP in 2024. Tightening monetary policy in the euro area has raised borrowing costs. For the private sector, in January 2023 they reached their highest level since October 2016. Still, new lending to the private sector has continued to grow, as banks expand lending capacity by clearing non-performing loans and through their growing on-lending of Greece's Next Generation EU credits.

Growth remains robust

Slowing employment gains and the erosion of real wages are projected to dampen private consumption growth. Fiscal tightening will also dent aggregate demand. Real investment growth will remain strong, reflecting higher borrowing costs and increasing spending related to the Greece 2.0 Plan, which includes public investment projects valued at nearly 1.0% of GDP in 2023 rising to 1.7% of GDP in 2024, and contributions of 0.8% of GDP annually for private investment projects. Headline inflation is projected to moderate in 2023, as the declines in energy prices are passed through, but to remain elevated reflecting ongoing increases in input costs, rising wages and capacity constraints. Achieving fiscal consolidation as foreseen will be crucial to obtain an investment-grade rating of Greece's sovereign debt. Consolidation would be challenged by, for instance, a renewed surge in energy or other global prices, prompting additional fiscal support. The risk that higher interest rates raise defaults on mortgage loans is mitigated by Greece's banks agreeing to freeze adjustable rates until April 2024 and by the relatively high share of recent mortgages issued at fixed interest rates.

Getting more women and youth into work would ease capacity constraints

Using any unforeseen fiscal revenues or underspending to reduce public debt rather than to increase transfers would help to contain inflationary pressure and reach an investment-grade sovereign debt rating. This would counteract rising borrowing costs and support Greece's need to raise investment over the long term. Growth could additionally be made more sustainable by enhancing public sector capacity to implement investments, including the Greece 2.0 priorities to expand renewable energies and renovations improving buildings' energy efficiency. Promoting the uptake of Greece's new paid paternal leave, flexible working arrangements and expanding care facilities could improve participation rates of women and youth, expanding opportunities and helping the economy manage its ageing population.

Hungary

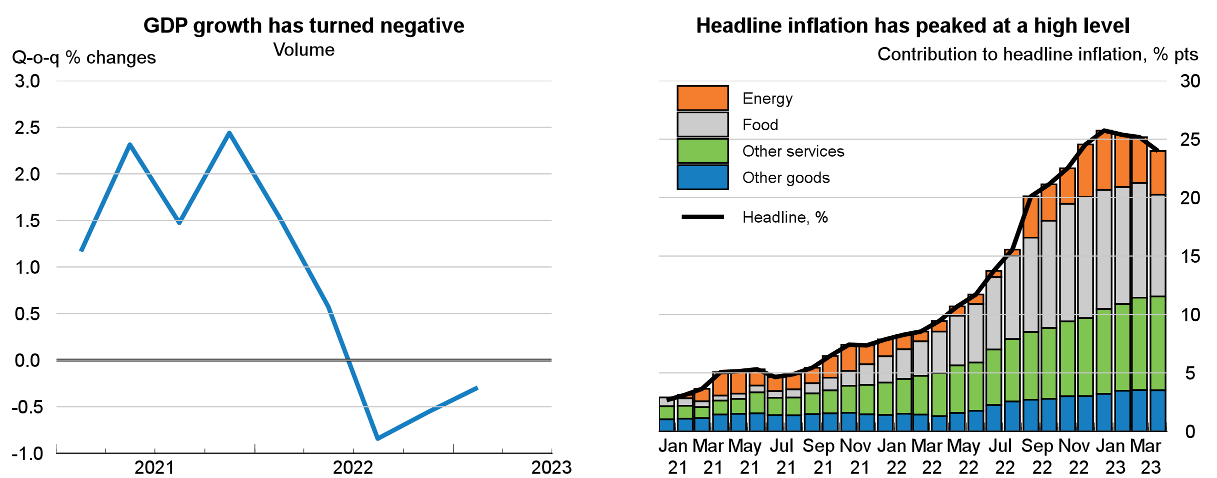
The recent slowdown in activity is expected to continue in early 2023. Real GDP is projected to stagnate in 2023, before rebounding by 2.5% in 2024. High inflation, high interest rates and low confidence will weigh on consumption and investment in 2023. Inflation is projected to decrease significantly after mid-2023. As it recedes, growth is expected to strengthen. The recession and its tepid recovery relative to the past will cause unemployment to increase slightly.

Monetary policy is expected to remain restrictive and fiscal policy will tighten in 2023, both of which will help to contain inflation. Reducing the budget deficit and reaching an agreement on the delivery of EU funds will be key to maintain investor confidence and create fiscal space to finance the green transition. Productivity growth should be raised by accelerating the digitalisation of the economy, fostering competition in product markets, and strengthening labour mobility.

The economy is slowing

The economic slowdown that started in the second half of 2022 is expected to continue in the first half of 2023. At 24.0% in April 2023, headline inflation has peaked, but this is not yet the case for core inflation, defined as excluding food and energy (at 17.1% in April). High inflation is eroding household purchasing power and consumption, while tight financial conditions and economic uncertainty are holding back investment. Quarter-on-quarter GDP growth in 2023Q1 was -0.3%, which is the third successive quarter of negative GDP growth.

Hungary



Source: OECD national accounts database; OECD Consumer Prices database; and OECD calculations.

StatLink https://stat.link/r35djo

Hungary: Demand, output and prices

Hungary	2019	2020	2021	2022	2023	2024
	Current prices HUF billion	Percentage changes, volume (2015 prices)				
GDP at market prices	47 674.2	-4.5	7.2	4.6	0.0	2.5
Private consumption	23 462.0	-1.2	4.6	6.4	-2.6	2.2
Government consumption	9 575.7	-0.5	1.7	0.8	0.3	1.1
Gross fixed capital formation	12 873.3	-7.1	6.5	1.2	-3.5	3.2
Final domestic demand	45 911.0	-2.7	4.4	3.7	-2.3	2.3
Stockbuilding[1]	662.8	0.0	1.8	0.3	-0.9	0.1
Total domestic demand	46 573.8	-2.6	6.3	3.8	-3.2	2.5
Exports of goods and services	38 868.6	-6.1	8.8	11.8	5.0	4.4
Imports of goods and services	37 768.3	-3.9	7.7	11.1	1.3	4.7
Net exports[1]	1 100.4	-2.0	1.0	0.7	3.3	-0.1
Memorandum items						
GDP deflator	_	6.4	6.4	15.3	12.2	6.4
Consumer price index	_	3.3	5.1	14.6	19.2	5.4
Core inflation index[2]	_	3.3	4.5	10.2	15.9	7.2
Unemployment rate (% of labour force)	_	4.1	4.0	3.6	4.2	4.3
Household saving ratio, net (% of disposable income)	_	10.8	12.7	7.5	5.9	7.1
General government financial balance (% of GDP)	_	-7.5	-7.1	-6.2	-4.2	-4.0
General government gross debt (% of GDP)	_	97.2	88.7	76.7	75.9	76.1
General government debt, Maastricht definition[3] (% of GDP)	_	79.3	76.6	73.3	72.5	72.8
Current account balance (% of GDP)	_	-1.1	-4.2	-8.1	-2.0	-0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/vpa3rl

Inflation in Hungary is currently the highest in the European Union. International energy and commodity price increases, compounded by currency depreciation, a tight labour market with strong wage growth, and expansionary fiscal policy until the first half of 2022 have all added to inflationary pressures. While price support measures helped to contain energy prices for most of 2022, the price cap on residential energy consumption only applies up to a threshold consumption level since August 2022 and those on motor fuels were removed in December 2022. Despite price caps on specific food products, food price inflation accounted for more than a third of headline inflation in early 2023, twice as much as energy. While inflation is expected to decline, inflation expectations of professional forecasters for 2024 remain above the central bank's 3% inflation target.

Monetary policy is restrictive and fiscal policy is expected to tighten in 2023

Monetary policy has tightened significantly since the end of 2021. The base interest rate has been raised to 13% and the overnight deposit rate, which has effectively become the monetary policy rate, currently stands at 17%. Higher minimum reserve requirements have added to tighter financial conditions. It is assumed that the monetary policy stance will remain broadly unchanged until the end of 2023, when inflation should have declined visibly. Fiscal policy is also expected to tighten in 2023, with slower growth of public consumption and public investment and higher business taxes in specific sectors. Nevertheless, the assumed phase-out of these temporary taxes in 2024 and the gradual increase in public debt financing costs will limit the decline in the fiscal deficit. Fiscal support measures should become increasingly targeted on the most vulnerable groups affected by high food inflation, and eventually support will need to be phased out.

Growth is expected to be muted in 2023 before picking up in 2024

Declining energy and commodity prices, tight financial conditions, and slower job creation contributing to slightly higher unemployment and slower wage growth are expected to pull down inflation, especially in the second half of 2023 and in 2024. This will support a progressive pick-up in GDP growth, driven by rising investment, and to a lesser extent private consumption. Downside risks to this scenario include stronger-than-expected wage pressures, more persistent inflation, especially for food and core items, renewed pressures on the exchange rate, and potential energy supply restrictions during next winter, as Hungary is still highly dependent on Russia for its oil and gas imports. On the upside, a faster recovery in export markets would stimulate domestic production.

A package of bold reforms would secure strong and inclusive growth

Reducing the budget deficit further and reaching an agreement to allow the delivery of EU funds will be important to maintain investor confidence and accelerate investments in the green transition. Incentives for improving the often-poor thermal efficiency of the housing stock and the development of low-carbon energy sources for the production of electricity could be bolstered. The latter would also reduce Hungary's high energy import dependence and prepare for rising electricity demand as electrification advances. Productivity growth could be boosted by a more competition-friendly regulatory framework that would strengthen competitive pressures, foster new market entry, and help spur the adoption of new technologies. A rigid housing market and an underdeveloped rental market, in addition to remaining weaknesses in local transport and rural commuting infrastructure, are currently holding back labour reallocation and geographical mobility. Similarly, the insufficient availability of affordable, high-quality childcare is holding back the participation of young women in the labour market. The number of childcare facilities has increased by nearly 20% since 2017 and further increases are expected in line with the economic policy priorities of Hungary.

Iceland

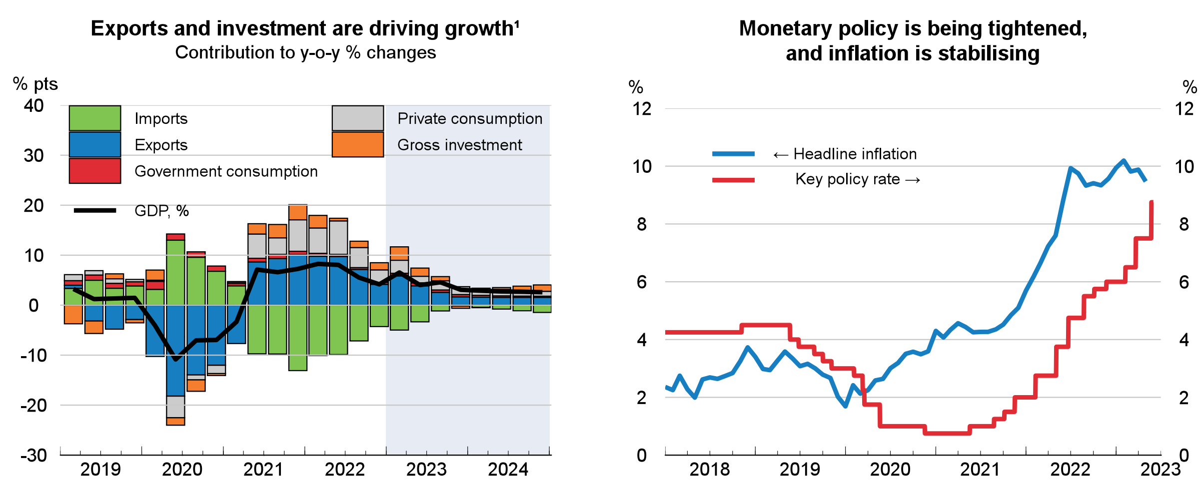
Economic growth will come down to 4.4% in 2023 and 2.6% in 2024. Private consumption will slow as wages moderate. So will business investment as financial conditions continue to tighten, and public investment will barely grow. In contrast, residential investment will pick up in the near term to work off pent-up demand. Export growth will slow given only modest growth in major trading partners. The unemployment rate will gradually rise towards 4.5% by the end of 2024. Headline inflation is expected to decline from around 10% in early 2023 to around 3% by late 2024.

In May, the central bank lifted the policy rate to 8.75%, the thirteenth increase since tightening started in May 2021 at 0.75%. The policy interest rate could be raised further to re-anchor inflation expectations and bring back inflation towards the 2.5% target. The fiscal consolidation planned for 2023-24 is appropriate to reduce inflationary pressures and maintain fiscal space. To foster sustainable productivity growth and help diversify the economy, innovation should be strengthened further, and the gender balance should become more equal across sectors.

Growth has peaked

The economy is slowing gradually, despite foreign tourism heading rapidly towards pre-pandemic levels. Exports of goods and services rich in energy content are weakening as global energy prices have come down. Household consumption is moderating. The late 2022 wage agreements may have halted the decline in real wages. Business investment is slowing as financial conditions become tighter and confidence declines. Government investment is barely growing. Inflation is hovering at around 10% since early 2023. The labour market remains tight, with the unemployment rate at around 3.5%, and labour participation continues expanding.

Iceland



1. The sum of components may deviate from observed GDP growth because of balancing items, chain-linking procedures and direct/indirect seasonal adjustment methods.
Source: OECD Economic Outlook 113 database; Statistics Iceland; and Central Bank of Iceland.

StatLink https://stat.link/5ytv3o

Iceland: Demand, output and prices

Iceland	2019	2020	2021	2022	2023	2024
	Current prices ISK billion	Percentage changes, volume (2015 prices)				
GDP at market prices	3 023.9	-7.2	4.3	6.4	4.4	2.6
Private consumption	1 518.4	-3.4	7.0	8.6	3.7	2.0
Government consumption	744.0	5.1	2.4	1.6	1.7	1.2
Gross fixed capital formation	631.0	-7.4	9.8	6.9	-5.5	3.1
Final domestic demand	2 893.4	-2.0	6.3	6.4	1.2	2.0
Stockbuilding[1]	- 5.4	1.0	-0.1	-0.1	0.0	0.0
Total domestic demand	2 888.0	-1.1	6.2	6.2	1.2	2.0
Exports of goods and services	1 320.6	-31.1	14.7	20.6	5.0	3.8
Imports of goods and services	1 184.7	-20.6	19.9	19.7	-1.8	2.4
Net exports[1]	135.9	-5.5	-2.0	-0.1	3.2	0.6
Memorandum items						
GDP deflator	_	4.1	6.6	9.0	6.4	3.5
Consumer price index	_	2.8	4.4	8.3	7.4	3.3
Core inflation index[2]	_	2.9	4.4	7.8	7.2	3.4
Unemployment rate (% of labour force)	_	6.4	6.0	3.7	3.9	4.3
General government financial balance (% of GDP)	_	-8.9	-8.4	-4.3	-2.5	-1.4
General government gross debt[3]	_	70.4	77.2	78.4	78.6	78.6
Current account balance (% of GDP)	_	1.3	-2.8	-1.8	-0.8	-0.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. Includes unfunded liabilities of government employee pension plans.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/9ac0gv

Monetary and fiscal policies continue to be tightened

In May, the central bank raised the interest rate by 125 basis points to 8.75%, the thirteenth increase since the cycle started in May 2021. Headline consumer price inflation peaked at around 10% in February and has flattened since as house prices are slowing, but underlying inflation has become more broad-based. The policy interest rate is expected to rise further to peak at around 9% in mid-2023. The króna has slightly appreciated over the past few months. Fiscal policy, which was contractionary in 2022, is projected to be tightened further in 2023 and 2024. This is necessary to counter inflationary pressures and to build up post-pandemic fiscal space.

The economy will slow

Economic growth is expected to decline from 6.4% in 2022 to 4.4% in 2023 and 2.6% in 2024. Household consumption will slow as real wages continue to decline. Export growth of energy-intensive goods will moderate as global energy prices will remain below their peak of 2022. Foreign tourism will no longer expand as fast, as domestic capacity limits become more apparent and economic growth remains moderate in major origin countries. Tighter financial conditions will weigh on business investment. Housing investment will recover in 2023 as pent-up demand is worked off but will abate in 2024 as higher real interest rates bite. The unemployment rate will edge up towards 4.3%. Inflation will gradually slow in the wake of macroeconomic policy tightening, although it is projected to stay above target at the end of the projection period. Inflation could remain higher than expected if wages are rising faster than agreed in wage settlements, triggering a wage-price spiral. Global financial risks, including the bank failures seen in the United States and Switzerland, could contaminate Iceland’s domestic financial sector. A sharp fall in house prices could spark a financial crisis.

Fostering innovation could underpin growth

Iceland outranks many European countries in terms of overall innovation performance, including cutting-edge technology for carbon capture and sustainable fish farming. Firms perform well overall in the adoption and use of digital technologies, although smaller firms tend to lag. To foster sustainable growth and help diversify the economy further, regulatory reform should ease market access for young and innovative firms. Adoption of new technologies, notably digital, should be encouraged further. The education system should provide more relevant skills and contribute to a more equal gender balance across professions and economic sectors, especially in areas that are important for a creative and innovative economy.

India

Weak global demand and the effect of monetary policy tightening to manage inflationary pressures will constrain the economy in FY 2023-24, limiting real GDP growth to 6%. Moderating inflation and monetary policy easing in the second half of 2024 will help discretionary household spending regain momentum. This, along with improved global conditions, will help economic activity to accelerate, with growth of 7% in real GDP in FY 2024-25.

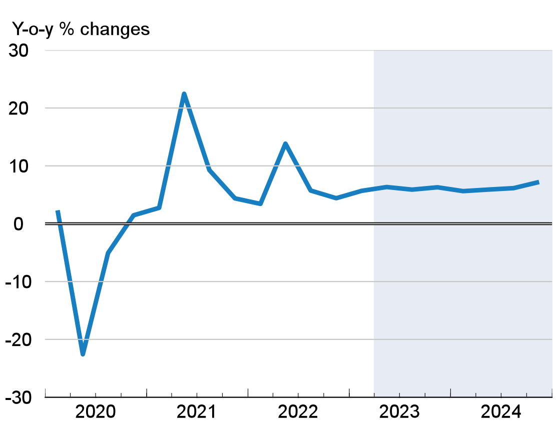
Despite an impressive growth and development record, daunting challenges remain. Creating good jobs is the most promising pathway to reduce poverty, which is particularly high in the female population. Increasing investment in education and vocational training, and updating labour laws, would help to achieve this objective. India is particularly vulnerable to extreme heatwaves and must make progress in mobilising resources for investment in the green economy.

Moderating demand and high inflation have slowed economic activity

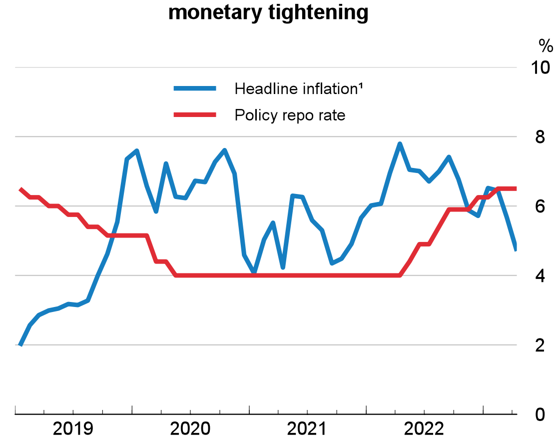
FY 2022-23 ended on a positive note, due to higher-than-expected agriculture output and strong government spending. However, high inflation, in particular for energy and food, and the ensuing monetary tightening to anchor expectations are weighing on purchasing power and household consumption, particularly in urban areas. Tighter financial market conditions are reflected in weakening credit-supported demand for capital goods, a good proxy for business investment. The merchandise trade deficit was 40% larger in FY 2022-23 than in FY 2021-22, with trade in petroleum accounting for over two-fifths of the deterioration. Although services export growth remains brisk and the sectoral surplus rose by 35%, it is insufficient to offset the imbalance in goods' trade. Low labour productivity is affecting the competitiveness of "Made in India" goods and participation in global value chains. The current account deficit narrowed in the October-December quarter to 2.2% of GDP, from 2.7% in the same period in FY 2021-22. Headline inflation has fallen below 6% (the central bank's upper bound of the tolerance band) since March 2023, mostly due to lower food prices, as well as base effects. Employment and wage estimates suggest improving labour market conditions in rural areas, while export-oriented service firms report increasing difficulties filling vacancies.

India 1

Real GDP growth is plateauing



Inflation remains a concern despite monetary tightening



1. Headline inflation refers to the change in price of all goods in the basket. OECD seasonal adjustment based on monthly consumer price index (index 2012 = 100) from the Ministry of Statistics and Programme Implementation (MOSPI).
Source: OECD Economic Outlook 113 database; CEIC; and RBI.

StatLink https://stat.link/p87fe6

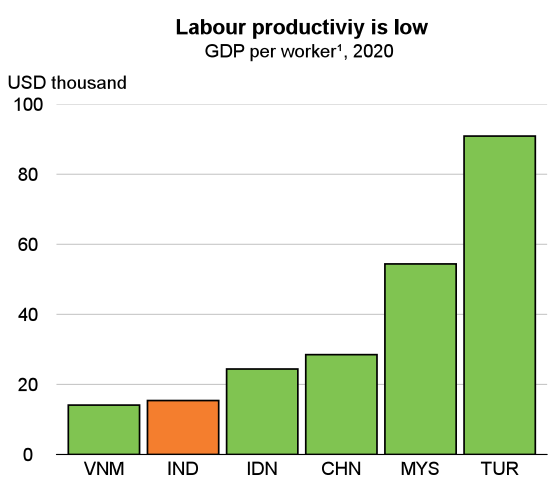
India: Demand, output and prices

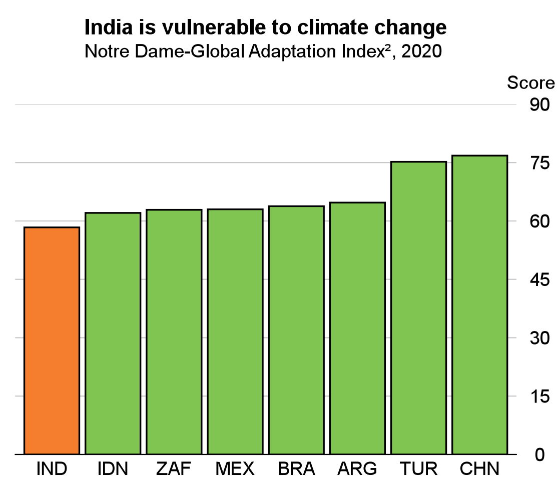
India	2019	2020	2021	2022	2023	2024
	Current prices INR trillion	Percentage changes, volume (2011/2012 prices)				
GDP at market prices	201.0	-5.8	9.1	7.2	6.0	7.0
Private consumption	122.5	-5.2	11.2	7.5	4.0	6.1
Government consumption	22.1	-0.9	6.6	0.1	7.1	7.6
Gross fixed capital formation	57.2	-7.3	14.6	11.4	8.3	6.6
Final domestic demand	201.8	-5.4	11.5	7.8	5.6	6.4
Stockbuilding[1,2]	4.4	-0.6	0.8	0.0	0.0	0.0
Total domestic demand	206.2	-6.9	8.0	8.1	4.4	6.4
Exports of goods and services	37.5	-9.1	29.3	13.6	8.6	7.1
Imports of goods and services	42.7	-13.7	21.8	17.1	1.8	4.4
Net exports[1]	- 5.2	1.4	0.9	-1.0	1.6	0.6
Memorandum items						
GDP deflator	_	4.7	8.5	8.2	5.1	6.6
Consumer price index	_	6.2	5.5	6.7	4.8	4.4
Wholesale price index[3]	_	1.3	13.0	9.4	2.9	4.5
General government financial balance[4] (% of GDP)	_	-13.1	-10.4	-8.9	-7.9	-7.9
Current account balance (% of GDP)	_	1.0	-1.2	-2.6	-1.8	-1.3

Note: Data refer to fiscal years starting in April.
1. Contributions to changes in real GDP, actual amount in the first column.
2. Actual amount in first column includes statistical discrepancies and valuables.
3. WPI, all commodities index.
4. Gross fiscal balance for central and state governments.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/mk9tip

India 2





1. GDP per worker at constant prices using 2017 PPP.
2. The Notre Dame-Global Adaptation Index is a composite indicator which summarises two sub-indices: 1) a country's vulnerability to climate change and other global challenges and 2) a country's readiness to improve resilience. The index is recalculated based on the best performing country's score (Norway = 100).
Source: APO Productivity Databook 2022; and University of Notre Dame, Notre Dame Global Adaptation Initiative.

StatLink https://stat.link/isb6vy

Domestic growth prospects are strongly influenced by global developments. India has seized the opportunity of discounted Urals oil, which has increased Russia's share in its energy imports. The sourcing of fertilisers from Russia has also increased considerably, more than doubling in volume in the case of urea. Overall, Indian imports from Russia rose from USD 9.9 billion (1.6% of total imports) in FY 2021-22 to USD 46.2 billion (6.5%) in FY 2022-23.

Macroeconomic policies remain restrictive

Monetary policy is focused on anchoring inflation expectations and bringing headline inflation consistently within the 2-6% tolerance band. A long cycle of policy rate increases came to a halt in April. Following one further small increase, rates are expected to remain unchanged until the end of the calendar year, when evidence will confirm whether core inflation, which is less sensitive to weather conditions and geopolitical tensions, has durably diminished. The projections assume mild interest rate declines from mid-2024.

During the projection period, the priority for fiscal policy is to control government debt, so as to keep it at sustainable levels, reduce interest payments, and thereby free resources for public investment in physical and human capital and initiatives to adapt to population aging. The Pradhan Mantri Garib Kalyan Anna Yojana scheme provided free foodgrains to eligible beneficiaries during the pandemic, but targeting was imprecise – as testified by the number of beneficiaries (820 million), well in excess of most estimates of the poor population (between 400 and 500 million) – and the cost excessive. Its suppression in 2023 reinforces the need to update the 2011 Census in order to guarantee coverage of eligible families. The next 25 years until the 2047 centenary of Independence will be crucial for India to fight poverty and the government strategy (so-called Amrit Kaal) will require a large increase in capital investment outlays.

The economy will not escape the global slowdown

After reaching 7.2% in FY 2022-23, real GDP growth is expected to slow to 6% in FY 2023-24, before rising to 7% in FY 2024-25. While indicators suggest that India's growth is stable for now, headwinds from the impact of rapid monetary policy tightening in the advanced economies, heightened global uncertainty and the lagged impact of domestic policy tightening will progressively take effect. With slower growth, inflation expectations, housing prices and wages will progressively moderate, helping headline inflation converge towards 4.5%. This will allow interest rates to be lowered from mid-2024. The trade restrictions (including export bans on various rice varieties) imposed in 2022 to fight inflation are assumed to be withdrawn. The current account deficit will narrow, reflecting abating import price pressures.

Most risks to the projections are tilted to the downside. While banks' solvency ratios and financial results have improved and the authorities have enhanced loan-loss provisioning and established a 'bad bank', any deterioration of banks' asset quality could threaten macro-financial stability. In the run-up to the 2024 elections, fiscal consolidation may be delayed, and the conclusion of trade agreements may become more difficult. A potentially below-normal monsoon season could also impact growth. Declining geopolitical uncertainty, on the other hand, would boost confidence and benefit all sectors, as would a faster-than-expected conclusion of free-trade agreements with key partners and the incorporation therein of services.

Climate change and gender gaps require targeted policies

More than half of the Indian population lives in the Indo-Gangetic Plain and is exposed to the increasingly frequent and extreme heatwaves caused by climate change. It is estimated that almost 100 000 extra lives are lost every year due to hot weather and the flooding that can follow. The economic costs are also large, including labour losses, a meagre wheat harvest, greater livestock mortality and power outages. Reducing global greenhouse gas emissions, including in India, will help limit such losses in the long term. However, measures that can immediately reduce the impact of extreme weather events are also needed, such as improved infrastructure to prevent flooding. Sustainable development also requires further progress in gender equality across many dimensions, including access to health, education and capital. Impressive results have been attained, for instance in financial inclusion, but substantial gaps remain. Policy formulation and execution should fully incorporate gender considerations and specific indicators. Enhanced policy efforts to increase childcare assistance, vocational training and life-long education for working women would also be welcome. Better enforcement of the land rights of women would strengthen their economic position and, by making it possible to use this asset as collateral, may also facilitate investments in climate mitigation and adaptation.

Indonesia

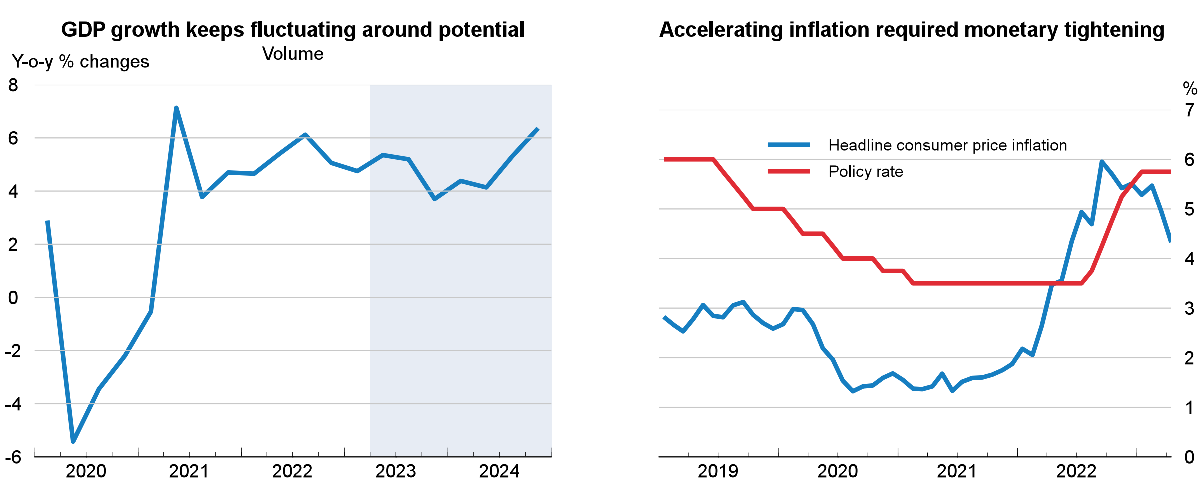
Real GDP growth will slow to 4.7% in 2023 and then reach 5.1% in 2024, once the impact of monetary tightening fades away and uncertainty about the 2024 elections abates. The economy has benefitted from strong commodity prices and will be sensitive to mounting global headwinds, including geopolitical tensions, slowing trade growth, and financial volatility. Low real wage increases and a soft labour market are holding back household consumption.

Monetary policy has become more restrictive since mid-2022, with the policy rate rising from 3.5% to 5.75%. Credit growth has weakened. Fiscal policy will become less supportive following the reinstatement of the 3%-of-GDP limit for the budget deficit. The incoming administration after the February 2024 elections should prioritise structural reforms to increase productivity and international competitiveness, while monitoring the impact of industrial and trade policies and adjusting them in case of disappointing results.

Disruptions from earlier pandemic-related lockdowns are still being felt

Output growth picked up in the fourth quarter of 2022, and was 5.0% higher than a year earlier, but moderated in the first quarter of 2023. The lifting of all remaining mobility restrictions as of 1 January 2023 is supporting the recovery in the services sector, but consumption is still significantly below its pre-pandemic trend. Demand for consumer durables was subdued in 2022. For instance, two-wheel vehicle sales were 10% lower than the pre-pandemic seven-year average, although sales picked up in early 2023. Consumers' caution partly reflects anaemic real wage growth. Leading indicators such as cement purchases and machinery imports suggest that the contribution of investment to GDP growth remains muted, despite the expansion of the government infrastructure programme. Price pressures continued to fade as the modest jump in food and public transport prices during this year's Eid-al-Fitr period contributed to the fall in inflation, to 4.3% year-on-year in April. Another positive signal comes from new stock market listings, with the number of listings at an all-time high in 2022, and the proceeds from listings the largest ever in the first quarter of this year.

Indonesia 1



Source: OECD Economic Outlook 113 database; and CEIC.

StatLink https://stat.link/xgk1d7

Indonesia: Demand, output and prices

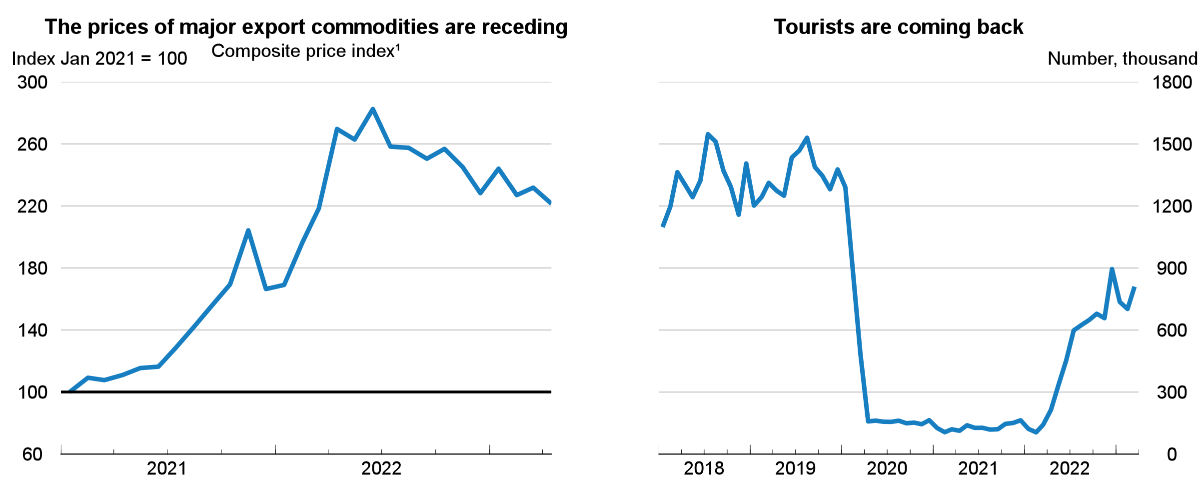
Indonesia	2019	2020	2021	2022	2023	2024
	Current prices IDR trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	15 832.7	-2.1	3.7	5.3	4.7	5.1
Private consumption	9 171.9	-2.7	2.0	4.9	4.9	5.8
Government consumption	1 394.6	2.1	4.2	-4.5	3.1	5.2
Gross fixed capital formation	5 121.4	-5.0	3.8	3.9	2.3	4.3
Final domestic demand	15 687.9	-3.1	2.8	3.8	3.9	5.3
Stockbuilding[1]	215.2	-0.7	1.5	1.0	0.0	0.0
Total domestic demand	15 903.1	-3.7	4.3	4.6	3.7	5.1
Exports of goods and services	2 943.5	-8.4	18.0	16.3	7.4	6.8
Imports of goods and services	3 013.9	-17.6	24.9	14.7	3.6	6.9
Net exports[1]	- 70.4	1.5	-0.4	0.8	1.0	0.3
Memorandum items						
GDP deflator	_	-0.4	6.0	9.6	3.0	2.0
Consumer price index	_	1.9	1.6	4.2	4.2	3.5
Private consumption deflator	_	1.9	1.7	4.8	4.1	3.7
General government financial balance (% of GDP)	_	-5.7	-4.8	-3.4	-2.5	-2.1
Current account balance (% of GDP)	_	-0.4	0.3	1.0	0.6	0.5

1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/j137a2

The impact of Russia's war of aggression against Ukraine on Indonesia has been mixed. Direct trade with both Russia and Ukraine is limited. However, replacing part of crude oil imports with discounted Urals oil from Russia is helping to contain inflationary pressure. On the other hand, disruptions in global value chains and operating restrictions in energy markets have fed into domestic prices, especially for food, fertilisers and fuels. Meanwhile, as a large producer of various crops, minerals and metals, Indonesia benefited from the large global price increases for some of these items. The terms of trade improved significantly in 2022 and net trade supported growth, despite measures aimed at limiting exports of palm oil and making them conditional upon prior servicing of domestic market obligations.

Indonesia 2



1. The price indices for individual commodities (palm oil, coal, iron ore, gold and nickel) are aggregated by using weights based on the share of each commodity in total 2021 exports of these commodities.
Source: Statistics Indonesia; Ministry of Energy and Mineral Resources; World Bank Commodity Markets Outlook; and CEIC.

StatLink https://stat.link/j19wrc

Monetary and fiscal policy have moved from supportive to neutral

Bank Indonesia increased the policy rate by 200 basis points in the second half of 2022 and is assumed to raise it slightly further in 2023 to 6%, and defer the first cut to the second half of 2024. Credit supply appears ample, but higher borrowing costs weigh on business investment and household consumption of durable goods. The increased share of commercial banks' reserves that must be invested in Treasury paper makes it important to consider how monetary policy decisions impact banks' net interest margins and overall financial stability. The termination of primary market purchases of government debt by the central bank should be accompanied by reinstating improved surveys of inflation expectations to help guide policy decisions. The recent vote of the Financial Omnibus Law, which empowers the central bank to purchase bonds directly from the government if the president declares a crisis, may create policy dilemmas and weaken the credibility of the monetary authorities.

The OECD projection assumes that no further fiscal support is provided via tax cuts and deferrals. The new Tax Harmonisation Law is likely to improve tax collection and the government is committed to respect the 2003 Fiscal Law that caps fiscal deficits at 3% of GDP, after a suspension in 2020-22 due to the pandemic. Due to sound macroeconomic policy, public debt (narrowly defined) stands at less than 40% of GDP, a manageable level given the composition in terms of maturity and creditors. Accordingly, there are adequate buffers to respond to future adverse shocks, for instance through increased capital spending. Spending on subsidies to households and businesses, principally for energy, amounts to some 3% of GDP, more than a quarter of tax revenues. This support is insufficiently targeted and inconsistent with emission reduction goals, but paring it back in the near term would prove very difficult.

Activity will keep growing, but slightly more slowly

In the course of 2023, GDP growth will gradually return towards the 5% trend growth seen over the past 15 years. Public investment will be boosted by the resumption of construction activity in the new capital city Nusantara. China's reopening should boost tourism exports, provided measures are implemented to improve planning and co-ordination at all levels of government and across relevant policy areas, such as health and safety, skills development and destination management. A more predictable supply of energy and grains, helped by improved storage facilities, will help to stabilise headline inflation within Bank Indonesia's target range (3±1%) from the second half of 2023.

Indonesia's dependence on commodities and reliance on international capital markets and personal remittances make it highly vulnerable to external developments. Despite improved fundamentals, a run on emerging markets could substantially shock the economy as in previous similar crises. On the domestic front, political risk may increase in the run-up to the elections if there are indications of a reversal in the delivery of critical reforms, which could interrupt progress in accountability and transparency.

Pro-active public policies can help in raising competitiveness, but caution is in order

Elevating Indonesia's participation in global value chains (GVC), while also promoting domestic value added and accelerating sustainable development, ranks high among the government priorities. Pro-active industrial and trade policies are being used, in particular an export ban on unprocessed nickel and incentives to attract global producers of batteries for electric vehicles. Constant monitoring of this strategy is necessary to avoid expensive mistakes and the pursuit of potentially contradictory goals. Improving the investment climate, focusing on the areas where the OECD Product Market Regulation indicators show that Indonesia lags behind its peers, could be a more effective policy, especially at a time when global companies are seeking to diminish their exposure to China. Such a horizontal approach to improve the investment climate is also more likely to generate jobs, including for women, than one that targets capital-intensive sectors. The business sector would also benefit from increasing labour supply through further reforms to promote formal employment among women, as well as more extensive childcare services and flexible working-time arrangements. Reforms should also create an environment conducive to large-scale investment in renewables. This would diversify the energy mix, currently skewed towards coal, helping achieve emissions reduction targets.

Ireland

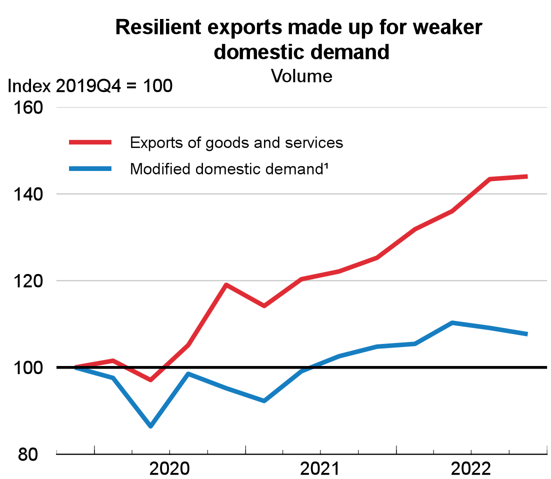
After two years of double-digit growth, GDP is set to decelerate, with growth projected at 4.4% in 2023 and 3.7% in 2024, as support from exports in multinational-dominated sectors gradually eases. Despite persistent inflation, consumer spending will be relatively strong in 2023, underpinned by significant employment growth and the summer tourist season. Confidence improvements will gradually strengthen business orders and enhance firms' incentives to invest. Modified domestic demand, which removes some distortions due to the high share of multinational firms, will grow by 1.8% in 2023, and 3.0% in 2024.

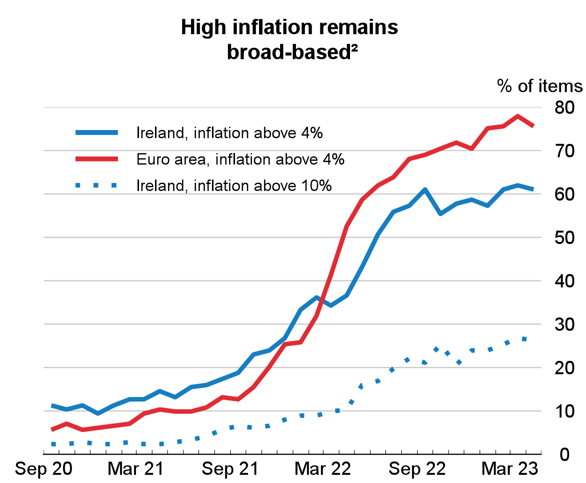
On the back of continued strength in tax receipts, the government has announced cost-of-living measures worth a total of 2.4% of GDP (4.4% of GNI*, i.e., gross national income excluding globalisation effects) since early-2022, with support becoming increasingly targeted. To improve the long-term sustainability of public finances and increase resilience to shocks, the allocation of windfall tax revenues to the National Reserve Fund should be continued, and adherence to the 5% spending rule should be rapidly restored. Productivity-enhancing structural reforms will be needed to cope with rapid population ageing and other long-term fiscal challenges.

Weak investment is weighing on the domestic economy

Supported by post-pandemic pent-up consumer demand and the strength of multinational-dominated sectors, GDP grew by over 12% in 2022. Household consumption remained resilient in the first quarter of 2023, supported by significant wage and employment growth and still large pandemic-related excess savings. However, a weaker global outlook, rising energy and input prices, and higher borrowing costs lowered firms' investment incentives, especially in the manufacturing sector. Combined with low exports, this led to a contraction in GDP in the first quarter of 2023.

Ireland





1. Excludes large transactions of foreign corporations that do not have a big impact on the domestic economy.
2. Calculations based on a common set of 213 unweighted sub-indices.
Source: OECD Economic Outlook 113 database; and Eurostat.

StatLink https://stat.link/hx8pe9

Ireland: Demand, output and prices

Ireland	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2020 prices)				
GDP at market prices	355.7	5.6	13.4	12.2	4.4	3.7
Private consumption	104.2	-11.9	4.5	6.8	3.2	4.1
Government consumption	42.8	10.4	6.0	1.6	0.7	0.7
Gross fixed capital formation	193.5	-17.0	-39.1	26.3	-12.2	6.7
Final domestic demand	340.6	-12.4	-18.1	15.1	-3.3	4.5
Stockbuilding[1]	4.2	0.6	0.5	1.1	-0.6	0.0
Total domestic demand	344.8	-11.8	-17.6	15.5	-4.3	4.2
Exports of goods and services	455.7	11.1	14.0	15.2	6.6	3.9
Imports of goods and services	444.8	-2.2	-8.3	19.0	4.5	4.4
Net exports[1]	11.0	17.0	27.9	2.4	4.6	1.1
Memorandum items						
Modified final domestic demand[2], volume	_	-6.0	5.6	8.5	1.8	3.0
GDP deflator	_	-0.5	0.4	5.2	3.3	2.0
Harmonised index of consumer prices	_	-0.5	2.4	8.1	4.9	3.0
Harmonised index of core inflation[3]	_	-0.1	1.7	4.6	3.6	3.1
Unemployment rate (% of labour force)	_	5.8	6.2	4.5	4.2	4.1
Household saving ratio, net (% of disposable income)	_	21.1	19.7	16.5	16.1	12.4
General government financial balance[4] (% of GDP)	_	-5.0	-1.6	1.6	1.7	2.4
General government gross debt (% of GDP)	_	71.6	65.5	46.7	43.1	39.5
General government debt, Maastricht definition[5] (% of GDP)	_	58.3	55.4	44.7	41.2	37.5
Current account balance (% of GDP)	_	-6.8	14.2	8.8	11.8	12.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Excludes airplanes purchased by leasing companies in Ireland but then operated in other countries and investment in imported intellectual property by multinationals.
3. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
4. Includes the one-off impact of recapitalisations in the banking sector.
5. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/vul4yx

With core inflation at 4.3% in April, underlying inflationary pressures persist. Year-on-year headline consumer price inflation eased to 6.3%, despite some acceleration in energy prices and continued strength in food price inflation, partly driven by contract renegotiations with long-term suppliers. In February, the government launched its third cost-of-living package (0.3% of 2022 GDP; 0.5% of GNI*), which included one-off welfare payments to pensioners and lower-income households, the extension of transitory reductions in energy-related VAT and excise duties to end-October, and a revamp of the temporary energy support scheme for SMEs, extended to end-May.

Buoyant, but partly transient, corporate tax revenues warrant caution

Since early 2022, the government has provided cost-of-living support worth 2.4% of GDP (4.4% of GNI*). Mostly temporary, these measures, about one third of which were targeted, mitigated the burden of surging energy bills on households and small businesses. Continued buoyancy in corporate tax receipts, which accounted for one fifth of total revenues, helped attain a fiscal surplus of 1.6% of GDP in 2022 (3.0% of GNI*). However, given the uncertain impact on multinationals' location strategies of the increased 15% effective corporate tax rate, set to kick in in 2024, part of any further windfall tax gains should continue to be allocated to the National Reserve Fund, on top of the EUR 6 billion already put in it since 2022, or to a new long-term savings fund, whose establishment is being discussed. Following the National Development Plan, public investment spending, particularly in housing, is set to remain strong. The budget surplus, though, is expected to increase to 2.4% of GDP in 2024, as public support is scaled back amidst eased economic uncertainty.

Tighter financial conditions pose some risks

Household consumption is set to remain resilient, supported by persistent wage growth, amidst skills shortages, and the summer tourist season. Rising demand, particularly for services, will boost business investment. Headline inflation is projected to ease, although the decline will be slowed by the phasing out of temporary reductions in energy-related indirect taxes in the latter half of 2023. Core inflation remains sticky, which may lead to higher-than-expected precautionary savings by households in 2024.Tightening financial conditions and rising input prices could derail investment to boost housing supply and residential retrofitting, including key public programmes. Further rises in interest rates may trigger sharp price corrections in the portfolios of commercial property funds, posing risks to financial stability. On the positive side, effective implementation of the Windsor Framework may support growth further by easing uncertainty about trade with the United Kingdom.

Fiscal caution and structural reforms are key to long-term welfare gains

Long-term fiscal sustainability and effective structural reforms are key for the government's investment-intensive reform agenda, ranging from climate and digital transitions to ensuring affordable quality housing and health services for a rapidly ageing population. Adherence to the 5% spending rule and allocating part of any further windfall tax gains to the National Reserve Fund, or a new long-term savings fund – were it to be established, are thus essential. Productivity-enhancing policies should also prioritise the reduction of gender imbalances, for instance by strengthening incentives for female labour market participation, to build on its positive post-COVID trend. Continuing to provide adequate public financial support for childcare and measures to expand childcare capacity, together with flexible work arrangements, are key. Any additional public support to income, if warranted by renewed energy price shocks, should preserve price signals, be temporary and targeted to low-income households via existing welfare schemes.

Israel

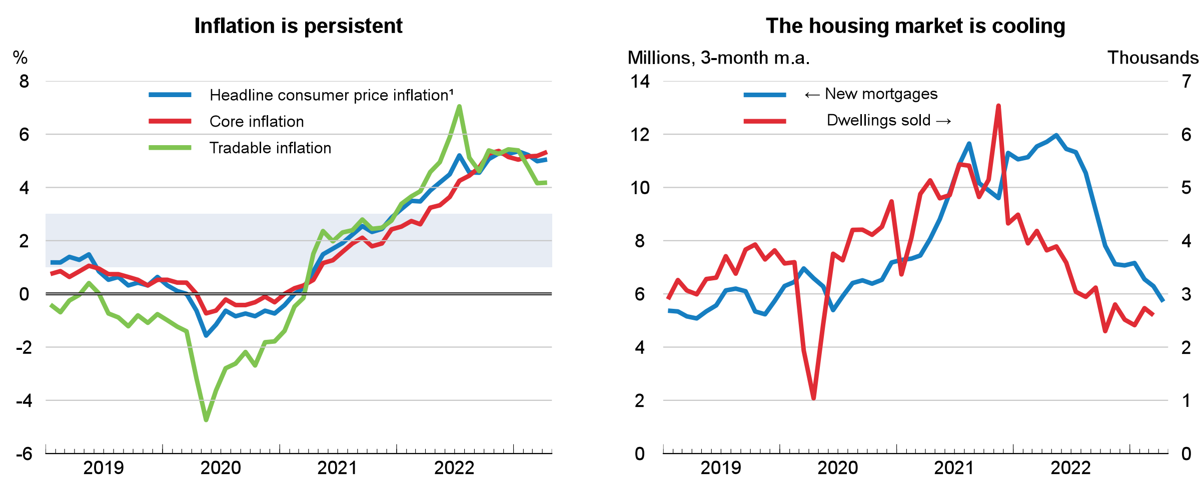
GDP is projected to grow by 2.9% in 2023 and 3.3% in 2024. Elevated inflation will weigh on private consumption growth and exports will be held back by moderate demand growth in trading partners. The increase in interest rates will slow investment growth. Growth is projected to pick up towards its potential rate in 2024 as inflation abates. Risks are skewed to the downside, related to high global uncertainty and domestic political tensions.

Tight monetary conditions should be maintained to bring inflation back to the target range. Fiscal policy should avoid adding to demand and inflationary pressures, and support to mitigate rising costs of living should become more targeted. Reforms to reduce import barriers and spur competition should continue. Labour market and educational reforms are needed to address demographic challenges and reduce wide labour market disparities.

Economic activity is moderating but remains robust

GDP growth moderated in the first quarter of 2023, but remained robust at 2.5% at an annualised quarterly rate. Private consumption contracted but private investment growth was strong. Business confidence has weakened but remains positive. Activity in the housing market continues to moderate, with the number of housing transactions declining. Capital raised by high-tech firms has declined considerably compared to the high levels in 2021 and early 2022. The shekel has depreciated in the first five months of the year and the stock market has markedly underperformed global indices. The labour market remains tight despite some recent easing. The job vacancy rate continues to decline, especially in the high-tech sector, but is still above pre-pandemic levels. Consumer price inflation, at 5% in April 2023, is above the 1-3% central bank target range and is broad based. Inflation of tradables has slowed, but housing and service inflation is persistent. One-year ahead inflation expectations hover around 3%.

Israel



1. Shaded area is the Bank of Israel's inflation target range (i.e. 1-3%).
Source: Israel Central Bureau of Statistics; Bank of Israel; and OECD calculations.

StatLink https://stat.link/m04h5a

Israel: Demand, output and prices

Israel	2019	2020	2021	2022	2023	2024
	Current prices NIS billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 434.6	-1.8	8.5	6.4	2.9	3.3
Private consumption	751.1	-7.9	11.1	7.8	2.7	4.0
Government consumption	316.5	2.8	4.3	0.7	2.1	1.2
Gross fixed capital formation	325.0	-3.8	11.5	9.0	6.2	4.0
Final domestic demand	1 392.7	-4.5	9.5	6.4	3.5	3.4
Stockbuilding[1]	9.7	1.2	0.5	1.0	-0.7	0.0
Total domestic demand	1 402.3	-3.3	9.8	7.3	2.6	3.3
Exports of goods and services	420.3	-2.7	14.5	8.1	-0.2	3.4
Imports of goods and services	388.0	-8.1	20.7	11.8	-0.7	3.6
Net exports[1]	32.3	1.4	-0.8	-0.6	0.1	0.0
Memorandum items						
GDP deflator	_	1.0	2.2	4.5	3.9	1.9
Consumer price index	_	-0.6	1.5	4.4	4.1	2.3
Core inflation index[2]	_	-0.1	1.3	4.0	4.1	2.3
Unemployment rate (% of labour force)	_	4.3	5.0	3.8	4.1	4.1
General government financial balance (% of GDP)	_	-10.8	-3.7	0.3	-1.1	-1.2
General government gross debt (% of GDP)	_	71.7	68.9	61.0	58.9	57.3
Current account balance (% of GDP)	_	5.4	4.3	3.7	4.5	4.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/6hrtn9

The effect of global energy price developments on domestic prices is limited due to Israel's self-sufficiency in natural gas, government measures and the regulation of most energy prices. Regulated electricity prices were lowered recently due to lower prices of imported coal used in electricity generation, but electricity prices remain slightly higher than in late 2022. Russia's war of aggression against Ukraine has led to a significant increase in immigration, with around 58 000 (0.6% of the population) new immigrants from Ukraine and Russia having arrived in Israel in 2022.

Monetary conditions have tightened

The central bank raised the policy rate from 0.1% to 4.75% between April 2022 and May 2023. Higher interest rates have led to a marked decline in the volume of new mortgages. Tax revenues are slowing as GDP growth is moderating and some transitory factors, for instance related to high real estate valuations, are dissipating. The budget for 2023 and 2024 foresees some moderate increase in spending. The budget balance will turn from a small surplus in 2022 to a deficit slightly above 1% of GDP in 2023 and 2024. To mitigate the increase in the cost of living, the government extended the expansion of child tax allowances and the reduction of the coal excise tax until end-2023, and the reduction of the excise taxes on gasoline until end-2024.

Growth is set to moderate

GDP is projected to grow at a more moderate pace in 2023 and 2024. Export growth will be held back by modest external demand growth. Elevated inflation is weighing on real disposable income and private consumption growth. The increase in real interest rates and high uncertainty is set to slow investment. The labour market will slightly cool as growth moderates. Inflation should gradually slow towards the mid-point of the central bank target range, supporting a pickup in domestic demand in 2024. Risks are skewed to the downside. An escalation of the conflict in Ukraine could adversely affect the economy via lower demand from trading partners and a re-intensification of pressures in global energy markets leading to higher inflation. Higher global and domestic interest rates could lead to increased volatility in financial markets. A more pronounced slowdown in the global hi-tech sector would also adversely affect growth in Israel. Heightened security incidents and continued political tensions around the judicial reform could increase risk perceptions, lead to tighter financial conditions, and weigh on business sentiment and investment.

The macroeconomic policy stance should remain tight

Monetary policy conditions should remain tight until inflation is firmly on a path towards the inflation target. Fiscal prudence is needed to avoid adding to inflationary pressures. Policy support to mitigate the rise in energy costs should become more targeted on the most affected households and firms, for example via temporary and targeted transfers instead of reductions in energy excise taxes. Reforms to reduce tariff and non-tariff import barriers and to spur competition should continue as they reduce the cost of living and boost productivity. Addressing demographic challenges, related to the rising share of population groups with weak labour market attachment, is crucial to maintain future growth and fiscal sustainability. This will require setting appropriate work incentives, better supporting working parents including by expanding child-care facilities in underserved areas, improving skills at all stages of the learning cycle, as well as facilitating mobility towards high productivity jobs and firms.

Italy

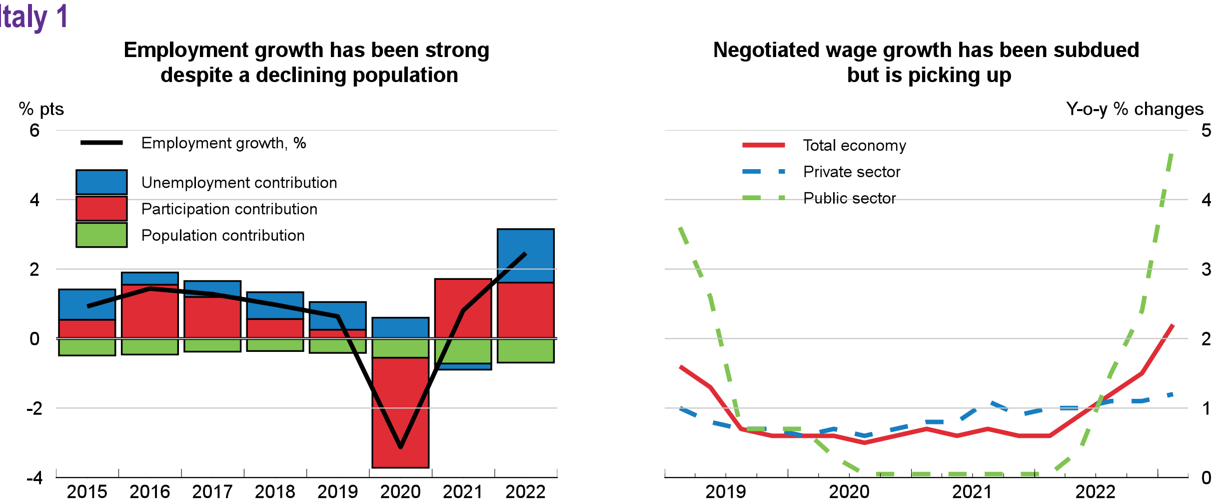
GDP growth is projected to decline from 3.8% in 2022 to 1.2% in 2023 and 1% in 2024. High inflation is eroding real incomes given subdued wage growth, financial conditions are tightening, and exceptional fiscal support related to the energy crisis is gradually being withdrawn, weighing on private consumption and investment. Domestic risks are broadly balanced. Accumulated household savings remain large, which may support a more rapid rebound of domestic demand than currently expected. By contrast, delays in the implementation of the National Recovery and Resilience Plan (NRRP) could lower GDP growth.

As the effects of monetary policy tightening are starting to bite and energy-related fiscal support to households and businesses is being scaled back, the macroeconomic policy stance is becoming restrictive. The mildly restrictive fiscal stance appears broadly appropriate, and continued consolidation will be needed in the years ahead to put the debt ratio on a more sustainable path. The speedy implementation of structural reforms and public investment plans in the NRRP will be paramount to sustain activity in the short term, and to lay the ground for sustainable growth in the medium term.

Activity is picking up

Following a contraction in the fourth quarter of 2022, real GDP picked up by 0.6% in the first quarter of 2023. Recent high-frequency indicators point to modest growth in the near term. While industrial production and retail sales remain subdued, business and consumer confidence have been strengthening over the past few months. The unemployment rate is historically low, vacancies are high, and employment continues to grow robustly, despite a shrinking working-age population. The vibrant labour market and recent declines in energy prices are stabilising real household incomes, supporting a modest recovery in private consumption in the first half of 2023.

Italy 1



Source: OECD Economic Outlook 113 database; and ISTAT.

StatLink https://stat.link/ex8qoy

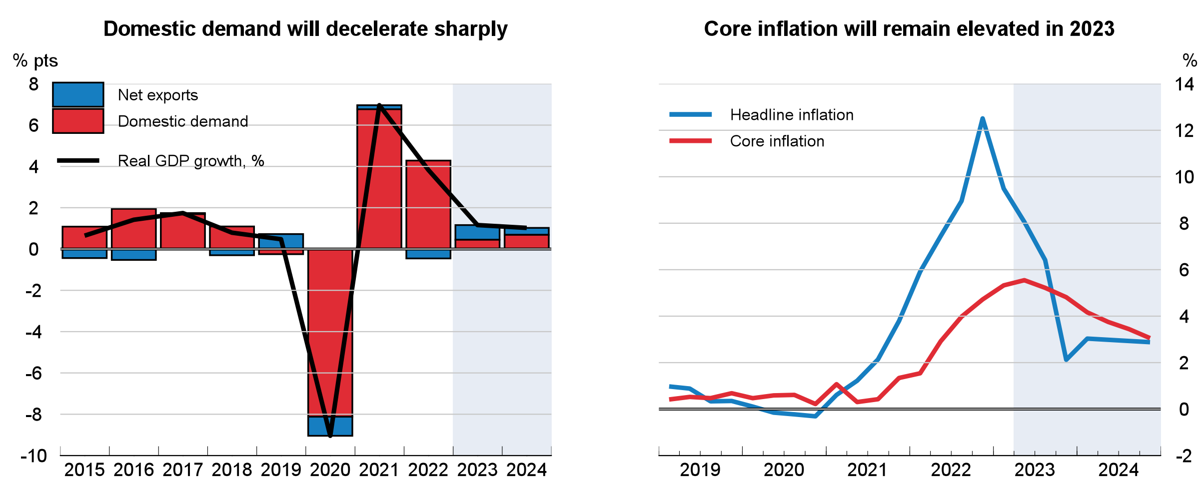
Italy: Demand, output and prices

Italy	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 796.4	-9.0	7.0	3.8	1.2	1.0
Private consumption	1 074.8	-10.4	4.7	4.6	0.9	0.9
Government consumption	334.5	0.0	1.5	0.0	0.7	-1.2
Gross fixed capital formation	323.2	-8.0	18.6	9.7	2.7	1.7
Final domestic demand	1 732.6	-8.0	6.6	4.8	1.2	0.6
Stockbuilding[1]	3.4	-0.4	0.4	-0.3	-0.8	0.0
Total domestic demand	1 736.0	-8.4	7.0	4.5	0.4	0.7
Exports of goods and services	569.1	-14.3	14.1	10.2	1.6	3.8
Imports of goods and services	508.6	-12.7	15.3	12.5	-0.3	3.0
Net exports[1]	60.5	-0.9	0.2	-0.5	0.7	0.3
Memorandum items						
GDP deflator	_	1.6	0.6	3.0	5.6	2.8
Harmonised index of consumer prices	_	-0.1	1.9	8.7	6.4	3.0
Harmonised index of core inflation[2]	_	0.5	0.8	3.3	5.2	3.6
Unemployment rate (% of labour force)	_	9.3	9.5	8.1	8.1	8.1
Household saving ratio, net (% of disposable income)	_	10.2	7.6	2.1	-0.7	-2.6
General government financial balance (% of GDP)	_	-9.7	-9.0	-8.0	-4.1	-3.2
General government gross debt (% of GDP)	_	185.3	176.2	151.3	147.6	146.4
General government debt, Maastricht definition[3] (% of GDP)	_	155.1	150.0	144.3	140.7	139.4
Current account balance (% of GDP)	_	3.9	3.1	-1.2	0.7	0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/zpjo1t

Italy 2



Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/nsha3e

Recent declines in international energy prices have been transmitted rapidly, lowering consumer price inflation, which declined from more than 12% in November to 8.1% in May. Due to high gas storage levels at the end of the autumn of 2022 and a mild winter, gas inventories in April were about twice those a year earlier. Given significant progress with the geographical diversification of gas supply over the past year, this suggests storage levels could approach capacity before the winter of 2023-24. Spillovers from recent international banking sector turbulence to the Italian banking sector have so far been limited.

Borrowing costs are rising while fiscal support is being phased out

The tightening of euro area monetary policy has led to a significant increase in borrowing costs for households and businesses, with bank lending rates having increased by more than 2 percentage points over the past year. It is also raising the government's cost of refinancing the large stock of public debt, with debt servicing costs expected to reach around 4% of GDP in 2024.

The government will phase out fiscal measures to cushion the impact of the energy price shock on households and businesses in mid-2023. Most energy crisis support measures adopted in 2022 – such as tax credits on businesses' electricity bills, reductions of fixed charges on gas and electricity, as well as targeted income support for low-income households – were extended into the first half of 2023. But generosity was reduced and some cost-inefficient and untargeted measures, such as the reduction in excise taxes on fossil fuels, were ended. The fiscal savings from the phasing out of crisis support and other fiscal tightening measures, including tightening of the rules on the costly "Superbonus" tax credit for building renovations, amount to about 2% of GDP in 2023. This is partly offset by the expected ramp-up of spending related to Next Generation EU (NGEU) by about 1½ per cent of GDP. Overall, the combination of lower energy prices, tighter financial conditions and mildly restrictive fiscal policy should lead to a gradual easing of inflationary pressures while allowing a modest recovery in activity.

Growth will pick up only slowly

Real GDP is projected to grow modestly over 2023-24 despite recent declines in energy prices and the expected strengthening of NGEU-related spending. The erosion of real incomes due to subdued wage growth in a context of high inflation, the withdrawal of exceptional fiscal support related to the energy crisis, and the tightening of financial conditions are weighing on private consumption and investment. These headwinds are only partly offset by the decline of inflation, as the energy price shock has led to wider price pressures that will dissipate only slowly. While the decline in energy prices is expected to reduce inflation both directly by reducing energy price inflation and indirectly by reducing firms' input costs, wage growth is expected to pick up over 2023-24. Increases in borrowing costs will curtail private investment, especially in the residential sector that will also be hit by the tightening of the "Superbonus" tax credit conditionality. Weakness in private investment will somewhat offset the positive impulse on total investment from the expected pick-up in public investment related to Next Generation EU funds. While net exports contribute positively to growth over 2023-24, the recent appreciation of the euro will limit further gains in export competitiveness.

Risks to growth are broadly balanced. Accumulated household savings remain large, which could drive a more rapid rebound of domestic demand than currently expected as households draw down excess savings. By contrast, negative spillovers from recent international banking sector turbulence or further delays in the implementation of public investment projects in the National Recovery and Resilience Plan (NRRP) could lower growth.

Structural reforms will be key to support growth and reduce the debt ratio

While fiscal policy over 2023-24 strikes an appropriate balance between fiscal prudence and supporting growth, in the years ahead more fiscal consolidation will be needed to put the debt-to-GDP ratio on a more sustainable path. Consolidation plans should include ambitious measures to tackle tax evasion and comprehensive spending reviews to increase the efficiency of public spending. The full implementation of the ambitious public investment and structural reform plans in the NRRP could durably lift Italy's GDP, which would have the added benefit of putting further downward pressure on the debt-to-GDP ratio. Ongoing reforms of the public administration, the justice system and competition are on track and remain critical to raise GDP in the medium term. But spending of NGEU funds is well behind schedule, with cumulated spending at the end of 2022 being about 50% below initial spending plans, which mainly reflects delays in the implementation of public investment projects. The priorities should be to swiftly replace unviable projects with viable ones and to strengthen the capacity of the public administration to efficiently manage and implement the public spending projects foreseen by the NPRR. These projects crucially include infrastructure spending to facilitate the digital and green transitions, as well as the expansion of public pre-school childcare to promote female labour market participation in the context of a rapidly shrinking working-age population.

Japan

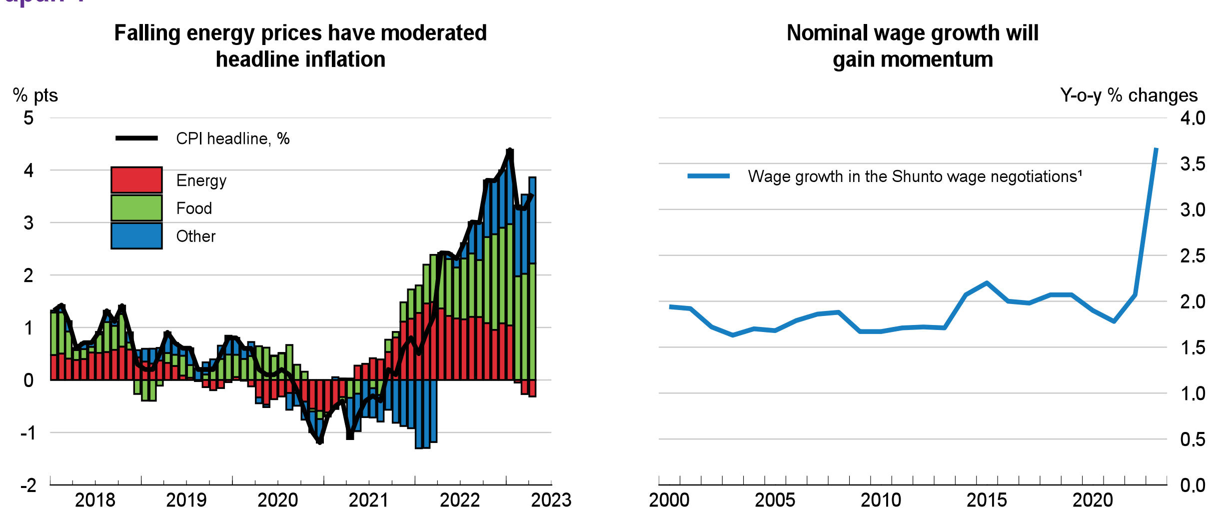
Real GDP is projected to grow by 1.3% in 2023 and 1.1% in 2024, mainly driven by domestic demand. Government support to help households cope with the energy price shock and increased defence spending will boost consumption and investment. Core inflation (excluding energy and food) will increase towards 2% as wage growth gains momentum and spreads to SMEs in 2024. The labour market will remain tight, with the unemployment rate edging down to 2.4% in 2024.

Given limited fiscal space, and the need to foster lower energy use, energy subsidies should become more targeted, with a view to eventually phasing them out. Additional structural spending and revenue measures are needed, especially given the fiscal pressures from an ageing population. A credible fiscal framework is also required to put the debt-to-GDP ratio on a clear downward path. Further modifications to the conduct of yield curve control can increase flexibility and lower the risks of abrupt changes later. The Bank of Japan should communicate its current and future monetary stance clearly and in a timely manner. Policies to boost productivity and reduce the gender wage gap are needed to improve well-being and medium-term fiscal sustainability.

Domestic demand remains the main driver of the recovery

Real GDP grew by 0.4% q-o-q in the first quarter of 2023, driven by strong internal demand. After peaking at 4.3% in January, headline consumer price inflation fell to 3.5% in April, partly due to the introduction of new subsidies to electricity and city gas bills. Despite a high job opening-to-applicant ratio and low unemployment, nominal wages were up by only 1.3% in March over a year earlier. However, the tentatively agreed increases of 2.1% in base pay and 3.7% in headline wages in this year's *Shunto* wage negotiations foreshadow greater wage momentum. Despite high inflation weighing on real disposable incomes, consumer confidence has risen and household consumption, especially in service sectors, has been growing steadily, reflecting the restoration of socio-economic activities. Following the opening of borders in October 2022, the Japanese government has classified COVID-19 in the same category as normal influenza from May 8, which will continue to support domestic demand.

Japan 1



1. As of 10 May, 2023.
Source: Ministry of Internal Affairs and Communications; Japanese Trade Union Confederation; and OECD calculations.

StatLink https://stat.link/o7rfwc

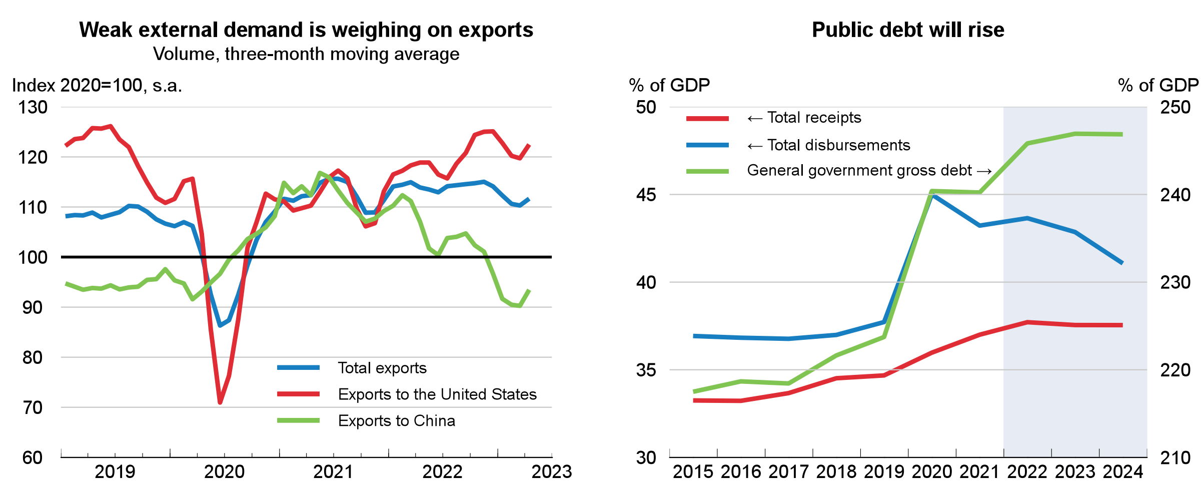
Japan: Demand, output and prices

Japan	2019	2020	2021	2022	2023	2024
	Current prices YEN trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	557.9	-4.3	2.2	1.0	1.3	1.1
Private consumption	304.4	-4.7	0.4	2.1	1.5	0.9
Government consumption	111.3	2.4	3.5	1.5	0.2	-0.5
Gross fixed capital formation	142.5	-3.6	-0.1	-1.1	3.1	2.1
Final domestic demand	558.2	-3.0	0.9	1.1	1.6	0.9
Stockbuilding[1]	1.4	-0.5	0.2	0.4	-0.3	0.0
Total domestic demand	559.5	-3.4	1.1	1.6	1.3	0.9
Exports of goods and services	97.4	-11.6	11.9	5.1	0.9	2.9
Imports of goods and services	99.0	-6.8	5.1	8.0	1.4	1.9
Net exports[1]	- 1.6	-0.8	1.0	-0.6	-0.2	0.1
Memorandum items						
GDP deflator	_	0.9	-0.2	0.2	2.5	1.9
Consumer price index[2]	_	0.0	-0.2	2.5	2.8	2.0
Core consumer price index[3]	_	0.1	-0.7	0.3	2.1	1.7
Unemployment rate (% of labour force)	_	2.8	2.8	2.6	2.5	2.4
Household saving ratio, net (% of disposable income)	_	11.4	7.8	5.4	3.1	2.1
General government financial balance (% of GDP)	_	-9.0	-6.2	-5.9	-5.3	-3.5
General government gross debt (% of GDP)	_	240.4	240.2	245.8	246.9	246.9
Current account balance (% of GDP)	_	2.9	3.9	1.9	2.0	2.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Calculated as the sum of the seasonally adjusted quarterly indices for each year.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/vs619z

Japan 2



Source: Bank of Japan; OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/9qw40n

A weaker global economy has slowed external demand growth, despite an easing of supply chain disruptions. The Bank of Japan's latest Tankan survey showed a divergence in business confidence between manufacturing, which continued to decline, and the non-manufacturing sector. While commodity prices have been decreasing and the slowdown in global monetary tightening has moderated the yen's depreciation, the trade deficit remains large. The number of inbound tourists has been recovering, but remains well below 2019 levels, partly due to the delayed return of Chinese tourists, who accounted for one quarter of total visitors in 2019. Adding to current price subsidies, a decrease in the renewables levy introduced in April has mitigated the energy shock further. However, the impact of these measures on prices is likely to be partly reversed from June, as seven major electricity companies increase their prices.

Macroeconomic policies will support households and firms

Following the October 2022 economic package, which includes measures to moderate energy and food prices (JPY 6.3 trillion, 1.2% of GDP), the government implemented further measures in March 2023 (JPY 2.2 trillion, 0.4% of GDP), financed by the contingency reserve fund from FY2022. The measures include one-off cash benefits to low-income households with children and a grant to local governments to protect households and local firms against high energy costs. The OECD projections assume the price subsidies to electricity and city gas will remain in place after September, the current official expiry date, but gradually decline over time. In 2024, fiscal support is projected to be scaled back with the end of pandemic-related measures and the gradual decline in energy price support. On the other hand, the annual defence budget will gradually increase from JPY 5.4 trillion in FY2022 to around JPY 9 trillion by FY2027 based on a new five-year plan announced in December 2022. The gross public debt-to-GDP ratio is projected to remain high at close to 247% in 2024.

While consumer price inflation excluding fresh foods, which is the measure the Bank of Japan uses to guide its monetary policy, has exceeded the 2% target since April 2022, the Bank recently announced that there will be no change in its monetary policy framework and stance. In line with the OECD baseline projections for inflation and wages, continued policy accommodation is projected through 2024. However, to safeguard financial stability and market functioning, the Bank is assumed to further modify the conduct of yield curve control, following the widening of the 10-year bond yield fluctuation band around zero from around +/- 25 basis points to around +/- 50 basis points in December 2022. Such a move would increase flexibility and lower the risks of abrupt future changes and should be accompanied by timely and clear communication of the current and future monetary policy stance.

Risks to the outlook are considerable

GDP growth is projected at 1.3% in 2023 and 1.1% in 2024, driven by domestic demand. Private consumption will be supported by savings accumulated during the pandemic and government measures, despite weak real disposable income growth. Government subsidies, especially for green and digital investment, will raise business investment, despite higher uncertainty. Headline consumer price inflation is projected to peak in the third quarter of 2023 due to higher food and electricity prices. Despite the agreement for stronger wage growth in larger companies, the impact on aggregate wages will be lagged and smaller because SMEs, which are still negotiating wage agreements, will only partly follow suit. As wage growth gains momentum, core inflation will gradually increase and approach 2% in the latter half of 2024. The labour market will remain tight, and the unemployment rate will edge down to 2.4% in 2024.

Downside risks include weaker-than-expected external demand and renewed supply chain disruptions, as well as a potential abrupt change in monetary and financial conditions. In the context of the high level of public debt, a loss of confidence in Japan's fiscal sustainability could destabilise the financial sector and the real economy, with large negative spillovers to the world economy. In contrast, growth could be stronger in the event of a faster-than-expected recovery of consumption, especially of services. It would also be boosted by stronger-than-expected external demand, including inbound tourism, related to the re-opening of China.

Structural and fiscal reforms are needed for resilient and sustainable growth

The expected decline in the labour force due to a shrinking and ageing population makes productivity gains essential to support well-being and fiscal sustainability. Enhancing labour market flexibility, improving insolvency procedures by increasing the wealth exemption from personal bankruptcy, and lowering barriers to foreign direct investment would strengthen business dynamism. The productivity gap between large firms and SMEs should be addressed by improving the targeting of R&D spending and supporting SMEs' ability to adopt digital technologies. Greater use of digital technologies can also improve fiscal sustainability by increasing the efficiency of health and long-term care spending. On the other hand, higher structural government expenditures without additional revenues would worsen fiscal sustainability and threaten sustainable growth. Fiscal consolidation efforts should resume on both the expenditure and the revenue side, including social security and tax system reforms, and improved spending efficiency, with a feasible target. Enhancing energy security and lowering dependence on fossil fuels requires stepping up the promotion of research, development, and deployment of green technologies, rolling out renewable energy and encouraging greater energy efficiency. Continuing Work Style reforms, including equal pay for equal work and flexible work arrangements, and improving child-care provision would promote female employment and reduce Japan's large gender wage gap. In the context of labour shortages, especially in ICT, reforming STEM curricula to make them more attractive to study and promoting greater female participation in these fields, such as through mentor programmes, are also key.

Korea

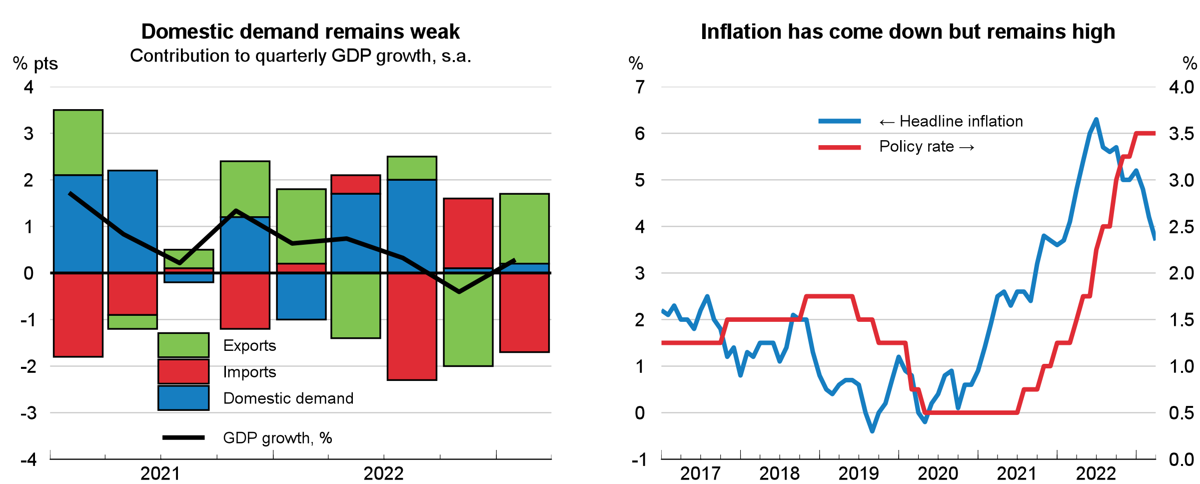
GDP growth is projected to decline to 1.5% in 2023 before picking up to 2.1% in 2024. China's recovery should boost exports over time. Private consumption and investment will remain weak in the near term in response to higher interest rates and a sluggish housing market, but will pick up gradually in 2024. Inflation will continue to decline, but only moderately, with utilities and services price adjustments yet to come. Employment is set to contract from high levels and unemployment to rise from historical lows.

The Bank of Korea has appropriately maintained the policy rate at 3.5% since January 2023 and signalled a data-driven approach going forward. Fiscal consolidation should proceed in view of rapid ageing, in line with the proposed fiscal rule. Support to households should become increasingly targeted to those that are not sufficiently protected by permanent social protection schemes. Structural reforms should facilitate the reallocation of labour and capital to expanding sectors and address high social protection gaps.

The economy has slowed

Real GDP grew by 0.3% in the first quarter of 2023, after a contraction in the previous quarter. Private consumption picked up, led by in-person services as the last pandemic curbs were lifted. High inflation and interest rates dragged down private investment. Exports and imports rebounded after a deep contraction in the fourth quarter of 2022. Headline inflation fell to 3.7% in April 2023, and core inflation remained largely unchanged at 4.0%, with services and utility prices increasing. Job creation has slowed after robust gains in 2022.

Korea



Source: OECD national accounts database; and Bank of Korea.

StatLink https://stat.link/hn2pmt

Korea: Demand, output and prices

Korea	2019	2020	2021	2022	2023	2024
	Current prices KRW trillion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 924.5	-0.7	4.1	2.6	1.5	2.1
Private consumption	935.9	-4.8	3.7	4.3	2.3	2.1
Government consumption	328.7	5.1	5.6	4.1	2.6	1.0
Gross fixed capital formation	579.0	3.5	2.8	-0.8	1.4	0.9
Final domestic demand	1 843.6	-0.4	3.8	2.6	2.0	1.5
Stockbuilding[1]	27.1	-0.8	-0.1	0.1	0.2	0.0
Total domestic demand	1 870.7	-1.2	3.6	2.7	2.2	1.5
Exports of goods and services	755.9	-1.7	10.8	3.3	2.4	4.6
Imports of goods and services	702.1	-3.1	10.1	3.7	4.0	3.3
Net exports[1]	53.8	0.5	0.7	0.0	-0.8	0.5
Memorandum items						
GDP deflator	_	1.6	2.5	1.2	1.4	3.0
Consumer price index	_	0.5	2.5	5.1	3.4	2.6
Core inflation index[2]	_	0.4	1.4	3.6	3.5	2.4
Unemployment rate (% of labour force)	_	4.0	3.6	2.9	3.0	3.3
Household saving ratio, net (% of disposable income)	_	14.7	13.7	12.0	12.0	11.0
General government financial balance (% of GDP)	_	-2.7	-0.8	-0.6	-0.1	0.5
General government gross debt (% of GDP)	_	50.0	50.6	53.4	55.0	57.1
Current account balance (% of GDP)	_	4.5	4.7	1.7	-0.3	0.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/xz1l3a

Korea's direct trade with Russia and Ukraine is limited, but rising energy and food prices pushed up inflation. A slowdown in global demand, notably for semiconductors, has dampened exports considerably, along with sluggish demand from China in late 2022. Together with a weak exchange rate since early 2022, notably against the US dollar, this has resulted in a trade deficit. Recent global bank failures have impacted financial conditions in Korea only very modestly so far.

Macroeconomic policies are being tightened

After raising the main policy rate ten times from 0.5% in August 2021 to 3.5% in January 2023, the Bank of Korea has kept it on hold. The policy rate is assumed to remain at the current level until the second half of 2024 by which time inflation is projected to be close to the 2% target. Fiscal policy will tighten in 2023 on the assumption that supplementary budgets will be avoided, which will work in the same direction as monetary policy. The 2023 budget cut the managed budget deficit (excluding social security) from 5.1% of GDP in 2022 to 2.6% of GDP by scaling back discretionary expenditures. The fiscal stance is assumed to be slightly contractionary in 2024, in line with the government's fiscal consolidation plan.

Growth is projected to weaken

Real GDP growth is expected to slow to 1.5% in 2023, before rebounding to 2.1% in 2024. Exports are set to pick up with China's recovery. Elevated debt servicing burdens and a sluggish housing market will continue to weigh on private consumption and investment in the short term, but demand growth should strengthen in 2024. Inflation will gradually moderate but remain above target, as planned increases in service and utility prices have been postponed until the second half of 2023. Further global financial turmoil could increase the household debt servicing burden and trigger volatility in financial markets. Increasing geopolitical tensions may lead to realignments of Korean supply chains. A stronger than expected recovery in China and easing geopolitical tensions would improve the economic outlook.

Structural challenges call for policy action

Against the backdrop of rapid population ageing, fiscal consolidation should proceed. The proposed fiscal rule, which caps the managed budget deficit at 3% of GDP, would help to limit the build-up of fiscal pressure. The pension reform to be announced in the second half of 2023 should help to secure adequate retirement income and fiscal sustainability. The government recently extended a temporary fuel tax cut until the end of August 2023 to ease living costs. It would be better to target vulnerable groups more directly, notably by addressing gaps and weaknesses in the social safety net, and enhancing incentives for energy savings. Stepping up training and activation policies for those who lose their job and strengthening the social safety net would facilitate workforce reallocation. Reducing the stringency of product market regulation would help to lower productivity gaps between large and small firms and reduce labour market dualism. Policies should also focus on reconciling career and family, including greater public financing of parental leave and expanding after-school care to boost female employment and fertility. To further reduce GHG emissions, Korea’s emission trading scheme should be aligned with climate targets.

Latvia

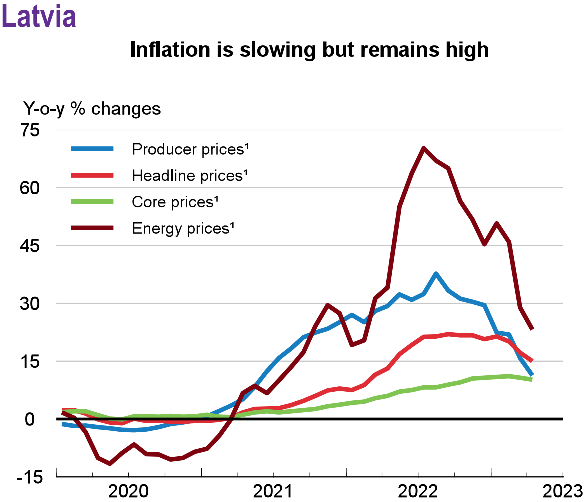
Economic growth will slow to 1.1% in 2023 before rebounding to 2.4% in 2024. High inflation will weigh on private consumption. Business investment will slow due to less favourable financial conditions and high uncertainty. Exports will improve gradually due to higher external demand. Inflation will ease but remain high as elevated producer prices pass through to consumers. Unemployment will rise slightly, but high wage demands and the rise in the minimum wage will support strong wage growth.

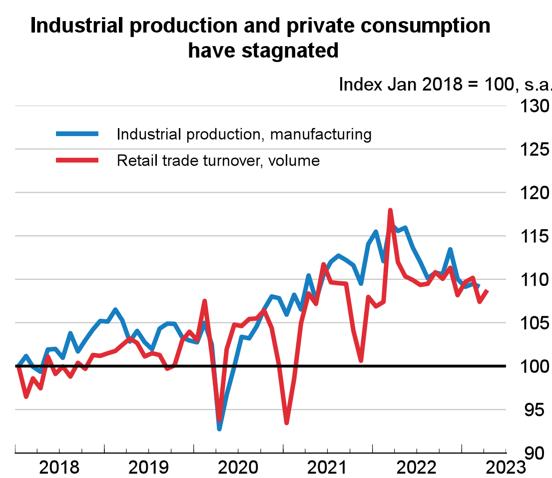
Untargeted measures to mitigate the impact of higher energy prices should be phased out as planned to limit additional inflationary pressures, incentivise energy savings and restore fiscal space to support structural changes. Raising the effective carbon price in sectors not covered by the EU-ETS and phasing out fuel subsidies while increasing public investment could help to accelerate the green transition and raise energy security. Active labour market policies should be expanded to reduce skill mismatches and facilitate job reallocation.

Inflation remains high

Latvia's economy entered a recession after Russia's war of aggression against Ukraine started, with the war hitting supply chains, private investment and trade. However, private consumption proved more resilient than expected during the winter despite high inflation and the reduced purchasing power of households. Economic sentiment has improved since September 2022, especially consumer confidence. In the first quarter of 2023, GDP grew by 0.6% compared to the previous quarter, led by strong non-residential investment. The labour market remains tight, even though pressures are starting to ease. The number of job vacancies declined by 14% in the fourth quarter of 2022 and is now lower than in 2019. Even so, the unemployment rate decreased from 7% in August 2022 to 6.5% in March 2023. Headline consumer price inflation has fallen since September 2022 due to declining energy prices but remains high at 15.0% in April 2023. Housing prices declined in the fourth quarter of 2022 after experiencing rapid growth since the beginning of 2021.

Latvia





1. Headline prices refer to the harmonised index of consumer prices, core prices refer to the harmonised index of consumer prices excluding food, energy, alcohol and tobacco, energy prices refer to the harmonised index of consumer prices of energy goods, producer prices refer to the producer prices index for all industry.
Source: OECD Prices database; and Statistical Central Bureau of Latvia.

StatLink https://stat.link/zw1032

Latvia: Demand, output and prices

Latvia	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	30.7	-2.2	4.1	2.0	1.1	2.4
Private consumption	17.9	-4.6	8.1	8.1	1.3	2.2
Government consumption	6.0	2.4	4.4	2.8	3.4	1.4
Gross fixed capital formation	7.1	-2.6	2.9	0.7	5.7	2.0
Final domestic demand	30.9	-2.8	6.1	5.3	2.6	2.0
Stockbuilding[1]	0.0	0.6	3.6	-1.3	0.7	0.0
Total domestic demand	30.9	-2.2	9.6	3.9	2.9	2.0
Exports of goods and services	18.4	-0.3	5.9	9.1	-0.4	2.9
Imports of goods and services	18.6	-0.3	15.3	11.7	2.1	2.4
Net exports[1]	- 0.2	0.0	-5.4	-2.0	-1.9	0.3
Memorandum items						
GDP deflator	_	1.0	6.5	14.1	8.0	5.1
Harmonised index of consumer prices	_	0.1	3.2	17.2	11.2	4.8
Harmonised index of core inflation[2]	_	0.9	1.9	7.6	9.0	4.8
Unemployment rate (% of labour force)	_	8.1	7.6	6.8	6.6	6.6
Household saving ratio, net (% of disposable income)	_	6.3	5.9	-5.6	-4.1	-5.5
General government financial balance (% of GDP)	_	-4.4	-7.1	-4.4	-3.6	-1.9
General government gross debt (% of GDP)	_	54.5	57.7	49.8	52.0	52.6
General government debt, Maastricht definition[3] (% of GDP)	_	42.0	43.7	40.8	43.0	43.6
Current account balance (% of GDP)	_	2.6	-4.2	-6.4	-2.8	-2.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/tlacf0

The energy and commodity price shocks and the war in Ukraine impact the economy through high energy inflation, increased uncertainty, and disruptions to the trade of commodities and materials, as well as to logistics and transport. However, in 2022, the effect on exports to Russia and Belarus was limited. Price growth remains driven by changes in energy and food prices, whose share in the CPI basket is higher than in other countries of the euro area. Although energy prices have decreased from their peak, they are about 30% higher than at the end of 2019. About 40 000 Ukrainian refugees had entered Latvia by the end of 2022 (2.1% of Latvia's population); 30% were children.

The government deficit is set to decline

Fiscal deficits will narrow over the next two years, with cumulative fiscal tightening of around 2% of GDP in 2023-24. Most of the support to mitigate the impact of high energy prices on households is to end in April 2023, and lower energy prices are reducing the fiscal costs. In addition, most spending for COVID-19 support has been phased out. Expenditures amounting to about 0.9% of GDP are assumed to be financed by grants from the EU Recovery and Resilience Facility in 2023 and 2024. Defence spending will rise from 2.2% of GDP in 2022 to about 2.4% in 2024. The minimum wage was raised by 22% in January 2023, from EUR 500 to EUR 620.

Higher interest rates will weigh on private investment

GDP growth will slow in 2023 as high inflation dampens private consumption, while high uncertainty and tightening monetary policy moderate business and real estate investment. Public investment will partially counteract this with an accelerated deployment of EU funds. The uptick in unemployment will be modest as the expected rebound in activity and labour shortages due to a shrinking population incentivise businesses to retain their employees. Wage growth will increase in 2023 due to the minimum wage rise. Exports will lead the recovery as declining energy prices increase demand from main trading partners. A major risk to the outlook is a cold winter in 2023-24 leading to higher-than-expected energy prices. The rapid rise in interest rates might lead to growing macro-financial vulnerabilities, while a sluggish absorption of European Union funds could slow public investment.

Investing in the green transition and addressing skilled labour shortages

Accelerating investment in renewables and the green transition is necessary to raise energy security but will require tackling skilled labour shortages. Providing tertiary students with greater financial support and improving access to, and the quality of, training (including by establishing training funds) is key. Raising skilled migration would require simplifying and accelerating administrative procedures including the recognition of foreign qualifications. Improving the supply of more affordable and better-quality housing and upgrading public transport services would help to spur labour mobility. Addressing gender stereotypes and enforcing anti-discrimination legislation is key to reduce the growing gender wage gap.

Lithuania

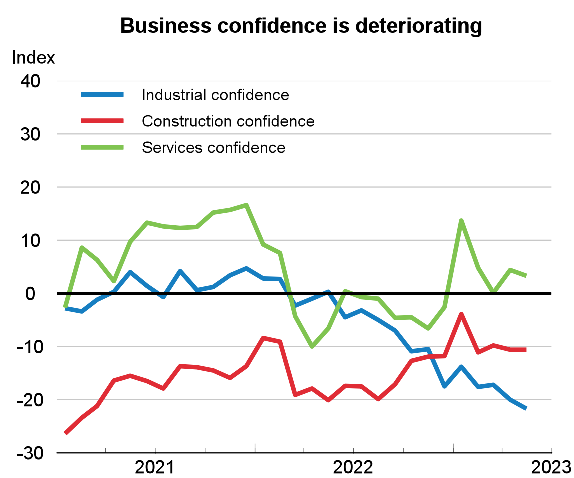
GDP is projected to stagnate in 2023 and rebound to 2.6% in 2024. High inflation will continue to weigh on private consumption. A weak outlook for global trade, uncertainty and geopolitical tensions affecting key trading partners will contribute to a sharp slowdown in exports. Inflation will start to ease with lower import prices for gas and oil. Public investment, strengthened by EU funds, will support growth. Unemployment is projected to increase slightly in the near term but wage growth is likely to remain robust due to labour shortages.

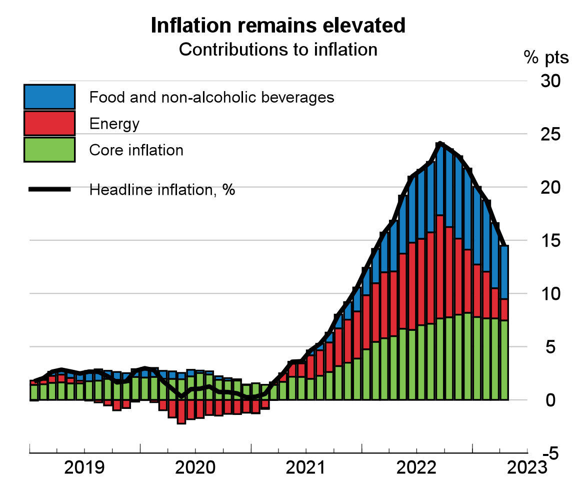
Fiscal policy support has helped households and firms with elevated energy costs. Support measures should become increasingly targeted on those not sufficiently protected by the general social protection system. Improving the quality of compulsory education would help to reduce skill-mismatches, while better management of state-owned enterprises would support productivity. Complementing emission reduction efforts with a carbon tax would both reduce the dependency on oil and gas imports and support the green transition.

The economy is slowing in face of headwinds

Economic activity slowed in the second half of 2022, as the impact of increasing inflation, uncertainty from geopolitical tensions, rising interest rates and deteriorating business confidence began to materialise. GDP declined by 2% in the first quarter of 2023 relative to the final quarter of 2022. Headline inflation stood at 13.3% in April 2023. Business confidence fell throughout 2022 and was again negative in the early months of 2023. Manufacturing production recorded a 8% contraction in February 2023 and retail sales contracted in the first three months of 2023. Unemployment has increased slightly but remains below the long-term average, wage growth remains robust and labour costs are rising.

Lithuania





Source: Eurostat, Business Confidence Indicators; and OECD, Consumer Prices database.

StatLink https://stat.link/wlv8qd

Lithuania: Demand, output and prices

Lithuania	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	48.9	0.0	6.0	1.9	0.0	2.6
Private consumption	29.4	-2.4	8.0	0.5	0.2	3.1
Government consumption	8.3	-1.4	0.9	0.5	-0.7	0.7
Gross fixed capital formation	10.5	-0.2	7.8	2.6	8.3	1.3
Final domestic demand	48.1	-1.8	6.6	0.9	1.8	2.3
Stockbuilding[1]	- 1.8	-1.8	-0.2	0.7	-2.9	0.8
Total domestic demand	46.3	-3.8	7.2	2.4	-0.3	3.1
Exports of goods and services	37.8	0.4	17.0	11.9	-1.0	3.8
Imports of goods and services	35.2	-4.5	19.9	12.3	-2.9	4.7
Net exports[1]	2.6	3.5	-0.3	0.2	1.7	-0.6
Memorandum items						
GDP deflator	_	1.9	6.3	16.7	10.1	4.3
Harmonised index of consumer prices	_	1.1	4.6	18.9	13.1	5.7
Harmonised index of core inflation[2]	_	2.6	3.4	10.5	12.0	5.6
Unemployment rate (% of labour force)	_	8.5	7.1	5.9	7.5	7.1
Household saving ratio, net (% of disposable income)	_	9.1	2.2	-2.1	4.6	7.7
General government financial balance (% of GDP)	_	-6.5	-1.2	-0.6	-1.4	-1.0
General government gross debt (% of GDP)	_	55.2	50.6	38.2	38.6	38.9
General government debt, Maastricht definition[3] (% of GDP)	_	46.3	43.7	38.4	38.9	39.2
Current account balance (% of GDP)	_	7.6	1.3	-5.1	-0.2	-0.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/gqtfuy

The ongoing re-orientation towards new trading partners has substantial economic costs. Replacing energy imports from Russia, which accounted for 73% and 42% of oil and gas imports, respectively, in 2020, has contributed to the highest inflation in 25 years, exacerbating the effects of rising food prices. Supply chain disruptions are weighing on activity as Belarus and Ukraine are important for the supply of some intermediate goods, such as metals and wood. Up to March 2023, almost 80,000 Ukrainian refugees have been registered for temporary protection.

Energy and price falls will ease public spending

Fiscal policy will be broadly neutral in 2023 and mildly restrictive in 2024. To ease the burden of inflation, the government extended a zero VAT rate on district heating for two more winter seasons in September 2022. In December 2022, a partial compensation of electricity and natural gas prices for consumers was extended until mid-2023. Lower energy prices are now reducing the fiscal cost of these measures and in conjunction with fewer benefit applications from new refugee arrivals, this will reduce public spending, despite rising defence outlays. Looking ahead, support should increasingly move away from general price compensation towards more targeted measures to assist vulnerable households, before eventually being phased out. Investment will be boosted by a quicker implementation of projects tied to the EU Recovery and Resilience plan, in addition to European Green Deal projects. Tighter monetary conditions are cooling the housing market and leading to a slowdown in investment. The number of building permits has been in decline, down 26% over 2022.

Inflation will restrain growth

GDP will stagnate in 2023 due to historically high inflation, which however will come down over 2023 and 2024 under the impact of tighter monetary policy and lower energy and food prices. Export growth will weaken due to the uncertainty from geopolitical tensions in key trading partners. Weakening business confidence and high levels of uncertainty will slow business and real estate investment. Public investment will partially counteract this with an accelerated deployment of EU funds, albeit at the risk of adding to inflationary pressures. Wage growth will become more moderate under the impact of a modest upturn in unemployment. Nevertheless, there are still considerable issues with skills shortages and employers are reluctant to release staff and rely on future hiring. GDP will rebound in 2024 as declining energy prices ease headline and eventually core inflation, leading to a recovery in consumption and exports. The main risk is slower than expected reductions in inflation that cut into confidence and growth.

Securing stronger and more sustainable growth

Persistent skills mismatches and low educational outcomes are increasingly holding back growth and earning opportunities and could be addressed by renewed policy efforts to improve the quality of compulsory education, including through better teacher training. Effective career guidance in schools and universities could help to reduce gender imbalances in STEM fields. Given the significant role of state-owned enterprises, a more transparent regulatory framework and improvements in management and governance of these enterprises would support productivity. Complementing emission reduction efforts with a carbon tax would both reduce the dependency on oil and gas imports and support the green transition. Such a tax could gradually align carbon prices across sectors, including those that are not covered by the European Emission Trading System.

Luxembourg

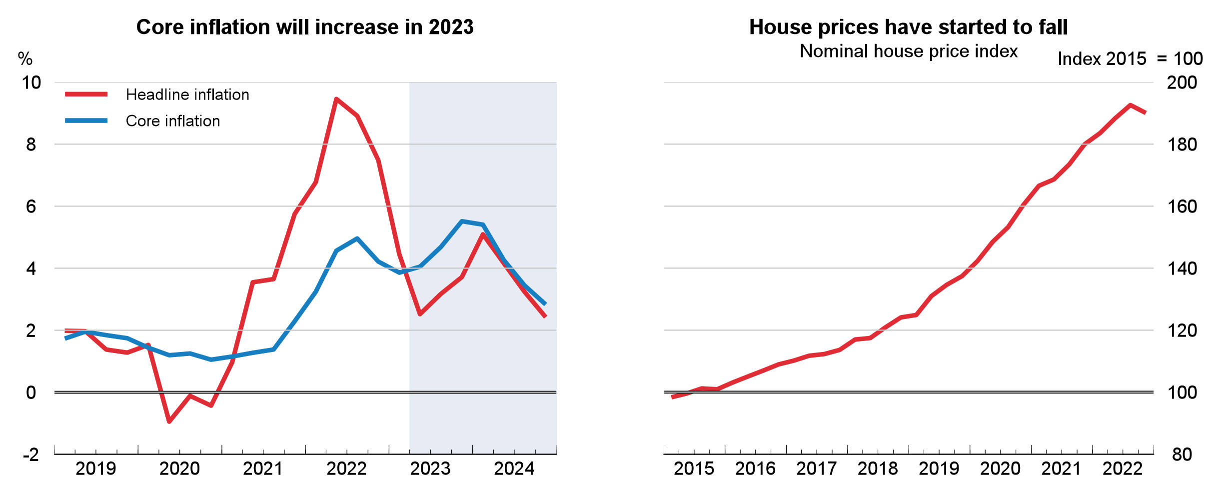
GDP growth is projected to slow to 0.8% in 2023 from 1.6% in 2022 before picking up to 2% in 2024. Measured activity in the key financial and insurance services sector is weakening, and tightening financial conditions are slowing private investment. Domestic consumption will sustain activity in 2023 and 2024, and a partial recovery in net exports and investment will boost growth in 2024. Risks are tilted to the downside, as the looming housing market correction might have a larger-than-expected impact on private consumption. Measured activity is highly sensitive to financial market prices and developments.

While some mild fiscal expansion might be warranted to sustain consumption in the short term, energy-related support should be phased out and the fiscal stance tightened as the economy recovers. Looking ahead, reforming the pension system to ensure long-term fiscal sustainability should be a priority. A reform of the wage indexation system to restrict indexation to non-energy price inflation should also be considered. Family policies to bring the working time of women more in line with that of men should be strengthened.

2022 ended with a sharp contraction

GDP shrank by over 3% in the fourth quarter of 2022. The slowdown was broad-based. However, key high-frequency indicators, such as retail sales and industrial production, show a possible rebound in domestic activities in the early part of this year. Headline consumer price inflation decreased substantially in the first months of 2023, to below 3% in April 2023, the lowest in the European Union. After growing more than 90% since 2015, residential property prices started to decline at the end of 2022. The labour market has so far proved resilient, with the unemployment rate staying below 5% over recent months.

Luxembourg



Source: OECD Economic Outlook 113 database; and OECD Analytical House Prices database.

StatLink https://stat.link/bw270u

Luxembourg: Demand, output and prices

Luxembourg	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	62.3	-0.8	5.1	1.6	0.8	2.0
Private consumption	21.0	-7.2	9.4	2.8	2.4	2.9
Government consumption	10.7	7.2	5.5	4.1	5.5	4.4
Gross fixed capital formation	10.8	-3.1	6.0	0.0	-4.0	0.1
Final domestic demand	42.5	-2.4	7.5	2.4	1.5	2.6
Stockbuilding[1]	0.6	-0.3	0.6	-0.2	0.1	0.0
Total domestic demand	43.1	-2.8	8.4	2.0	1.7	2.6
Exports of goods and services	127.4	0.2	9.7	-0.6	1.0	2.6
Imports of goods and services	108.2	-0.4	11.9	-0.8	1.4	2.9
Net exports[1]	19.2	1.1	-0.2	0.3	-0.3	0.3
Memorandum items						
GDP deflator	_	4.7	6.1	6.6	1.2	1.9
Harmonised index of consumer prices	_	0.0	3.5	8.2	3.5	3.7
Harmonised index of core inflation[2]	_	1.2	1.5	4.2	4.5	4.0
Unemployment rate (% of labour force)	_	6.4	5.7	4.8	5.3	5.4
Household saving ratio, net (% of disposable income)	_	19.0	12.4	12.0	17.1	15.8
General government financial balance (% of GDP)	_	-3.4	0.7	0.2	-2.3	-2.3
General government gross debt (% of GDP)	_	32.7	31.5	28.9	32.1	36.0
General government debt, Maastricht definition[3] (% of GDP)	_	24.5	24.6	24.6	27.8	31.7
Current account balance (% of GDP)	_	3.2	4.6	5.0	8.8	8.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/fmbywl

Weakness in global financial markets in 2022 hit Luxembourg's mutual fund industry, contributing to a pronounced slowdown in the financial and insurance services sector in the last quarter of last year. Turmoil in the banking sector in some OECD countries in 2023 does not seem to have spread to Luxembourg so far. Global energy prices rose sharply in 2022 but their recent reversion towards historical averages has contributed to disinflation.

Generous fiscal policy support measures are being extended

Financial conditions are expected to keep tightening as a result of euro area monetary policy and are contributing to the correction in the housing market. In accordance with the social partners, the government legislated a fiscal support package last year, worth about 3% of GDP over 2022-23. The package helps the economy deal with the energy price shock and keeps inflationary pressures in check to limit the extent of the automatic wage indexation to inflation. It includes capping gas and electricity prices for all households, distributing subsidies to disadvantaged households and energy-intensive firms, and a one-year cut of the value added tax (VAT) rate. A new agreement was reached in March 2023 to extend most measures to 2024. In addition, the government announced the indexation of the personal income tax brackets to inflation in fiscal year 2024 as well as a generous one-year personal income tax credit for 2023. These measures will result in a significant easing of the fiscal stance, with the budget balance expected to change from 0.2% of GDP in 2022 to a deficit of almost 2½ per cent of GDP in 2023.

Growth will slow substantially in 2023 before picking up in 2024

GDP growth is projected to slow to 0.8% in 2023. Tighter euro area and global financial conditions will reduce the volume of cross-border financial activities and increase borrowing costs, dragging down net exports and private investment. Activity will be supported by healthy domestic consumption helped by rising disposable real incomes, on the back of three rounds of wage indexation and expansionary fiscal policy. Growth will pick up to 2% in 2024, benefitting from a modest recovery in exports and private investment and continued robust growth of domestic consumption. The unemployment rate will tick upwards, reaching over 5½ per cent in the first half of 2024. Headline inflation will decrease in 2023, due to the reduction in energy prices and the VAT rate cut, before rising slightly in 2024 due to the expiration of the VAT rate cut and wage pressures. Core inflation will increase in 2023, due to wage indexation, before easing in 2024. A larger-than-expected housing market correction represents a significant downside risk.

The government should focus on embedding resilience

The government should scale back energy-related fiscal support while energy prices are in line with their historical averages and look to strengthen the fiscal balance. If energy and food prices spike again, support should be extended only to vulnerable households inadequately covered by the general social protection system. Looking ahead, addressing long-term fiscal pressures from the pension system due to ageing is a key priority. A reform of the wage indexation system to restrict indexation to non-energy price inflation would help to manage external price shocks. While Luxembourg has managed to close the gender wage gap, family policies, such as the harmonisation of paternity and maternity leave, should be introduced to attract more women into the labour market and bring their average working time more in line with that of men.

Mexico

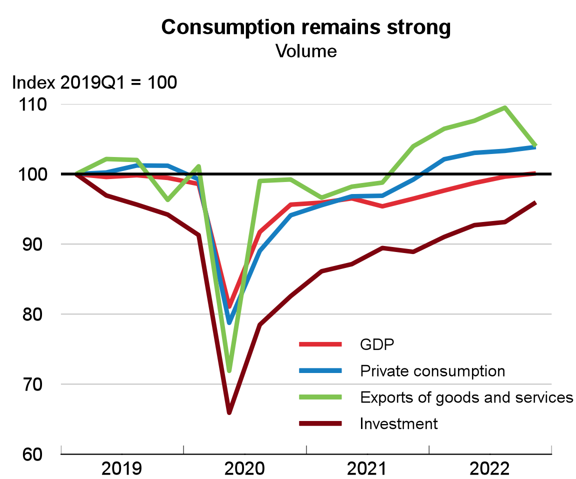
Real GDP growth is projected to reach 2.6% in 2023 and edge down to 2.1% in 2024. Consumption will be supported by the improvement in the labour market but will be dampened by high inflation. Investment will benefit from the easing of bottlenecks in global value chains and the relocation of manufacturing activity to Mexico. Export growth will be held back by the United States economic slowdown. Inflation will decline to 5.9% in 2023 and 3.7% in 2024.

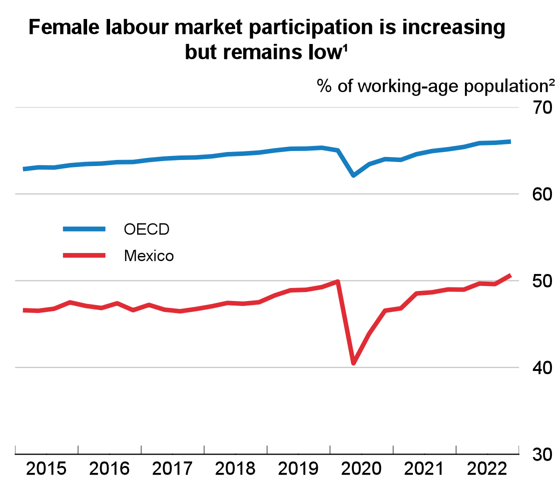
As inflation recedes, ending the fiscal support to mitigate the impact of high energy prices would create fiscal space to increase spending in education and infrastructure. Monetary policy should remain restrictive to ensure that inflation decreases durably towards target. Higher regulatory certainty, including in the energy sector, would help to make the most of the ongoing near-shoring of production processes to Mexico.

The domestic economy remains resilient despite inflationary pressures

Activity increased by 1.1% in the first quarter of 2023. Consumption remains resilient, supported by increases in formal employment and real wages. Remittances are high and consumer credit is gradually recovering, although it remains below its pre-covid level. Manufacturing has started to soften, as external demand from the United States has weakened. Investment in machinery and equipment is strengthening, favoured by near-shoring. Conversely, construction remains more than 10% below its pre-pandemic level. The unemployment rate is historically low and labour market participation continues to increase. Headline inflation has started to decline, reaching 6.2% (year-to-year) in April, while core inflation remains stickier, at 7.7%, with inflation in food-related services trending up.

Mexico





1. Seasonally adjusted quarterly rates.
2. All women aged 15-64.
Source: OECD Economic Outlook 113 database; and OECD Short-term Labour Statistics.

StatLink https://stat.link/5ndfmz

Mexico: Demand, output and prices

Mexico	2019	2020	2021	2022	2023	2024
	Current prices MXN billion	Percentage changes, volume (2013 prices)				
GDP at market prices	24 445.7	-8.0	4.7	3.1	2.6	2.1
Private consumption	15 866.4	-10.3	7.6	6.1	2.0	2.2
Government consumption	2 785.2	-0.3	-0.6	1.0	1.3	1.2
Gross fixed capital formation	5 037.8	-17.7	10.5	6.0	5.4	3.8
Final domestic demand	23 689.4	-10.7	7.1	5.5	2.6	2.4
Stockbuilding[1]	818.6	-0.7	0.7	-0.1	0.0	0.0
Total domestic demand	24 508.0	-11.5	8.3	5.3	2.7	2.4
Exports of goods and services	9 490.1	-7.3	7.1	7.5	0.3	4.7
Imports of goods and services	9 552.4	-13.7	15.6	8.9	2.5	5.3
Net exports[1]	- 62.3	2.4	-2.8	-0.5	-0.9	-0.3
Memorandum items						
GDP deflator	_	4.2	5.2	7.0	5.3	3.7
Consumer price index	_	3.4	5.7	7.9	5.9	3.7
Core inflation index[2]	_	3.8	4.7	7.6	7.0	3.7
Unemployment rate[3] (% of labour force)	_	4.4	4.1	3.3	3.1	3.2
Current account balance (% of GDP)	_	2.0	-0.6	-1.0	-0.7	-0.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding volatile items: agricultural, energy and tariffs approved by various levels of government.
3. Based on National Employment Survey.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/o2cjl8

A retail fuel price stabilisation mechanism, put in place to reduce cost pressures and support household purchasing power, has contained headline inflation, at a budgetary cost of 1.4% of GDP in 2022. It is assumed that this mechanism remains in place during 2023 and 2024. Higher oil revenues covered the cost of the stabilisation mechanism in 2022 but allowing the passthrough of global fuel price changes to domestic retail prices would provide better incentives for energy savings and create some fiscal space to strengthen social programmes or education spending. Mexican banks exceed regulatory liquidity and capitalisation requirements, helping them to navigate recent episodes of financial turmoil in the global banking system. Risks associated with tighter global financial conditions are mitigated by ample international reserves, active public debt management, low private sector debt and contingent credit lines.

Monetary policy will need to remain restrictive

To respond to mounting inflationary pressures and anchor inflation expectations, the central bank has gradually increased the policy rate, to 11.25%. Headline inflation has started to soften, but with core inflation proving persistent and inflation expectations still above target, monetary policy should remain restrictive. The policy rate is assumed to remain unchanged until the end of 2023, when it would start to be gradually reduced. Fiscal policy remains prudent and continues to prioritise some social programmes, particularly non-contributory pensions, and priority infrastructure projects in the South. The budget deficit is expected to increase to 3.7% of GDP in 2023, from 3.4% of GDP in 2022, with the official measure of public debt expected to stabilise around 50% of GDP.

Growth will moderate

The economy is projected to expand by 2.6% this year and 2.1% in 2024. Private consumption will be a key driver of growth, supported by low unemployment. Exports will suffer from slower growth in the main trading partners but will continue to benefit from deep integration in manufacturing value chains. Inflation will gradually slow in 2023 and 2024, as the impact of higher interest rates takes effect and external pressures abate. However, the inflation outlook remains very uncertain. Inflation may be more persistent than anticipated, if for example a wage-price spiral materialises. Episodes of global financial turmoil may trigger greater risk aversion and increase financing costs and foreign exchange market volatility. On the upside, a swifter reconfiguration of global value chains could boost investment more than anticipated.

Boosting productivity and female labour market participation are key priorities

Broadening tax bases would help to respond to increasing spending needs in education, health and infrastructure, and boost productivity and growth, while safeguarding the commitment to debt sustainability. Improving access and the quality of early childhood education and care would support female labour force participation and reduce educational inequalities. Reducing the regulatory cost of formalising a business, particularly at subnational level, and continuing to improve labour dispute resolution mechanisms, would support stronger formal employment. Promoting renewables energy and public urban and interurban transport would reduce emissions and the use of fossil fuels.

Netherlands

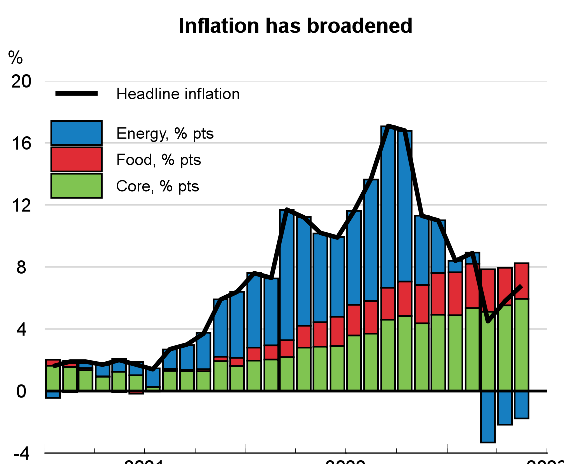
Economic growth is projected to moderate to 0.9% in 2023 before picking up to 1.4% in 2024. Headline inflation is expected to fall to 2.2% in 2024 on the back of declining energy prices, but core inflation will remain elevated at 3.9%. Growth is supported by private consumption, aided by energy support measures and increases in benefits since the beginning of 2023. After slowing in 2023, export growth is expected to improve in 2024 as external demand picks up. Private investment will slow due to higher uncertainty, rising interest rates and lower credit availability. The labour market will remain tight, although the unemployment rate will edge up to 4.1% by late 2024.

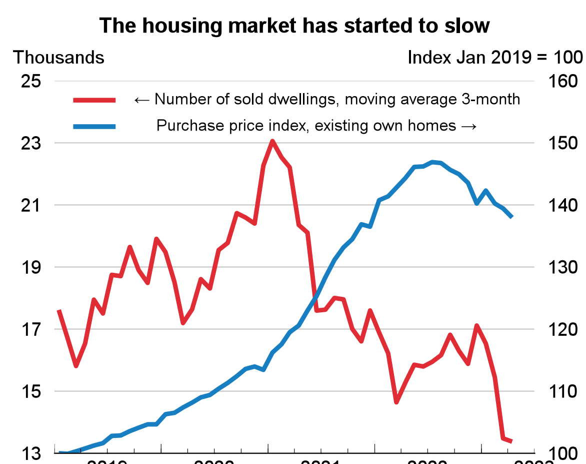
The fiscal stance is slightly expansionary. Annual real expenditure ceilings defined in the fiscal policy framework have been exceeded since 2020, and the government should aim to return to the fiscal rules. Continuing to tackle structural challenges should be a priority, focusing on accelerating the green transition and reducing labour market tightness.

Economic activity started to slow

GDP contracted by 0.7% in the first quarter of 2023 due to falling exports and a decline in gas inventories. Private investment contributed positively to growth and producer sentiment remained above its long-term average. While private consumption stalled, consumer confidence and the willingness to buy have improved since the beginning of 2023, albeit from historically low levels. Price pressures continue, with headline inflation remaining elevated at 6.8% in May. Rising service prices contributed to persistently high core inflation of 8.2% in May. The labour market remains tight with less than one unemployed person per vacancy. Collective labour agreement wages were up 5.7% in May over a year earlier. Housing market corrections are continuing, with the prices of owner-occupied dwellings falling by 4.4% over the year to April and the number of sales declining by almost 20%.

Netherlands





Source: CBS.

StatLink https://stat.link/tozpg4

Netherlands: Demand, output and prices

Netherlands	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	812.9	-3.9	4.9	4.5	0.9	1.4
Private consumption	353.5	-6.4	3.6	6.5	1.7	0.7
Government consumption	200.1	1.5	5.2	1.6	2.8	1.4
Gross fixed capital formation	172.9	-2.6	3.2	2.5	2.2	0.0
Final domestic demand	726.5	-3.3	4.0	4.1	2.1	0.7
Stockbuilding[1]	6.8	-0.8	-0.1	0.0	-1.0	0.0
Total domestic demand	733.3	-4.2	3.9	4.1	1.0	0.7
Exports of goods and services	670.7	-4.4	5.2	4.7	1.0	2.8
Imports of goods and services	591.1	-4.8	4.0	4.2	1.1	2.1
Net exports[1]	79.6	-0.1	1.4	0.9	0.0	0.8
Memorandum items						
GDP deflator	_	1.9	2.4	5.3	5.6	2.0
Harmonised index of consumer prices	_	1.1	2.8	11.6	3.2	2.2
Harmonised index of core inflation[2]	_	1.9	1.8	4.8	6.8	3.9
Unemployment rate (% of labour force)	_	4.9	4.2	3.5	3.7	4.0
Household saving ratio, net[3] (% of disposable income)	_	18.8	17.6	12.7	10.7	13.2
General government financial balance (% of GDP)	_	-3.7	-2.4	0.0	-1.0	-0.7
General government gross debt (% of GDP)	_	70.2	66.7	54.7	54.1	54.0
General government debt, Maastricht definition[4] (% of GDP)	_	54.7	52.5	51.0	50.5	50.3
Current account balance (% of GDP)	_	5.1	7.3	4.4	5.3	6.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Including savings in life insurance and pension schemes.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/r86syx

Direct trade linkages with Russia and Ukraine are limited, but the country is exposed to disruptions to the supply of commodities and materials from this region, as well as to logistics and transport blockages. Russia’s war of aggression against Ukraine has had implications for the Dutch economy not only through high energy prices and increased uncertainty, but also through depressed world trade growth. Russia’s invasion of Ukraine led to an inflow of approximately 86 850 Ukrainian refugees in 2022 of which more than a third were employed by end-2022.

The fiscal deficit is set to improve in the short term

The fiscal deficit is expected to increase due to increased spending on energy support measures and lower gas receipts. To support households facing a high cost of living, the government introduced in 2023 several permanent measures worth about EUR 5 billion annually (about 0.6% of GDP), including a 10.2% rise in the minimum wage, rising social benefits, and a decrease in the rate of income tax payable in the first tax band. Temporary measures of about EUR 6 billion in 2023 (about 0.7% of GDP) include an energy discount for lower-income households and a continuation of the 21% reduction in the excise duty on fuel. The government debt ratio is likely to remain stable at around 50% of GDP in 2023 and 2024, as the energy price cap is expected to end December 2023. It is also expected that the government will not be able to spend some of the budgeted funds in the short term due to the tight labour market.

Economic growth is set to moderate

GDP is expected to slow to 0.9% in 2023 and to pick up to 1.4% in 2024. Growth in 2023 is supported by private consumption, aided by the purchasing power package. Slowing private residential and non-residential investments will weigh on growth over 2023-24 amidst uncertainty, rising interest rates and credit tightening. Headline inflation is expected to fall due to lower energy prices, but core inflation is likely to remain elevated until 2024. Wages react to inflation with a lag and are projected to rise by 5.3% in 2023 and by 4.9% in 2024. The unemployment rate will gradually rise to 4.1% by the second half of 2024. Export growth in 2023 is expected to weaken due to a slowdown in GDP growth in main trading partners, before improving again in 2024. Several risks surround the outlook, including severe weather next winter with higher-than-expected energy prices, and increasing macro-financial vulnerabilities, as rapidly rising interest rates could increase the risk of financial contagion through the global financial system. A faster-than-expected return of inflation to target in the major economies could allow central banks to loosen monetary policy, stimulating demand.

Reducing energy dependence and increasing labour supply should be a priority

Fiscal support to households and energy-intensive small and medium-sized enterprises was needed amidst rapidly rising energy costs, but the welcome quick implementation meant that measures could not be targeted to households most in need. To improve targeting of future support measures, the government should accelerate the development of data and IT infrastructure to identify vulnerable households. Accelerating the green transition to ensure energy security and reduce fossil fuel dependence should remain a priority. The labour market is very tight despite high employment, due to skill mismatches and low hours worked – particularly by women. In addition to current plans to expand free child-care, streamlining existing income-dependent benefits into a system of fewer allowances and tax credits could help to increase working hours, as the net benefits of an additional hour worked would be more transparent. Shifting the composition of active labour market policies towards training, especially green and digital skills, could help both with skill mismatch and the acceleration of the green transition.

New Zealand

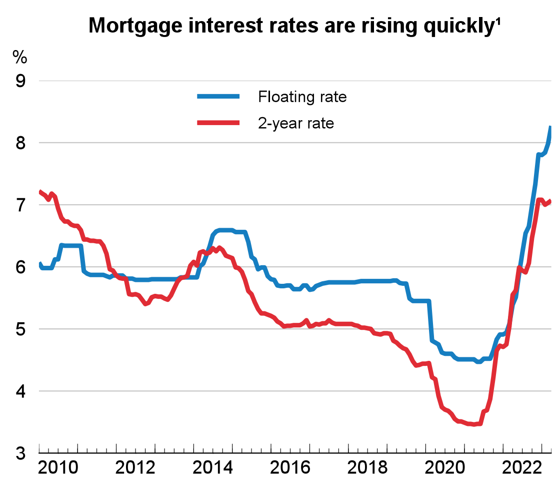
Real GDP growth is projected to ease to 1% in 2023 and 1.2% in 2024. Private consumption is set to weaken due to lower employment growth and rising mortgage-servicing costs. Higher interest rates and declining house prices will weigh on investment. Unemployment is expected to increase throughout the projection period, on the back of weaker activity growth. The slowdown in demand, increasing spare capacity and stabilising energy prices should gradually reduce inflation through 2023-24.

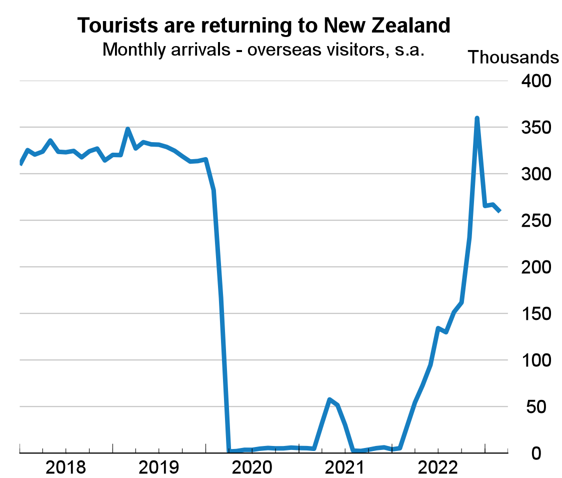
Inflation remains well above the central bank's target range and, together with still elevated medium-term inflation expectations and rapid wage growth, requires monetary policy to remain restrictive. Public debt has risen substantially in recent years and fiscal consolidation should continue to ensure that the government is on track to meet its 2026 operating surplus target. This will also help reduce inflationary pressures. Reforms that strengthen ICT skills supply are essential for sustainably boosting productivity and growth.

The economy is beginning to slow amid policy tightening

Economic activity is beginning to slow amid high inflation and rising interest rates. Private consumption has held up well, owing to high employment, but investment, especially residential construction, has weakened. Business sentiment remains subdued. Forward-looking indicators point to a softening of labour market pressures, with a lack of demand overtaking labour shortages as the most important factor limiting output. Inflation remains high and broad-based. In the first quarter of 2023, year-on-year headline consumer price inflation eased but was still 6.7%. Core inflation continued to rise, reaching 6.8%, fuelled by strong growth in wages and service prices. Inflation expectations are also still high but have started to decline, especially at the two-year horizon. The extreme weather events that hit New Zealand's North Island early in the year caused severe damage to local communities and infrastructure, including important highways. Production losses were concentrated in the primary sector, likely leading to upward pressure on food prices and lower agricultural and horticultural exports. International tourism arrivals have recovered rapidly, and net immigration is high, which will also contribute to inflation in the short run. Elevated global commodity and energy prices have contributed to strong imported inflation. The direct implications from financial volatility in the US and Europe have been limited, as domestic banks have sound liquidity and have taken on relatively little interest rate risk.

New Zealand





1. Average new standard mortgage rates advertised by registered banks in New Zealand.
Source: Reserve Bank of New Zealand; and Statistics New Zealand.

StatLink https://stat.link/mzdueh

New Zealand: Demand, output and prices

New Zealand	2019	2020	2021	2022	2023	2024
	Current prices NZD billion	Percentage changes, volume (2009/2010 prices)				
GDP at market prices	319.8	-1.1	6.0	2.2	1.0	1.2
Private consumption	183.2	-2.0	7.5	2.9	-1.0	0.3
Government consumption	59.6	7.2	8.2	4.5	-1.2	0.8
Gross fixed capital formation	75.7	-4.5	12.4	3.6	-2.3	0.1
Final domestic demand	318.6	-0.9	8.8	3.4	-1.4	0.3
Stockbuilding[1]	1.1	-0.8	1.3	0.0	0.2	0.0
Total domestic demand	319.7	-1.7	10.2	3.3	-1.2	0.3
Exports of goods and services	87.7	-13.4	-2.6	-1.0	8.4	5.5
Imports of goods and services	87.6	-16.0	15.1	4.4	1.8	1.9
Net exports[1]	0.1	0.7	-4.1	-1.3	1.5	0.8
Memorandum items						
GDP deflator	_	2.2	2.9	5.6	3.9	3.4
Consumer price index	_	1.7	3.9	7.2	5.5	3.6
Core inflation index[2]	_	2.2	3.7	6.0	5.7	3.6
Unemployment rate (% of labour force)	_	4.6	3.8	3.3	3.8	4.8
Household saving ratio, net (% of disposable income)	_	8.9	9.1	2.1	1.9	2.7
General government financial balance (% of GDP)	_	-8.0	-6.6	-4.4	-4.3	-4.3
General government gross debt (% of GDP)	_	42.6	45.2	50.8	54.6	58.3
Current account balance (% of GDP)	_	-1.3	-5.8	-8.6	-7.8	-6.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/4rcsu2

Macroeconomic policies are tightening

Macroeconomic policy is shifting quickly to a restrictive stance. The Reserve Bank of New Zealand (RBNZ) raised the Official Cash Rate (OCR) by a further 25 basis points to 5.50% in May, stating that this would increase confidence that inflation falls back to the midpoint of the 1-3% target band. This brings the cumulative policy interest rate increase to 4.75 percentage points since the beginning of 2022. The OCR is expected to remain stable until mid-2024 before starting to decline. Tightening of the fiscal stance is expected to reduce the underlying fiscal balance by 1.2 percentage points of GDP over 2023 and 2024, reflecting plans to keep new spending growth modest to meet the target of a return to budget surplus by 2026. A lower reduction in the headline balance is expected due to below-trend economic growth and the fiscal cost of recovering and rebuilding following the North Island weather events. The temporary cuts in petrol excise tax, road user charges and public transport fares introduced in 2022 were extended further to end-June at an estimated cost of NZD 718 million (0.2% of GDP) for March to June 2023.

Economic growth is projected to weaken

Real GDP growth is set to slow sharply this year, mainly owing to weakening domestic demand. Rising debt servicing costs, falling housing wealth and a softening labour market will hold back household consumption although high migration will temper the slowdown. Business and residential investment will contract due to tightening financial conditions, declining house prices and easing demand. The recovery in international tourism and stronger Chinese growth will help export growth pick up. Unemployment is set to increase gradually over the projection period, due to moderating economic activity and a growing labour force due to population growth. Inflation will slow but remain firmly above target in 2023 before falling further in 2024, as aggregate demand stalls and an increasing labour supply alleviates wage pressures. Key risks include lower-than-projected wage moderation, and the occurrence of more extreme weather events, both of which would boost inflation and hamper growth. The housing market slowdown could also be sharper, more prolonged and involve higher mortgage payment defaults than expected. On the upside, stronger-than-expected tourism and migration inflows would be a boost for growth but also slow disinflation.

Reducing inflation is a pre-requisite for a sustainable recovery

After a rapid and large tightening of monetary policy, it is time to monitor whether the substantial rise in interest rates is sufficient to cool excess demand pressures and durably reduce inflation. To reduce the risk of further policy tightening, it is important that the government sticks to its plans to increase overall spending only moderately, helping to cool demand. This will be challenging given extra spending pressures arising from the need to repair infrastructure and other severe weather damage. The reversal of cuts in petrol excise tax and road user charges cuts from July will help make some room for this weather-related expenditure. Indexation of the main social benefits to average wage growth will help provide protection against higher energy price rises for those on lower incomes. Any additional future energy support should be very tightly targeted based on income and vulnerability to higher energy prices and encourage energy saving. Restoring macroeconomic stability should be accompanied by a structural reform programme strongly focused on improving economic performance through digitalisation. This requires improving ICT skills supply, including by encouraging women to pursue digital careers through greater participation in mathematics education, and making it easier for small firms to reap the rewards of digitalisation through lower barriers to participate in government procurement of IT and greater support for exporting digital services.

Norway

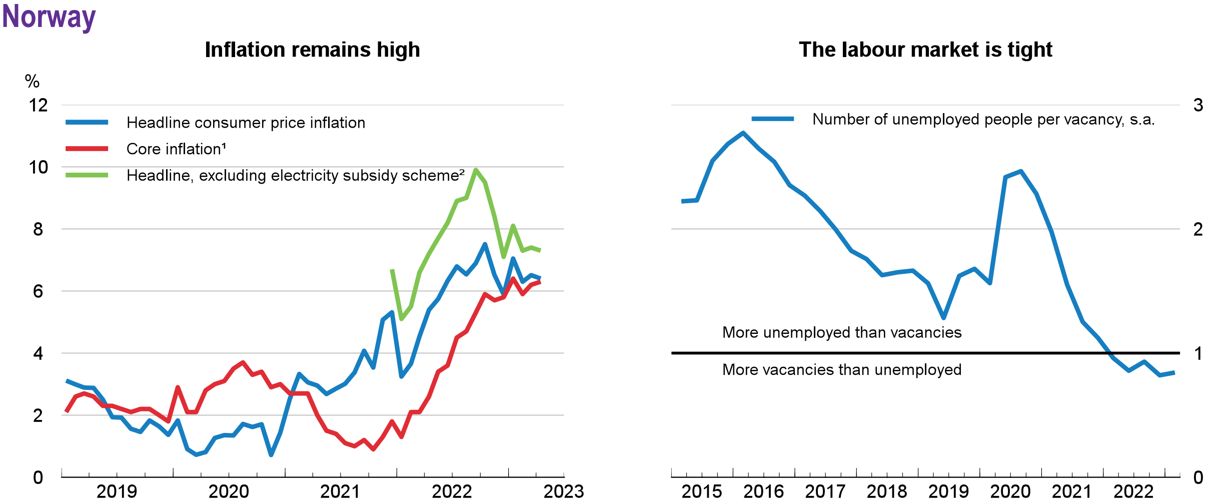
Mainland GDP growth is projected to slow to 1.2% in 2023. High inflation and policy tightening are weighing on domestic demand. The economy will strengthen gradually but output growth will remain moderate at 1.3% in 2024. Economic activity will benefit from a decline in energy prices. Underlying inflation will also fall, albeit sluggishly, due to the tight labour market and the recent weakening of the Norwegian currency that will feed through to inflation with a lag. Unemployment will edge up as the economy softens but remain around pre-pandemic levels.

Monetary policy tightening is appropriate to bring inflation towards the central bank target of 2%. Fiscal support to households on account of high energy costs should be phased out, with protection of the vulnerable being provided through the social safety net. Structural reforms should focus on facilitating the green transition, encouraging higher labour force participation and fostering skills for the digital era.

High inflation continues to weigh on domestic demand

Mainland GDP growth slowed in the first quarter of 2023 compared to the previous quarter. High inflation and interest rate increases have continued to weigh on real incomes, consumer confidence and investment activity in the housing sector. Even so, private consumption has been supported by electricity price subsidies and the reversal of the excess household saving observed during the pandemic. Large fluctuations in car sales have also impacted economic activity. Vehicle purchases surged towards the end 2022, ahead of the announced car tax changes from 2023, and then contracted as the temporary effects dissipated, affecting consumption growth in 2023. Headline consumer price inflation peaked in October 2022, but was still 6.4% in April 2023. Nominal wages grew by 4.3% in 2022, exceeding the increase agreed in wage negotiations, with tight labour markets fuelling wage growth. Ongoing wage negotiations point to wage growth of around 5¼ per cent in 2023.

Norway



1. Core inflation is Statistics Norway's CPI-ATE measure which adjusts for tax changes and excludes energy products.
2. Hypothetical CPI calculated by Statistics Norway showing overall price growth if the government had not introduced the electricity subsidy scheme for households.
Source: Statistics Norway.

StatLink https://stat.link/2ekd41

Norway: Demand, output and prices

Norway	2019 Current prices NOK billion	2020	2021	2022	2023	2024
		Percentage changes, volume (2020 prices)				
Mainland GDP at market prices[1]	3 067.1	-2.8	4.2	3.8	1.2	1.3
Total GDP at market prices	3 596.9	-1.3	3.9	3.3	1.5	1.5
Private consumption	1 579.0	-6.2	4.4	6.9	-0.5	1.1
Government consumption	867.0	-0.5	5.0	0.1	1.4	0.6
Gross fixed capital formation	957.7	-4.1	-0.8	4.3	0.4	1.1
Final domestic demand	3 403.8	-4.2	3.1	4.3	0.2	1.0
Stockbuilding[2]	107.4	0.1	-0.4	0.1	0.5	0.0
Total domestic demand	3 511.1	-3.9	2.6	4.4	0.9	1.0
Exports of goods and services	1 318.0	-2.3	5.8	5.9	5.1	3.5
Imports of goods and services	1 232.1	-9.9	1.7	9.2	4.8	3.8
Net exports[2]	85.8	2.5	1.3	-0.2	1.6	0.7
Memorandum items						
GDP deflator	_	-2.5	17.1	28.1	-4.8	3.1
Consumer price index	_	1.3	3.5	5.8	5.4	3.5
Core inflation index[3]	_	2.7	1.7	3.6	5.8	3.7
Unemployment rate (% of labour force)	_	4.7	4.4	3.2	3.7	3.8
Household saving ratio, net (% of disposable income)	_	12.9	12.7	3.6	2.3	1.6
General government financial balance (% of GDP)	_	-2.6	10.6	26.0	17.1	17.1
General government gross debt (% of GDP)	_	53.3	49.1	43.1	..	..
Current account balance (% of GDP)	_	1.1	13.6	30.6	23.9	23.6

1. GDP excluding oil and shipping.
2. Contributions to changes in real GDP, actual amount in the first column.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/81ukiy

Elevated global energy prices have boosted Norway's terms of trade and pushed petroleum-related revenues to record highs. Oil and gas investment is likely to pick up, countering a contraction in recent years, in view of the number of projects submitted by the oil companies towards the end 2022. Norway plans on taking around 40 000 of Ukrainian refugees in 2023, in addition to the 35 000 received in 2022.

Taming inflation is key

Fiscal policy was initially planned to have an approximately neutral effect on economic activity, but after a revision of the 2023 Budget it is expansionary, spurring economic activity by 0.3-0.4% of GDP for the mainland and thereby adding to inflationary pressure. Expenditure has been raised by around 0.5% of GDP to reflect higher-than-foreseen inflation and wage growth and by 0.2% of GDP on account of increased support for Ukraine via the Nansen Programme. Households will continue to receive the electricity support subsidy until end-2023. The Norges Bank increased the policy rate further by 0.25% percentage points in May 2023 to 3.25%. Inflation remains well above target, inflation expectations are rising and the Norwegian currency has depreciated considerably this year, calling for additional monetary tightening. The OECD projections assume that the policy rate will peak at 3.75% in the fourth quarter of 2023 and remain at this level until end-2024.

Growth will strengthen gradually but remain moderate

Mainland GDP growth is projected to slow to 1.2% in 2023 amid high inflation and tighter policies. The economy will recover gradually over 2023-24 but output growth will remain moderate at 1.3% in 2024. Lower energy prices and easing demand should help bring headline inflation down, to around 3¼ per cent by late 2024. Business investment will benefit from more buoyant external demand and implementation of climate-related projects in 2024. The labour market will remain tight given labour shortages, despite some increase in unemployment, keeping wage growth strong. Core inflation will fall slowly as a result and remain well above the 2% target at the end of projection period. The growth outlook is uncertain. Price and wage inflation could remain higher than expected, lowering growth prospects. Higher borrowing costs could exacerbate risks related to high household indebtedness. Weaker growth in Norway's trading partners could also dent prospects. On the upside, successful labour market integration of Ukrainian refugees could help ease labour market and wage pressures.

Boosting productivity and green growth

Enhancing innovation and technology adoption are essential for high productivity growth. There is scope to strengthen skills that are relevant for the digital era by increasing the number of students graduating from sciences, technology, engineering and mathematics (STEM), and addressing regional disparities in digital infrastructure. The female employment rate is high in Norway and the gender wage gap is comparatively low. The workforce attachment of men and women needs to strengthen, however, including through disability benefit reforms to reduce incentives for early retirement. Accelerating the climate transition is another key priority for sustainable growth. Continued support for the promotion of green-technology initiatives would help with the transition.

Peru

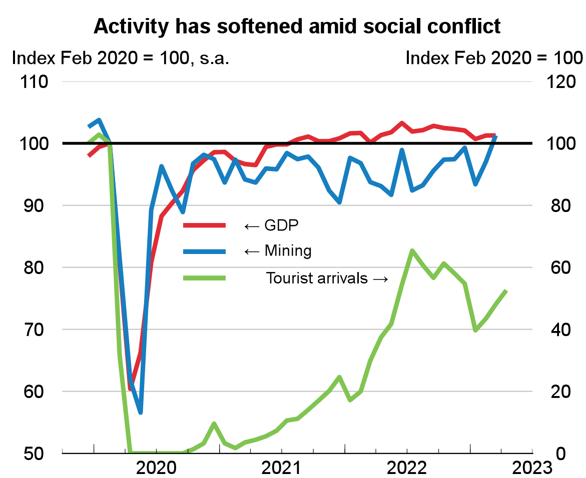
Peru's GDP is expected to grow by 1.7% this year and by 2.9% in 2024. Political uncertainty, extreme weather events, high interest rates and inflation will constrain private consumption and investment. Slow budget execution by subnational governments will hamper public investment, partly offset by a recent package of measures to boost investment. The recovery in tourism and copper production will boost exports. Inflation is expected to slow and return to target by early-2024.

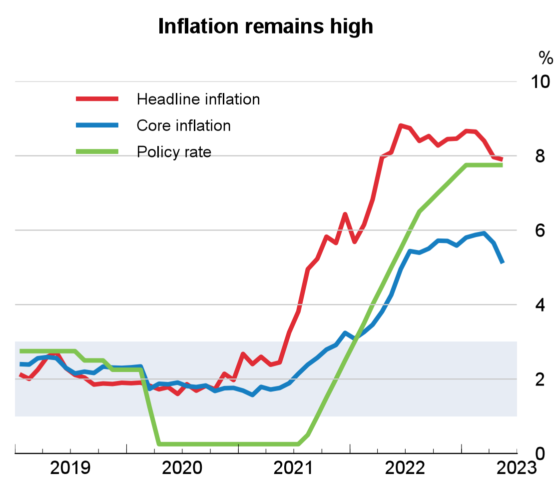
The central bank should maintain a restrictive stance to anchor inflation expectations. Maintaining the planned fiscal consolidation path will ensure the sustainability of public debt. Implementing a tax reform to increase public revenues and enhance tax progressivity is needed to address pressing infrastructure and social needs. Expanding quality early childhood education will be key to reduce informality and increase female labour force participation, boosting potential growth.

Social unrest and extreme weather are weighing on growth

Economic activity has slowed sharply due to social unrest, extreme weather conditions, political uncertainty, high inflation, and monetary tightening. GDP contracted by 0.4% year-on-year in the first quarter of the year with construction, agriculture and tourism hardly hit. After a sharp decline at the beginning of the year, mining is recovering as social unrest and road blockades dissipate, and a newly established mine starts fully operating. Cyclone-related supply-chain disruptions in March added to the economic slowdown. Private investment was particularly hard hit in the first quarter of the year, declining by 12% with respect to the same quarter last year. Private consumption also slowed, with a modest year-on-year increase of 0.4%. However, other short-term indicators, such as electricity generation, suggest an ongoing recovery and historically high public investment growth in the first four months of the year provides support.

Peru





Source: INEI; and BCRP.

StatLink https://stat.link/a56wos

Peru: Demand, output and prices

Peru	2019	2020	2021	2022	2023	2024
	Current prices PEN billion	Percentage changes, volume (2007 prices)				
GDP at market prices	761.6	-10.8	13.3	2.7	1.7	2.9
Private consumption	493.5	-9.7	12.3	3.5	1.3	2.7
Government consumption	100.7	8.5	5.2	-0.9	1.6	1.2
Gross fixed capital formation	159.8	-16.5	34.2	0.7	-4.9	2.0
Final domestic demand	754.0	-8.7	15.3	2.3	-0.1	2.4
Stockbuilding[1]	- 1.1	-1.7	-0.6	0.0	0.1	0.0
Total domestic demand	752.9	-10.6	15.2	2.3	0.0	2.4
Exports of goods and services	183.3	-16.3	19.1	6.0	3.3	4.3
Imports of goods and services	174.5	-15.4	26.2	4.2	-2.6	2.4
Net exports[1]	8.7	-0.2	-2.0	0.4	1.7	0.5
Memorandum items						
GDP deflator	_	3.9	8.4	4.5	6.4	2.4
Consumer price index	_	1.8	4.0	7.9	6.9	3.4
Core inflation index[2]	_	1.9	2.2	4.7	5.1	3.3
Unemployment rate (% of labour force)	_	7.7	5.9	4.4	4.6	3.7
Current account balance (% of GDP)	_	1.1	-2.3	-4.1	-1.1	-1.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/w74c8z

Annual headline inflation decreased to 7.9% in May after peaking at 8.8% in June 2022. While energy price inflation has slowed, food prices continue to add to inflation owing to social unrest and cyclone related-supply-chain disruptions. Core inflation edged down to 5.1% in May from a peak of 5.9% in March 2023. Furthermore, 12-month ahead inflation expectations declined further to 4.2% in April. Wage increases have been contained, and real wages are 5% below their 2019 level. Risks associated with global financial conditions are mitigated by large currency reserves and low public debt. The financial sector remains resilient amid well-capitalised banks, with large liquidity buffers.

Monetary and fiscal policy will remain restrictive

The central bank has raised rates quickly to battle inflation and has recently paused its tightening cycle owing to the deceleration in economic activity and receding inflation expectations. Headline inflation has started to soften, but with core inflation persisting and inflation expectations still above target, monetary policy should remain restrictive. The policy rate is assumed to remain stable until the end of 2023, when it would start to be gradually reduced. To protect households from high inflation and support the weak economy, the authorities launched a fiscal support programme, complying with the fiscal rules, that will partly offset the negative impact of political uncertainty with a combination of targeted and temporary cash transfers, public investment, and credit relief for SMEs. Fiscal policy should remain prudent in line with the planned fiscal consolidation and rebuild fiscal buffers to be able to face additional shocks, including natural hazards.

Economic growth will remain weak in an uncertain environment

Political uncertainty, high inflation and tight financial conditions will weigh on business and consumer confidence. Inflation should slowly converge to within the 1-3% target range by early 2024 allowing an easing of monetary policy and supporting household consumption and investment. Policies to boost public investment and public-private-partnerships, as part of the implementation of the *Con Punche Peru* stimulus plan and measures to address the climate emergency, will support domestic demand, and the recovery in tourism and copper production will boost exports. Domestic risks stem primarily from high political uncertainty, and renewed flare-ups in social unrest. *El Niño*, a natural event that has become more frequent due to climate change, is projected to be mild but remains a risk as it can evolve rapidly, leading to heavy rainfall and large economic losses and endanger the planned fiscal consolidation. A slower than anticipated upturn in China, Peru’s main trading partner, and lower copper prices would negatively affect exports, fiscal revenues, and prospects for investment.

Reforms to reignite growth and close gender gaps are needed

Raising long-term growth will hinge on improving state capacity at the national and subnational levels and addressing corruption to ensure the delivery of high-quality public services and infrastructure. Adequate funding for social and infrastructure spending and closing regional gaps will require improved spending efficiency and higher tax revenues. These could be achieved by lowering tax evasion and tax expenditures and enhancing the progressivity of taxation. Reducing labour charges would increase social protection coverage and curb informality, particularly for low-income, young, and female workers. Improving access to high-quality early childhood education would reduce informality, improve female labour market participation and job quality, and boost productivity.

Poland

Real GDP growth is projected to slow to 0.9% in 2023 as high uncertainty, high inflation and tighter monetary policy weaken demand growth, before recovering to 2.1% in 2024. EU Recovery and Resilience funds are expected to boost investment, but further delays would entail lower growth. Inflation peaked earlier this year, but it is likely to remain elevated and above target by the end of 2024 as domestic inflationary pressure from robust labour markets and fiscal spending continues.

Interest rates should be raised further to prevent persistently high inflation. Fiscal policy needs to be well calibrated to avoid adding inflationary pressure in the economy while ensuring fiscal support better targets vulnerable households. In the medium term, accelerated decarbonisation and digitalisation, supported by policies to improve skills, would boost energy security and lead to greener and stronger economic growth.

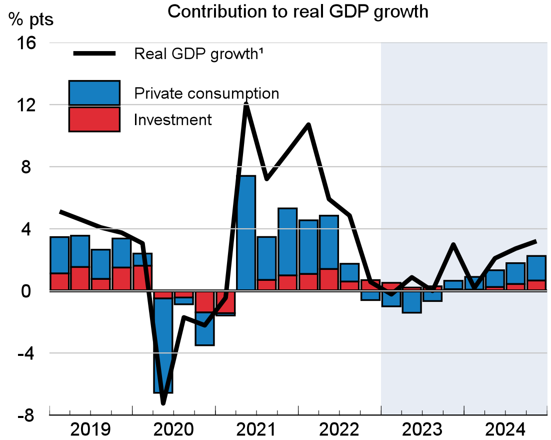
The domestic economy has weakened amid high inflation and uncertainty

Output grew by 5.4% in 2022 but quarterly growth was volatile, and the economy slowed considerably over the year, due to falling private consumption and slowing investment and inventory growth. While GDP rose by 3.8% in the first quarter of 2023 relative to the previous quarter, output levels were broadly flat compared to a year ago. Consumer and business confidence have improved somewhat, but they remain below levels seen before Russia's war of aggression against Ukraine. Retail sales and industrial production point to continued weakness in output. Headline inflation peaked in February but is still high, at 13% in May, pushed up by food and energy. Core inflation remains elevated, at 12.2% in April.

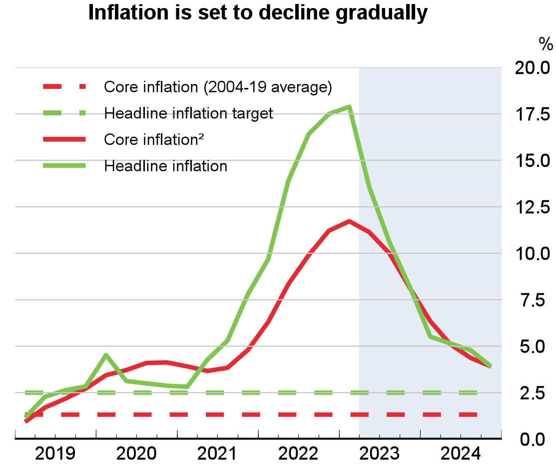
Poland

Weak private consumption is holding back growth

Contribution to real GDP growth



Inflation is set to decline gradually



1. Year-on-year percentage changes.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database; and OECD calculations.

StatLink https://stat.link/1r6pja

Poland: Demand, output and prices

Poland	2019	2020	2021	2022	2023	2024
	Current prices PLN billion	Percentage changes, volume (2015 prices)				
GDP at market prices	2 285.8	-2.0	6.8	5.4	0.9	2.1
Private consumption	1 323.4	-3.4	6.2	3.3	-1.1	2.1
Government consumption	410.8	4.6	4.8	-1.0	-2.0	2.8
Gross fixed capital formation	433.8	-1.0	0.3	5.5	1.7	2.2
Final domestic demand	2 168.0	-1.4	4.8	2.8	-0.7	2.3
Stockbuilding[1]	33.6	-1.2	3.2	3.0	-0.8	-0.1
Total domestic demand	2 201.6	-2.5	8.9	5.9	-1.4	2.1
Exports of goods and services	1 216.6	-1.1	12.3	6.2	2.4	2.0
Imports of goods and services	1 132.4	-2.5	16.1	6.2	-0.2	1.7
Net exports[1]	84.2	0.7	-1.1	0.2	1.6	0.2
Memorandum items						
GDP deflator	_	4.3	5.5	10.8	10.5	4.1
Consumer price index	_	3.4	5.1	14.4	12.4	4.8
Core inflation index[2]	_	3.8	4.1	9.0	10.2	4.9
Unemployment rate (% of labour force)	_	3.2	3.3	2.9	3.4	3.8
Household saving ratio, net (% of disposable income)	_	9.5	2.0	0.7	2.2	3.0
General government financial balance (% of GDP)	_	-6.9	-1.8	-3.7	-4.7	-3.4
General government debt, Maastricht definition[3] (% of GDP)	_	57.2	53.6	49.2	50.6	52.1
Current account balance (% of GDP)	_	2.5	-1.5	-3.0	-1.2	-0.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/j5bsli

The war in Ukraine has had a significant effect on the labour market. By March 2023, around 1.6 million Ukrainians had settled in Poland, equivalent to 4% of the population, even though many men returned to Ukraine. Half of the refugees are adults, and most have found work, although often in lower-skilled occupations, alleviating some of the wage pressure in the labour market. The unemployment rate remains low at around 3% and nominal wage growth is high, partly boosted by a 20% rise in the national minimum wage. However, there are some signs that labour demand is softening, with the number of posted vacancies a fifth lower than at the start of 2022.

Monetary policy remains restrictive while fiscal support continues

Fiscal policy continues to support the economy. The Anti-Inflation Shields have been largely replaced by electricity and gas price caps for households and businesses this year while the zero VAT rate on food and subsidies to energy-intensive companies have been maintained. These new measures are expected to cost up to 1.9% of GDP and should expire by the end of 2023. National defence spending will rise from 2.2% of GDP in 2022 to 3% of GDP in 2023 while health spending will increase as well. This will lead to a widening of the fiscal deficit in 2023 although it is expected to start narrowing in 2024. Monetary policy has remained unchanged, with the policy rate at 6.75% since September 2022. Given sizeable fiscal support in the economy and persistent inflationary pressure, the policy interest rate should rise further to 7.25% before beginning to ease in the second half of 2024.

The economy is projected to slow before recovering as inflation gradually falls

Real GDP growth is projected to slow significantly to 0.9% in 2023, as the effects of high inflation, high uncertainty and restrictive monetary policy bear down on consumption and investment. As these effects recede, GDP growth is expected to gradually recover to 2.1% in 2024, boosted by EU funds. With the external environment expected to improve, exports should support growth. Having peaked in the first quarter, inflation is forecast to continue declining, as growth in mostly regulated energy prices moderates, averaging 12.4% over 2023. Domestic inflationary pressure from the labour market and fiscal spending is likely to ease somewhat over 2024 leading inflation to slowly decline to 4.8%. There are risks to the outlook. Continued disagreements between the Polish government and the European Commission on strengthening the judiciary could further delay the disbursement of EU Recovery and Resilience funds. Any additional fiscal spending in the run-up to the autumn elections may prolong high inflation, requiring tighter monetary policy for longer.

Policies should be coordinated and facilitate the green and digital transitions

Fiscal policy should avoid adding to inflationary pressure in the economy. It should continue to protect the most vulnerable households from inflation but should be better targeted and designed to incentivise energy savings. Further diversification of energy imports and increasing investment in renewables would improve energy security and contribute to greener growth. To facilitate the digital and green transitions and address skills shortages, labour market policies should upgrade weak basic skills and improve access to lifelong training for older adults, the unemployed and the low-skilled. Integration of refugees, mostly comprising women with children, should continue through childcare, schooling and language training. To address these long-term spending pressures and ensure sustainable public finances, the government needs to develop a credible medium-term fiscal strategy and should establish an independent fiscal council.

Portugal

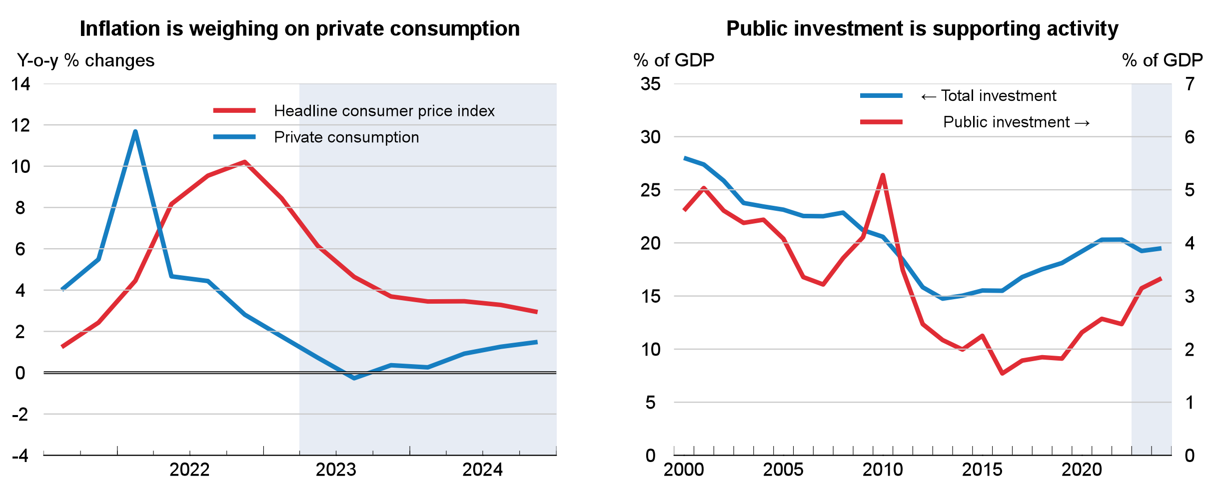
Real GDP growth is projected to reach 2.5% in 2023 and 1.5% in 2024. The Recovery and Resilience Plan (RRP) should significantly boost public investment, though there are risks that implementation delays continue. Strengthening external demand will support exports, particularly of services. The employment rate will remain historically high and wages will accelerate. However, headline consumer price inflation of 5.7% in 2023 and 3.3% in 2024 will reduce purchasing power and weigh on consumption growth.

The implementation of the RRP is supporting growth and renewed support measures in 2023 are helping to smooth the inflationary shock on households' purchasing power. While public debt has declined below its 2019 level, it remains the third highest in the EU. A strengthened fiscal framework and more efficient spending will help to address mounting spending pressures from an ageing population and strong investment needs. A timely implementation of the RRP will strengthen green infrastructure, skill acquisition and healthcare capacity, supporting sustainable growth, but could also slow the decline in inflation.

Growth is picking up

As energy and food prices remain high and interest rates continue to rise, growth in domestic demand has declined. Elevated consumer price inflation, which eased to 6.9% in the year to April, is reducing household purchasing power. Yet, RRP spending, fiscal support measures worth around 3.7% of GDP in 2023 and increasing activity in trading partners are supporting activity. GDP grew by 1.6% on a quarterly basis in the first quarter of 2023, significantly boosted by strong export growth. Consumer confidence has increased recently but remains subdued and the Bank of Portugal's coincident private consumption indicator increased in April. Business confidence in services, retail and industry has been increasing, although from a low level. Despite an increase in the unemployment rate, historically-high employment rates, rising wage growth and government cash transfers are providing support to households.

Portugal



Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/7if2do

Portugal: Demand, output and prices

Portugal	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2016 prices)				
GDP at market prices	214.4	-8.3	5.5	6.7	2.5	1.5
Private consumption	137.3	-7.0	4.7	5.8	0.6	1.0
Government consumption	36.4	0.3	4.6	1.7	2.6	1.2
Gross fixed capital formation	38.8	-2.2	8.7	3.1	3.1	4.2
Final domestic demand	212.6	-4.9	5.4	4.5	1.5	1.7
Stockbuilding[1]	0.8	-0.5	0.3	0.1	-1.0	0.0
Total domestic demand	213.4	-5.3	5.6	4.5	0.5	1.7
Exports of goods and services	93.3	-18.6	13.4	16.6	8.0	2.6
Imports of goods and services	92.3	-11.8	13.2	11.1	3.5	3.0
Net exports[1]	1.0	-3.0	-0.2	2.0	2.2	-0.1
Memorandum items						
GDP deflator	_	2.0	1.5	4.4	8.0	3.4
Harmonised index of consumer prices	_	-0.1	0.9	8.1	5.7	3.3
Harmonised index of core inflation[2]	_	-0.2	0.2	5.0	4.7	3.4
Unemployment rate (% of labour force)	_	7.0	6.6	6.0	7.4	7.5
Household saving ratio, net (% of disposable income)	_	3.3	1.3	-1.5	2.0	1.8
General government financial balance[3] (% of GDP)	_	-5.8	-2.9	-0.4	-0.1	-0.1
General government gross debt (% of GDP)	_	157.5	143.8	116.6	109.0	105.6
General government debt, Maastricht definition[4] (% of GDP)	_	134.9	125.4	113.9	106.2	102.9
Current account balance (% of GDP)	_	-1.0	-0.8	-1.3	2.9	3.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. Based on national accounts definition.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/5lv40u

Elevated energy and food prices are raising costs for households and firms, although fiscal measures are providing some offset. Monetary and financial conditions are becoming less supportive. Increasing interest rates are rapidly raising mortgage payments, with around 90% of mortgages subject to rates fixed for up to one year, holding back household consumption and investment. The risk of energy supply shortages appears contained, with around 60% of electricity generated from renewable sources in 2022, gas imports arriving via ship and elevated storage levels.

Fiscal policy support will ease

Fiscal policy, including through the RRP, is supporting growth in 2023, but also adding to inflationary pressures, before becoming mildly restrictive in 2024. Spending from RRP grants is projected to increase from 0.3% of GDP in 2022, to 1.5% of GDP in 2023 and 1.3% of GDP in 2024, boosting public investment. Measures to help cushion the inflation shock are expected to reach 1.9% of GDP in 2022 and 3.7% of GDP in 2023. They include electricity, gas and fuel price subsidies, as well as social transfers, some of which are targeted to low-income households and families with children, an increase in pension payments, and temporary cuts in energy taxes and VAT. To maintain strong incentives for energy savings and the green transition, it will be important to increasingly target support to the most vulnerable households and phase out energy support measures. The budget deficit is projected to ease to 0.1% of GDP in 2023 and 2024. A 7.8% increase in the minimum wage in 2023, and a further 6.6% rise set for 2024, as well as tax incentives for firms to raise wages will support household income. However, the foreseen rise in labour costs could hold back low-wage employment.

Growth will strengthen

GDP growth is projected to reach 2.5% in 2023 and 1.5% in 2024. The spending of European funds is significantly boosting public investment, but high uncertainty and rising interest rates will continue to weigh on business and housing investment. The projected acceleration in activity across trading partners will support exports. Despite buoyant wage developments, consumption growth will moderate as employment growth eases, elevated inflation continues to reduce purchasing power and rising interest rates raise debt-servicing costs. Fiscal measures will provide some offset to support the incomes of vulnerable households, but they will slow the decline in inflation. Headline consumer price inflation will moderate to 5.7% in 2023 and 3.3% in 2024 as energy and food prices stabilise. The phasing out of energy and inflation support and high nominal GDP growth will help lower public debt to around 103% of GDP in 2024 (Maastricht definition). Higher-than-expected employment or wage growth would support consumption yet would also fuel inflation. RRP spending could be implemented more slowly than projected, implying both lower growth and lower inflation, but the forthcoming updates could also accelerate the pace of disbursements.

Policies to tackle long-standing challenges will support a sustained recovery

Public debt relative to GDP remains high. More efficient spending and a strengthened fiscal framework are needed to help face mounting fiscal pressures from population ageing and strong investment needs. Temporary fiscal support to cushion the inflation shock should be gradually phased out. Gradually strengthening carbon pricing, and aligning prices across sectors and fuels, while protecting vulnerable groups will help reach ambitious climate goals. Reforms and investments under the RRP have a strong potential to support growth through more effective public sector management, green infrastructure and further skill acquisition. Ensuring the complete implementation of the RRP will maximise the benefits. Continuing to improve access to good-quality childcare would allow more women to enter the labour market and help reduce labour market disparities.

Romania

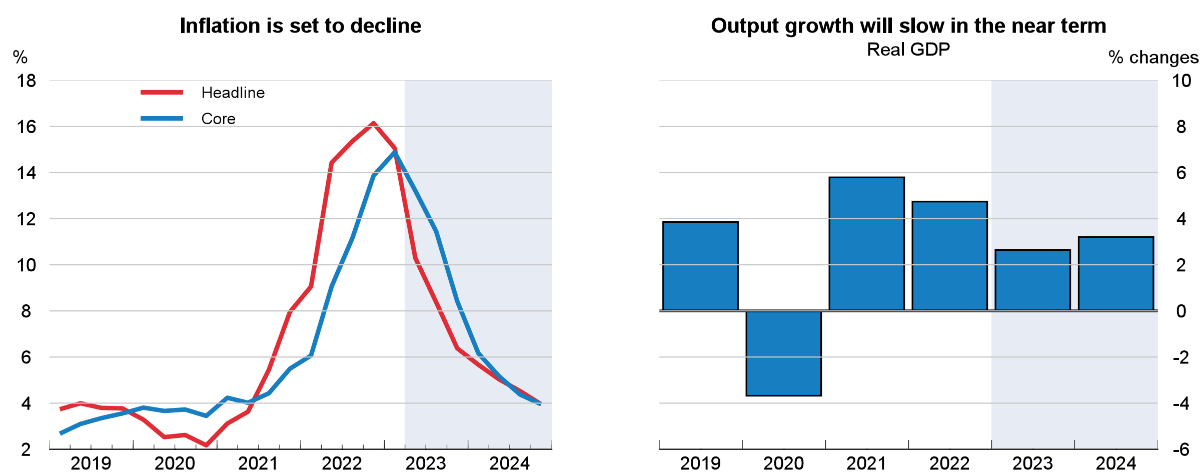
Economic growth will weaken in the near term, reflecting soft demand in the face of continued high inflation, elevated interest rates and subdued growth in trading partners. Recovery, beginning in the second half of this year, will be driven by strengthening household consumption, and foreign demand. The annual increase in output will be 2.6% in 2023 and 3.2% in 2024. The unemployment rate will decline in 2024 but remain above pre-pandemic levels. Consumer price inflation is expected to slow over the next eighteen months but continue to be above target.

Monetary conditions have been significantly tightened and the policy rate should be held at its current level until inflation expectations are durably re-anchored. Fiscal consolidation will be modest in 2024. Longer term, a wider tax base is needed to fund spending on structural reforms, including in health and education while also ensuring fiscal sustainability. Reducing greenhouse gas emissions requires greater renewable energy investment and more energy-efficient buildings. Scope to bring greater numbers of women into employment remains substantial.

Higher interest rates are tempering demand and cooling inflation

Recent indicators point to a further decline in output growth in the near term. The post-COVID-19 catch-up has ended, and price inflation and higher interest rates are damping demand. Preliminary information suggests GDP growth slowed in the first quarter to 0.1% (quarter on quarter). Meanwhile, however, an annual increase of 17.6% in the minimum wage came into force in January, bolstering household incomes and boosting aggregate demand and inflation. The consequent pressure on labour costs has likely weighed on employment growth. Headline inflation looks to have peaked; it was 11.4% in April having been over 16% in late 2022.

Romania



Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/uxz3hk

Romania: Demand, output and prices

Romania	2019	2020	2021	2022	2023	2024
	Current prices RON billion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 063.8	-3.7	5.8	4.7	2.6	3.2
Private consumption	662.5	-3.9	8.1	5.5	3.6	2.3
Government consumption	186.6	1.1	1.3	4.3	2.2	2.5
Gross fixed capital formation	244.5	1.1	1.9	8.0	2.8	4.6
Final domestic demand	1 093.5	-1.8	5.4	5.9	3.2	2.8
Stockbuilding[1]	13.9	-0.9	1.1	-0.8	0.0	0.0
Total domestic demand	1 107.4	-2.4	6.6	5.2	3.4	2.8
Exports of goods and services	427.6	-9.5	12.6	9.6	3.9	3.3
Imports of goods and services	471.3	-5.2	14.9	9.9	4.8	2.4
Net exports[1]	- 43.6	-1.5	-1.5	-0.7	-0.7	0.2
Memorandum items						
GDP deflator	_	4.1	5.2	13.4	8.3	5.5
Consumer price index	_	2.6	5.0	13.8	9.9	4.8
Core consumer price index[2]	_	3.7	4.5	10.1	11.9	4.9
Unemployment rate (% of labour force)	_	6.1	5.6	5.6	5.8	5.7
General government financial balance (% of GDP)	_	-9.2	-7.1	-6.2	-6.9	-6.7
General government gross debt (% of GDP)	_	58.9	57.4	51.7	55.8	60.0
General government debt, Maastricht definition[3] (% of GDP)	_	46.9	48.6	47.3	51.4	55.6
Current account balance (% of GDP)	_	-4.9	-7.2	-9.3	-10.0	-9.4

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/acfh2q

Government price caps have distanced households and some segments of the business sector from the volatility in wholesale European energy prices, including the falls in prices in recent months. As of May 2023, around 131 000 Ukrainian refugees (equivalent to 0.7% of Romania's population) have remained in Romania according to United Nations estimates. However, most incoming refugees transit to other countries. These increases in the number of people in Romania have boosted consumption.

Fiscal deficits are set to persist

Separate support packages for households and businesses to temper the impact of high inflation are underway. These are estimated to add about 2% of GDP to fiscal spending over 2023-24, principally in 2023. There is also an energy price cap, which is scheduled to end in March 2025. These supports are prolonging above-trend transfer spending and are the principal reason for no further deficit decline in 2023. Central bank policy rate increases started in October 2021. The rate has been on hold following a rise of 25 basis points to 7% in January. Under the economic conditions described in the projection, the policy rate should be kept at its current level to the end of 2024 to re-anchor inflation expectations and bring price growth back to target. However, it is possible that further rate increases may be required.

Output growth will strengthen in 2024

After weakening in the first half of this year, GDP growth is expected to gradually strengthen over the remainder of the projection period. The economy will expand by 2.6% in 2023 and 3.2% in 2024. The pick-up in growth will be broad-based, with stronger household consumption, business investment and exports. Inflation is projected to decline due to easing import price growth and lower capacity utilisation. However, the large minimum wage increase will, in the near term, limit the speed of inflation reduction by increasing firms' labour costs and household spending capacity. Inflation is projected to still be above the upper bound of the central bank's target (2.5% within a target band of +/- 1 percentage point) by end 2024, at 3.4% in annualised terms. Risks around energy prices and energy security remain sizeable.

More women in the workforce would reduce inequality and bolster potential output

Improving living standards and long-term growth in Romania require further structural improvements on multiple fronts, including tax collection, welfare support, red tape, anti-corruption measures and infrastructure investment. Success in the latter hinges in part on improving the capacity to absorb EU funds. The gender employment gap is wide; in 2022, the employment rate among women was 17 percentage points lower than that for men, a large disparity when compared with OECD countries. Faster improvement in the availability of affordable childcare would help raise female employment. Romania's path to reducing greenhouse gas emissions includes a phase-out of remaining coal-based energy and the expansion of nuclear and renewable energy. Scope for energy efficiency gains by raising performance requirements on new buildings and support for retrofits is considerable.

Slovak Republic

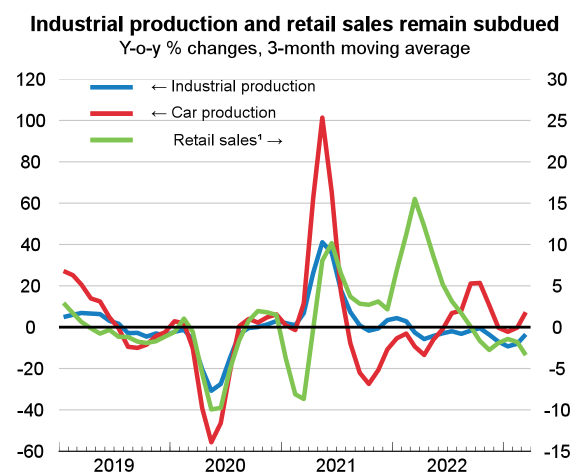
GDP growth is projected to be 1.3% in 2023 before picking up to 2% in 2024. High inflation will weigh on private consumption growth, although the impact is mitigated by substantial government support measures. Investment growth will be supported by the absorption of substantial EU funds in 2023. The recovery of global demand and continued easing of supply chain disruptions will boost export growth in 2024. The main risks to the projections are related to an escalation of Russia's war of aggression against Ukraine, which would weigh on foreign demand and could lead to a resurgence of global energy prices, increased inflation and lower growth.

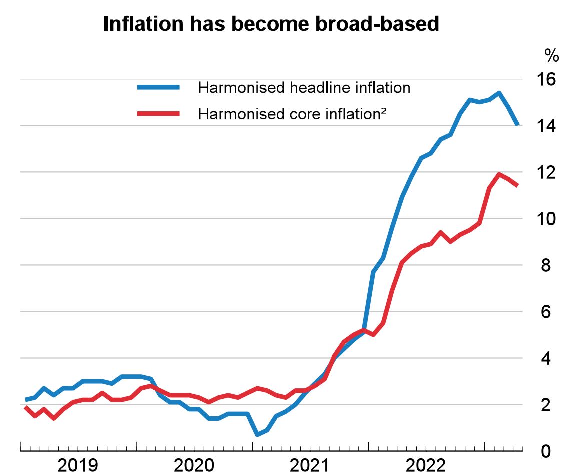
Fiscal support to households and firms to mitigate the rise in energy prices should be better targeted to limit additional demand pressures at a time of high inflation. Specific consolidation measures should be spelled out to ensure fiscal sustainability. Accelerating investment in the green transition, including improvements to the energy efficiency of buildings, will help enhance energy security and mitigate climate change.

Economic growth remains subdued

The economy continued to grow moderately in the first quarter of 2023, by 0.2% compared to the previous quarter. Domestic demand growth slowed, and net exports supported the economy on account of a significant drop in imports. Consumer and business confidence remained weak in April. Harmonised consumer price inflation is high (14.0% in April) and broad-based, with core inflation reaching 11.4% in April. The labour market has been resilient. The registered unemployment rate declined to 5.3% in April, close to pre-pandemic levels (5.2%).

Slovak Republic





1. Volume terms.
2. Core inflation refers to the overall index excluding energy, food, alcohol and tobacco.
Source: Statistical Office of the Slovak Republic; and Eurostat.

StatLink https://stat.link/9cwg7r

Slovak Republic: Demand, output and prices

Slovak Republic	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	94.4	-3.3	4.9	1.7	1.3	2.0
Private consumption	53.2	-1.4	1.8	5.1	0.6	1.6
Government consumption	18.5	-0.6	4.2	-3.2	0.2	0.5
Gross fixed capital formation	20.3	-10.8	0.2	6.5	9.9	3.8
Final domestic demand	92.0	-3.3	2.0	3.6	2.3	1.8
Stockbuilding[1]	2.2	-1.9	2.0	0.2	2.0	0.0
Total domestic demand	94.2	-4.8	4.3	3.7	4.0	1.7
Exports of goods and services	86.7	-6.5	10.6	1.2	3.0	4.4
Imports of goods and services	86.5	-8.3	12.0	3.3	5.7	3.9
Net exports[1]	0.2	1.7	-0.9	-2.0	-3.0	0.2
Memorandum items						
GDP deflator	_	2.4	2.4	7.5	9.4	4.9
Harmonised index of consumer prices	_	2.0	2.8	12.1	11.0	5.6
Harmonised index of core inflation[2]	_	2.4	3.3	8.2	9.5	4.9
Unemployment rate (% of labour force)	_	6.7	6.8	6.1	6.3	6.3
Household saving ratio, net (% of disposable income)	_	5.6	3.3	-1.8	0.2	1.6
General government financial balance (% of GDP)	_	-5.4	-5.4	-2.0	-5.8	-4.3
General government gross debt (% of GDP)	_	79.1	80.0	65.9	66.3	65.5
General government debt, Maastricht definition[3] (% of GDP)	_	58.9	61.0	57.8	58.2	57.4
Current account balance (% of GDP)	_	0.6	-2.5	-8.2	-10.2	-9.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/qlj74g

Slovakia has managed to reduce its high energy dependency on Russia. The recently signed agreement to purchase natural gas from the North Sea until 2024 will further improve energy security. Around 15,000 Ukrainian refugees found employment by the end of 2022 (about 0.5% of the labour force), mostly in low-skilled occupations with labour shortages. Tighter monetary and financial conditions have led to a decline in housing construction and new mortgage loans. House prices have been declining since June 2022.

The fiscal accounts will deteriorate sharply in 2023

The government has adopted measures amounting to 2.5% of GDP to mitigate the effects of the energy crisis in 2023. For example, increases in gas and heating prices for households are capped. In addition, the government reimburses firms 80% (100% for small firms) of the gas and electricity costs above a certain price threshold. Permanent measures, such as higher tax allowances for families with children, significant wage increases for workers in the healthcare sector, and reduced VAT rates for catering, sports and tourism industries will add about 1.7% of GDP to the budget deficit. Slovakia can still draw unused 2014-20 EU Cohesion policy funds of about 4.3% of GDP in 2023, which together with funds from the EU Recovery and Resilience Plan (1.4% of GDP in 2023 and 2.3% in 2024) will boost public investment this year. Part of the unspent EU cohesion funds will be used to finance the energy support measures. Overall, the fiscal stance is expected to be strongly expansionary in 2023. Government fiscal plans foresee structural consolidation to start in 2024.

Growth in 2023 will be mainly driven by investment

High inflation will weigh on real wages and private consumption, but will be attenuated by government support measures. Real wages are projected to increase in 2024, which should support a pick-up in private consumption and some rebuilding of households' savings. Substantial EU funds will boost investment in 2023. The continued easing of supply chain disruptions will lead to an acceleration of exports and help regain some of the export market share lost in recent years, especially in the automotive sector. Headline inflation is projected to slow from the second half of 2023 due to reductions in global energy and food prices, while core inflation will decline more slowly due to the lagged pass-through of energy prices to other goods prices and the effects of nominal wage increases. The main downside risks to the projections are related to a prolonged war in Ukraine, which would weigh on foreign demand and could lead to the resurgence of global energy prices. Lower absorption of EU funds would negatively affect investment.

Better targeting and timely reduction of fiscal support is needed

Fiscal support for households and firms should be better targeted to limit additional demand stimulus at a time of high inflation and help preserve incentives to lower energy use. For example, support to households should target only those inadequately covered by the general social protection system. If resources allocated for energy support measures remain unspent, they should be used to reduce public debt. Consolidation measures for 2024 and beyond should be specified in line with recently adopted expenditure ceilings to ensure fiscal sustainability. The recovery plan allocates an important share of resources to the green transition, including improvements in the energy efficiency of the housing stock. Investment in these areas should be accelerated to reduce carbon emissions and improve energy security. Policies aimed at increasing labour force participation of mothers with young children, such as expanding the supply of high-quality and affordable childcare facilities, could boost labour supply and mitigate the effects of ageing.

Slovenia

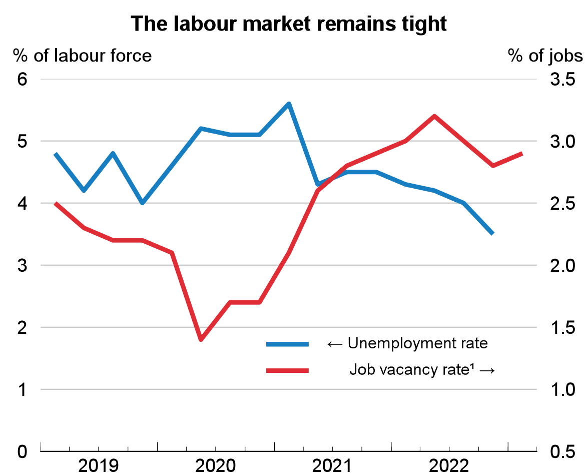
GDP growth is projected to slow to 1.5% in 2023, reflecting weak domestic and external demand. The labour market is expected to remain tight, fuelling stronger wage growth and contributing to inflationary pressures. Growth will strengthen to 2.6% in 2024 as inflationary pressures gradually recede.

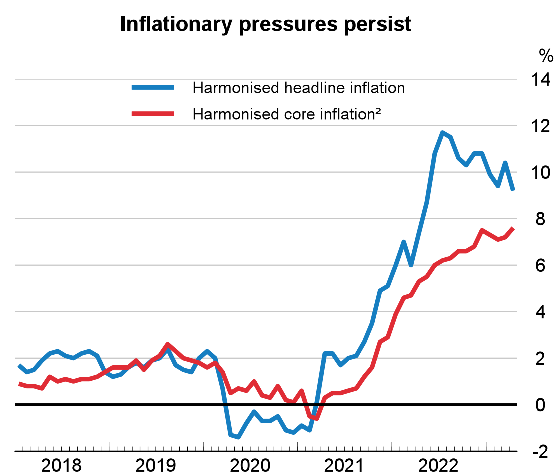
Fiscal policy will remain expansionary in 2023, before tightening in 2024. This reflects government measures to mitigate the effects of high energy prices on households, as well as higher public investment and public sector wages. Fiscal support should be financed by spending cuts as the current expansionary fiscal stance risks intensifying inflationary pressures. Structural reforms are needed to safeguard fiscal sustainability and raise potential growth, including measures to improve the labour force participation of older workers and extend working lives, as well as a lower labour tax burden, financed by higher property and environmental taxation.

Economic activity remains resilient

Economic activity expanded more than expected in the last quarter of 2022, driven by private consumption and government spending. The expansion continued in the first quarter of 2023, with GDP up by 0.6% quarter-on-quarter. The labour market remains tight with an unemployment rate of 3.2% in March. This is reflected in strong wage growth. In the fourth quarter of 2022, labour costs per hour worked grew by 11.9% year-on-year. Minimum wages rose by 12% in January 2023, while negotiated public sector wages increased by 8.5% between October 2022 and April 2023. Wage pressures have contributed to persistently high core inflation of 7.6% in April. Headline inflation peaked at 11.7% in July and slowly declined to 9.2% in April, reflecting falling energy prices.

Slovenia





1. The job vacancy rate measures the proportion of total posts that are vacant, expressed as the ratio of the number of job vacancies to the number of occupied posts plus the number of job vacancies.
2. Core inflation refers to the overall index excluding energy, food, alcohol and tobacco.
Source: Statistical Office of Slovenia; and Eurostat.

StatLink https://stat.link/qukhvo

Slovenia: Demand, Output and prices

Slovenia	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	48.5	-4.3	8.2	5.4	1.5	2.6
Private consumption	25.5	-6.9	9.5	8.9	2.1	2.3
Government consumption	8.9	4.1	5.8	0.9	1.2	1.8
Gross fixed capital formation	9.5	-7.9	13.7	7.8	2.0	2.1
Final domestic demand	43.8	-4.9	9.6	6.9	1.9	2.1
Stockbuilding[1]	0.5	0.1	0.4	1.1	-1.3	0.0
Total domestic demand	44.4	-4.7	9.9	8.3	1.0	2.1
Exports of goods and services	40.6	-8.6	14.5	6.5	1.4	5.0
Imports of goods and services	36.4	-9.6	17.6	9.8	0.3	4.5
Net exports[1]	4.2	0.0	-0.8	-2.1	1.0	0.6
Memorandum items						
GDP deflator	_	1.3	2.6	7.2	8.2	4.4
Harmonised index of consumer prices	_	-0.3	2.0	9.3	7.3	4.4
Harmonised index of core inflation[2]	_	0.8	0.9	5.9	6.9	4.6
Unemployment rate (% of labour force)	_	5.0	4.8	4.0	4.3	4.3
Household saving ratio, net (% of disposable income)	_	16.3	12.1	-0.3	-2.5	-2.6
General government financial balance (% of GDP)	_	-7.7	-4.6	-3.0	-4.1	-2.9
General government gross debt (% of GDP)	_	109.9	95.2	71.9	70.9	68.4
General government debt, Maastricht definition[3] (% of GDP)	_	79.6	74.5	69.9	68.9	66.5
Current account balance (% of GDP)	_	7.6	3.8	-0.4	1.4	0.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/wagf8x

Gas rationing was avoided due to consumption savings, a diversification of gas suppliers and a milder-than-usual winter. Gas consumption from August 2022 to March 2023 was almost 14% lower than the comparable average consumption over the past five years. Gas imports from Russia were replaced by higher imports from Algeria and Norway, among others. Euro area monetary policy tightening has resulted in tighter financial conditions. Year-on-year growth in loans moderated to 3.6% in March.

Fiscal policy adds to inflationary pressures

The government announced spending of 1.6% of GDP for 2023 to support households and businesses during the energy crisis. This includes direct subsidies to households and businesses and temporary tax cuts. The government also capped the price of electricity and gas in September 2022 until the end of 2023 for households and small businesses. This temporary measure is assumed to be phased out by the end of 2023. In addition, structural measures include an increase in spending on long-term care by 0.4% of GDP in 2024. These measures are expected to increase the budget deficit to 4.1% of GDP in 2023, before the fiscal stance is tightened in 2024 by over 1% of GDP. The expansionary fiscal stance in 2023 adds to demand and inflationary pressures.

Growth is set to slow

Growth is projected to slow to 1.5% in 2023, reflecting weaker domestic and external demand. High inflation will continue to weigh on private consumption. Weaker demand, higher interest rates and tighter financial conditions will slow investment growth, although the inflow of EU funds should moderate the slowdown to some extent. The labour market will remain tight, with historically low unemployment contributing to stronger wage growth. Domestic price pressures will keep headline inflation elevated, despite the fall in energy prices. Growth will pick up in 2024 as external demand recovers and headline inflation gradually recedes. Downside risks depend on the impact of Russia's war of aggression against Ukraine on energy and food prices, as well as the effects of tighter financial conditions on investment. Stronger-than-expected wage growth could keep inflationary pressures elevated for longer. On the upside, stronger immigration could help reduce labour market shortages and wage pressures.

Reducing demand pressures requires faster fiscal consolidation

Faster fiscal consolidation is needed to reduce demand pressures. This entails a rapid phase-out of energy price caps. Spending on long-term care should be financed by cuts to other recurrent spending. Continued efforts to diversify gas supply, including LNG capacity in coordination with the European Union, will help improve energy security. Such efforts should be implemented alongside structural reforms to raise potential growth. This includes a growth-friendly tax reform to lower the labour tax burden, financed by higher environmental and property taxation. This should be complemented by measures to improve the labour force participation of older workers and extend working lives, including by raising the minimum years of contributions required to retire and stronger incentives to remain in the work force after the statutory retirement age. Targeted information campaigns to attract more girls and women to ICT studies could support digitalisation and help address skill shortages.

South Africa

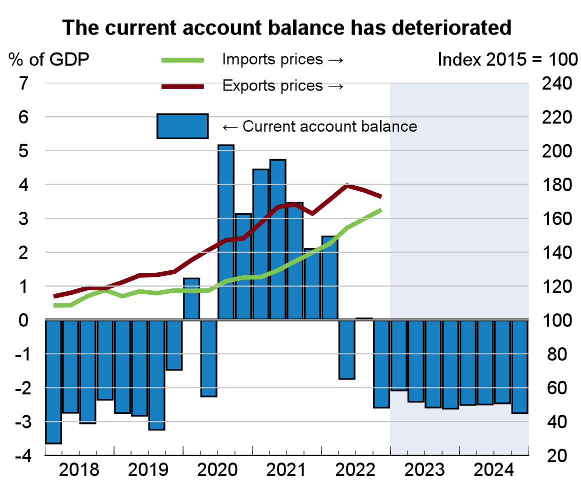
GDP growth is projected to slow to 0.3% in 2023 before picking up to 1% in 2024. Investment will become a much-needed driver of growth as the energy crisis requires additional power generation capacity. Higher interest rates and inflation are denting consumption, while electricity outages and lower global growth are weighing on exports. Investment will boost imports and, together with declines in the terms of trade, widen the current account deficit. Inflation will respond slowly to tighter monetary policy, with significant risks around the pace of this decline.

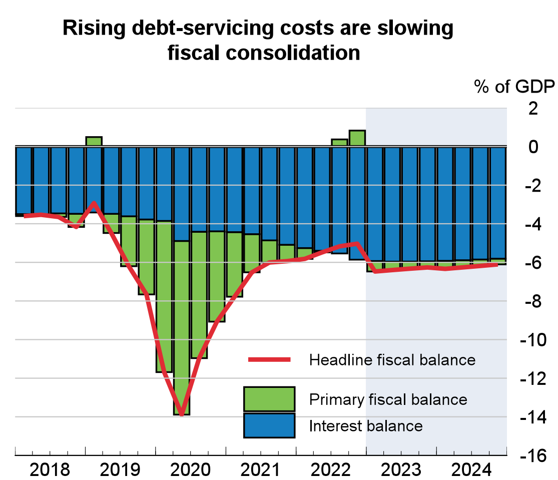
The energy crisis will slow the pace of fiscal consolidation as necessary public support to the sector results in additional expenditures. Falling commodity prices and slower growth will lower revenues. Broadening the income tax base and raising property and environmental taxes would help to offset this decline and improve equity. Monetary policy should stay the course to bring inflation down. The ongoing restructuring in the electricity market should be used to improve the quality of energy infrastructure and diversify energy sources, boosting productivity and resilience.

The outlook continues to deteriorate

GDP declined by 1.3% in the fourth quarter of 2022 as exports fell by 4.8%, constrained by chronic electricity outages and ongoing challenges in railway freight transport, such as frequent derailments, a shortage of locomotives, and cable theft. The terms of trade have declined due to lower export and higher import prices. Employment remains below pre-pandemic levels and real total earnings fell 2.6% in the year to December 2022, tempering earlier concerns of rising wage pressures. Nevertheless, annual headline and core inflation rose to 6.8% and 5.3% respectively in April, driven mostly by food and services inflation.

South Africa





Source: Economic Outlook 113 database.

StatLink https://stat.link/b7kgwr

South Africa: Demand, output and prices

South Africa	2019 Current prices ZAR billion	2020	2021	2022	2023	2024
		Percentage changes, volume (2015 prices)				
GDP at market prices	5 613.7	-6.3	4.9	2.0	0.3	1.0
Private consumption	3 588.9	-5.9	5.6	2.6	1.2	1.5
Government consumption	1 104.5	0.8	0.6	0.9	0.1	1.1
Gross fixed capital formation	865.5	-14.6	0.2	4.7	3.4	5.6
Final domestic demand	5 558.9	-5.9	3.8	2.6	1.3	2.0
Stockbuilding[1]	24.5	-1.8	0.9	1.1	0.0	0.0
Total domestic demand	5 583.3	-8.0	4.8	3.8	1.3	1.9
Exports of goods and services	1 532.4	-11.9	10.0	7.5	-1.4	1.9
Imports of goods and services	1 502.1	-17.4	9.5	14.2	2.0	5.2
Net exports[1]	30.3	1.8	0.1	-1.7	-1.0	-1.0
Memorandum items						
GDP deflator	_	5.7	6.2	5.1	3.8	3.6
Consumer price index	_	3.3	4.6	6.9	6.0	4.7
Core inflation index[2]	_	3.4	3.1	4.6	5.3	4.7
General government financial balance (% of GDP)	_	-11.3	-6.6	-5.4	-6.4	-6.2
Current account balance (% of GDP)	_	2.0	3.7	-0.5	-2.4	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/6dcjzb

Electricity cuts have been in effect on most days since September, and outages often amount to 4-8 hours a day. Between February and April, a national state of disaster was declared. Supply disruptions weigh heavily on exports and the current account, which moved to a deficit of 2.6% of GDP in the fourth quarter of 2022. Large external financing needs increase the exposure to higher financing costs and potential volatility in global financial markets.

Slowing fiscal consolidation is adding pressure on monetary policy

The government budget projects a narrowing headline deficit, to reach 3.9% in the 2023-24 fiscal year. However, part of the announced support package to the national power monopoly Eskom, amounting to 2.5% of GDP, was not included in this budget. In addition, falling commodity prices and slower growth will reduce tax revenues in the current fiscal year, while rising political pressures for more permanent income support through the "Social Distress Relief" grant and for higher public wages are likely to push up spending. The projected slower pace of fiscal consolidation than foreseen in the budget will add to inflationary pressures and financial vulnerabilities, putting a higher burden on monetary policy. The central bank raised the policy rate to 8.25% in May and is expected to maintain it at that level until mid-2024, when inflation is projected to start falling slowly.

An unprecedented energy crisis holds back growth and fuels inflation

Regular electricity cuts will persist in 2023 and weigh on exports. Household spending will be limited by high inflation and tight financial conditions. After a weak patch in 2023, private investment, particularly in power generation, will become the main driver of growth over 2024. This should reduce the frequency of electricity cuts and relax constraints on growth by the end of 2024. Rising investment will push up imports, which together with a decline in the terms of trade and supply disruptions to exports, will weigh on the current account. Widespread electricity outages will continue to put pressure on a broad range of prices, despite weak growth. Inflation is expected to remain above the target midpoint of 4.5% during 2023 but fall back into the target range of 3-6% in 2024 as the delayed effects of monetary policy are felt. The recent weakening of the currency points to upside inflation risks. Electricity cuts and reduced activity from SMEs could lead to vulnerabilities in the corporate sector, exposing domestic banks. On the upside, additional investment in electricity generation could alleviate supply constraints more rapidly than expected.

Promoting competition in network sectors would improve living standards

Reducing supply bottlenecks through investments in the electricity sector should be the priority. Lowering the regulatory burden and entry barriers in network sectors, namely rail and energy, would increase supply, foster competition, boost private investment in high-quality infrastructure, improve the quality of services and lower consumer prices. Beyond the positive impact on productivity and growth, lower prices for network services would benefit low-income households the most, helping to curb inequality and poverty. Limiting power outages would also increase the personal safety and security of women, increasing incentives for female labour force participation, and helping to reduce the incidence of gender-based violence. Better access to childcare facilities would improve women's access to economic opportunities.

Spain

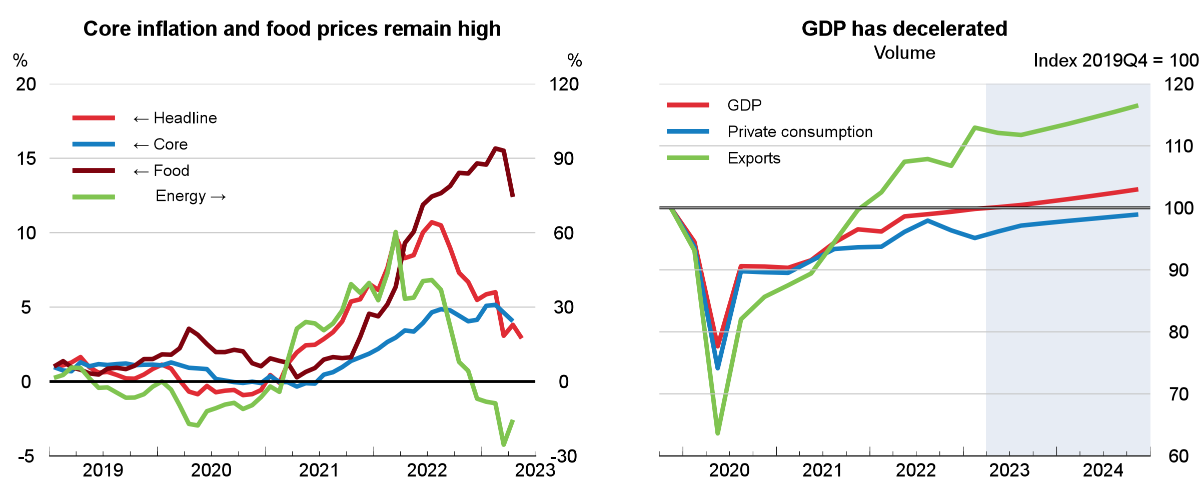
GDP growth is projected to slow to 2.1% in 2023 and 1.9% in 2024, after two years of strong post-COVID growth of 5.5%. Lower inflation and a resilient labour market will support households' consumption. Stronger external demand will underpin export growth. Better demand prospects will encourage private business investment, notwithstanding the rise in the cost of financing. Headline inflation will edge down to 3.9% in 2024 on the back of declining energy prices and monetary policy tightening.

The fiscal stance is expected to tighten to address high debt. As inflation recedes, fiscal support measures to mitigate the impact of high energy prices should be phased out. The implementation of the Recovery Plan, largely relying on Next Generation EU funds, will induce significant public investments, and can raise growth potential. Continuing to tackle low productivity growth and reduce fossil-fuel dependence should be a priority.

Growth has proved resilient

Faced with a challenging environment in the context of Russia's war of aggression against Ukraine, the Spanish economy has held up remarkably well. GDP increased by 0.5% in the first quarter of 2023 compared to the previous quarter and was 3.8% higher than a year earlier. Business and consumer confidence have improved since the autumn, even if consumer confidence remains very low. The labour market is dynamic, with employment growth of 1.3% in the first quarter of 2023. The unemployment rate decreased slightly from 13.0% in December 2022 to 12.7% in April 2023. Headline inflation (harmonised index) fell to 2.9% in May, owing to lower energy prices. Core inflation stood at 4.1% and food inflation at 12.4% in April 2023. Nominal wages increased by 3.0% between the first quarter of 2022 and the same quarter of 2023.

Spain



Source: Instituto Nacional de Estadistíca; Eurostat; and OECD Economic Outlook 113 database.

StatLink https://stat.link/ywvh4d

Spain: Demand, output and prices

Spain	2019	2020	2021	2022	2023	2024
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 245.5	-11.3	5.5	5.5	2.1	1.9
Private consumption	714.5	-12.2	6.0	4.4	0.5	2.0
Government consumption	234.9	3.5	2.9	-0.7	1.8	2.0
Gross fixed capital formation	249.5	-9.7	0.9	4.6	0.0	2.9
Final domestic demand	1 199.0	-8.7	4.2	3.4	0.7	2.2
Stockbuilding¹	9.9	-0.8	1.0	-0.2	0.2	0.0
Total domestic demand	1 208.9	-9.4	5.3	3.1	0.8	2.2
Exports of goods and services	434.8	-19.9	14.4	14.4	5.8	2.4
Imports of goods and services	398.2	-14.9	13.9	7.9	2.9	3.2
Net exports¹	36.6	-2.2	0.3	2.4	1.3	-0.2
Memorandum items						
GDP deflator	_	1.2	2.3	4.3	6.0	3.8
Harmonised index of consumer prices	_	-0.3	3.0	8.3	3.9	3.9
Harmonised index of core inflation²	_	0.5	0.6	3.8	4.8	3.7
Unemployment rate (% of labour force)	_	15.5	14.8	12.9	12.8	12.4
Household saving ratio, net (% of disposable income)	_	10.8	7.0	2.0	2.0	0.4
General government financial balance (% of GDP)	_	-10.1	-6.9	-4.8	-3.5	-3.2
General government gross debt (% of GDP)	_	148.2	142.7	117.7	115.2	114.4
General government debt, Maastricht definition³ (% of GDP)	_	120.4	118.3	113.2	110.8	109.9
Current account balance (% of GDP)	_	0.6	1.0	0.6	4.0	3.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
3. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/hkpuni

Monetary policy tightening in the euro area is weighing on financing conditions and weakening the demand for loans. Housing credit to households and credit to firms decreased by 2.0% and 2.2% year-on-year in April 2023, respectively. The housing market is cooling, with a slowdown in housing sales. Households are highly exposed to rising interest rates, given the heavy concentration of variable-rate mortgages (75% of the stock), even if most new mortgages are contracted at fixed rates. This entails a risk of impairment losses for banks, which calls for close monitoring.

The fiscal deficit is set to improve

To support households and businesses with the high cost-of-living, the government approved new measures in December 2022 worth about 0.8% of GDP, including a VAT cut on essential food products, a EUR 200 cheque for low-income households and targeted support to specific sectors (agriculture and the ceramics industry). In addition, previous tax cuts on gas and electricity and some subsidies on transport fees have been prolonged. The 20 cent/litre fuel rebate has been refocused on hauliers, fishers and farmers and was halved in April 2023. Some of these measures are expected to end in June 2023, but the VAT cut on food and subsidies on transport fees are expected to be prolonged until the end of 2024. Tax cuts on energy are expected to be partly phased out in 2024. Overall, fiscal policy is assumed to be mildly restrictive over 2023-24. The government deficit is projected to decline to 3.5% of GDP in 2023 and 3.2% of GDP in 2024.

Steady GDP growth is expected to continue

GDP growth is expected to moderate from 5.5% in 2022 to 2.1% in 2023 and 1.9% in 2024. Inflation is projected to recede from 8.3% in 2022 to 3.9% in 2023 and 2024, which would support household consumption. Stronger external demand will underpin export growth. Better demand prospects will allow for a gradual improvement in business investment, although the rise in the cost of financing will limit its scope. High interest rates will also curtail housing investment, which is expected to decrease in 2023 and remain broadly stable in 2024. GDP growth will benefit from sizeable public spending linked to the Recovery Transformation and Resilience Plan (RTRP). There are several risks surrounding the outlook, including an escalation of the war in Ukraine that could push up energy prices, and increasing macro-financial vulnerabilities, as rapidly rising interest rates could increase the risk of financial contagion through the global financial system. On the upside, a faster-than-expected return of inflation to the target could allow central banks to loosen monetary policy, stimulating domestic demand.

Raising productivity growth and lowering fossil-fuel dependence are key

Continuous efforts are needed to boost productivity and innovation. Provided that good investment projects are selected and reforms implemented, the EU funds can raise growth potential. The effective implementation of prior reforms addressing the internal fragmentation of product markets, which can be a barrier to the entry and growth of innovative firms, can raise the impact of EU funds on economic activity. Improving skills and enhancing education outcomes can improve job prospects, especially for the youth, and should be prioritised, together with more efficient active labour market policies, for an inclusive recovery. Increasing the availability of good quality early childhood education and care for children under the age of three could help raise female labour force participation. Increasing girls' interest and enrolment in STEM studies should be a priority. Increasing the energy efficiency of buildings, stepping up investment in sustainable transport and promoting a higher share of renewables, as planned, together with higher carbon taxes, would reduce dependence on fossil fuels and advance the green transition.

Sweden

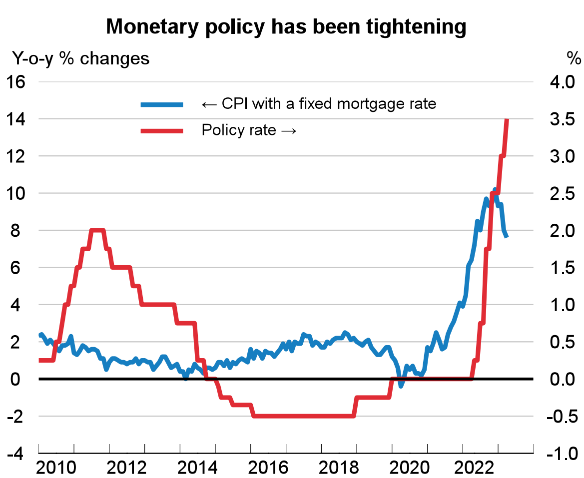
The economy is expected to contract by 0.3% in 2023 and grow by 1.4% in 2024. Private investment will decline in 2023, with construction activity set to drop significantly due to higher construction costs and falling housing prices. Elevated inflation will continue to reduce households' real disposable income in the near term. Private consumption growth is projected to pick up somewhat from mid-2023 as real disposable incomes start to recover.

Monetary policy should be tightened further as needed to curb inflation and ensure that inflation expectations are anchored. Temporary energy support should be gradually phased out to effectively manage inflationary pressure and help meet climate targets. Population ageing calls for mobilising underutilised labour resources, notably the low-skilled and the foreign-born. Achieving this goal requires reforms to taxes and benefits to strengthen work incentives and discourage income shifting from labour to capital, as well as easing rent controls.

Weak private consumption weighs on growth

After falling by 0.5% in 2022 Q4, GDP rebounded by 0.6% in 2023Q1, mainly driven by exports and inventories. However, household consumption and residential investment continued to decline. Property prices have fallen considerably, reducing investment and household wealth. Sentiment indicators point to very depressed household confidence. Manufacturing output has held up, with considerable order backlogs, but new orders are decreasing. The labour market has remained robust, but there are signs of a slowdown, with layoff notices increasing and companies preparing to downsize their workforce. Consumer price inflation with a fixed mortgage rate (CPIF) moderated to 7.6% in April, but CPIF inflation excluding energy stood at 8.4% suggesting broad inflationary pressures. In April, the social partners in the manufacturing sector agreed modest nominal wage increases of 4.1% in 2023 and 3.3% in 2024.

Sweden



1. Real estate price index for one- or two-dwelling buildings. The index has been deflated with the CPI.
Source: The Riksbank; and Statistics Sweden.

StatLink https://stat.link/fongh5

Sweden: Demand, output and prices

Sweden	2019	2020	2021	2022	2023	2024
	Current prices SEK billion	Percentage changes, volume (2022 prices)				
GDP at market prices	5 052.5	-2.3	5.9	2.9	-0.3	1.4
Private consumption	2 268.6	-3.2	6.2	2.0	-2.7	2.0
Government consumption	1 300.5	-2.0	2.9	0.1	1.2	1.2
Gross fixed capital formation	1 235.6	1.6	6.8	6.2	-1.6	0.1
Final domestic demand	4 804.7	-1.7	5.4	2.6	-1.4	1.3
Stockbuilding[1]	34.6	-0.7	0.4	1.1	-0.3	0.0
Total domestic demand	4 839.3	-2.4	5.9	3.7	-1.6	1.2
Exports of goods and services	2 419.9	-5.9	10.8	7.1	4.0	3.3
Imports of goods and services	2 206.7	-6.3	11.3	9.4	1.6	3.2
Net exports[1]	213.2	0.0	0.3	-0.6	1.3	0.2
Memorandum items						
GDP deflator	_	2.0	2.6	5.6	6.1	2.5
Consumer price index[2]	_	0.5	2.2	8.4	7.9	2.4
Core inflation index[3]	_	0.5	2.4	7.7	6.3	2.4
Unemployment rate (% of labour force)	_	8.5	8.8	7.5	7.9	8.0
Household saving ratio, net (% of disposable income)	_	17.0	15.5	13.9	13.8	13.6
General government financial balance (% of GDP)	_	-2.8	0.0	0.7	-0.4	-0.6
General government debt, Maastricht definition[4] (% of GDP)	_	39.9	36.5	32.8	32.7	32.7
Current account balance (% of GDP)	_	5.9	6.5	4.2	5.6	5.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. The consumer price index includes mortgage interest costs.
3. Consumer price index with fixed interest rates.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/p8q219

Russia's war of aggression against Ukraine is taking a toll on the Swedish economy. Elevated energy and food prices continue to put a strain on activity. The number of Ukrainian refugees in Sweden reached about 56 000 (0.5% of the population) as of mid-May. Export growth has been significantly reduced due to weak markets in key trading partners, while tightening global financial conditions and the weakening of the Swedish Krona have heightened the risk of financial stress.

Macroeconomic policies have been tightened

In response to high inflation and the weak Swedish Krona, the Riksbank raised its repo rate to 3.5%, the highest rate in nearly 15 years. The policy rate is expected to be raised by an additional 25 basis points in June and remain at this level throughout the latter half of 2023 and 2024. The fiscal stance is set to be broadly neutral in 2023 and 2024 with discretionary spending being scaled back. The spring 2023 budget bill includes new measures of around SEK 4 billion (0.1% of GDP) focusing on defence and education. It also temporarily raises housing subsidies for the economically vulnerable. It follows three off-cycle budgets totalling SEK 2.4 billion (0.05% of GDP) related to a revenue cap for electricity producers, temporary fuel tax reductions, and military aid to Ukraine. SEK 57 billion (1.1% of GDP) of transmission bottleneck fees collected during the energy crisis is being refunded to households and businesses in 2023, but will not directly affect the fiscal balance.

Declining housing investments will further depress the economy

The economy is projected to shrink by 0.3% in 2023 before rebounding by 1.4% in 2024. Employment is set to decline as companies adjust staffing plans in response to the output contraction. Construction will decline significantly in 2023 due to higher construction costs and sluggish demand. Households will adjust their consumption further in response to declining housing wealth and real disposable income, and rising unemployment. Inflation is expected to moderate and converge towards the target by the end of 2024, as imported inflation slows and monetary tightening increasingly takes effect. A moderate pick-up of consumption is expected from mid-2023 as the inflation shock dissipates and the housing market stabilises. Lower-than-expected inflation could increase real disposable incomes and allow easier nominal interest rates, thereby boosting housing prices, private consumption and investment. Stubborn inflation and higher-than-expected interest rate increases would have the opposite effect and could lead to significant financial challenges for highly leveraged commercial real estate developers. Weaker-than-expected growth in major trading partners, notably the United States and the European Union, would weigh on the export-oriented Swedish economy.

Policy priorities for better labour market functioning and the green transition

The current pivot towards less expansive fiscal policy to hold back inflationary pressures should continue, and energy crisis support should be phased out. A return to the normal practice where spending decisions are taken in the ordinary budget process would strengthen fiscal discipline. Persistent structural unemployment is a challenge. Relaxing rent controls could improve labour mobility, especially among low-income workers. Carefully reviewing social assistance and other benefits typically taken up by inactive foreign-born women who struggle to enter the labour market due to low levels of education could improve work incentives for this group. Reducing Sweden's high labour tax wedge and the difference in tax rates on labour and capital income could boost work incentives and reduce incentives to shift income from labour to capital. Streamlining permitting procedures is essential to maintain momentum in Sweden’s ongoing green transition, which will require major investments in electricity generation, storage and transmission. The government’s intention to reduce biofuel blending requirements necessitates a general tightening of climate policies to reach its 2030 target for sectors not covered by the EU ETS.

Switzerland

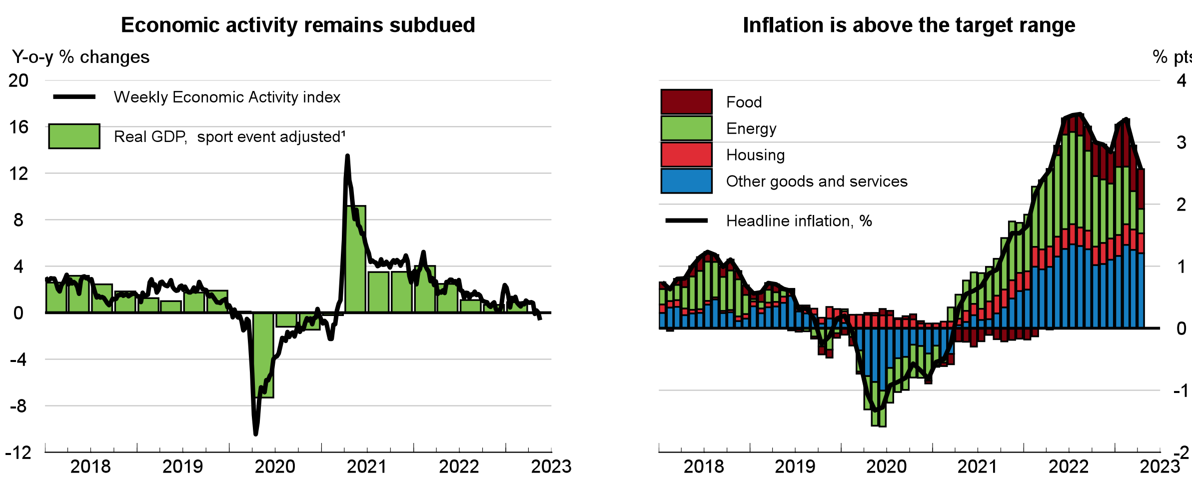
The economy is projected to grow by 0.6% in 2023 and 1.2% in 2024. Tighter financial conditions, subdued economic sentiment and heightened inflation will moderate household consumption and private investment. Geopolitical tensions and elevated uncertainty will reduce trade. Headline inflation will remain above the Swiss National Bank's target range of 0-2% in 2023, before moderating towards the end of that year. Financial market stress, house price corrections and a further weakening of foreign demand are key downside risks to activity.

Monetary policy will need to be tightened further to ensure that inflation returns to the target range, and risks to financial stability will need to be closely monitored. Continued fiscal surpluses are appropriate, but targeted measures to assist the most vulnerable households should be maintained. Structural policies are needed to increase labour market integration among under-represented groups, and to raise energy efficiency to help ensure energy security and improve environmental sustainability.

Economic activity is weak and inflation elevated

Indicators point to positive yet subdued growth dynamics in recent months. Consumer confidence remains weak, on the back of heightened inflation and tighter financial conditions. Russia's war of aggression against Ukraine is weighing on global demand, thus lowering exports and investment. However, the labour market is tight with a low unemployment rate. Headline inflation was 2.6% in April 2023, above the 0-2% target range of the Swiss National Bank (SNB). Medium-term inflation expectations of firms and analysts remain below 2%, within the target range.

Switzerland



1. GDP adjusted for the effects of major international sporting events. Such events can have a sizable impact on Swiss GDP, as international sporting organisations based in Switzerland receive revenues from television and branding rights. As the events do not occur every year, their impact on Swiss GDP complicates business cycle analysis.
Source: State Secretariat for Economic Affairs (SECO); and OECD Consumer Prices database.

StatLink https://stat.link/oyw5va

Switzerland: Demand, output and prices

Switzerland	2019	2020	2021	2022	2023	2024
	Current prices CHF billion	Percentage changes, volume (2015 prices)				
GDP at market prices	717.3	-2.5	4.2	2.1	0.6	1.2
Private consumption	375.6	-4.2	1.7	4.0	1.4	0.9
Government consumption	81.4	3.5	3.5	-0.5	0.6	0.7
Gross fixed capital formation	190.8	-3.1	4.1	-0.8	1.1	0.0
Final domestic demand	647.8	-2.9	2.7	2.0	1.2	0.6
Stockbuilding[1]	- 2.2	2.1	-3.2	-0.4	-0.3	0.0
Total domestic demand	645.5	-0.6	-0.8	1.5	0.8	0.6
Exports of goods and services	481.0	-5.5	12.2	5.8	4.2	3.1
Imports of goods and services	409.3	-3.0	4.9	5.7	5.3	2.6
Net exports[1]	71.7	-2.0	5.0	0.7	-0.1	0.7
Memorandum items						
GDP deflator	_	-0.8	1.1	3.3	2.4	1.3
Consumer price index	_	-0.7	0.6	2.8	2.4	1.2
Core inflation index[2]	_	-0.3	0.3	1.7	2.2	1.4
Unemployment rate (% of labour force)	_	4.8	5.1	4.3	4.4	4.6
Household saving ratio, net (% of disposable income)	_	22.5	21.9	18.4	17.0	16.5
General government financial balance (% of GDP)	_	-3.1	-0.5	1.0	0.1	0.4
General government gross debt (% of GDP)	_	43.8	41.2	41.3	41.8	41.9
Current account balance (% of GDP)	_	0.4	8.8	10.1	10.1	10.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/j38ihv

Stress in global financial markets in March culminated in the takeover of Credit Suisse by UBS – combining Switzerland's two globally systemically important banks. Sizeable deposit outflows and loss of confidence in Credit Suisse, following years of financial losses and poor risk management practices, led to the state-facilitated transaction. The Swiss authorities provided emergency liquidity lines and guarantees to support the takeover, staving off near-term financial stability concerns. The projections assume that financial sector stress remains contained over the remainder of 2023 and 2024. Gas supplies for next winter remain a concern as about one-half of natural gas consumed was imported from Russia before the war. Recommendations of the authorities to limit the use of natural gas have been heeded. In the winter months of October 2022 to March 2023, gas consumption was reduced by more than 15% compared to the average of the last five years, while the use of electricity only fell by 4%. The projections assume no major energy supply disruptions over the 2023-24 winter.

Further rate increases are needed to bring inflation back within the target range

The SNB has significantly tightened monetary policy since last year. The 0.5 percentage point increase in March 2023 brought the main policy rate to 1.5% and the SNB has continued to intervene in the foreign exchange rate market to ensure appropriate monetary conditions. As core inflationary pressures persist and global interest rates are rising, the key policy rate is assumed to increase to 2.25% by the third quarter of 2023 and remain at that level throughout the projection period. The general government registered a larger-than-expected surplus in 2022, which is expected to moderate to 0.1% of GDP in 2023 due to the absence of profit transfers from the SNB and outlays on national security and refugees. The Federal Council has taken steps to limit expenditures from 2024 onwards and a 0.3% of GDP surplus is projected for 2024.

GDP growth will slow amid tightened financial conditions

Real GDP growth is projected to remain below potential until the second quarter of 2024, reflecting the impact of tighter monetary policy on domestic demand and slow global demand growth. Rising services prices alongside high energy costs will keep headline inflation above the central bank's 0-2% target range until the end of 2023. Uncertainty surrounding the outlook is high. Substantial financial sector stress or a price correction in the real estate market could threaten financial stability. Severe energy supply disruptions could adversely affect industrial production, while also increasing price pressures. On the other hand, a rapid and durable end to the war in Ukraine would support global growth, restore consumer confidence and lower energy prices.

Increasing inclusiveness and accelerating the green transition can raise growth

The countercyclical capital buffer on residential properties is at the maximum level of 2.5% (according to Basel III) and house prices are still rising. Close monitoring of financial risks related to rising interest rates and the real estate market is warranted. Undertaking fiscal consolidation is appropriate to maintain ample fiscal buffers, but support to the vulnerable, including refugees, should be maintained. Increasing the supply of affordable childcare and lowering work disincentives for second earners would help support the labour market integration of mothers with children. Simplifying and speeding-up the process for recognition of foreign qualifications and increased access to training programmes can boost skills and raise labour market participation among groups that are underrepresented in the labour market. Further investment in renewable energy would reduce reliance on the gas and oil markets and enhance energy security.

Türkiye

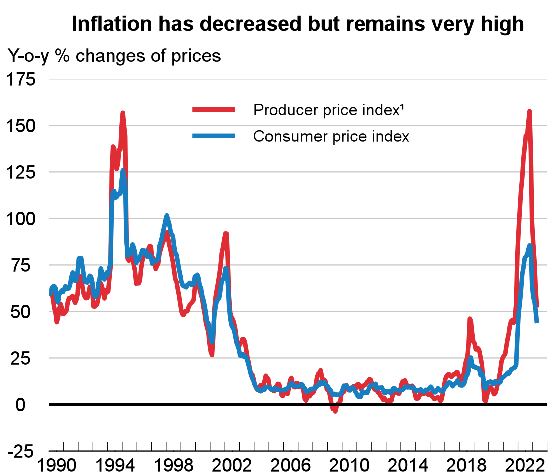
Economic growth is projected to moderate to 3.6% in 2023 due to weaker exports, while domestic demand will remain the main driver of growth. The devastating earthquake at the beginning of this year brought widespread damage in southern Türkiye. However, the boost from reconstruction is expected to largely offset the negative impact from disruption to economic activity. The unemployment rate is expected to stay close to 10%. Easy financial conditions will help keep inflation above 40% in 2023 and 2024 and nominal wages will also grow rapidly.

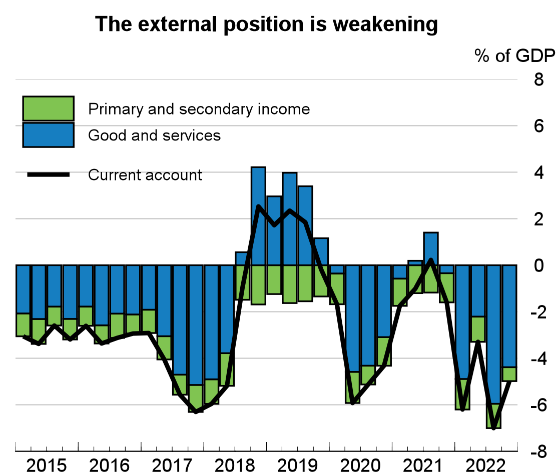
Following the earthquake, monetary and fiscal policy will continue to support the economy. However, anchoring inflation expectations remains challenging. To this end, monetary policy should be tightened with policy rate increases timed carefully and accompanied by clear communication about future moves. Structural reforms to improve the regulatory framework and ensure a rules-based, level-playing field for the business sector would further strengthen economic resilience.

Reconstruction work from the earthquakes is already underway

At the beginning of 2023, two very large earthquakes and numerous aftershocks hit Türkiye's southern region. More than 50 thousand people died and more than 3 million people were displaced, and the damage to buildings, infrastructure and production capacities has been huge. Retail sales, turnover indices and industrial production fell sharply in February. However, indicators suggest a rapid recovery in activity as reconstruction work is gathering momentum and trade and industrial production in the earthquake-affected region have been partly restored. Inflation has decreased, in particular due to base effects, but remains high, and inflation expectations are still above the inflation target of 5%. However, energy prices have declined somewhat in recent months. External imbalances have widened, with the current account deficit reaching 5.3% of GDP at the end of 2022.

Türkiye





1. Producer price index refers to domestic industrial activities.

Source: OECD Main Economic Indicators database; OECD Balance of Payments; and CBRT.

StatLink https://stat.link/j9prz0

Türkiye: Demand, output and prices

Türkiye	2019	2020	2021	2022	2023	2024
	Current prices TRY billion	Percentage changes, volume (2009 prices)				
GDP at market prices	4 311.7	1.9	11.4	5.6	3.6	3.7
Private consumption	2 456.3	3.0	15.7	19.3	9.1	2.5
Government consumption	665.5	2.5	2.7	5.3	6.7	6.1
Gross fixed capital formation	1 117.1	7.4	7.4	2.8	8.2	6.7
Final domestic demand	4 238.8	4.1	11.3	12.4	8.8	4.3
Stockbuilding[1]	- 29.1	3.6	-6.2	-6.2	-0.3	0.0
Total domestic demand	4 209.7	8.4	4.1	5.1	8.1	4.1
Exports of goods and services	1 402.5	-14.4	24.9	9.1	0.3	4.2
Imports of goods and services	1 300.5	6.7	2.4	7.9	11.9	5.6
Net exports[1]	102.0	-6.7	6.4	0.4	-5.0	-0.7
Memorandum items						
GDP deflator	_	14.9	29.0	96.1	66.5	47.0
Potential GDP, volume	_	4.1	4.3	4.0	3.8	3.8
Consumer price index[2]	_	12.3	19.6	72.3	44.8	40.8
Core inflation index[3]	_	11.2	18.3	57.3	46.3	41.2
Unemployment rate (% of labour force)	_	13.1	12.0	10.5	10.0	9.9
Current account balance (% of GDP)	_	-4.5	-0.9	-5.4	-4.7	-3.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Based on yearly averages.
3. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/5xfiag

The volatility in world energy prices has highlighted the risks arising from high dependency on external energy supply - Türkiye imports 99% of its gas and 93% of its oil. The recent start of natural gas production from the Sakarya field will ease these risks somewhat; estimates indicate that by the end of 2023, domestic gas production will cover 7% of domestic consumption. In 2022, the authorities implemented several measures cushioning households from energy price inflation, including untargeted measures such as tax cuts on energy and the abolition of some electricity fees. These measures are expected to remain in place throughout the projection period.

Monetary and fiscal policy will remain supportive

The government has announced a series of measures supporting those affected by the disaster, including wage-bill subsidies to businesses. A new body, the Disaster Reconstruction Fund, is being established, which will oversee the allocation of resources for the restoration of infrastructure. The EU and other international donors have pledged USD 7.5 billion (0.6% of 2023 GDP) towards humanitarian aid and reconstruction. In addition, the Central Bank of the Republic of Türkiye further cut its main interest rate from 9% to 8.5% to cushion the economic impact of the earthquake. It also granted some exemptions from the banks' reserve holding obligations to encourage loans to the earthquake-hit zone. The central bank is expected to hold its policy rate at 8.5% over the projection period.

Growth will remain solid but there are significant risks

Despite the negative impact of the earthquake, the economy will grow at 3.6% in 2023 as the reconstruction effort and fiscal support will largely offset the negative impact on production and supply chain disruptions. In addition to public transfers and public investment, business and residential investment will increase as firms and households repair or replace damaged equipment and buildings. Private consumption will be supported by a minimum wage rise of 50% and fiscal support. Export growth will slow in 2023, but gain traction in 2024 as global demand strengthens. Inflation will remain high through 2023 owing to expansionary monetary policy and high wage growth. Risks are tilted to the downside. Large external financing needs and rapidly declining reserve buffers leave the economy highly vulnerable to turbulence and headwinds.

Macroeconomic and structural policies need reform

The government should continue to provide necessary support to those affected by the earthquake and those lower-income households suffering from rising living costs. This support is warranted but should be temporary and targeted to the most vulnerable to keep fiscal costs manageable. At the same time, more balanced and sustainable growth requires a more transparent and robust macroeconomic policy framework. Anchoring inflation expectations is a key challenge. Monetary policy should be tightened with carefully timed policy rate increases accompanied by clear communication about future moves. Confidence in the independence of the central bank needs to improve, including by reducing the turnover of the Bank's board. Structural weaknesses stemming from competition policy and business regulation related to complex and burdensome administrative procedures to obtain permits, licences or concessions, hamper the creation of formal businesses. Labour market regulations also need to be further improved to support the creation of more and higher-quality jobs. In addition, there remains scope to increase labour supply, including well-designed hiring subsidies targeted at the most vulnerable groups. Increasing and broadening the provision of quality early childhood education and care can help to improve access of women to the labour market.

United Kingdom

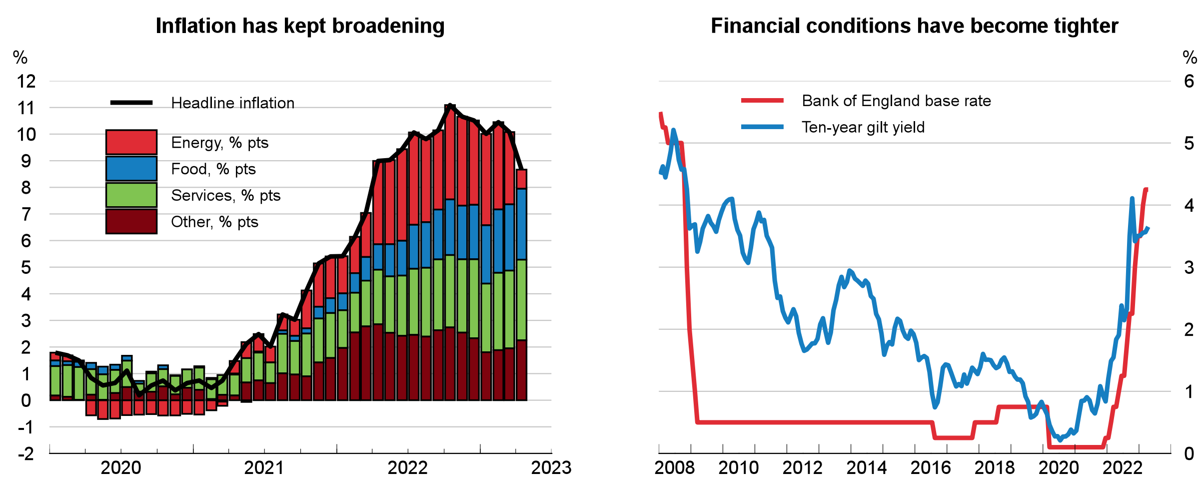
GDP growth is expected to be modest at 0.3% in 2023 and to improve moderately to 1.0% in 2024. Government consumption and investment will continue to prop up the economy, before a gradual strengthening of private expenditure due to falling wholesale gas prices and improved global conditions. Headline inflation is projected to slow on the back of declining energy prices and to come down close to target by the end of 2024. Core inflation is set to be more persistent due to strong services inflation, only receding to 3.2% in 2024. Unemployment will rise, reaching 4.5% in 2024.

Monetary policy will remain tight, increasingly weighing on output and lowering inflation, and the fiscal stance will be restrictive over 2023-24. However, little fiscal space is left, leaving the government significantly exposed to movements in interest rates. Swiftly implementing the spring budget's supply-side measures to increase labour supply, and providing certainty for investment and trade are key to strengthening potential growth.

Price pressures persist despite slowing activity and tighter financial conditions

Private consumption and housing investment weakened in the latter half of 2022. The first quarterly estimate for 2023 points to lacklustre real GDP growth of 0.1% in the three months to March. Retail sales volumes were 3.0% lower in April than in the same month last year, and consumer confidence remains depressed, although improving. Business sentiment is mixed, with a robust pick up in services but continuing weakness in manufacturing. Net mortgage borrowing continued to fall in March, while the average cost of bank loans to firms remains elevated at almost 5.8%, significantly above the rate of about 2.0% when the monetary tightening cycle started in December 2021.

United Kingdom 1



Source: Office of National Statistics; and OECD Economic Outlook 113 database.

StatLink https://stat.link/s83bzk

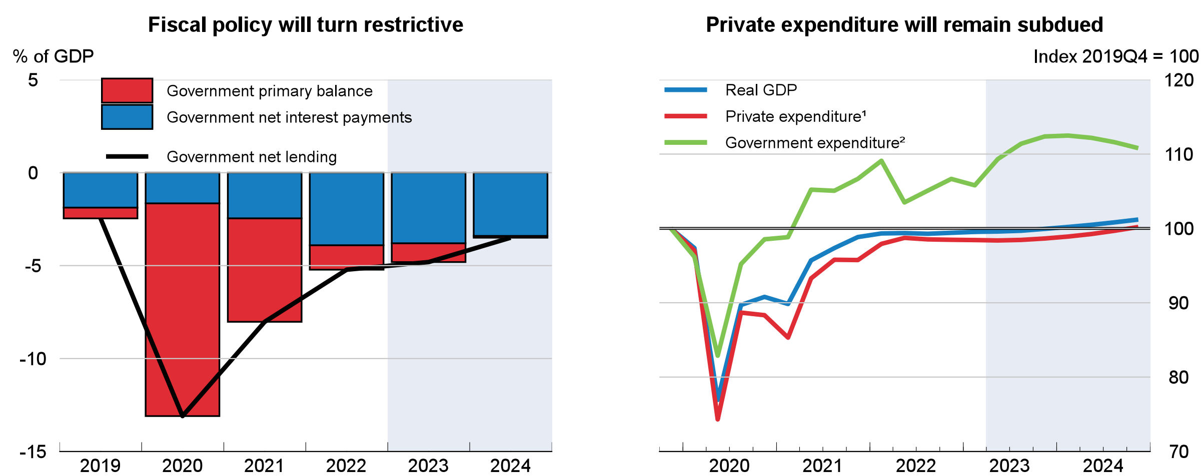
United Kingdom: Demand, output and prices

United Kingdom	2019	2020	2021	2022	2023	2024
	Current prices GBP billion	Percentage changes, volume (2019 prices)				
GDP at market prices	2 238.3	-11.0	7.6	4.1	0.3	1.0
Private consumption	1 440.0	-13.2	6.3	5.6	0.5	1.3
Government consumption	425.6	-7.3	12.5	1.8	1.7	1.7
Gross fixed capital formation	403.4	-10.5	6.1	8.6	1.0	0.6
Final domestic demand	2 269.0	-11.6	7.6	5.3	0.8	1.2
Stockbuilding[1]	5.5	-0.7	1.3	-0.9	-1.7	0.0
Total domestic demand	2 274.5	-12.3	8.8	4.3	-0.8	1.3
Exports of goods and services	699.7	-12.1	2.2	9.9	-3.4	1.1
Imports of goods and services	735.8	-16.0	6.2	13.3	-6.6	1.9
Net exports[1]	- 36.1	1.5	-1.1	-1.1	1.3	-0.3
Memorandum items						
GDP deflator	_	5.9	0.0	5.4	4.8	2.3
Harmonised index of consumer prices	_	0.9	2.6	9.1	6.9	2.8
Harmonised index of core inflation[2]	_	1.4	2.4	5.9	5.3	3.2
Unemployment rate (% of labour force)	_	4.6	4.5	3.7	4.2	4.5
Household saving ratio, gross (% of disposable income)	_	15.8	12.6	8.5	7.9	7.6
General government financial balance (% of GDP)	_	-13.1	-8.0	-5.2	-4.8	-3.5
General government gross debt (% of GDP)	_	105.6	105.9	101.0	102.5	103.8
Current account balance (% of GDP)	_	-3.2	-1.5	-3.8	-3.9	-3.7

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/mxuzoh

United Kingdom 2



1. Private consumption, housing investment and business investment.
2. Government consumption and government investment.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/xi6puj

Annual nominal wage growth in the three months to March was 5.8%, lower than both headline and core inflation. Vacancies posted a tenth consecutive quarterly fall in April, and unemployment is picking up. Yet, annual headline inflation remains high at 8.7% in April, despite the drop in the contribution of energy prices. Both rising services prices and elevated goods prices contribute to the persistence of core inflation, which at 6.8% in April, is the highest rate observed since March 1992. Imported food materials inflation continues to push up producer prices and headline consumer prices, with the food and non-alcoholic beverages annual inflation rate at 19.0% in April, the second highest observed for over 45 years after that in March 2023. By contrast, a fall in wholesale energy prices has eased the cost-of-living squeeze, and the steady appreciation of sterling against the US dollar attenuates imported inflation overall.

After monetary policy, fiscal policy is becoming more restrictive

The Bank of England brought its base rate to 4.5% in May, close to the assumed terminal value of 4.75% for the current monetary tightening cycle. The Bank is also proceeding with quantitative tightening by gradually reducing its bond holdings by GPB 80 billion by September 2023, through a mixture of redemptions and active sales, and by decreasing its stock of sterling corporate bonds. Monetary policy is not expected to ease until the second half of 2024, with two cuts of 25 basis points in the Bank's base rate in the third and fourth quarters as core inflation converges towards target.

The fiscal stance will be restrictive over 2023-24, as the government complies with its national fiscal rule of decreasing public debt within a five-year horizon against the backdrop of significantly higher borrowing costs. The government's 2023 spring budget includes the continuation of energy support measures, some of which are expected to become obsolete by the third quarter of 2023 as energy prices fall. Cumulative costs across fiscal years 2022/23 and 2023/24 are estimated at about GBP 78 billion (about 3% of GDP), of which GPB 15 billion is recouped via windfall taxes on energy producers. The main measures are the energy price subsidies to households and businesses, extended until the end of March 2024 (GPB 47 billion, about 1.8% of GDP); targeted cost-of-living payments (GPB 25 billion, about 1% of GDP); and the fuel duty freeze, also extended until the end of March 2024 (GPB 5 billion, about 0.2% of GDP). The spring budget also includes childcare subsidies and pension tax allowances, which are expected to gradually increase labour market participation, and a new "full-expensing" investment allowance, which is meant to foster investment and compensate for the expiration of the "super deduction" and the increase in the corporate income tax rate from the second quarter of 2023. Higher defence expenditure is also planned. A freeze of income tax brackets will significantly increase fiscal pressure on households, pushing 1.7 million people to start paying income taxes and 1.2 million people to pay higher rates.

Private expenditure will remain subdued

GDP will grow by 0.3% in 2023 and 1.0% in 2024. The contribution of government expenditure to GDP growth in the second half of 2022 will carry over to the first quarters of 2023, owing in part to energy support measures. Private expenditure will strengthen moderately as energy prices recede, benefits such as pensions and universal credit are uprated, labour participation increases, and global economic conditions improve. However, weak household income growth will weigh on consumption despite the fall in inflation, monetary tightening will slow both housing and already sluggish business investment, and uncertainty will continue to reduce the contribution of trade to growth. Real wages will stagnate in 2023, as a gradual easing of labour market conditions limits nominal wage growth, before eventually increasing in 2024 thanks to lower inflation. Unemployment will increase steadily to about 4.5% as growth remains subdued. The government deficit will improve from 5.2% of GDP in 2022 to 3.5% of GDP in 2024, owing to both consolidation and higher growth.

Significant risks surround the outlook. The high interest burden on public debt and the recent drop in average debt maturity leave the public finances exposed to movements in bond yields. Renewed increases in wholesale energy prices due to Russia's war of aggression against Ukraine would further squeeze real incomes given the United Kingdom's high dependence on natural gas. Faster-than-expected resolution of uncertainty regarding future trade relationships is an upside risk.

Lifting labour supply is necessary and boosting investment is a top priority

Labour market participation remains weaker than before the pandemic, and women disproportionately work part-time because of care responsibilities. The childcare measure, which offers 30 hours a week of free childcare for working parents of nine-to-24-month-olds, should be implemented swiftly, as it will raise labour market participation and potential output while reducing gender inequalities in earnings. Energy support should be gradually withdrawn, except measures focused on households insufficiently protected against high energy prices through the regular social safety net. Providing certainty regarding investment conditions and future trade relationships is essential to boost productivity and accelerate the low-carbon transition.

United States

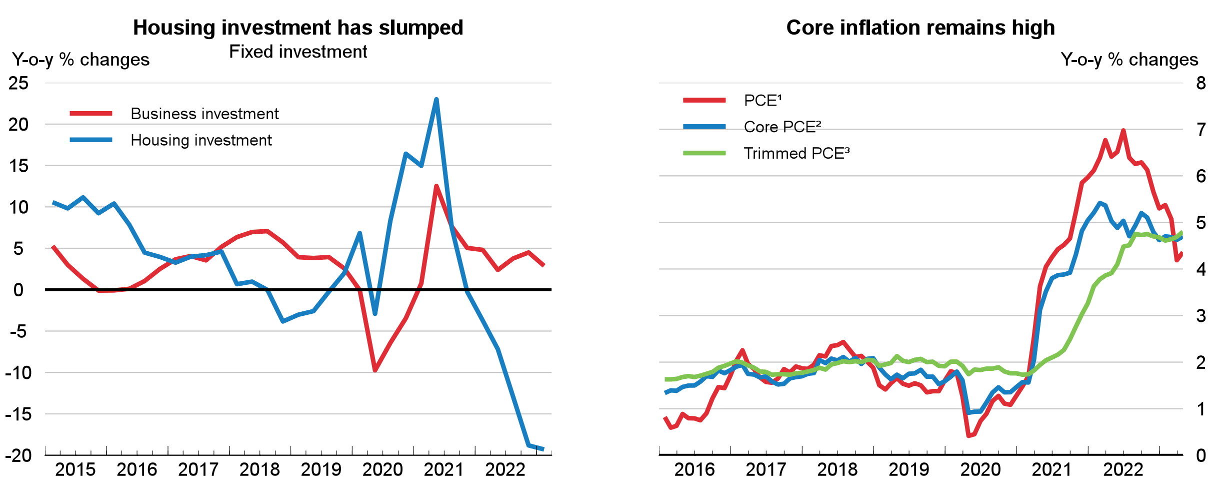
Real GDP is projected to grow by 1.6% in 2023 and 1.0% in 2024. Growth in private consumption and investment is expected to moderate in response to the tightening in monetary and financial conditions and as savings are further depleted. As demand slows, employment is expected to fall and the unemployment rate is projected to gradually rise towards 4½ per cent in 2024. With labour market tightness abating, wage growth is expected to moderate further, along with inflationary pressures. Nonetheless, the economic outlook could worsen if rising interest rates expose further financial fragilities. On the upside, faster-than-anticipated disinflation could allow an earlier easing of monetary policy that supports economic growth.

The lagged impact of monetary policy tightening along with a further increase in the federal funds rate will weigh on economic growth. Temporary fiscal support introduced during the pandemic has now unwound and the stock of household savings accumulated through the pandemic is being rapidly drawn down. Labour force participation of women would benefit from improving access to childcare through increased public funding. At the same time, the quality of childcare could be improved by establishing minimum federal standards for care provision and a quality rating system for childcare centres that is harmonised across states.

Economic activity continues to slow

Real GDP growth eased in the first quarter of 2023, growing at an annual rate of 1.3% compared with 2.6% in Q4 2022. Housing investment further declined, partly reflecting the tightening in financial conditions. There have been continued robust aggregate employment gains, but this has been less apparent in interest-rate sensitive sectors such as construction and manufacturing. Nominal wage growth has moderated somewhat, but remains high by historical standards. Although growth in the personal consumption expenditures price index fell to 4.4% in year-on-year terms in April 2023 from its peak of 7% in mid-2022, inflationary pressures in the services sector remain elevated.

United States 1



1. Personal consumption expenditures price index.
2. Personal consumption expenditures price index excluding food and energy.
3. The Trimmed Mean PCE inflation rate is published by the Federal Reserve Bank of Dallas and is an alternative measure of core inflation in the price index for personal consumption expenditures (PCE).
Source: U.S. Bureau of Economic Analysis (BEA); and Federal Reserve Bank of Dallas.

StatLink https://stat.link/2t7zuc

United States: Demand, output and prices

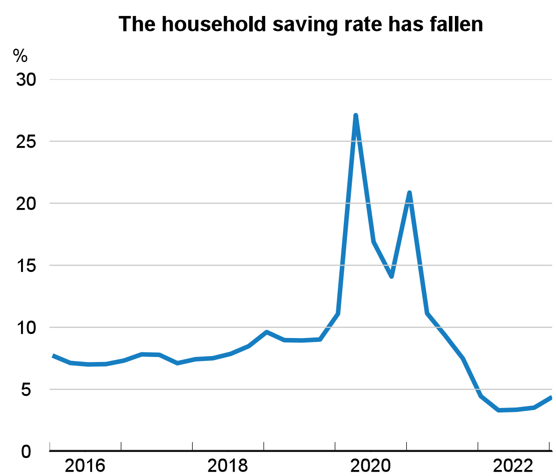
United States	2019	2020	2021	2022	2023	2024
	Current prices USD billion	Percentage changes, volume (2012 prices)				
GDP at market prices	21 381.0	-2.8	5.9	2.1	1.6	1.0
Private consumption	14 392.7	-3.0	8.3	2.7	2.2	1.0
Government consumption	3 008.8	2.2	1.3	-0.2	2.3	0.3
Gross fixed capital formation	4 485.5	-1.2	5.7	-0.5	-1.3	0.8
Final domestic demand	21 887.0	-1.9	6.7	1.7	1.5	0.9
Stockbuilding[1]	72.8	-0.6	0.2	0.7	-0.5	0.0
Total domestic demand	21 959.8	-2.4	7.0	2.4	1.0	0.9
Exports of goods and services	2 538.5	-13.2	6.1	7.1	4.0	3.6
Imports of goods and services	3 117.2	-9.0	14.1	8.1	-0.2	2.6
Net exports[1]	- 578.8	-0.3	-1.2	-0.4	0.5	0.0
Memorandum items						
GDP deflator	_	1.3	4.5	7.0	3.9	2.4
Personal consumption expenditures deflator	_	1.1	4.0	6.2	3.9	2.6
Core personal consumption expenditures deflator[2]	_	1.3	3.5	5.0	4.2	2.6
Unemployment rate (% of labour force)	_	8.1	5.4	3.6	3.7	4.4
Household saving ratio, net (% of disposable income)	_	17.5	12.4	3.7	2.7	3.5
General government financial balance (% of GDP)	_	-14.9	-12.1	-4.2	-5.1	-5.1
General government gross debt (% of GDP)	_	133.3	126.2	121.2	121.3	123.3
Current account balance (% of GDP)	_	-2.9	-3.6	-3.7	-3.3	-3.3

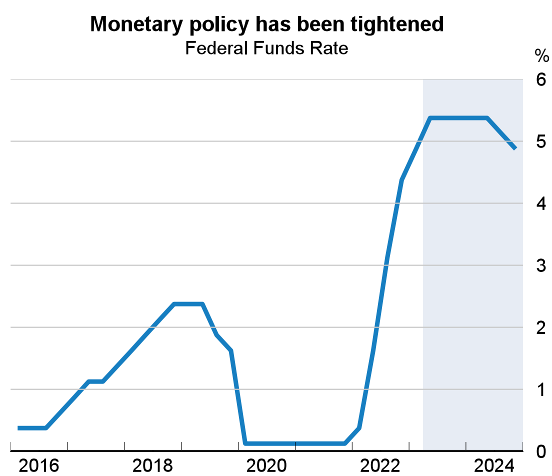
1. Contributions to changes in real GDP, actual amount in the first column.
2. Deflator for private consumption excluding food and energy.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/vc5iu1

Recent external developments have been largely supportive of economic growth. Bilateral exports to China have picked up in recent months, consistent with rebounding Chinese activity following the relaxation of pandemic-related restrictions. In addition, more stable global energy prices are dampening inflation in the United States. Domestic gasoline prices rose sharply through the first half of 2022 but have now declined to around the level observed immediately prior to the onset of Russia’s war of aggression against Ukraine.

United States 2





Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/xr49yk

Monetary and fiscal policy are no longer stimulating the economy

The Federal Open Market Committee has continued tightening monetary policy in response to the ongoing inflationary pressures. The federal funds rate has been lifted to the 5- 5¼ per cent range and central bank holdings of Treasury securities, agency debt and agency mortgage-backed securities continue to be reduced. The collapse of several regional banks in March prompted the Federal Reserve to introduce a new facility to provide short-term liquidity support to financial institutions. Nonetheless, surveys subsequently noted a tightening in bank lending standards amid increased uncertainty and concerns about liquidity. The OECD projections assume that the Federal Funds Rate is raised by a further 25 basis points in the coming months. The policy rate is assumed to remain at that level until the second half of 2024, at which point it starts to ease.

The projections assume a cumulative fiscal consolidation of around 1 per cent of GDP over 2023-24. Temporary fiscal support introduced during the pandemic has now been unwound. Nonetheless, some fiscal transfers from Federal to state and local governments are yet to be fully spent. The household saving rate has declined sharply since 2021 and much of the remaining excess savings pool accumulated during the pandemic is held by higher income households with lower marginal propensity to consume. The ongoing implementation of projects related to the Infrastructure Investment and Jobs Act will push public investment as a share of GDP slightly higher in the coming years. The aggregate impact on demand of the Inflation Reduction Act provisions will be limited in the period to 2024, with expenditure on a range of climate and energy initiatives and extensions to health care subsidies estimated to be offset by the introduction of a minimum corporate tax. The federal government reached the debt limit of US$31.4 trillion in January and the Treasury subsequently enacted “extraordinary measures” to meet financial obligations. A recent agreement to suspend the debt limit until 2025 and cap discretionary spending over the next two years is expected to reduce government outlays by 0.2% of GDP in 2024.

Economic growth will weaken

Real GDP is projected to grow by 1.6% in 2023 and 1.0% in 2024. Following a period of very strong nominal growth, spending on private consumption and investment is expected to moderate in response to the tightening of monetary and financial conditions and as excess savings are further depleted. Employment is anticipated to fall and the unemployment rate to gradually rise towards 4½ per cent in 2024. With labour market tightness abating, wage growth is expected to moderate, prompting a gradual decline in services inflation. Nonetheless, core inflation is not projected to return to around the Federal Reserve 2% target before late 2024.

There are both downside and upside risks to the projections. Rising interest rates will further impact debt-interest costs of households and businesses and this may exacerbate existing fragilities in the financial sector. On the upside, inflation could moderate more quickly if weaker labour demand results in a faster-than-anticipated decline in wage growth, allowing an earlier easing of monetary policy by the Federal Reserve.

Improving childcare access would promote gender equity

Further reducing the fiscal deficit would improve the sustainability of public finances and help curtail inflationary pressures. Revenue-raising options include phasing out regressive deductions from the tax code, such as the mortgage interest tax deduction and state and local tax deductions, and increasing the taxation of capital gains on inherited assets. The climate transition remains a key priority and further regulatory changes, green investment, structural reforms and carbon pricing will be required over the years ahead. In addition, promoting female participation in the labour market should be a priority given the large gap in participation rates between men and women. This partly reflects low affordability and availability of childcare. A fundamental issue is a lack of funding that means most families eligible for childcare support do not currently receive it. In addition, the quality of available care could be better ensured by establishing minimum federal standards for care provision and a quality rating system for childcare centres that is harmonised across states.