1. General assessment of the macroeconomic situation

Introduction

There are some signs that the global outlook has started to brighten, even though growth remains modest. The impact of tighter monetary conditions continues, especially in housing and credit markets, but global activity is proving relatively resilient, inflation is falling faster than initially projected and private sector confidence is now improving. Supply and demand imbalances in labour markets are easing, with unemployment remaining at or close to record lows, real incomes have begun to turn up as inflation moderates, and trade growth has turned positive. However, developments continue to diverge across countries, with softer outcomes in Europe and most low-income countries, offset by strong growth in the United States and many large emerging-market economies.

Global GDP growth is projected to be 3.1% in 2024, unchanged from 2023, before edging up to 3.2% in 2025 helped by stronger real income growth and lower policy interest rates (Table 1.1). The overall macroeconomic policy mix is nonetheless expected to remain restrictive in most economies, with real interest rates declining only gradually and mild fiscal consolidation in most countries over the next two years. China is an important exception, with low interest rates and significant additional fiscal support now appearing likely in 2024 and 2025. The divergence across economies is expected to persist in the near term but fade as the recovery in Europe becomes more firmly based, and growth moderates in the United States, India and several other emerging-market economies. Annual consumer price inflation in the G20 economies is projected to ease gradually, helped by fading cost pressures, declining to 3.6% in 2025 from 5.9% in 2024. By the end of 2025, inflation is projected to be back on target in most major economies.

The overall risks around the outlook are becoming better balanced, but substantial uncertainty remains. High geopolitical tensions remain a significant near-term adverse risk, particularly if the evolving conflicts in the Middle East were to intensify and disrupt energy and financial markets, pushing up inflation and reducing growth. Further reductions in inflation may also be slower than expected if cost pressures and margins remain elevated, particularly in services. This could result in slower-than-expected reductions in policy interest rates, exposing financial vulnerabilities and potentially generating a sharper slowdown in labour markets. Another key downside risk is that the future impact of higher real interest rates proves stronger than anticipated. Debt-service burdens are already high and could rise further as low-yielding debt is rolled over, or as fixed-term borrowing rates are renegotiated. Some sectors, particularly commercial real estate, remain hard pressed, and corporate bankruptcies and defaults are now above pre-pandemic levels in several countries, posing risks to financial stability. Growth could also disappoint in China, either due to the persistent weakness in property markets or smaller-than-anticipated fiscal support over the next two years, although activity could be stronger than expected if fiscal support is extensive or well-targeted. On the upside, demand growth could prove stronger than expected, especially in advanced economies if households and corporates draw more fully on the savings accumulated during the pandemic. Continued strong labour force growth in many countries might also enable inflation to fall more quickly than anticipated.

Against this backdrop, the key policy priorities are to ensure a durable reduction in inflation, establish a fiscal path that will address rising pressures, and undertake reforms to raise sustainable and inclusive growth in the medium term.

- Monetary policy needs to remain prudent to ensure that underlying inflationary pressures are durably contained. Scope exists to lower nominal policy interest rates this year and next as inflation declines, but the policy stance should remain restrictive in most major economies for some time. With real interest rates currently high, policy interest rates will need to move towards neutral levels as inflation returns to target to ensure that growth does not weaken excessively and inflation does not undershoot. In Japan, a gradual increase in policy interest rates would be appropriate in 2024-25 provided inflation settles at 2%, as projected. Easier global financial conditions enhance policy space in emerging-market economies, but the pace of rate reductions will need to remain cautious to maintain anchored inflation expectations and avoid disruptive capital outflows as yield differentials narrow with the advanced economies.

- Governments face mounting fiscal challenges from rising debt and sizeable additional spending pressures from ageing populations, climate change mitigation and adaptation, defence and the need to finance new reforms. Debt-service costs are also increasing as low-yielding debt matures and is replaced by new issuance. Without action, future debt burdens will rise significantly. Few countries appear likely to achieve a sustained primary budget surplus in the near term, making it challenging to stabilise debt. Stronger efforts to contain spending, enhance revenues, and increase growth would improve debt sustainability and resilience, and preserve the resources needed to support climate and distributional goals.

- The foundations for future output and productivity growth need to be strengthened. Ambitious structural policy reforms are required to improve educational outcomes, enhance skills development and innovation, and reduce the constraints in labour and product markets that impede investment and labour force participation. Strengthening skills, removing obstacles to the entry and expansion of new firms, and well-designed science and technology policies are all essential to help countries strengthen their innovative capacity and to maximise the benefits gained from adopting technologies and ideas developed elsewhere. New general-purpose technologies, such as artificial intelligence, can enhance the productivity of capital.

- In an interconnected world, enhanced multilateral co-operation is needed to help knowledge and innovation spread, strengthen global trade, ensure faster and better co-ordinated progress towards decarbonisation, and help reduce debt burdens in lower-income countries. Trade and industrial policy choices should strive for more resilient global value chains without eroding the potential benefits for efficiency and innovation, or overlooking the income gains from lowering other trade barriers, especially in services and digital sectors. Faster progress towards decarbonisation is also essential. Innovation is one essential pillar of policy efforts, helping to lower the cost of new technologies. Increasing green and digital infrastructure investment, strengthening standards to enable a reduction in emissions, and raising the scope and level of carbon pricing are other key areas for policy action.

Table 1.1. Global GDP growth is projected to remain steady this year and next

	Average 2013-2019	2022	2023	2024	2025	2023 Q4	2024 Q4	2025 Q4
				Per cent				
Real GDP growth[1]								
World[2]	3.4	3.4	3.1	3.1	3.2	3.3	3.1	3.2
G20[2]	3.5	3.1	3.4	3.1	3.1	3.6	3.0	3.1
OECD[2]	2.3	3.0	1.7	1.7	1.8	1.7	1.7	1.9
United States	2.5	1.9	2.5	2.6	1.8	3.1	1.8	1.9
Euro area	1.9	3.5	0.5	0.7	1.5	0.0	1.2	1.6
Japan	0.8	1.0	1.9	0.5	1.1	1.3	1.0	1.0
Non-OECD[2]	4.4	3.7	4.4	4.2	4.3	4.7	4.3	4.2
China	6.8	3.0	5.2	4.9	4.5	5.6	4.7	4.5
India[3]	6.8	7.0	7.8	6.6	6.6			
Brazil	-0.4	3.1	2.9	1.9	2.1			
OECD unemployment rate[4]	6.5	5.0	4.8	5.0	5.0	4.9	5.1	5.0
Inflation[1]								
G20[2,5]	3.0	7.9	6.3	5.9	3.6	5.3	4.5	3.1
OECD[6]	1.6	9.4	7.1	4.8	3.5	5.7	4.1	3.1
United States[7]	1.3	6.5	3.7	2.4	2.0	2.8	2.5	1.9
Euro area[8]	0.9	8.4	5.4	2.3	2.2	2.7	2.3	2.0
Japan[9]	0.9	2.5	3.3	2.1	2.0	2.9	1.6	2.0
OECD fiscal balance[10]	-3.2	-3.3	-4.8	-4.5	-4.1			
World real trade growth[1]	3.4	5.3	1.0	2.3	3.3	1.9	2.5	3.5

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. Moving nominal private consumption weights, using purchasing power parities.
7. Personal consumption expenditures deflator.
8. Harmonised consumer price index.
9. National consumer price index.
10. Per cent of GDP.

Source: OECD Economic Outlook 115 database.

Recent Developments

Global activity has proved surprisingly resilient so far

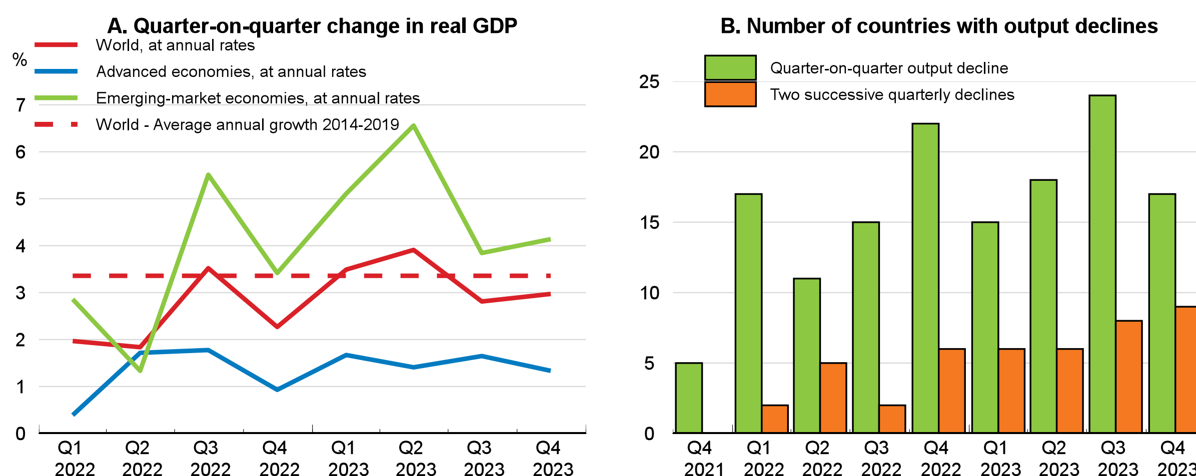
Global growth in 2023 continued at an annual rate of a little over 3% despite the drag exerted by tighter financial conditions and other adverse factors, including the ongoing war in Ukraine and the evolving conflicts in the Middle East (Figure 1.1, Panel A). This was similar to the rate prevailing in the immediate pre-pandemic period and considerably better than projected a year ago.[1] Still, the resilience of the global economy has not been universal. Growth was robust in the United States, driven by strong household consumption and unexpectedly expansionary fiscal policy, and in many large emerging-market economies, but weakened in many other advanced economies, especially in Europe, and in low-income countries as a group. A rising number of economies experienced a technical recession in 2023, with two or more

[1] Global growth in per capita terms in 2023 was slightly above the pre-pandemic pace, reflecting slower global population growth than on average per annum over the 2010s.

consecutive quarterly output declines (Figure 1.1, Panel B). Output declined in 12 OECD economies over the year to the fourth quarter, including Germany and the United Kingdom, and stagnated in the euro area. This weakness in Europe reflects the lingering effects from the large energy price shock in 2022 and the slowdown in credit growth in economies with a relatively high dependence on bank-based financing. Growth was resilient in Japan in 2023, helped by still-accommodative monetary policy and a mildly expansionary fiscal stance, but slowed in the latter half of the year.

Amongst major emerging-market economies, (expenditure-based) GDP growth was buoyant in India, helped by strong public investment, and Indonesia, and surprised on the upside in Brazil, Mexico and Türkiye, despite tighter financial conditions. Growth also strengthened in China in the first quarter of 2024, with policy stimulus measures helping to offset continued weakness in property markets. In contrast, outcomes have remained weaker in several vulnerable countries, amidst restrictive financial conditions and growing signs of adverse effects from climate disruptions. Although the strong El Niño event that began in mid-2023 yielded a string of global temperature records, making 2023 the warmest year in modern history, it did not have much effect on global agricultural output or commodity prices. Regional effects have, however, been large in some cases. Severe drought in Southern Africa has sharply reduced grain harvests and resulted in water shortages and power cuts. This is one factor in the disappointing growth of low-income countries as a group in 2023.

Figure 1.1. Global growth held up in 2023, but some economies experienced a recession



Note: In Panel A, the global, advanced economy and emerging-market economy aggregates are derived using moving PPP weights. Panel B count based on 58 advanced and emerging-market economies.
Source: OECD Economic Outlook 115 database; and OECD calculations.

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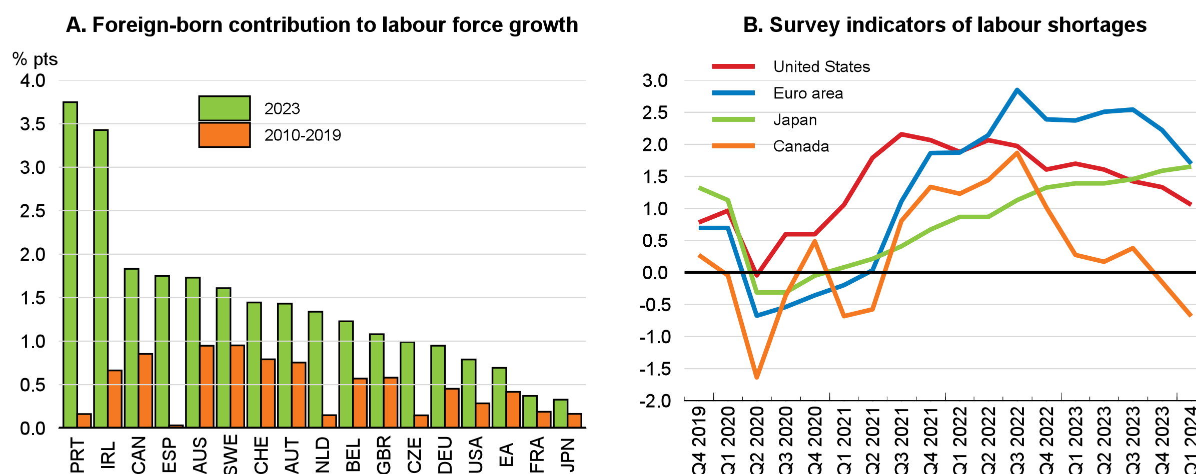
Positive supply-side developments in many advanced economies have also helped to underpin growth. 2023 was a year of exceptionally large migration inflows in some OECD economies, including the United States, the United Kingdom, Canada, Spain and Australia. This had positive effects on the availability of workers, boosting overall GDP growth (Figure 1.2, Panel A). However, per capita GDP growth rates were much lower, and in some cases negative.[2] Output per worker also declined in 2023 in all of these economies, with the exception of the United States.

[2] Canada, Colombia, the Netherlands, New Zealand, Poland and the United Kingdom all had positive real GDP growth in 2023 but a decline in real GDP per capita.

Figure 1.2. Strong immigration has boosted the labour force in some countries, and labour shortages have generally eased



Note: In Panel A, the figure shows the contribution of the growth of the foreign-born labour force to total labour force growth. Annual average contribution for 2010-19. The labour force corresponds to the population aged 15 and over either in or seeking employment. In Panel B, the data are standardised national survey indicators: the percentage of small firms with at least one hard-to-fill job (United States); the inverse of the employment conditions diffusion index in the Tankan survey for all firms in all industries (Japan); the share of firms reporting labour as a factor limiting their production (euro area); and the percentage of firms reporting labour shortages (Canada). For the euro area the answers for services and industries have been aggregated using their respective share in gross output. The standardisation is constructed to yield an average of zero and a standard deviation of 1 over the period 2003-2023. A decline represents an easing in labour shortages.

Source: Australian Bureau of Statistics; Bank of Canada; Bank of Japan; Statistics Canada; Eurostat; European Commission; UK Office of National Statistics; US Bureau of Labor Statistics; US National Federation of Independent Businesses; and OECD calculations.

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Strong labour force growth, and labour participation rates rising to a record high in the OECD as a whole in 2023, have helped supply and demand conditions in labour markets become better balanced, although conditions still remain relatively tight. Employment growth has slowed, the number of vacancies has declined, and total hours worked have eased in some countries, but unemployment rates generally remain close to historical lows. Vacancy-unemployment ratios are also still above pre-pandemic norms in many countries, including the United States, the Netherlands, Norway and Belgium.[3] Survey evidence suggests that firms now have fewer pressing labour shortages (Figure 1.2, Panel B), although earlier difficulties in recruiting workers with suitable skills may encourage companies to retain workers unless demand weakens substantially.

Nominal wage growth is now moderating in most countries as inflation declines, Japan being one exception, with the outcome of the spring wage round pointing to sizeable base pay gains of over 3½ per cent for union employees over the next year. Even so, with productivity growth remaining weak in many countries, the growth of unit labour costs often remains above levels compatible with inflation settling durably at 2%. Over the year to the fourth quarter of 2023, based on the OECD countries with available data, unit labour costs are estimated to have risen by 6.7% in the median economy. By contrast, unit profits

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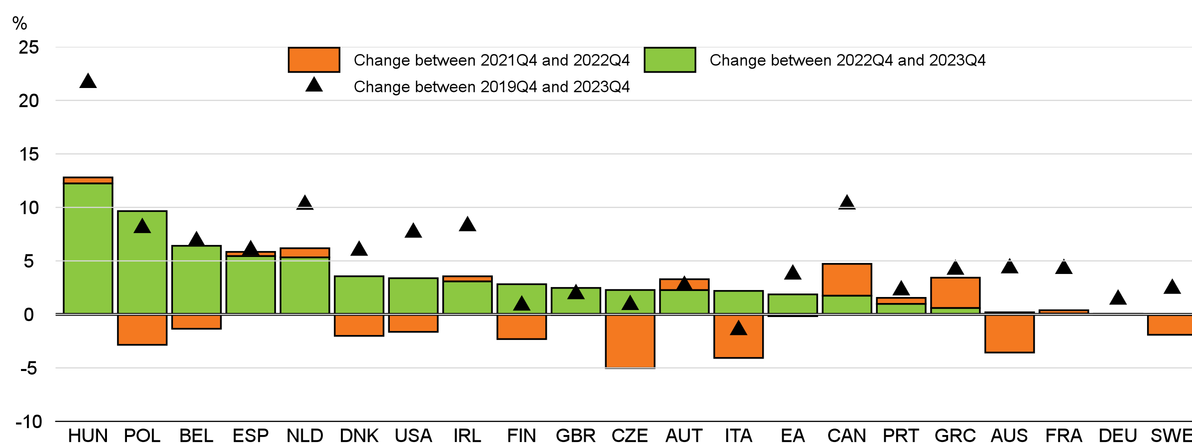
[3] There is a question of whether migration flows have been fully reflected in labour market data. For example, recent estimates from the Congressional Budget Office of net migration to the United States are well above those of the Census Bureau, used by the Bureau of Labor Statistics in its employment reports (Edelberg and Watson, 2024). An inability of surveys to fully capture new additions to the labour force may help to explain why wage growth has tended to moderate even as recorded unemployment rates remain low.

fell by 0.2% in the median OECD economy in the same period. This decline in unit profits comes after the strong rise of 8.8% in unit profits in 2022.

Continuing employment growth, high nominal wage growth and falling inflation have recently generated a recovery in real household disposable incomes in many OECD economies. Nonetheless, the situation varies across countries, with real income stagnation in Australia, France, Germany and Sweden over the year to the fourth quarter of 2023 (Figure 1.3). The gradual revival of real incomes has helped to underpin consumers' expenditure. Even so, private consumption growth in 2023 was modest in all major OECD economies with the exception of the United States, where the stock of excess household savings continued to fall (OECD, 2024a), delivering robust spending growth. Amongst the emerging-market economies, consumer spending growth was also robust in Brazil, Costa Rica, India, Indonesia and Türkiye.

Figure 1.3. Real income growth has started to recover in many countries

Growth of real household disposable income



Note: Gross nominal household disposable income deflated by the private consumption deflator. For Austria, Belgium, Czechia, Greece, Ireland, the Netherlands and Poland, data for 2023Q4 are OECD Economic Outlook projections. Countries shown are ones with data available up to at least 2023 Q3.
Source: OECD Economic Outlook 115 database; OECD Quarterly non-Financial Accounts by Institutional Sector database; Eurostat; and OECD calculations.

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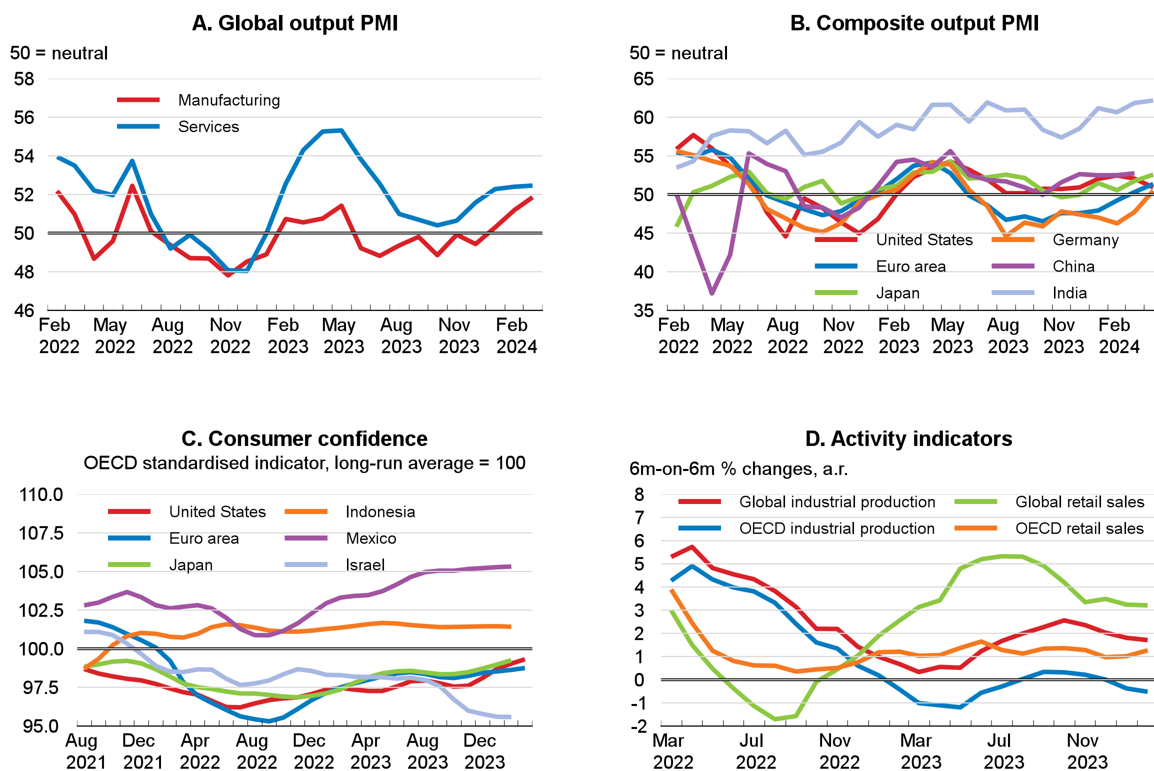
The rise in interest rates over the past two years has hit activity in the housing market. Between the first quarter of 2022 and the last quarter of 2023, residential investment fell by close to 6½ per cent in the median OECD economy, with even larger declines in some G7 economies, including the United States. The rise in mortgage rates has also been reflected in falling real house prices in many countries, and a drop in nominal prices in a few, including Denmark, Finland, Germany, Korea, New Zealand and Sweden. Even where prices have remained near their peaks, the volume of transactions has often contracted sharply (OECD, 2024a), with many sellers preferring to keep properties off the market rather than accept a lower price. In several European economies, including Türkiye, as well as Korea and China, the volume of transactions has declined by between 20-30% since the start of 2022.

Business investment has generally held up better since interest rates began to increase, but by the second half of last year there were increasing signs of weakness: three-quarters of OECD economies with available data had falling private non-residential fixed investment by the last quarter of 2023. Corporate profit levels continued to be supported by resilient global growth in 2023, but the strong upturn seen in 2022 has at least partially reversed in many countries. Subdued credit growth, rising debt-service payments, and a decline in business dynamism are all factors that could moderate business investment growth for some time.

Recent monthly indicators have been mixed across countries, but collectively suggest that the moderation in global growth around the turn of the year has bottomed out. Business surveys point to improving activity in both manufacturing and services, helped by strong momentum in India and signs of stronger outcomes in China and most major advanced economies (Figure 1.4, Panels A and B). Consumer confidence is improving, but remains subdued relative to long-term norms in most major advanced economies, as well as in China (Figure 1.4, Panel C). There has also been a recent sharp downturn in Israel. But confidence has held up better in many emerging-market economies where growth has remained resilient, including Indonesia and Mexico. High-frequency indicators of consumer spending moderated a little in recent months, though they generally remained resilient. In contrast, industrial production growth generally remained soft outside of China (Figure 1.4, Panel D).

Figure 1.4. Recent activity indicators point to improved confidence but modest growth momentum



Note: In Panels A and B, values below 50 indicate that a balance of firms reports a contraction in output. The global and OECD aggregates in Panel D are PPP-weighted measures. The retail sales measure uses monthly household expenditure for the United States, the monthly real consumption activity indicator for Japan, and retail sales volumes in other countries.
Source: OECD Economic Outlook 115 database; S&P Global; OECD Main Economic Indicators database; Bank of Japan; and OECD calculations.

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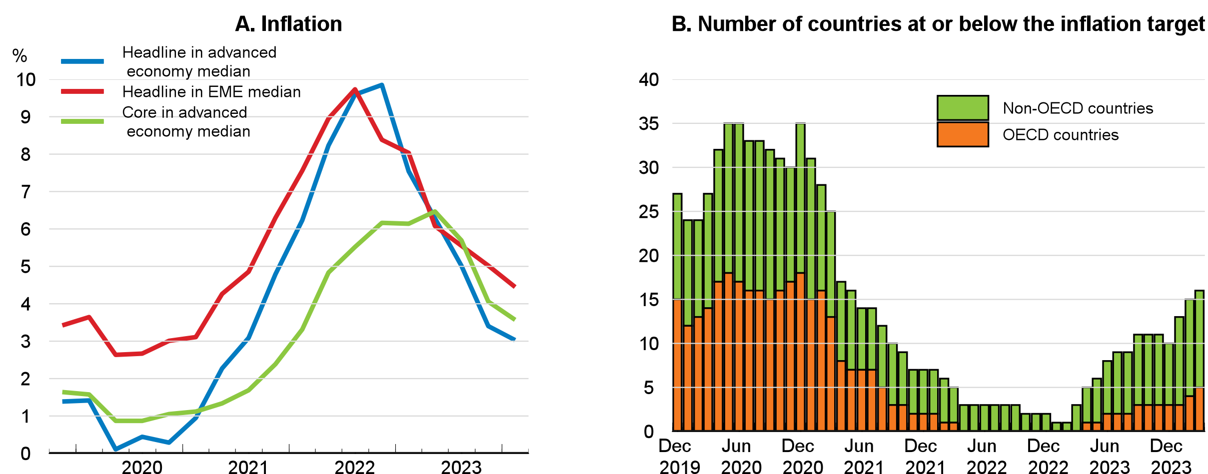
Inflation has fallen towards targets, but some pressures persist

Headline inflation fell rapidly in most economies during 2023 (Figure 1.5, Panel A), helped by generally restrictive monetary policy settings, lower energy prices and continued easing of supply chain pressures. Food price inflation also came down sharply in most countries, as good harvests for key crops such as wheat and corn resulted in prices falling rapidly from highs reached after the start of the war in Ukraine. Average inflation in the median advanced economy fell from 9.9% in the last quarter of 2022 to 3% in the first quarter of 2024. Annual inflation was also generally easing among emerging-market economies except for Argentina and Türkiye, where inflation has risen further into 2024. However, recent month-on-month increases in these countries have begun to moderate. Inflation in China has remained very low, standing at 0.1% in March. Headline inflation is now at or below target in about a third of economies worldwide (Figure 1.5, Panel B).

Figure 1.5. Inflation pressures continue to ease



Note: In Panel A, advanced economy median and emerging-market economies (EME) median denote the median inflation rate in the advanced economies and the emerging-market economies respectively. Based on 34 advanced economies and 16 emerging-market economies. Panel B covers 22 OECD economies (the euro area is included but no individual euro area member countries) and 25 non-OECD countries. For central banks targeting a range, the mid-point was used.
Source: OECD Economic Outlook 115 database; OECD Consumer Price database; Eurostat; various Central Banks; and OECD calculations.

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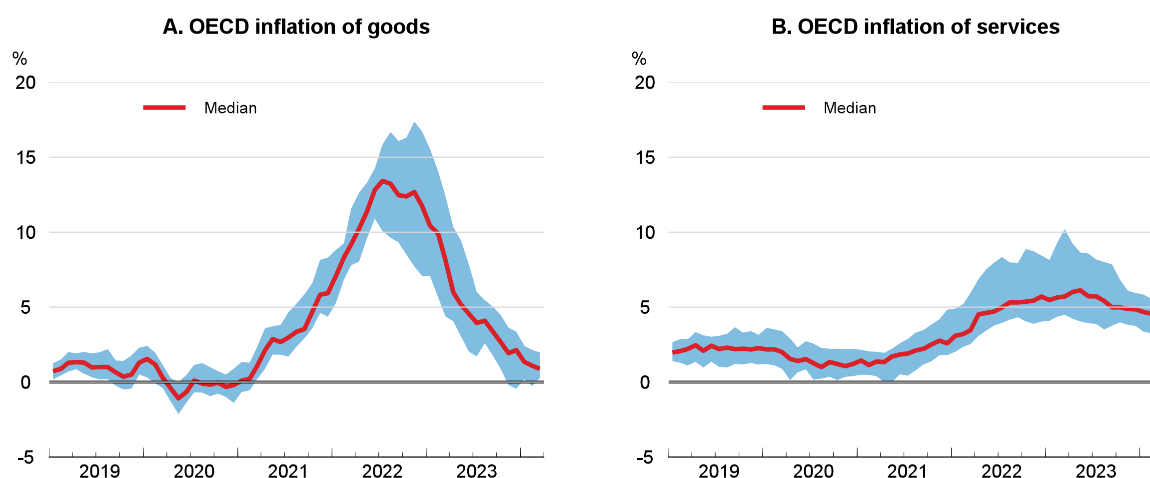
Measures of underlying inflation, including core inflation (excluding food and energy), trimmed means and median inflation, have also moved down over the past year, but more slowly than headline inflation. Core goods price inflation has generally fallen steadily, but services price inflation has been stickier, remaining well above pre-pandemic averages in most OECD countries (Figure 1.6). In part this reflects the greater weight of unit labour costs in many services, as well as higher unit profits in some sectors. As of March, annual services price inflation remained at 4% in the United States (based on the PCE) and the euro area, and over 6% in several countries in Central and Eastern Europe.

One widely used approach to assess the contributions to inflation from supply and demand factors (Shapiro, 2022; OECD, 2024a) suggests that both supply-driven and demand-driven price changes continued to make positive contributions to inflation up to the fourth quarter of 2023 in a range of advanced economies. However, relative to a year earlier, when annual inflation was higher, the contributions of supply-driven items have fallen by more than the demand-driven contributions (Figure 1.7). These estimates suggest that in most of these economies, the bulk of the disinflation seen over the past year corresponds to an easing of supply-driven inflation. In part, this may reflect the inflation measure being used for the analysis (private consumption deflators in the national accounts) as these include food and energy where supply factors are particularly important. At the same time, analyses of core inflation in the United States (Konczal, 2023) and the euro area (Bańbura et al, 2024) find that disinflation in core prices (excluding food and energy) has also been primarily supply-driven. Such findings do not mean that the tightening of monetary policy since early 2022 has had little effect, not least because softer demand will have contributed to the easing of some supply-side pressures on inflation, but may suggest that the disinflationary effect of squeezed demand has yet to be fully felt.[4]

Figure 1.6. Goods price inflation is back to normal levels, but services price inflation is still high

OECD median and inter-quartile range



Note: Based on national consumer price index data for 28 OECD countries. The blue shaded areas show the range between the 1st quartile and the 3rd quartile.
Source: OECD Consumer Prices database; and OECD calculations.

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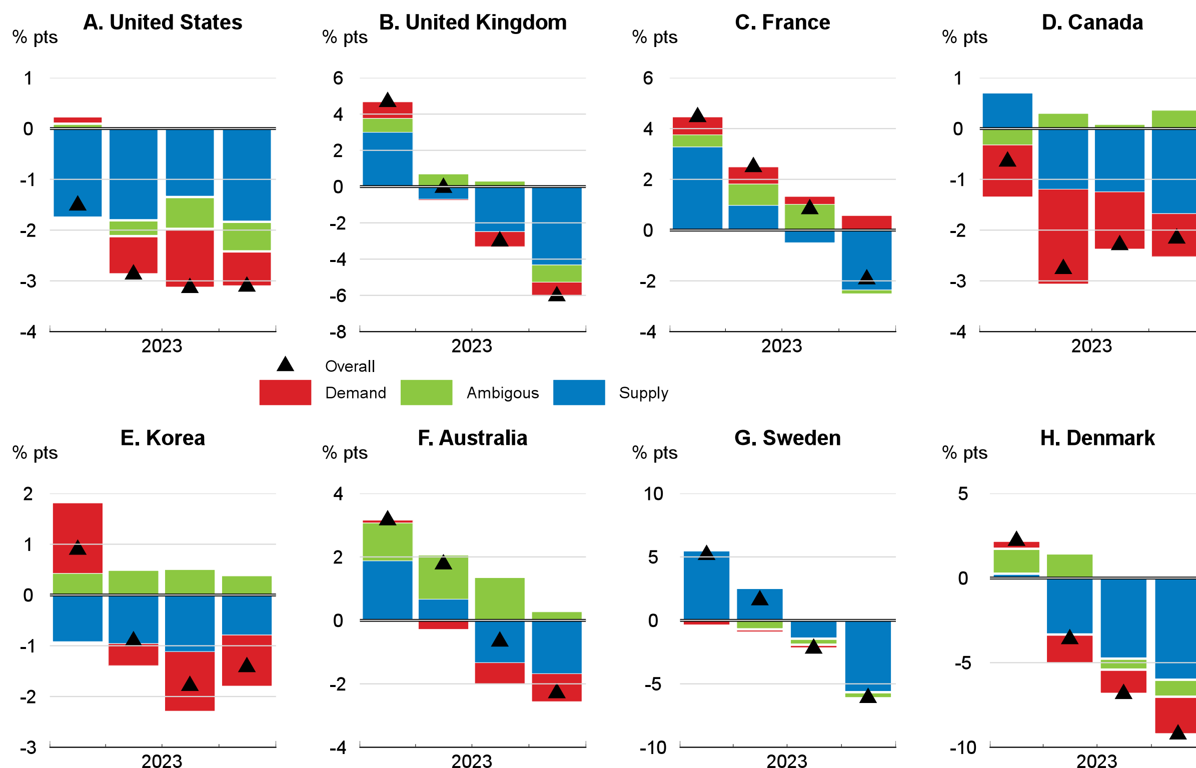
[4] It could also have been that, in the absence of a tightening of monetary policy, the contribution of demand-driven factors would have increased.

Figure 1.7. Supply factors account for the bulk of disinflation over the past year

Estimated contribution to year-on-year change in annual consumer price inflation



Note: The chart shows the difference between the estimated contribution of each of the three categories to the annual headline inflation rate in the current quarter and the contribution to the annual inflation rate a year earlier. Based on disaggregated data for prices and expenditure. Shocks to prices and volumes are identified using the residuals from rolling 10-year vector autoregressions for quarter-on-quarter changes in prices and volumes of each item in the price index (the private consumption deflator). Price and volume residuals with the same sign are assumed to reflect demand shocks and residuals with opposite signs to reflect supply shocks. An intermediate range, labelled "ambiguous", is identified when price and/or volume residuals are too small to be considered significant. The contributions of each category to year-on-year inflation are calculated as the sum of the latest four quarterly contributions.

Source: Australian Bureau of Statistics; Bank of Korea; INSEE; Statistics Canada; Statistics Demark; Statistics Sweden; UK Office of National Statistics; US Bureau of Economic Analysis; and OECD calculations.

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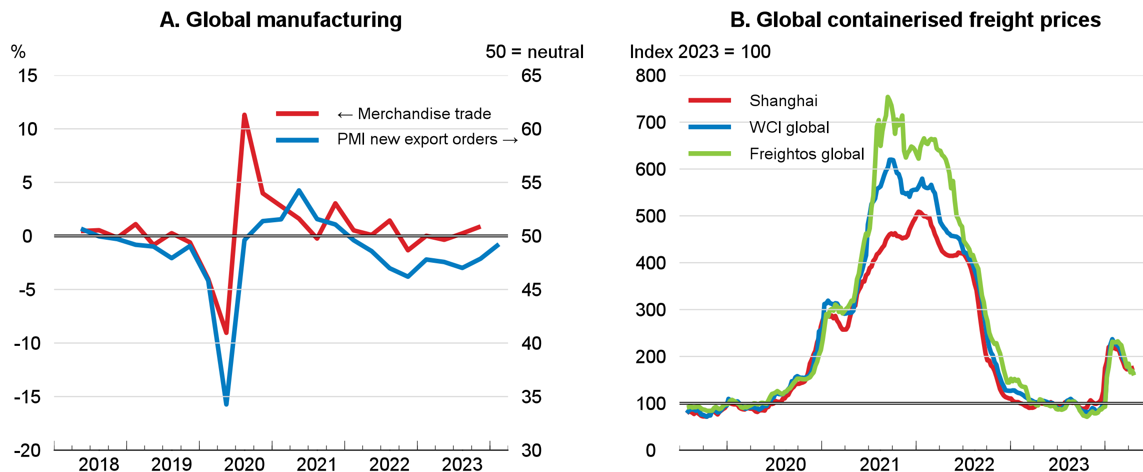
Trade is showing signs of recovery

Annual world trade volume growth slowed significantly in 2023 to 1%, after the robust increase of 5.3% in 2022. Inventory reductions and the shift in consumption towards less trade-intensive services contributed to the slowdown, especially in the United States and Europe, although a continued recovery in international travel helped support overall services trade. US import volumes declined by 1.7% in 2023, after growth of 8.6% in 2022, exerting a significant drag on export growth in trading partners. China was a notable exception to the global pattern, with reopening helping trade growth to strengthen after a decline in 2022. This cushioned the moderation in external demand for many other emerging-market economies. Strong growth in China, Korea and the United States helped aggregate global trade growth rebound in the fourth quarter of 2023, despite continued weakness in Europe. The upturn was particularly marked in exports, with a significant gap appearing between recorded export and import growth in the latter half of 2023.

Recent high-frequency indicators suggest that the recovery of trade continued in early 2024, although it remains fragile and heavily dependent on the United States and China. In February, the CPB estimate of monthly global merchandise trade volumes was just 0.3% higher than December 2023. Survey measures of global manufacturing export orders have, however, turned up from a low level (Figure 1.8, Panel A), and service export orders have strengthened. Air traffic data signal that the recovery of cross-border travel and strong growth in air freight traffic has persisted, supported by vigorous growth in e-commerce and spillovers from disruptions to maritime traffic in the Red Sea.

Figure 1.8. Export orders have begun to improve but shipping costs remain elevated

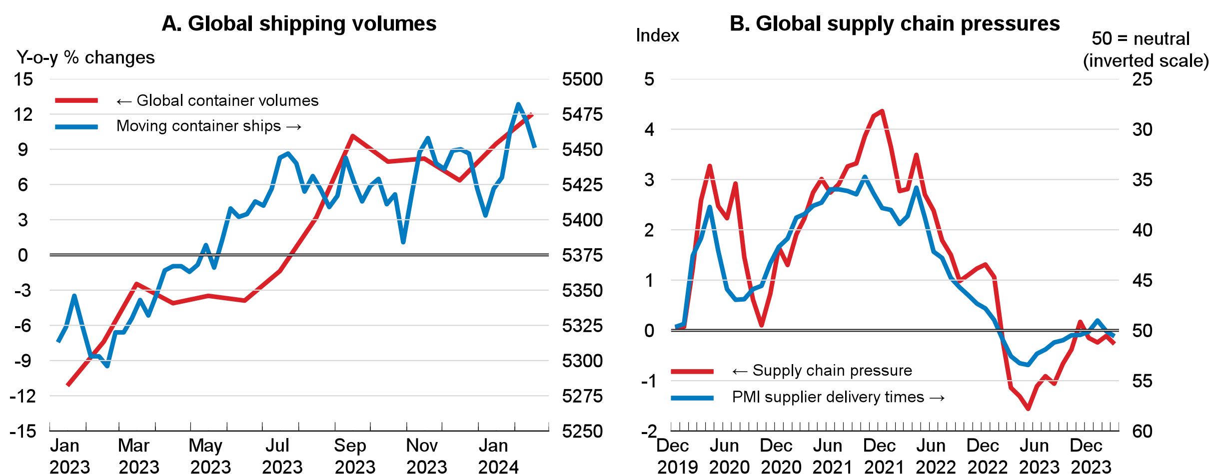


Note: Quarterly trade volume growth, non-annualised. PMI new export orders are a quarterly average of monthly data. Values for new export orders below 50 indicate that a balance of firms reports a contraction. Container prices based on twenty-foot equivalent units.
Source: OECD Economic Outlook 115 database; S&P Global; Bloomberg; and OECD calculations.

Attacks on shipping in the Red Sea have resulted in trade flows being re-routed. Since the attacks began in December 2023, container ship transits through the Suez Canal have fallen, with average daily vessels between January and mid-April about 51% lower than in the last quarter of 2023. Re-routing around the Cape of Good Hope has affected approximately 9% of the world's maritime trade, and around 18% of long-haul ocean vessel volumes, resulting in journey times for affected cargo between North Europe and Asia rising by about 30%. Drought in the Panama Canal has further lengthened journey times as ships are diverted.[5] These developments have pushed up shipping costs. Although prices have eased from their January peaks, shipping costs remain about 60% higher than in 2023 (Figure 1.8, Panel B). The new routes have led to some delays, with an estimated 53% of vessels arriving on time in February, compared to about 65% of vessels in September 2023, but the average length of delays has begun to fall as shipping schedules adjust to the new, longer routes (Sea-Intelligence, 2024). Indicators of supply chain bottlenecks have so far worsened only marginally, remaining below levels seen during 2021-22 (Figure 1.9). Higher shipping costs are expected to slightly lower the pace of disinflation, but pass-through into headline inflation is expected to be limited as moderate global demand growth and the ongoing delivery of new shipping vessels have helped to contain supply constraints so far.

[5] Vessels avoiding the Panama Canal had been directed through the Red Sea over the past year, resulting in higher volumes through the Red Sea prior to the recent attacks.

Figure 1.9. The impact of shipping attacks on supply chains is so far limited



Note: Container volumes in millions of twenty-foot equivalents; monthly. Moving container ships based on weekly data, daily average to 14 February 2023. Supplier delivery times are inverted in Panel B since an increase in supplier delivery times tends to be negative for production.
Source: Federal Reserve Bank of New York; Kiel Trade Indicator; S&P Global; Xeneta; Bloomberg; and OECD calculations.

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Financial conditions have eased but real interest rates remain elevated

Global financial conditions have eased modestly in recent months. Equity prices have strengthened, volatility has receded, and indicators of broader financial stress remain contained. Nonetheless, financial conditions remain restrictive, with elevated forward-looking real interest rates (see below) continuing to weigh on activity. With higher lending rates and tighter credit standards, credit growth in most major advanced economies remains negative in real terms, even though there are some signs of stabilisation in recent data.

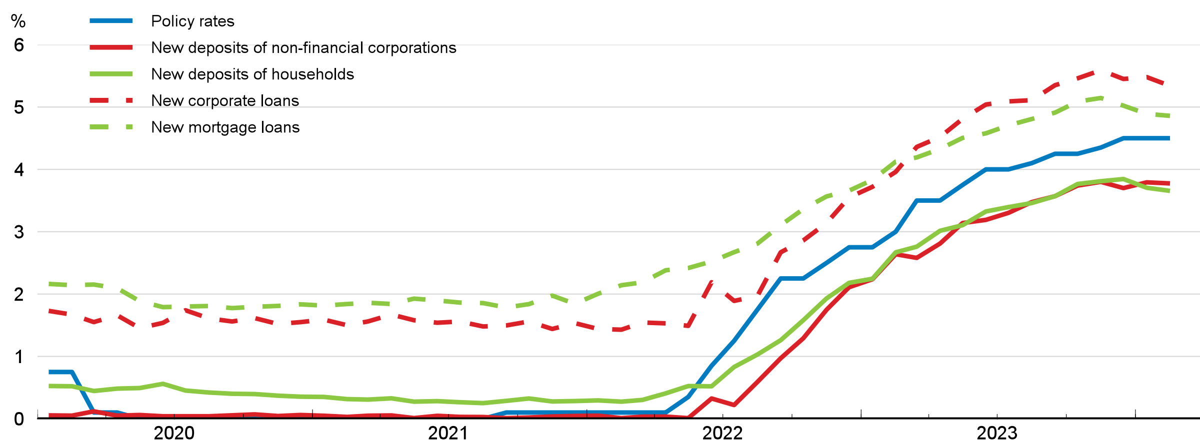
After falling markedly in late 2023, nominal long-term government bond yields have increased since early 2024 in most economies, reflecting upward shifts in market expectations of the future path of policy interest rates in the major advanced economies and higher term premia. Quantitative tightening programmes are also placing some mild upward pressure at the margin (Du et al., 2024). In contrast, corporate bond spreads have moderated, for both investment grade and speculative bonds, despite an ongoing upturn in the number of corporate bankruptcies in some countries. Strong demand for key tech-related equities and resilient risk appetite have boosted equity prices this year, although China is a notable exception. The US dollar has appreciated moderately in nominal effective terms since January and large currency depreciations relative to the US dollar have occurred in high inflation emerging-market countries.[6]

[6] In Argentina, a significant realignment of the official bilateral exchange rate with the US dollar was implemented in December, as part of efforts to restore macroeconomic stability, implying a 54% devaluation of the domestic currency.

There are signs that the transmission of monetary policy tightening to credit conditions may be approaching its end in most advanced economies. Bank lending rates to firms and household mortgages have edged down recently (Figure 1.10), as have household deposit rates, suggesting a completed pass-through of past policy rate increases. The tightening in credit standards has also moderated in many large economies for loans to non-financial corporations and halted in some euro area economies for household mortgages.[7] Supply and demand factors both help to explain the persistence of subdued credit growth in advanced economies, though signs of stabilisation are now appearing (Figure 1.11, Panel A). Credit growth has begun to strengthen in Brazil and Mexico in real terms (Figure 1.11, Panel B), helped by an upturn in credit demand and the earlier end to policy rate increases in these countries.

Figure 1.10. Bank lending and deposit rates have stopped rising in the advanced economies

Median rates across advanced economies



Note: The advanced economies are Australia, Canada, Denmark, France, Germany, Italy, Japan, New Zealand, Norway, Spain, Sweden, Switzerland, the United Kingdom, and the United States. In the computation of median deposit rates, offer rates are used for New Zealand, Norway, and the United States, and deposits of all sectors (without distinguishing between firms and households) are used for Japan, New Zealand, and the United States.
Source: Bank of Canada; Bank of England; Bank of Japan; Danmarks Nationalbank; European Central Bank; Japan Housing Finance Agency; Reserve Bank of Australia; Reserve Bank of New Zealand; Statistics Norway; Statistics Sweden; Swiss National Bank; US Federal Reserve; and OECD calculations.

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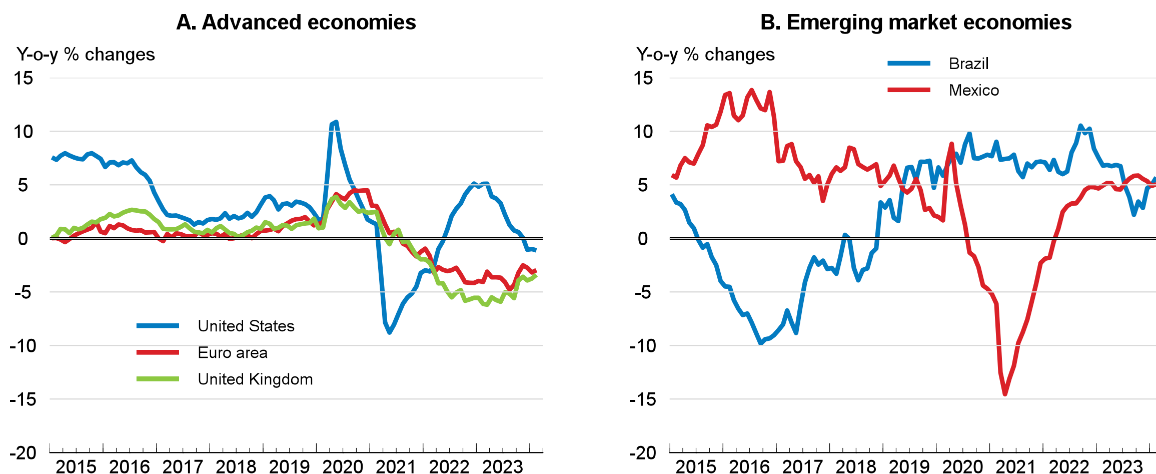
[7] Bank lending surveys also show that the drop in credit demand by firms and households has moderated in advanced economies.

Figure 1.11. Recent credit dynamics differ considerably across economies

Credit outstanding to households and companies



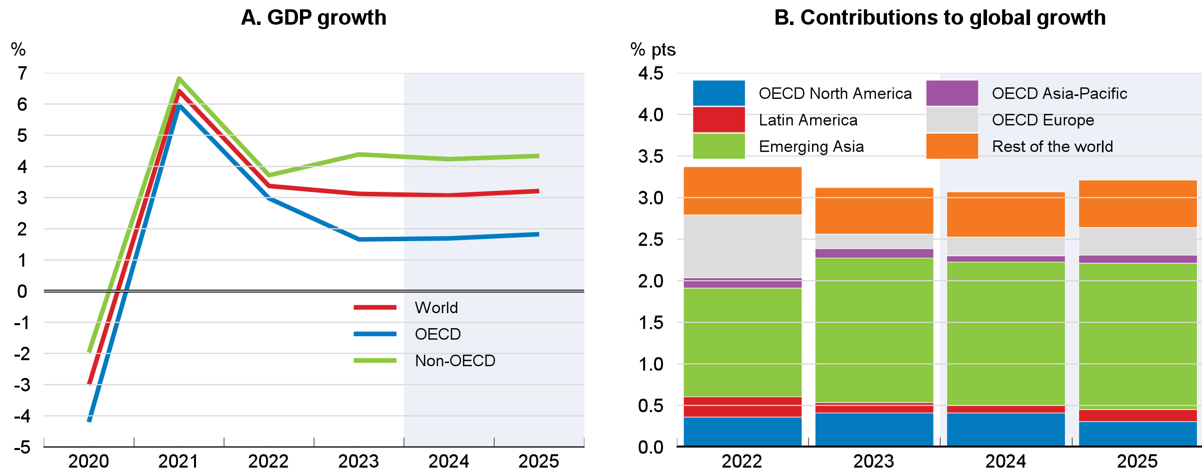
Note: Deflated with national consumer price indices. For the United States, credit outstanding refers to loans plus leases.
Source: Banco Central do Brasil; Banco de México; Bank of England; European Central Bank; US Federal Reserve; and OECD calculations.

Projections

Global growth, which slowed in the second half of 2023, is expected to stabilise and then pick up slightly through 2024-25. In part, this reflects better momentum than previously expected in the United States and some emerging-market economies. More broadly, faster disinflation than projected a few months ago is projected to result in a widespread easing of monetary policy as inflation converges towards central bank targets. This should sustain a recovery in real incomes and boost interest-rate-sensitive expenditures. Stronger policy stimulus in China is also expected to help sustain domestic demand, despite the ongoing weakness in the property sector, with recent announcements signalling additional government bond issuance of around 1¼ per cent of GDP in 2024. In Europe, recent growth has been weak, but the easing of inflation over the past few months should help to underpin an improvement in activity. Global GDP growth is projected to be 3.1% in 2024 and edge up to 3.2% in 2025, after 3.1% in 2023 (Figure 1.12; Table 1.1). This is weaker than seen in the decade before the global financial crisis, but close to currently estimated potential growth rates in both advanced and emerging-market economies.

A projected continued fall in headline and core inflation should enable central banks to begin lowering policy rates this year in many economies, although real rates will remain restrictive (above estimated neutral levels) for some time. At the same time, fiscal policy is projected to be tightened modestly in most OECD countries, leaving the overall macroeconomic policy stance restrictive. Continued fiscal and monetary stimulus is expected in China, but in Brazil, India, and several other large emerging-market economies, policy interest rates are projected to decline with fiscal policy projected to be mildly restrictive in 2024 and 2025.

Figure 1.12. Global growth is projected to remain modest



Note: In Panel B, Emerging Asia comprises China, India, Indonesia and the Dynamic Asian Economies (Hong Kong (China), Malaysia, the Philippines, Singapore, Chinese Taipei, Thailand and Viet Nam). Latin America comprises Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico and Peru. Contributions calculated using moving PPP shares of global GDP.
Source: OECD Economic Outlook 115 database; and OECD calculations.

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The prospects for individual major economies/regions are as follows:

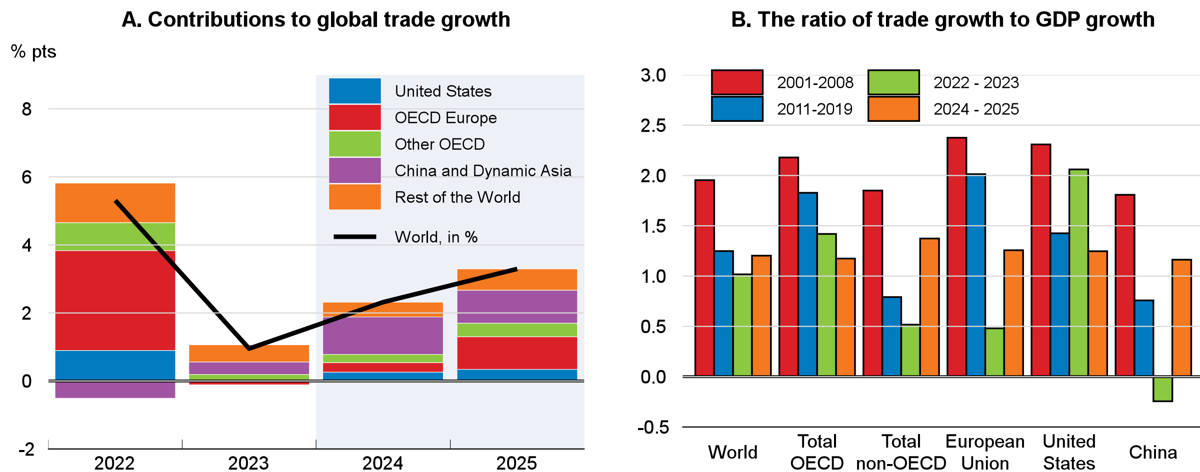
- In the United States, higher borrowing costs and the fading of support from rising asset prices and the rundown of accumulated excess household savings are expected to moderate domestic demand in mid-2024, despite a resilient labour market. Gradual monetary easing is projected to spur a pick-up from late 2024 through 2025. On an annual basis, GDP growth is projected to be 2.6% in 2024 and 1.8% in 2025. The impact of higher interest rates remains more visible in Canada, especially in the housing market. A recovery in real incomes, continued rapid population growth and stronger external demand are projected to help GDP growth improve from 1.0% in 2024 to 1.8% in 2025, with per capita GDP starting to rise in 2025. Inflation is now within sight of central bank objectives in both the United States and Canada. Headline and core inflation are projected to converge on 2% in 2025 in both countries.
- Growth in Japan is projected to recover steadily after the first quarter of 2024, with domestic demand underpinned by stronger real wage growth, continued accommodative monetary policy and temporary tax cuts. GDP is projected to expand by 0.5% in 2024 and 1.1% in 2025. Headline consumer price inflation is expected to moderate before converging to the 2% target as government subsidies end and wage growth gains momentum. Korea's economy is projected to grow by 2.6% in 2024 and by 2.2% in 2025, helped by stronger global demand for semiconductors and a gradual upturn in domestic demand as the monetary policy stance becomes less restrictive. Headline inflation is projected to stay at around 3% in the near term before moderating to target by the end of 2024.

- The euro area and the United Kingdom ended 2023 in recession, but the unwinding of the effects from the large adverse energy price shock of 2022, a recovery in real household incomes, tight labour markets and reductions in policy interest rates are projected to help generate a gradual rebound. The euro area is projected to grow by 0.7% in 2024 and 1.5% in 2025, with several member states expected to benefit from a faster rate of disbursement of the Recovery and Resilience funds. Growth in the United Kingdom is projected to pick up to 0.4% and 1.0% in 2024 and 2025, with the more moderate upturn reflecting a tighter macroeconomic policy mix and somewhat higher inflation in 2024, although, as in the euro area, inflation is projected to converge on target by the end of 2025.
- GDP growth in China is projected to slow only modestly to 4.9% in 2024 and 4.5% in 2025, despite the drag from the ongoing adjustment in the real estate sector. Growth is projected to be buoyed by supportive macroeconomic policies, including a sizeable fiscal stimulus in 2024 and infrastructure investment, and strengthening external demand. Inflation is projected to remain low, averaging 0.3% in 2024 and 1.3% in 2025.
- India and Indonesia are projected to continue to enjoy broadly stable and rapid economic growth in the next two years. Strong investment and improving business confidence in India are projected to sustain real GDP growth of just over 6½ per cent in both FY 2024-25 and FY 2025-26, despite relatively sluggish private consumption growth. The Indonesian economy is projected to continue to grow by a little over 5% this year and next. Household spending is projected to be the key factor driving growth, supported by improved confidence, an expected move to a mildly accommodative fiscal stance, and falling interest rates. In both economies, headline inflation is projected to moderate and approach central bank targets by late 2025 provided food prices escape further disruptions from extreme weather events.
- Despite tight monetary policies, growth has held up relatively well in Brazil and Mexico, aided by resilient labour markets. GDP growth in Mexico is projected to be 2.2% in 2024 and 2.0% in 2025, helped by strong public infrastructure investment this year and the ongoing nearshoring of manufacturing activities. Output in Brazil is projected to expand by 1.9% this year and 2.1% in 2025, driven by household spending and the support for incomes provided by job growth and the higher minimum wage. Monetary policy is expected to remain restrictive in both economies, but to continue to ease gradually as inflation moderates, with inflation declining to central bank targets in the course of next year.

Global trade growth is expected to recover alongside GDP over the next two years, with trade volumes (goods plus services) projected to increase by 2.3% in 2024 and 3.3% in 2025. Continued steady growth in the United States, the stimulus measures being undertaken in China and a trade rebound in the Dynamic Asian economies are key cyclical factors behind the projected trade upturn, particularly in 2024 (Figure 1.13, Panel A). Services trade will continue to recover steadily, including in China. Softer import demand in India is responsible for the slowdown in the contribution from other non-OECD economies to global trade growth in 2024.[8] By 2025, a lower cost of trade finance and a gradual recovery in investment, particularly in Europe, will provide further support for trade. More balanced growth across manufacturing and services should help to raise the trade intensity of GDP growth in 2024-25. By the end of 2025, global trade openness (the ratio of trade to GDP) is expected to be 0.3 percentage points higher than in the final quarter of 2023, with the ratio of global trade growth to global GDP growth approaching pre-2019 levels (Figure 1.13, Panel B).

[8] El Niño and export bans from India have lowered rice exports, but global cereals production is expected to be positive (FAO, 2024).

Figure 1.13. Global trade growth is projected to strengthen gradually



Note: Trade volumes based on an average of import and export volumes. In Panel A, Dynamic Asia includes Hong Kong (China), Malaysia, Chinese Taipei, the Philippines, Singapore, Thailand and Viet Nam. The trade elasticity in Panel B is calculated as the ratio of world trade growth to GDP growth, both measured in constant 2015 USD. The European Union (EU) includes the 22 OECD countries who are members of the European Union plus Bulgaria, Croatia and Romania, and includes intra-EU trade. The EU average for 2011-2019 excludes 2013.
Source: OECD Economic Outlook 115 database; and OECD calculations.

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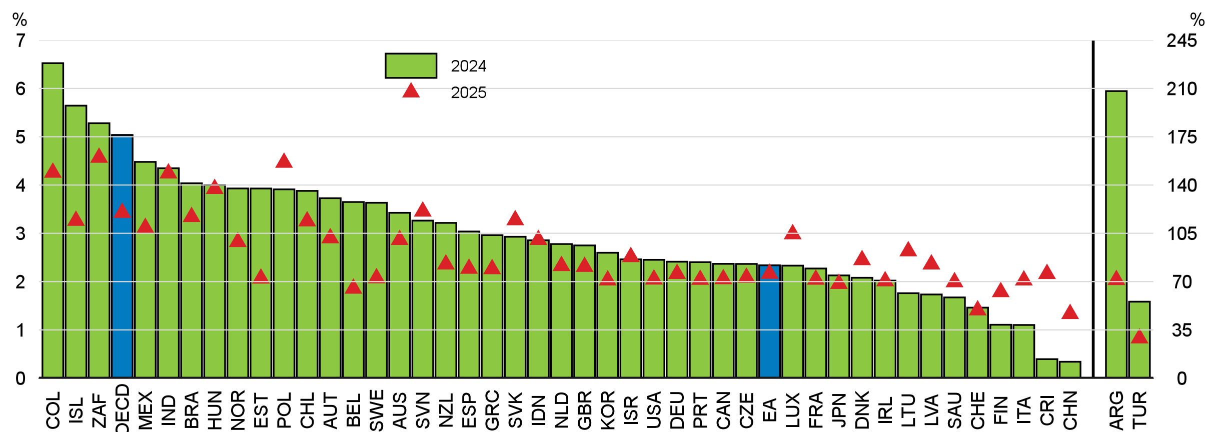
Resilient employment growth and real wage gains will sustain growth in real household incomes and household expenditure in most advanced economies. However, large stocks of excess household savings are generally projected to persist. Labour force growth is expected to moderate slightly, but still be just under 1% in the OECD this year, helped in some countries by continued sizeable migration flows: the labour force is projected to grow by around 2% in Australia, Canada, Ireland and New Zealand. This will support potential output and help to further moderate nominal wage growth.

The OECD-wide average unemployment rate is projected to rise marginally over 2024-25 to 5%, with employment growth expected to slow from about 1¾ per cent in 2023 to around ¾ per cent per annum on average over 2024-25. A projected pick-up in labour productivity growth this year and next, combined with an easing of nominal wage growth as inflation declines, should allow unit labour cost growth to be contained. In the OECD as a whole, unit labour cost growth is projected to moderate from 4½ per cent in 2023 to below 3% in 2024 and just under 2% in 2025. Corporate profit margins are also projected to ease in several countries, helping to lower overall unit cost growth.

Inflation is generally projected to converge on central bank targets by the end of 2025 in most advanced economies, although it may remain above 2½ per cent in some smaller European economies (Figure 1.14). Past declines in commodity prices will help to keep intermediate input cost increases and goods price inflation low this year despite higher shipping costs. The projected easing of unit cost growth will also reduce inflationary pressure, especially in service sectors. Inflation rates among the major emerging-market economies are expected to follow more disparate paths. Very high initial inflation rates in Argentina and Türkiye are expected to come down over 2024-25 but remain in double digits at the end of this period. Inflation is projected to stay very low in China, and to gradually decline towards policy targets in most other economies.

Figure 1.14. Inflation is projected to decline over the next two years

Consumer price inflation



Note: Argentina and Türkiye are shown on the right-hand scale, all other countries on the left-hand scale. Personal consumption expenditure price index for the United States, harmonised index of consumer prices for the euro area aggregate, euro area member states and the United Kingdom, and national consumer price indices for all other countries. India projections are based on fiscal years, starting in April.
Source: OECD Economic Outlook 115 database; and OECD calculations.

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Risks

Geopolitical risks remain elevated

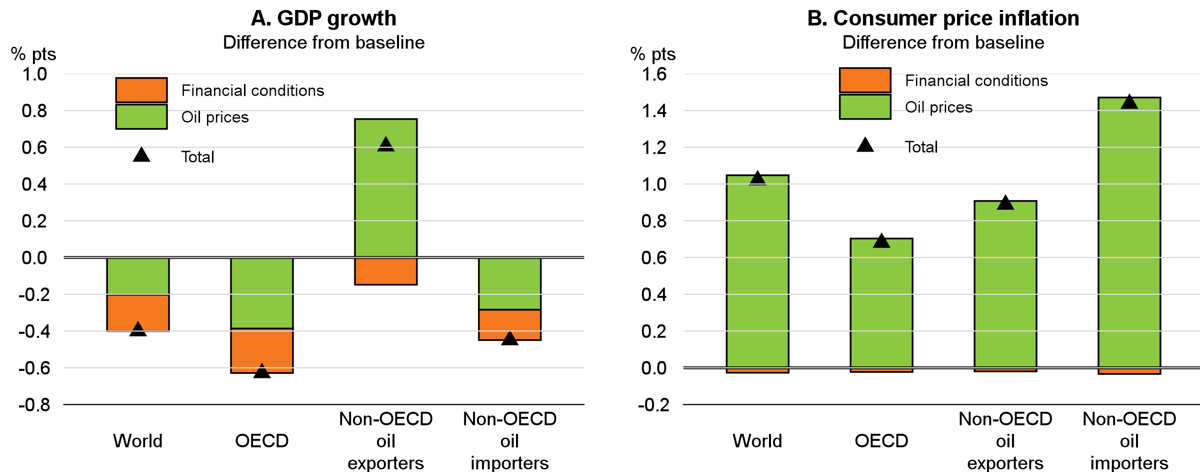
High geopolitical tensions remain a significant near-term adverse risk, particularly if the evolving conflicts in the Middle East were to intensify and disrupt energy and financial markets. For instance, around 30% of the global trade in oil and 20% in liquefied natural gas is transported via the Strait of Hormuz, with no alternative means to bring these volumes to market (IEA, 2024). Conflict is unlikely to halt the flow of energy through the Strait entirely, but even short-lived disruptions to energy trade would have large impacts (IEA, 2024).

An illustrative scenario, using the NiGEM global macroeconomic model, highlights the potential near-term implications of an unexpected surge in oil prices. The scenario considers a rise in oil prices of 25% on average in the first year and 10% in the second year, with an initial spike of 40% in oil prices in the first quarter of the shock. This initial spike would briefly take oil prices back to the peaks seen in the immediate aftermath of Russia's invasion of Ukraine. Global financial conditions are also assumed to tighten, due to risk repricing in the aftermath of the shock, with a 10% decline in global equity prices and higher investment risk premia. Policy interest rates remain endogenous in all economies.

- Global output growth declines by 0.4 percentage points in the first year of the scenario (Figure 1.15, Panel A), with weaker real incomes and tighter financial conditions hitting consumer spending and investment. The advanced economies are relatively hard-hit by the financial shock. In contrast, an improvement in the terms of trade boosts output in the major non-OECD oil-exporting economies.
- Global inflation rises by 1 percentage point in the first year of the shock (Figure 1.15, Panel B), with the largest effects in emerging-market and developing economies that are oil importers. This reflects the relatively high share of energy in the consumer price index in these countries.

Figure 1.15. A sharp spike in oil prices would raise inflation and hit growth

First year effects



Note: Simulated impact of an unanticipated first year rise of 25% in oil prices with an initial spike of 40% in the first quarter, an increase of 50 basis points in global investment risk premia and an average decline of 10% in equity prices in all countries. The green bar shows the direct impact from higher oil prices, the orange bar shows the additional impact of higher risk premia and lower equity prices.
Source: OECD calculations using the NiGEM macroeconomic model.

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- Policy interest rates rise by around 50 basis points in many economies to help ensure that inflation expectations remain anchored, with private short-term inflation expectations relatively sensitive to changes in oil prices.
- The automatic budgetary stabilisers are allowed to cushion the impact of the shock, but no additional discretionary fiscal support is assumed to be provided to households to compensate for higher energy costs. Any such support would help to underpin household real incomes but would add further to the already rising debt burdens in many countries.

The impact of an intensification of the evolving conflicts in the Middle East and resultant energy price spikes could be magnified if it pushed up shipping costs substantially further and increased the extent to which these are passed through into import prices. For instance, damage to tankers travelling through the Strait of Hormuz would significantly disrupt the already very tight supply balance of the global tanker market. This would compound shipping cost increases and generate delays in physical oil supply, even if vessels continued to transit the Strait. In addition, if shipping through the Red Sea were placed at further risk, there could be a further rise in the proportion of vessels using the longer Cape of Good Hope route. The use of important sea-to-air hubs in the Middle East that connect Asian and European trade might also be hampered. Such disruptions would weigh further on overall growth and the ability of suppliers to adjust to shocks.

Inflation may prove more persistent than projected

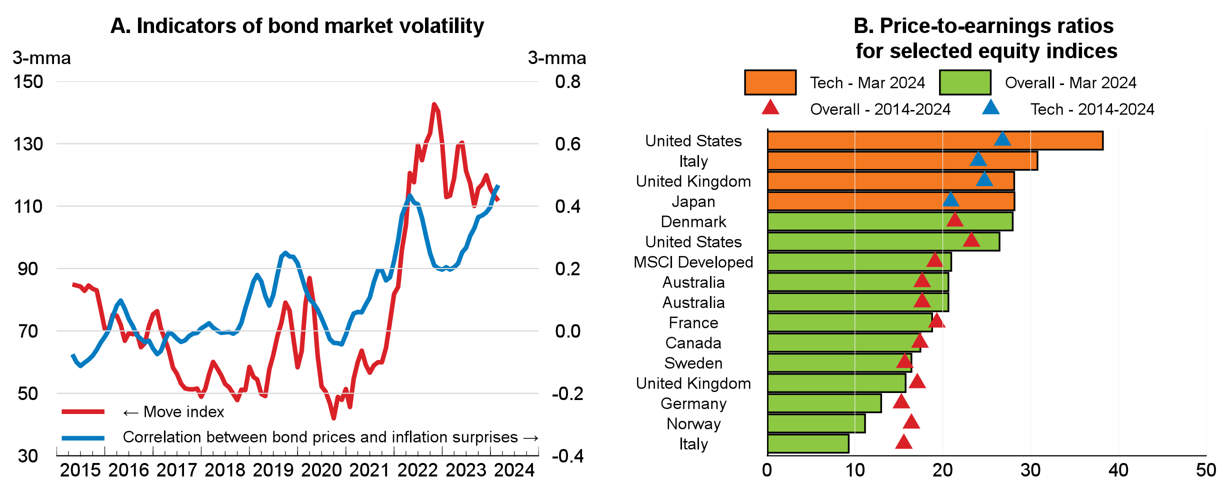
A key related risk is that ongoing disinflation may proceed more slowly than anticipated. In the baseline projections, core and headline inflation both continue to move down over 2024-25. By assumption, there are no surges in energy or food commodity prices, while the growth of unit costs is projected to subside as productivity growth picks up, wage gains moderate and markups ease. In this scenario, the rate of increase of service prices, which are disproportionately influenced by labour costs, comes down steadily to normal (pre-pandemic) levels by 2025. The projected easing of inflation is consistent with inflation expectations remaining anchored around central bank objectives.

However, the "last mile" of central banks' disinflation efforts could still prove to be slower and more difficult than the progress made to date. In addition to the risks from the evolving conflicts in the Middle East, renewed spikes in energy or food prices could also occur if the OPEC+ countries intensified production cuts or if extreme weather or conflict affected key food supplies. Unit cost growth could also carry on increasing rapidly if the projected upturn in productivity growth does not materialise, if the pace of wage gains remains higher than projected, or if markups rise further. In these cases, there would be a risk that inflation expectations drift upwards, making it more difficult to get inflation back to target. In such a scenario, central banks would have to maintain restrictive policy settings for longer, raising the risks of weakening demand significantly and triggering sharp falls in bond and equity prices.

Financial markets remain vulnerable to sudden repricing

Financial markets have so far proved resilient to the tightening of monetary policy. But vulnerabilities remain, with risks of rapid asset repricing if expectations of future interest rate reductions prove too optimistic. Global interest rates remain volatile, and uncertainty about the future size and timing of policy interest rate changes remains high (Figure 1.16, Panel A; BIS, 2024). If market expectations of forthcoming policy rate cuts prove misplaced, risk and term premia are likely to rise, potentially leading to a sharp correction in bond markets.

Figure 1.16. Risks of a sharp asset price correction remain high



Note: In Panel A, 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. The blue line shows the 12-month rolling correlation between monthly changes in bond prices and Citi indices of inflation surprises (computed as outturns minus expectations). Inflation surprises and bond prices are taken in absolute value. A high correlation suggests that bond prices react strongly to inflation surprises. The sample includes the United States, the United Kingdom and Germany. Panel B: the price-to-earnings ratios are obtained by dividing the market price per share by the earnings per share of all companies listed in a given stock market. A ratio above the 2014-24 average is one indication that the price-to-earnings ratio is high relative to the historical average and therefore that equities are possibly overvalued. The orange and green bars are computed as the average of daily values in March 2024. The 2014-24 average is computed as the average of daily values between March 2014 and March 2024.
Source: LSEG; Citi; and OECD calculations.

Repricing could also occur in other asset classes. Equity price volatility remains low, but equity valuations appear stretched by some metrics, adding to repricing risks if interest rate expectations change or growth disappoints. Equity price-to-earnings ratios are above the average of the past decade in several markets – including the United States – especially in the tech sector, where future returns are particularly uncertain (Figure 1.16, Panel B). Risks remain of a sizeable price correction if downside shocks materialise. The market stress of spring 2023 that affected the banking sector in several countries was a reminder that swings in the prices and liquidity of financial assets can quickly reveal underlying balance sheet vulnerabilities.

The lagged effects from policy tightening could still expose vulnerabilities

Although they have not yet materialised, risks remain that the lagged effects of past monetary policy actions on growth and employment could be larger than anticipated, leading to an economic slowdown and exposing financial vulnerabilities. The pass-through of past policy rate increases to bank lending rates appears to be broadly completed. However, the transmission to activity has been cushioned so far in some countries by the large savings accumulated during the pandemic by households and corporates, and by the extent to which corporates and households were able to borrow in earlier years when interest rates were exceptionally low.

As more borrowing rates are renegotiated, or as debt matures and is replaced by new loans, the effects of tighter monetary policy could increasingly be felt. Higher interest rates are already being reflected in the interest expenses paid by households, which rose to 4.2% of disposable income in the third quarter of 2023 on average in advanced economies, up from 1.6% in 2019. Risks for households are particularly large in countries where mortgages are primarily offered at variable rates, including Australia, Canada, Finland and Poland, and in countries where rates are fixed for a relatively short period, since a potentially larger share of income will be devoted to meeting interest payments in the coming quarters.[9]

Given high debt and debt-service costs in several countries, corporate balance sheets could come under increasing stress. A majority of corporate bonds are issued with fixed rates, but about 30% of existing corporate debt in advanced economies is due to mature by 2026, with an even higher share in emerging-market economies (OECD 2024b). The quality of corporate debt has also deteriorated over time, with a higher share of debt either now below investment grade or with the lowest investment grade rating. The debt interest expenses of non-financial corporations in advanced economies rose to 15.1% of their operating surplus in the third quarter of 2023 on average, up from 9% in 2019 (Figure 1.17, Panel A). The aggregate interest coverage ratio has also declined (Figure 1.17, Panel B). Moreover, corporate bankruptcies are continuing to rise. This was to be expected given their extremely low post-pandemic level, but in some countries, including Canada, France and the United Kingdom, the number of bankruptcies now exceeds pre-pandemic levels.[10]

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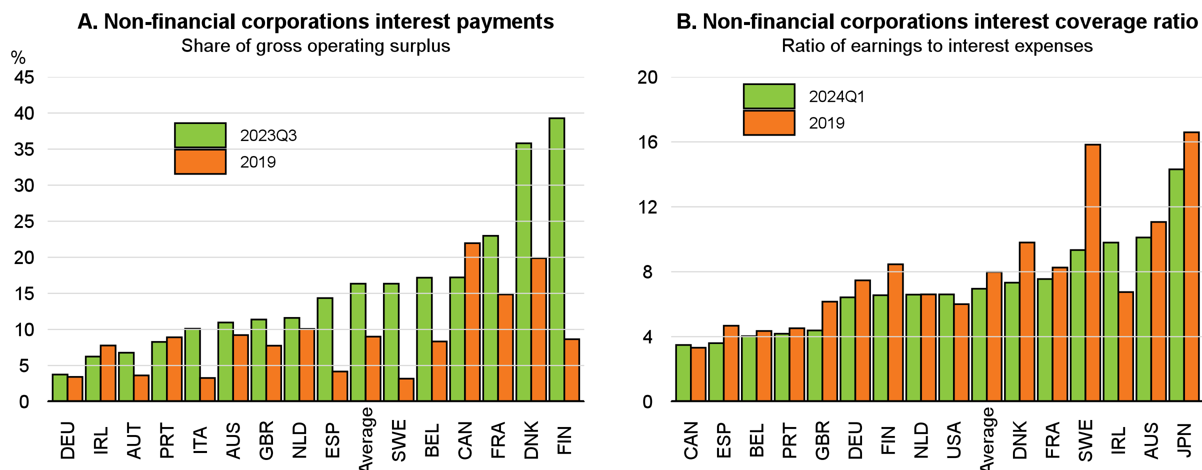
[9] In Canada, estimates suggest that, without any income growth, the median Canadian household might need to dedicate an estimated additional 4% of their pre-tax income to mortgage payments by the end of 2027 (teNyenhuis and Su, 2023).

[10] In a scenario in which interest rates remain above 2022 levels in the coming years, an additional 6 to 11 per cent of globally listed companies could be at risk of financial distress (OECD 2024b).

Figure 1.17. Corporate balance sheets could come under stress



Note: In Panel A, interest expenses are reported as shares of gross operating surplus and mixed income. The interest coverage ratio in Panel B is defined as the ratio of earnings before interest and taxes to interest expenses and is an indicator of the ability to make interest payments using cash flows.
Source: LSEG; OECD National Accounts; and OECD calculations.

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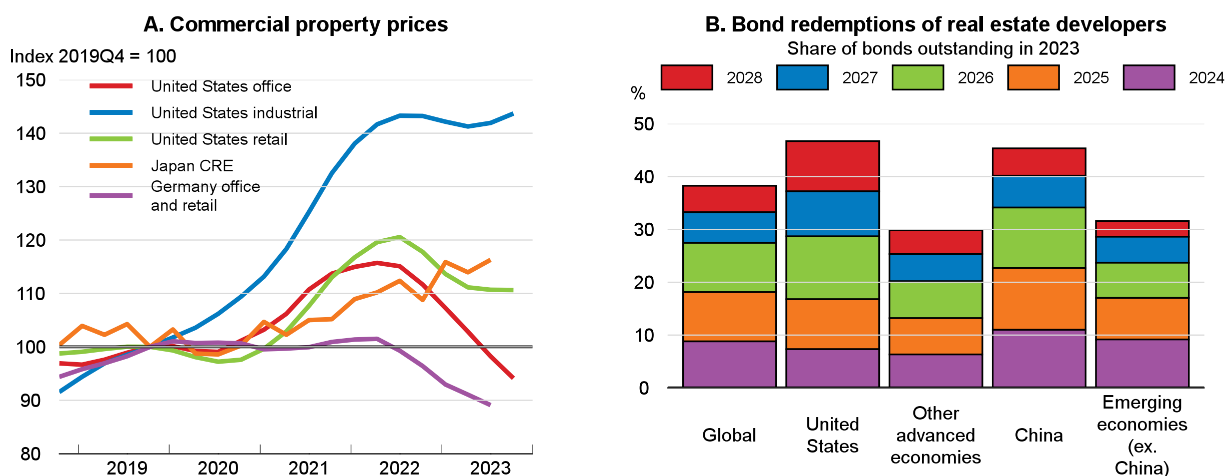
Rising delinquencies (missed payments) and bankruptcies could lead to severe credit losses for banks and non-bank financial institutions. In some countries, falling prices for residential and commercial real estate (CRE), especially offices (Figure 1.18, Panel A), and associated loan repayment difficulties, are already weighing on the balance sheets of banks, real estate investment trusts and other non-bank investors. Risks of a large correction remain prominent in CRE office markets, where structural changes associated with remote working add to the impact of rising interest rates. Delinquencies of commercial mortgage-backed securities, particularly those collateralised by offices, have risen recently, and about 40% of real estate developers' corporate bonds will mature by 2028 (Figure 1.18, Panel B).

Figure 1.18. There are rising vulnerabilities in commercial real estate markets



Note: In Panel A, data for the United States are MSCI transaction-based commercial property price indices that measure the actual price movements for the main types of commercial property using repeat-sales regression methodology. Commercial real estate prices in Germany and Japan are from the Bank for International Settlements. In Panel B, data are calculated based on bonds issued by real estate developers in 36 advanced and 46 emerging-market economies.
Source: LSEG; Bank for International Settlements; and OECD calculations.

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Banks remain vulnerable to duration risks if higher-than-expected interest rates or renewed deposit outflows lead to sudden price changes and forced asset sales. In turn, this would tighten lending conditions to households and companies. Non-bank financial institutions also continue to face potential stress from liquidity mismatches in their portfolios, with risks of margin and collateral calls that lead to fire sales in the event of large mark-to-market losses on their assets. Losses at non-bank financial institutions could quickly spill over to banks due to large direct and indirect exposures, leading to wider financial stress.[11] Investment funds, which now account for almost 20% of global financial assets, have significant exposures to corporate bond markets, holding about one-quarter of the bonds of non-financial corporations in the United States and about one-third of such bonds in the euro area. Around two-fifths of these corporate bonds are non-investment grade, with relatively high default risks (OECD, 2024b).

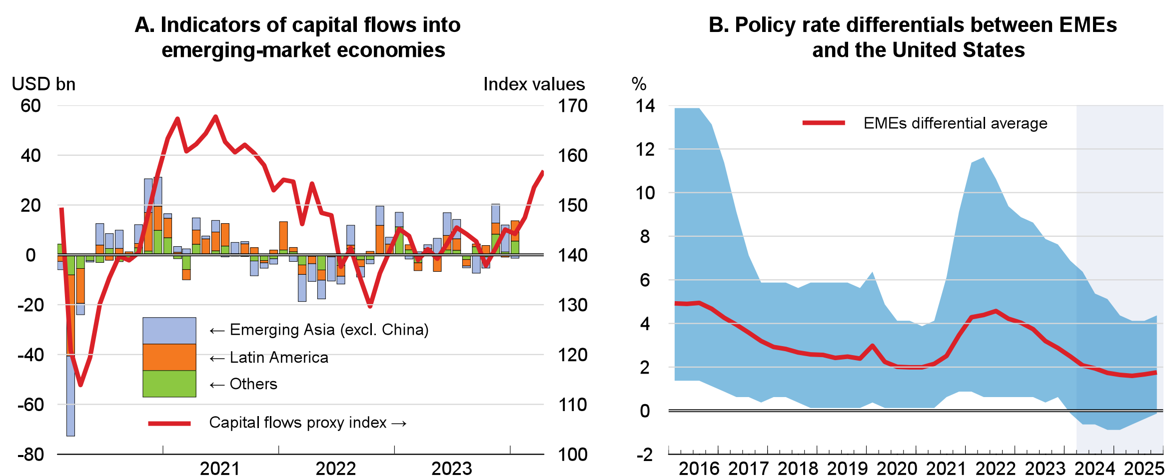
Narrowing policy rate differentials with advanced economies and rising debt are key risks in emerging markets

Emerging markets have so far coped well with the high global interest rate environment. GDP growth has surprised to the upside, inflation has declined in most countries, and foreign investors have generally remained in local bond markets. Capital flows to emerging-market economies excluding China have risen over the past year, with net portfolio inflows into equities and especially bonds (Figure 1.19, Panel A). Foreign direct investment (FDI) into many major emerging-market market economies, especially Brazil and some other Latin American economies, has also held up relatively well. China is a notable exception, with new FDI inflows slowing sharply, and portfolio inflows reflecting continuing concerns about the property sector. Sovereign spreads remain elevated for countries with below-investment grade rating but are generally low elsewhere by historical standards. Amidst mounting debt-service costs, around one-half of low-income countries and many middle-income countries are either in, or estimated to be at high risk of, debt distress (World Bank, 2024).

Interest rate differentials with respect to advanced economies remain sizeable, encouraging portfolio capital inflows, but policy rate differentials to the United States are projected to continue narrowing in coming quarters (Figure 1.19, Panel B). A risk is that this could prompt capital **outflows and possibly currency depreciations, especially if interest rates in advanced economies stay higher for longer than expected.** Emerging markets with high public debt or high financing costs could also be exposed if debt-service costs rise further, potentially compromising their market access. In many economies with elevated bond spreads, a comparatively low average maturity of government debt exacerbates rollover risks (see below). Several low-income economies with weak credit ratings have seen the cost of borrowing rise sharply over the past year, and now face interest rates more than 500 basis points above US interest rates.

[11] Non-bank financial institutions have become increasingly important in the global financial system and accounted for around 47% of global financial assets in 2022 (FSB, 2023).

Figure 1.19. Narrowing interest rate differentials could lead to capital outflows in emerging-market economies



Note: Panel A shows the gross portfolio inflows data from the OECD Monthly Capital Flow dataset for 20 emerging-market economies grouped by three 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. In Panel B, the red line shows the differential between the average of 11 emerging-market economies and the United States. The blue area shows the range between the highest and the lowest policy rate differential among the 11 emerging-market economies.

Source: OECD Economic Outlook 115 database; OECD Monthly Capital Flow dataset; Bloomberg; and OECD calculations.

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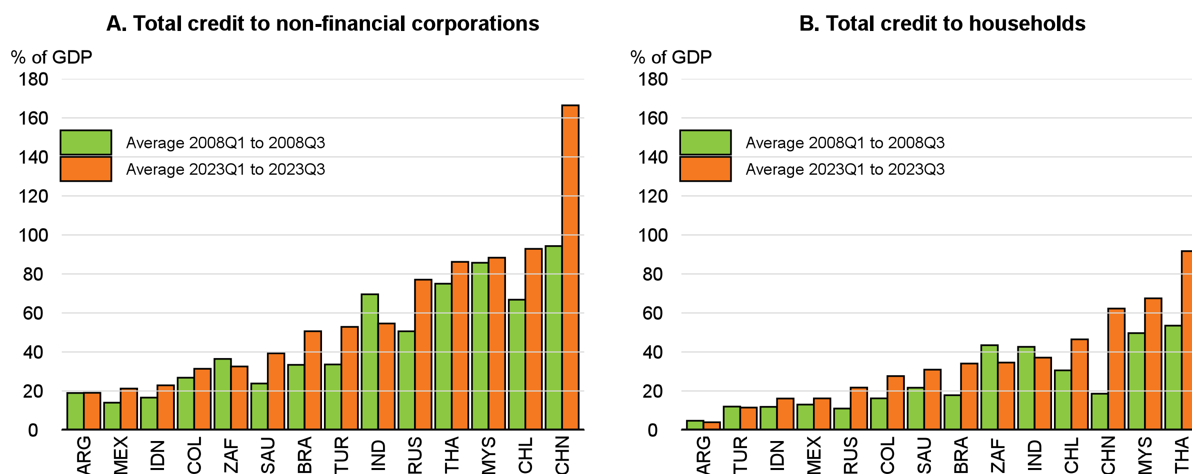
In emerging-market economies where private sector debt is high and mostly denominated in foreign currency, currency depreciations could also lead to meaningful increases in debt-servicing costs for firms and households. Corporate and household debt has risen sharply in some countries over the past 15 years (Figure 1.20), with a high proportion in foreign currencies, especially in Latin American economies.[12] Chinese corporate bond debt represented almost one-fifth of the outstanding global total in 2023 (OECD 2024b). In Argentina, Indonesia, Mexico and Türkiye, more than half of outstanding corporate debt securities were denominated in foreign currencies in 2023. Over half of emerging-market economies' corporate debt is expected to mature within the next three years, raising rollover risks (OECD 2024b). Household debt is on average lower than corporate debt and of longer maturity, but has also risen quickly in some economies since 2008, including in China, Malaysia and Thailand (Figure 1.20, Panel B).

[12] Corporate debt has surged by 14 per cent of GDP on average since 2008.

Figure 1.20. Private debt has risen rapidly in several emerging-market economies



Notes: Total credit includes bank loans and debt securities from all sectors of the economy.
Source: Bank for International Settlements; and OECD calculations.

Growth outcomes in China are uncertain

China is a key driver of the expansion of the world economy. Even as China's growth rate has slowed, its increasing weight in the global economy has meant that its contribution to global growth remains very large.[13] Thus, growth outcomes in China are a key risk to projections of global growth: for every 1 percentage point that China's GDP growth falls short of the projection, the direct effect on global growth is approximately 0.2 percentage points, and any indirect effects via tighter financial conditions would add to that (OECD, 2023b).

China is currently projected to maintain higher growth rates in 2024-25 than previously anticipated. Despite the ongoing slump in China's large real estate sector and continued problems with debt, it is expected that monetary and fiscal stimulus will compensate, at least in the near term, keeping the rate of GDP and trade growth high. There are two-way risks around these projections. The fiscal stimulus may not materialise in the amounts announced, or it might only redistribute government debt between central and local levels without raising total public spending much, if at all. In this event, growth in China could prove substantially weaker than projected, particularly in 2025. However, further sizeable additional bond issuance in 2025, beyond that already planned, could keep growth higher than projected. This would entail small but positive spillovers for China's trading partners, although it would also raise China's government debt further, adding to future challenges.

Upside risks

There are a number of scenarios that could result in stronger-than-expected outcomes over the next two years. A renewed downward move in key commodity prices, in particular energy, would result in faster disinflation than projected. OPEC+ production cuts to date have only halted the decline in oil prices, and a breakdown in cartel discipline, a shift in the stance of swing producer Saudi Arabia, or unexpected growth in non-OPEC+ production (particularly in the United States and Brazil) could weaken oil prices. Moreover,

[13] The contribution was larger in 2023, when the Chinese economy grew by 5.2%, than it was in the 2000s when the growth rate was about twice as high.

if the European Union continues to make the sort of rapid progress in ramping up electricity production via renewables seen during 2022-23, global demand for fossil fuels could be weaker than expected.[14] Relatedly, an earlier-than-expected moderation of geopolitical tensions, notably in the Middle East, would represent a mild positive shock, reducing uncertainty and lowering shipping costs and delays. A faster-than-expected further easing of supply constraints in labour markets from continued strong labour force growth would also aid disinflation.

Demand growth could also prove stronger than expected, especially in advanced economies, if households and corporates were to draw more fully on the savings accumulated during the pandemic. Excess household savings at the end of 2023 are estimated to have been equivalent to 10% or more of disposable income in many economies, including Japan and the euro area (Barnard and Ollivaud, 2024). The projections reflect the assumption that household saving rates are little changed in 2024-25, but if excess savings are drawn down, private consumption growth would be stronger than projected, although this could also slow disinflation.

Policies

Monetary policy should remain prudent to ensure durable disinflation

Policy interest rates have remained unchanged in most major advanced economies in recent months. However, rate reductions have occurred in several central European economies and Switzerland, and the negative interest rate policy and yield curve control have been ended in Japan, with the target policy rate range now set around 0 to 0.1%. Forward-looking real interest rates remain higher than pre-pandemic norms, with the notable exception of Japan, where policy remains accommodative despite the recent shift (Figure 1.21). Central bank balance sheet reductions, mainly reflecting declining bond holdings due to quantitative tightening (QT), have continued along well-communicated paths, and have been stepped up in some jurisdictions. The cumulative effects of past tightening have continued to feed through into economic activity, housing and credit markets.

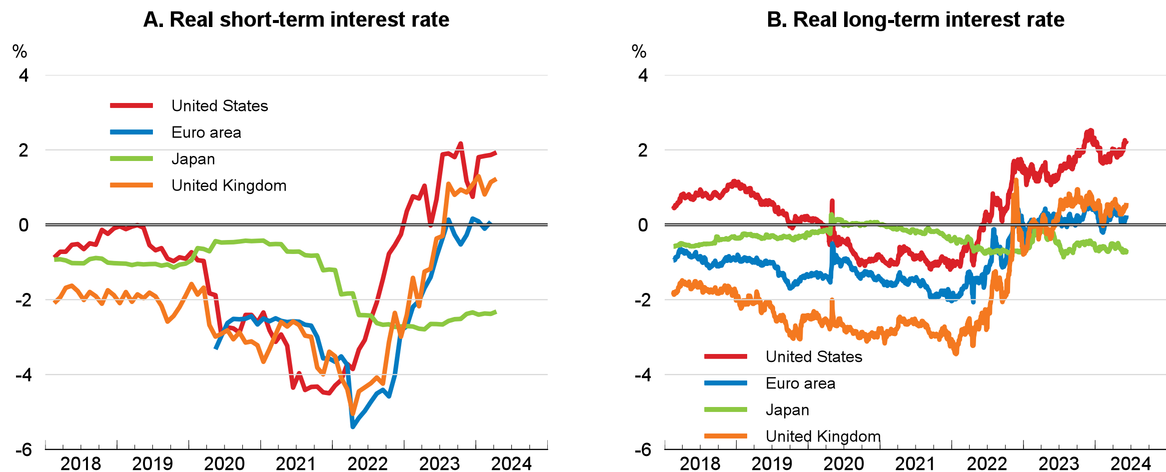
Monetary policy needs to remain prudent to ensure that underlying inflationary pressures are durably contained. Scope exists to start lowering nominal policy rates provided inflation continues to ease, but the policy stance should remain restrictive for some time. The pace and scale of policy rate reductions will be data dependent and may vary across countries depending on economic conditions. A continued narrowing of imbalances in labour markets and declining cost and price pressures in services sectors, where inflation is proving stickier, will be critical factors.

Given the projected outlook for inflation and growth, policy interest rate reductions are expected to start this year in all the major advanced economies other than Japan (Figure 1.22).

- In the United States, reductions in the federal funds rate are projected to begin in the third quarter of 2024, with rates being lowered to 3¾-4% by the end of 2025, when inflation is expected to have converged to 2%. Bond holdings are projected to decline further throughout 2024-25 following a pre-announced path.
- In the euro area, policy rate reductions are also projected to begin in the third quarter of 2024, with the deposit facility rate easing to 2.5% by the end of 2025. The decline in Eurosystem bond holdings is expected to gather speed, with no reinvestment of Asset Purchase Programme redemptions and a gradual phase-out of reinvestment of maturing Pandemic Emergency Purchase Programme securities over the second half of 2024.

[14] EU gas consumption since 2022 is on track for meeting the union’s ambitious REPowerEU targets, which would eliminate the need for LNG imports by 2030. EU consumption of coal for electricity production also fell sharply in 2023.

Figure 1.21. Forward-looking real interest rates remain elevated in most countries



Note: In Panel A, the real short-term interest rates are calculated using nominal one-year government bond yields and one year-ahead inflation expectations by consumers in the United States, the euro area and the United Kingdom, and by corporates participating in the Tankan Survey in Japan. In Panel B, the real long-term interest rates show 10-year inflation-linked bond yields.
Source: OECD Economic Outlook 115 database; Bank of England; Bank of Japan; Board of Governors of the Federal Reserve System; European Central Bank; University of Michigan; and OECD calculations.

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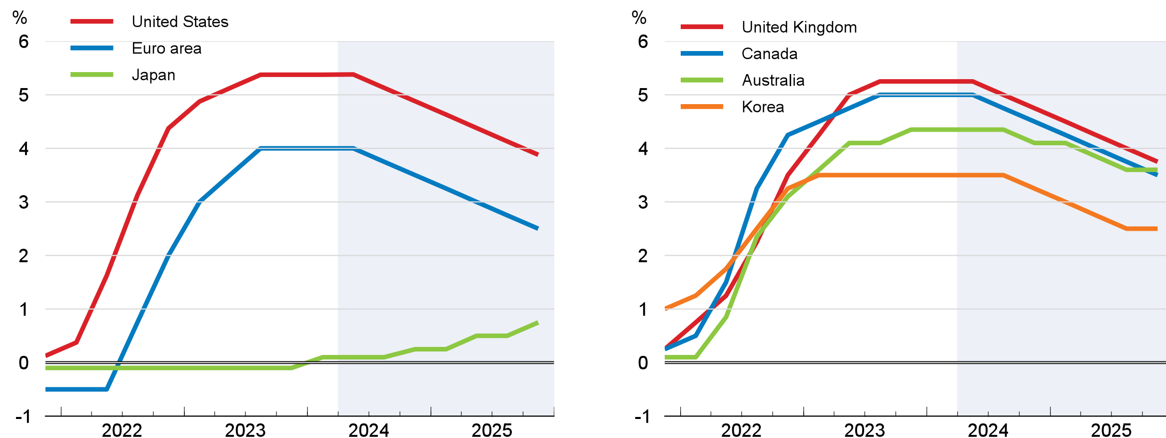
- In Japan, the policy rate is projected to increase gradually to 0.75% by the end of 2025, as core inflation stabilises around 2% and a positive output gap develops. Nevertheless, the monetary policy stance is expected to remain accommodative, with negative real interest rates persisting throughout 2024-25.
- Reductions in policy rates are projected to begin in the second half of 2024 in Australia, Canada, Korea and the United Kingdom. Central bank bond holdings are assumed to decline further in all these countries other than Korea.

Figure 1.22. Policy rates are projected to decline this year in most large advanced economies



Note: Panel A shows the midpoint of the federal funds target range for the United States and the deposit facility rate for the euro area.
Source: OECD Economic Outlook 115 database; and OECD calculations.

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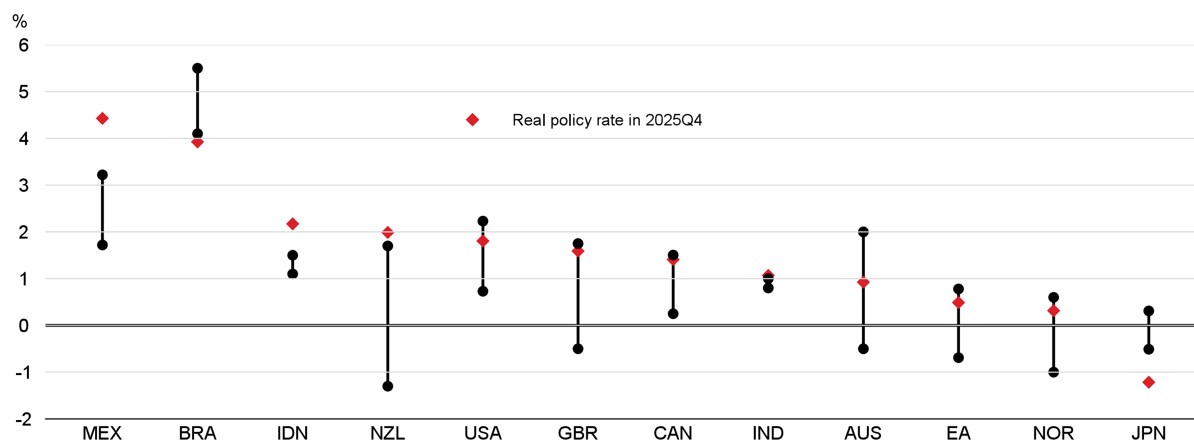
In the medium term, central banks will aim to bring policy interest rates back towards levels consistent with neutral real rates – the real interest rate at which the policy stance is neither accommodative nor restrictive. However, the neutral real rate is unobserved and hard to gauge, with recent estimates typically varying between -1% and 2% across the advanced economies and reaching higher values for some emerging markets (Figure 1.23). The declining trend in estimated neutral rates over recent decades is not easy to extrapolate. Population ageing and weak potential output growth will keep rates low, but a larger supply of public debt and the possibility of stronger investment demand for the climate transition could place upward pressure on neutral rates. By the end of 2025, real policy rates are generally projected to have converged towards estimated ranges for neutral rates, though often remaining close to the top of those ranges or above them. Even if real rates fall further, nominal policy rates may remain at higher levels than prior to the pandemic if inflation settles at target rather than dropping persistently below target, as in the decade after the global financial crisis.

Figure 1.23. Real policy rates in most economies are projected to converge towards estimates of neutral levels



Note: For each jurisdiction, the figure shows a range (min-max) of estimates for the real neutral rate, understood as a longer-run equilibrium real short-term interest rate. The minimum and maximum values come from the following estimates: the Holston-Laubach-Williams (HLW) model estimate (Federal Reserve Bank of New York, 2023) and the Lubik-Matthes (LM) model estimate (Federal Reserve Bank of Richmond, 2023) for Q4 2023 for the United States; the HLW and LM model estimates for Q3 2023 (Benigno et al., 2024) for the euro area; the HLW model estimate for Q4 2021 (IMF, 2023a) and the DSGE model estimate for 2013-2017 (Okazaki and Sudo, 2018) for Japan; the range of estimates from term structure models based on data up to end-March 2017 (Bank of England, 2018) for the United Kingdom; the lower bound of estimates in nominal terms by the Bank of Canada for 2024 deflated with the 2% inflation target (Bank of Canada, 2024) and the HLW model estimate for Q4 2021 (IMF, 2023a) for Canada; the range of the estimates for 2022 (Ellis, 2022) for Australia; the range of the estimates on real neutral OCR (Reserve Bank of New Zealand, 2022) for New Zealand; the range of model estimates for 2021 (Meyer et al., 2022) for Norway; the range of estimates for Q1 2023 (Banco Central do Brasil, 2023) for Brazil; the range of long-run average estimates (Carrillo et al., 2018) for Mexico; the range of the LW model estimates for Q4 2021 (Reserve Bank of India, 2022) for India; and the range of the HLW estimate for Q2 2022 and the yield curve model of Basdevant, Björksten, and Karagedikli for Q4 2022 (IMF, 2023b) for Indonesia. The projected real policy rate in 2025Q4 is calculated using the nominal policy rate deflated by annual core inflation over 2024Q4-2025Q4 (except for India and Indonesia, where headline inflation is used).
Source: OECD Economic Outlook 115 database; and OECD calculations.

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Quantitative tightening has so far proceeded smoothly, with sizeable reductions in bond holdings inducing only a minor tightening in financial conditions and reinforcing the move to a more restrictive policy stance. However, uncertainty remains about its duration and potential impact once policy rates begin to decline. The likely coexistence of QT and policy rate reductions, with potentially opposite impacts on long-term yields and financial conditions more generally, could raise uncertainty in the absence of clear communication. Recent QT announcements are estimated to have increased sovereign bond yields by an estimated 4-8 basis points -- a much smaller effect (in absolute terms) than the estimated past declines in yields resulting from quantitative easing -- with no significant disruptions in the operation of financial markets (Du et al., 2024). However, determining the optimal level of reserves for the conduct of monetary policy, near which QT should slow and then stop, is challenging, not least due to risks of liquidity stress (Lopez-Salido and Vissing-Jorgensen, 2023).

Fiscal policy needs to address mounting pressures to ensure debt sustainability

The fiscal projections for 2024-25 are conditional on announced government measures and OECD assessments of current plans (Annex 1.A). A mild fiscal tightening is expected in many countries, as governments start to rebuild fiscal buffers. In the median advanced OECD economy, the underlying primary balance is projected to improve by 0.3% of potential GDP in 2024 and 0.4% in 2025.

- In the United States, the fiscal stance is expected to tighten modestly this year, helping to moderate domestic demand. The underlying primary deficit is projected to remain large, but narrow to 3.5% of potential GDP in 2024 (an improvement of 0.5 percentage points).
- In the euro area, the underlying primary deficit is projected to shrink by a cumulative 1½ per cent of potential GDP over 2024-25. This reflects the gradual withdrawal of energy support, as well as fiscal consolidation in large economies such as Germany and France.[15]
- In Japan, the sizeable underlying primary deficit is projected to narrow from an estimated 3.9% of potential GDP in 2023 to 2.3% of GDP in 2025, reflecting the planned phase-out of energy support measures. Higher spending on defence and support for families with children, together with temporary cuts to income and residency taxes, will, however, limit the overall improvement in the budget balance.
- The fiscal stance is projected to tighten over 2024-25 in Canada, Korea and the United Kingdom while remaining broadly neutral in Australia. Among smaller economies, substantial improvements in underlying primary balances of 2½ per cent of potential GDP or more are projected in Hungary and Iceland. In contrast, fiscal expansions exceeding 1½ per cent of potential GDP are expected in Denmark and Portugal over 2024-25.

Despite these measures, the ratio of government debt to GDP is projected to rise further in several OECD economies. Overall OECD gross general government liabilities are projected to be 117% of GDP at the end of 2025, some 42 percentage points higher than before the global financial crisis. High debt and the increase in interest rates will result in the costs of servicing government debt rising further as debt issued at past low rates matures and is replaced by new higher-yielding issuance. In the median advanced economy, the projected increase in the ratio of interest payments to GDP is 0.5 percentage points over the period from 2021 to 2025. However, outcomes will continue to vary widely across countries. Some countries, such as Portugal, have managed to contain growth in interest payments by reducing public debt. In others, the recent rapid growth in the cost of interest payments on inflation-indexed debt will moderate as inflation eases. Upward pressure on debt-service burdens is expected to continue beyond 2025, as in

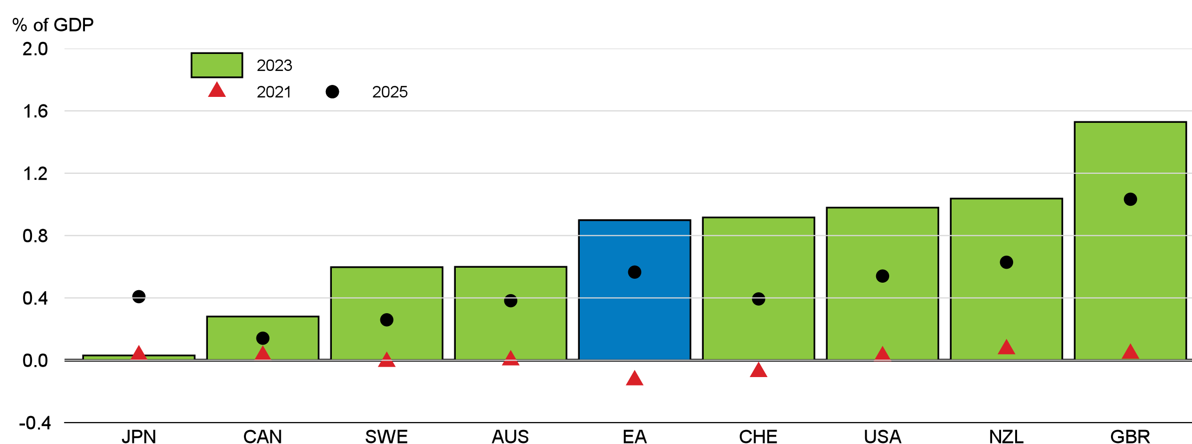
[15] In Italy, a change in the accounting treatment of tax credits for home improvements contributes to a substantial improvement in the estimated underlying primary deficit over 2024-25.

many countries long-term interest rates are projected to exceed average rates of interest paid on the total stock of public debt for some time.

Rising interest rates are also weighing on the public finances through central bank losses. Over the past 15 years, commercial bank reserves held at the central bank, typically remunerated at or close to the policy rate, have increased hugely, largely as a counterpart to quantitative easing. Monetary policy tightening since 2021 has resulted in sharp increases in central bank interest expenses (Figure 1.24), leading to financial losses.[16] Reserves remuneration costs will likely remain elevated for some time, although quantitative tightening and projected reductions in policy rates will help lower their magnitude. While central bank losses are not in general transmitted one-for-one into budget balances, they imply an extended period of reduced or zero central bank remittances and, in some economies, additional indemnification payments by the Treasury.

Figure 1.24. Payments on reserves by central banks have risen substantially

Interest payments on central bank reserves



Note: Interest payments are estimated as reserve balances at the end of each month multiplied by the respective contemporaneous interest rates. Account is taken of tiering schemes for reserves remuneration, but the estimates remain stylised and illustrative. They assume unchanged balances and rates for one month and the non-coincidence of calendar months and reserve maintenance periods. For each country, the following close substitutes for reserves are included: reverse repurchase agreement operations (RRP) for the United States, the deposit facility for the euro area and debt certificates for Sweden. The estimation of interest expenses in 2025 is based on the following assumptions: reserves balances, including their close substitutes, decrease at the same rate as bond holdings during 2024 and are kept constant in nominal terms during 2025; bond holdings decrease according to the QT announcements of the respective central banks made up to 24 April 2024 (for Japan and Switzerland, which do not pursue QT, reserves are assumed to remain constant in nominal terms throughout 2024-25); interest rates applied to reserves and their close substitutes change according to the projected changes in policy rates in this Economic Outlook.
Source: OECD Economic Outlook 115 database; Bank of Canada; Bank of England; Bank of Japan; Board of Governors of the Federal Reserve System; European Central Bank; Reserve Bank of Australia; Reserve Bank of New Zealand; Sveriges Riksbank; Swiss National Bank; and OECD calculations.

[16] In some countries, especially in Europe, the rise in central bank interest expenses relative to GDP since 2021 has exceeded the increase in general government interest payments as a share of GDP.

Fiscal pressures are expected to build in the years ahead. In the absence of any offsetting fiscal policy adjustment, the ratio of net government financial liabilities to GDP in the median G7 country could rise by 70 percentage points by 2040 (OECD, 2023a). Without policy changes, population ageing will make public expenditure on pensions, health and long-term care rise significantly in many advanced economies, accounting for around one-third of the projected increase in debt-to-GDP ratios by 2040. Continued structural budget deficits and higher refinancing costs than in the past are other key sources of possible future debt pressures. The higher outlays on defence planned in many countries and climate change mitigation and adaptation measures will likely further complicate efforts to build fiscal buffers.[17]

Durably lowering public debt-to-GDP ratios has typically required governments to contain spending growth to keep primary budget balances in surplus for several years, often coupled with GDP growth above the interest rate on public debt (OECD, 2023a; Figure 1.25). In many past instances, sustaining declines in primary expenditure relative to GDP entailed spending restraint in politically sensitive areas such as pensions, civil service wages and subsidies, as well as cutting public investment. Reducing public debt-to-GDP ratios through such means may prove more challenging for countries facing mounting spending pressures in the future, particularly if real interest rates fail to return to past low levels relative to GDP growth. In 2025, most OECD economies are still projected to be running primary budget deficits, including the United States, Japan and the euro area as a whole. As inflation returns to target and monetary policy gradually becomes less restrictive, stronger consolidation efforts than those currently planned are called for in many countries if debt ratios are to be put on a downward trajectory.

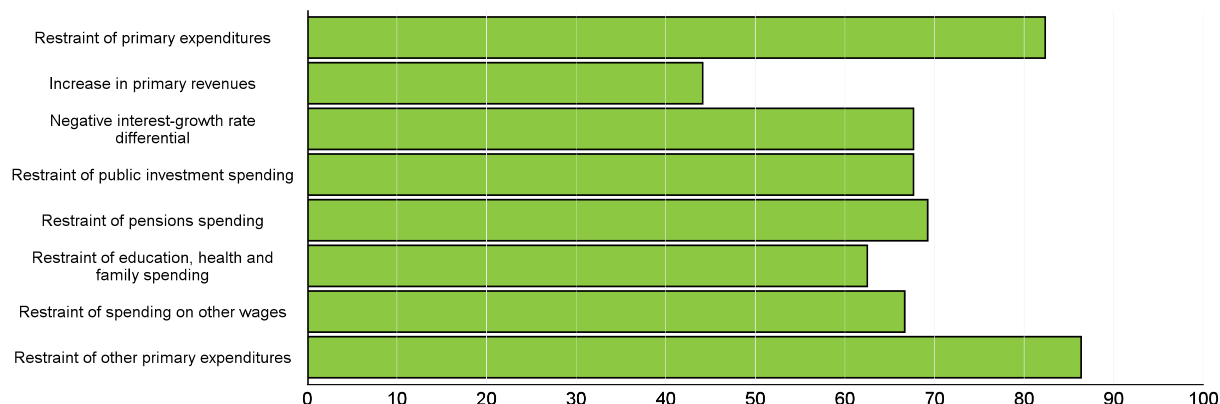
The country policy recommendations in this Outlook highlight that spending restraint is a key priority to ensure a sustainable trajectory for public debt (Figure 1.26). However, spending restraint should be selective, as expenditure items typically have different impacts on growth and equity, and often there are important trade-offs to consider (Cournède et al, 2014). The most common key areas for action are reforms to pensions and to other social benefits and subsidies.[18] Pension reform can mitigate fiscal costs associated with population ageing. For instance, increasing the statutory retirement age as longevity rises can complement policies aimed at narrowing paths to early retirement and support longer working lives. Ensuring that other social benefits and subsidies are adequately targeted would help to avoid distortions in incentives, and yield budgetary savings, whilst maintaining support for those most in need. Better fiscal frameworks are also a common key recommendation. In several countries, spending reviews could help prioritise spending and improve efficiency in the use of public resources, and should be integrated in budget processes (Tryggvadottir, 2022). Many countries should also improve medium-term budget planning, aided by appropriate fiscal rules.

[17] Since 2022, defence spending has grown faster than GDP in many OECD countries, including in Central and Eastern Europe. Other countries aim to spend more on defence in the years ahead. Among those implementing detailed medium-term plans to that effect, France, Germany and Japan are targeting defence expenditure increases worth respectively 0.4, 0.7 and 1% of GDP (OECD, 2023b).

[18] In contrast, procurement reforms or wage bill containment are seldom found among the key priorities. These measures are nonetheless important in many countries, but the largest payoffs for the sustainability of the public finances or immediate fiscal savings often lie elsewhere.

Figure 1.25. Past experience suggests that it will be challenging to reduce debt burdens

Per cent of previous debt reduction episodes in OECD economies

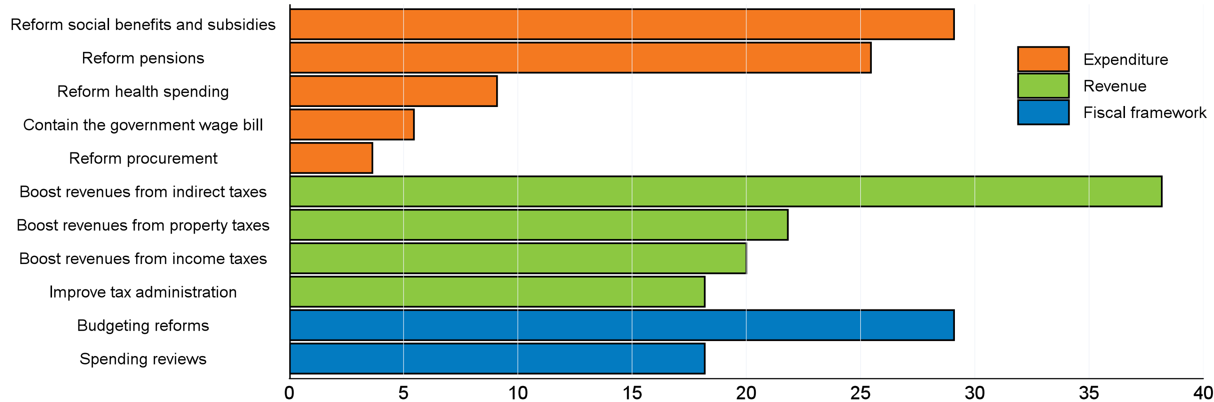


Note: The chart shows the percentage of 34 debt reduction episodes in OECD economies between the late 1970s and 2019 that fall into each category. The debt reduction episodes are defined in Annex 1. B. of OECD (2023a). The chart is based on the items identified in Figures 1.B.1; 1.B.2; and 1.B.3 of OECD (2023a). The differential between the implicit interest rate on debt and GDP growth corresponds to the sum of the orange and purple bars in Figure 1.B.1. The average annual change in primary expenditure as a share of GDP over the length of each episode relative to its initial value (red bars in Figure 1.B.2) is decomposed into several expenditure components as defined in the OECD Public Finance Dataset. "Education, health and family" denotes most current spending devoted to education, health care and, within social protection, family and children. "Other wages" includes most wages, as well as intermediate consumption, in functions other than education and health. "Other primary expenditures" includes unemployment benefits, sickness and disability spending, subsidies, non-social transfers and, in some cases, a statistical discrepancy term. In some episodes, not all expenditure components could be identified due to data limitations. For this reason, the total sample of episodes is reduced for: restraint of pensions spending (sample size: 26 episodes), restraint of education, health and family spending (24), restraint of spending on other wages (24), and restraint of other primary expenditures (22).
Source: OECD calculations.

Higher tax revenues should also play a key role in restoring or expanding fiscal space (Figure 1.26). Many countries have scope to raise revenues by eliminating distortive tax expenditures across different tax bases. A widespread key priority is to raise proportionally more revenue from consumption, environmental and property taxes. Such measures would limit the drag on economic growth from the tax system, including in countries where the overall tax burden may need to increase. Several advanced economies also have scope to efficiently shift their tax mixes to rely less heavily on taxing wages, which can discourage employment. To the extent that such reforms lift take-home pay for low-wage earners, they can also help to reduce income inequality (Akgun et al., 2017). Many emerging-market economies should, by contrast, look to boost total government revenues, often by broadening tax bases. In countries where informality is widespread, tax administration upgrades can help to improve compliance, shift activity to the formal economy and expand government revenues. Such revenue-raising measures can also help fund higher spending in priority areas.

Figure 1.26. Key policy priorities to rebuild fiscal space

Per cent of countries



Note: The figure reports the share of 55 countries for which a given recommendation is made in this Economic Outlook. “Indirect taxes” includes consumption and environmental taxes, such as fuel or carbon taxes. “Income taxes” covers personal and corporate income tax and social security contributions. “Tax administration” reforms include measures to strengthen enforcement and tackle tax evasion. “Budgeting reforms” include measures to improve medium-term budgeting and implement or strengthen numerical fiscal rules. Reforms boosting revenues from one tax category may be offset, at least in part, by parallel reforms that lower revenues from other taxes. This would reduce the total direct effect on budget balances, although efficient tax mix switches can increase national income relative to public debt in the longer term.
Source: OECD Economic Outlook 115 database; and OECD calculations.

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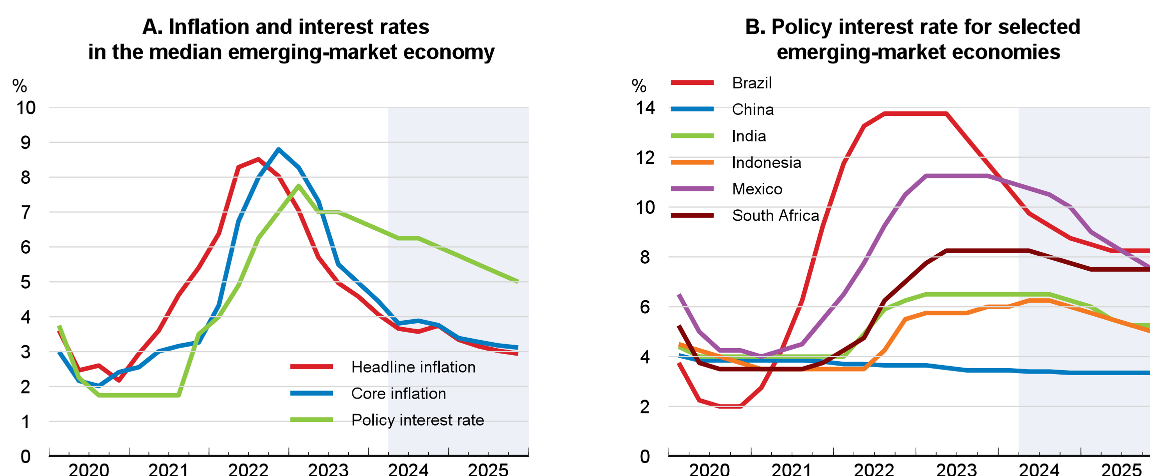
In emerging-market economies, improved monetary policy space should be used prudently and accompanied by fiscal reforms

Differences in underlying economic developments are being reflected in an increasingly divergent monetary policy stance in the major emerging-market economies. With inflation remaining very low, China has continued to reduce reserve requirement ratios and policy rates to help boost liquidity and support growth. Policy rates are also being lowered from elevated levels in many Latin American countries, including Brazil and Mexico, as inflation has fallen sharply towards target, though the monetary stance remains restrictive. In other economies, including India and South Africa, policy rates remain at their peaks. Russia and Türkiye have recently increased policy rates to curb persistently high inflation, and Indonesia has raised the policy rate to strengthen exchange rate stability.

Policy rate reductions are expected in many countries over the next two years (Figure 1.27), but their pace should remain prudent to ensure that inflation expectations remain well anchored. Easier global financial conditions and the anticipated onset of policy rate reductions in the major advanced economies enhance policy space in emerging markets, but a rapid narrowing of interest rate differentials could reignite capital outflows and currency depreciations (see risk section).

- Nominal policy rate reductions are projected to continue in Brazil as inflation moderates. In Mexico, policy rate cuts are expected to gather pace from the second half of 2024 as headline and core inflation converge to 3%, the midpoint of the target band.
- Modest policy rate reductions are projected to begin in the second half of 2024 in India and Indonesia as inflation eases and rate reductions get underway in the United States. China is expected to maintain an accommodative stance in 2024-25.

Figure 1.27. Monetary policy will remain restrictive in many emerging-market economies despite policy interest rate reductions



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 headline inflation and the policy rate, and Brazil, Bulgaria, Chile, Colombia, Costa Rica, Mexico, Peru, Romania and South Africa for core inflation.
Source: OECD Economic Outlook 115 database; and OECD calculations.

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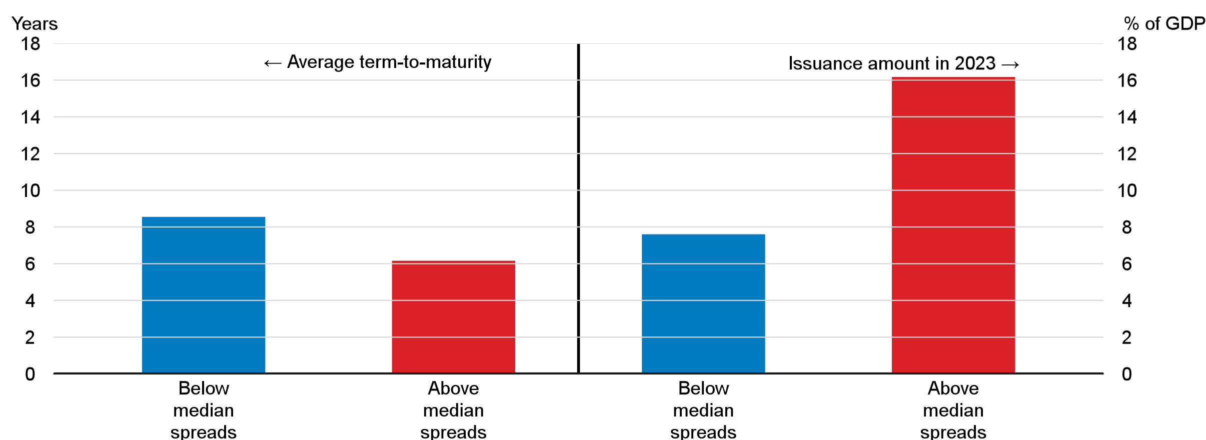
- Policy rate reductions in the second half of 2024 and early 2025 are projected in South Africa as inflation converges durably to the central bank target range.
- In Türkiye, declining but still high inflation is expected to result in the policy rate remaining at 50% in 2024 with reductions starting only during 2025.

Fiscal developments in 2023 were mixed across emerging-market economies. Expansions were implemented in Brazil and South Africa, reflecting a combination of lower revenues and higher social spending. In contrast, consolidations occurred in Colombia, Mexico and India, despite continued strong growth of public capital expenditure in the latter. Policy divergence is expected to persist in 2024, with sizeable near-term fiscal expansions in Colombia, China and Mexico, reflecting new infrastructure projects and social programmes, and a restrictive stance in Brazil, India, South Africa and Türkiye. In 2025, the more expansionary fiscal stance is projected to continue in China, with further issuance of ultra-long government bonds on top of those issued this year, but some consolidation is projected in most other emerging-market economies.

The prospects for fiscal sustainability remain challenging. Sovereign debt is elevated in many emerging-market economies and is expected to rise further in the coming years, and rising interest payments and revenue shortfalls limit the capacity to undertake the investment necessary for sustainable development. In addition, debt sustainability might also be endangered in a number of emerging-market economies facing elevated spreads, especially if debt issuance remains sizeable, as the average maturity of their government debt is comparatively low (Figure 1.28).

Governments need to rebuild fiscal space and reduce debt-service burdens while protecting essential spending for development. In this regard, the modest fiscal consolidations projected in several emerging-market economies in the medium term appear appropriate. At the same time, revenue collection should also be reinforced, and tax evasion curbed, including by improved tax administration, modernised property registries and streamlined corporate tax codes. Stronger efforts to enhance the effectiveness of fiscal rules and debt management and promote spending efficiency (especially on subsidies) would also help. Efforts to introduce or strengthen independent fiscal institutions, in Latin America and elsewhere, could enhance fiscal credibility (Caldera Sánchez et al., 2024), lower financing costs and help limit pro-cyclical policies in commodity-rich countries.

Figure 1.28. Debt sustainability in some emerging market economies may be jeopardised by high sovereign spreads and low debt maturity



Note: The figure shows average term to maturity of sovereign debt and 2023 sovereign debt issuance for a sample of 40 emerging and low-income countries. Countries are grouped according to whether EMBI spreads to USD-denominated bonds in March 2024 were above or below the sample median. Average debt to maturity is computed for marketable debt issued over the period 2020-2023 and outstanding as of end-March 2024.
Source: Factset; LSEG; World Bank; and OECD calculations.

More ambition is needed on structural policies to improve growth and advance the climate transition

Beyond the near term, the prospects for long-term growth and improvements in living standards appear modest. Stronger policy action is required to remove impediments to greater investment and employment, to enhance skills development and to intensify innovation.

- In advanced economies, the trend rate of GDP per capita growth declined after the global financial crisis. There is no reversal of this decline in the advanced economies in the latest OECD long-term baseline projections based on current policy settings (Guillemette and Château, 2023). OECD-wide average annual GDP per capita growth through 2060 is projected to be about 1.7%, in line with the post-2007 average. The slowdown reflects weaker investment growth and a slower pace of increase in total factor productivity. Population ageing will also weigh increasingly on potential output growth.

- While emerging-market and developing economies as a group continue to record faster growth in per capita incomes than advanced economies, the rate of income convergence has slowed in recent decades, and in some cases stopped altogether. Demographic headwinds are becoming increasingly important in a number of major countries, including China. In many countries, improving the operation and regulation of product and labour markets, including through lower barriers to trade and investment, and enhanced economic governance, are key priorities.

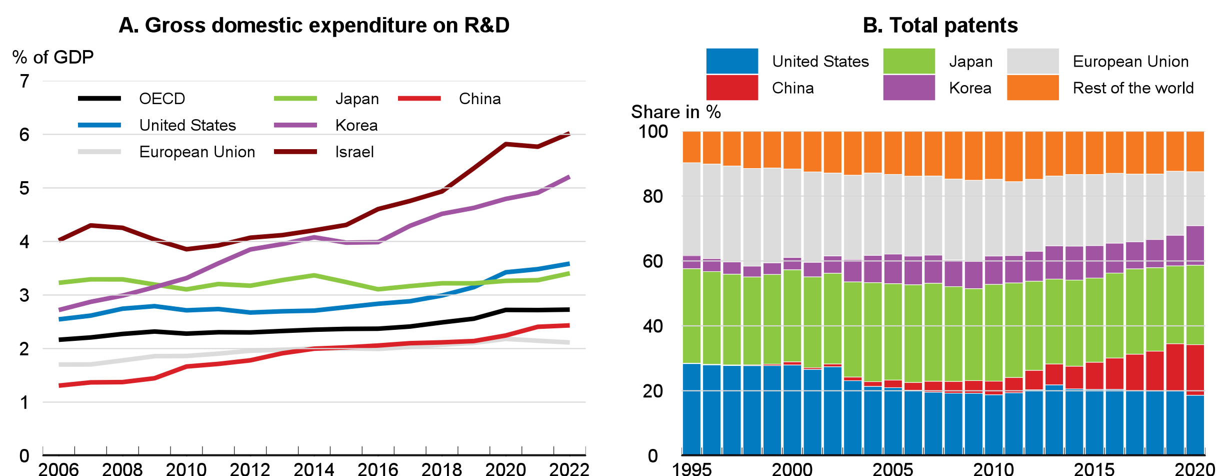
Although the main benefit of reforms should be felt gradually over a number of years, some timely and well-targeted policies could start to alleviate constraints even in the near term. For example, in countries experiencing labour shortages, greater immigration, targeted training and measures to increase labour force participation of women and older workers could boost output and reduce labour cost pressures. In so doing, they could also help to reduce public debt burdens, which surged during the pandemic. Such reforms are among the common priorities identified in *Going for Growth* (OECD, 2023c).

Innovation policies have a critical role in strengthening productivity

Innovation is a key determinant of technological progress and productivity growth, increasingly so in knowledge-based economies. National innovation efforts reflect both domestic research expertise, research and development (R&D) and organisational know-how, and the ability to effectively adopt and adapt ideas and technologies developed in other countries. The latter is especially important for smaller economies, with the majority of R&D and patenting concentrated in a few large economies (Figure 1.29).

While the majority of research efforts are undertaken in the private sector, government policies have an important role to play in fostering innovation, particularly as the societal returns to innovation often exceed the private returns. Well-designed public support for R&D, whether for basic government-funded research, direct grants to businesses or R&D tax incentives, can strengthen innovation, with recent *Going for Growth* reform recommendations often focused on achieving a better balance between the two types of support for businesses and rigorous evaluation of grant programmes. As of 2020, government direct and indirect funding of business R&D was relatively small, at around 0.2% of GDP in the OECD as whole, but varied widely, being close to twice that amount in France, the United Kingdom and Austria, and almost zero in a number of smaller European countries, Chile, Colombia and Mexico (OECD, 2023d).

Figure 1.29. Innovation efforts have improved over time but are highly concentrated across countries



Note: Patent data based on IP5 patent families, by nationality of applicant.
Source: OECD Main Science and Technology Indicators database; and OECD calculations.

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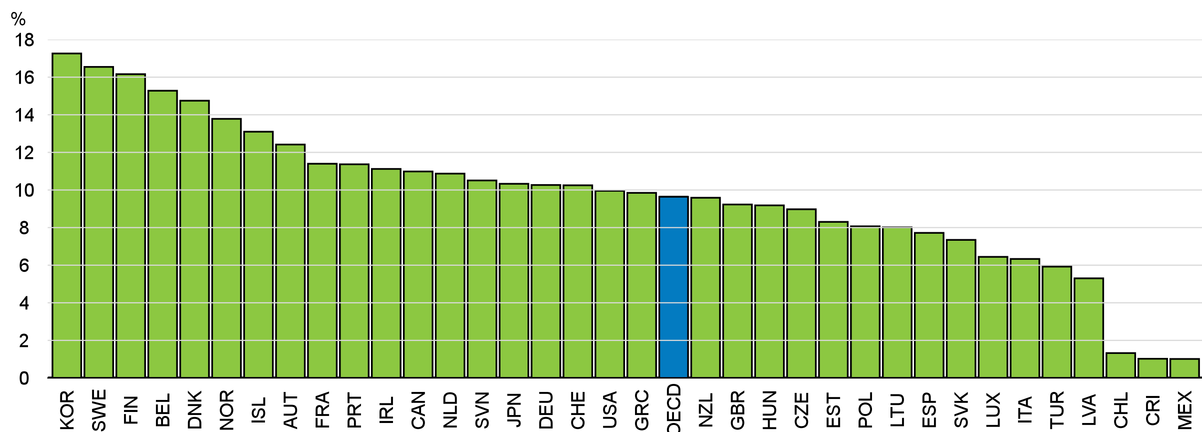
Product, labour and financial market policies that encourage the entry of new firms and the reallocation of capital and jobs across firms, effective insolvency legislation that does not penalise entrepreneurial efforts, and well-designed science policies are all essential to help countries strengthen their innovative capacity. Training and education policies are also critical to help provide the skills required by companies and to equip people with the ability to effectively use new products and processes, including digital technologies. In this respect, the differences in the share of researchers in total employment across countries (Figure 1.30) may affect the ability to adopt new processes and technologies as well as domestic innovation activities. In many emerging-market economies, a key priority is to strengthen the ability to benefit from innovations elsewhere. To that end, skills linked to higher vocational education and training as well as primary and secondary education are critical.

It is also important to strengthen knowledge transmission through collaboration between firms and researchers at home and abroad, and between research institutes or universities and business. Such linkages also vary widely across countries, pointing to possible areas where reforms could be effective. In the OECD as a whole, around 8% of patents had foreign co-inventors in 2019, but the share was close to 25% in the median OECD economy, and over 40% in Belgium, Costa Rica, Ireland, Luxembourg and Switzerland.

A key unknown is the extent to which the generalised use of artificial intelligence (AI) could trigger an acceleration of innovation and improved trend productivity growth. The share of firms making use of AI has risen rapidly, with one survey suggesting that around one-third of businesses in the United States and the European Union made use of AI in 2023 (EIB, 2024). Most of these are large companies (Figure 1.31). There is evidence suggesting that the positive growth impact of AI could be sizeable for individual firms, but there is as yet no clear evidence of economy-wide effects (Filippuci et al., 2024). The net effect of AI will depend on many factors, including the extent to which new technologies are widely diffused or concentrated in a few leading firms, and the extent to which AI is labour enhancing as opposed to labour replacing. Apart from the implications for innovation and average productivity growth, the broader distributional and societal consequences of the generalised use of AI remain uncertain.

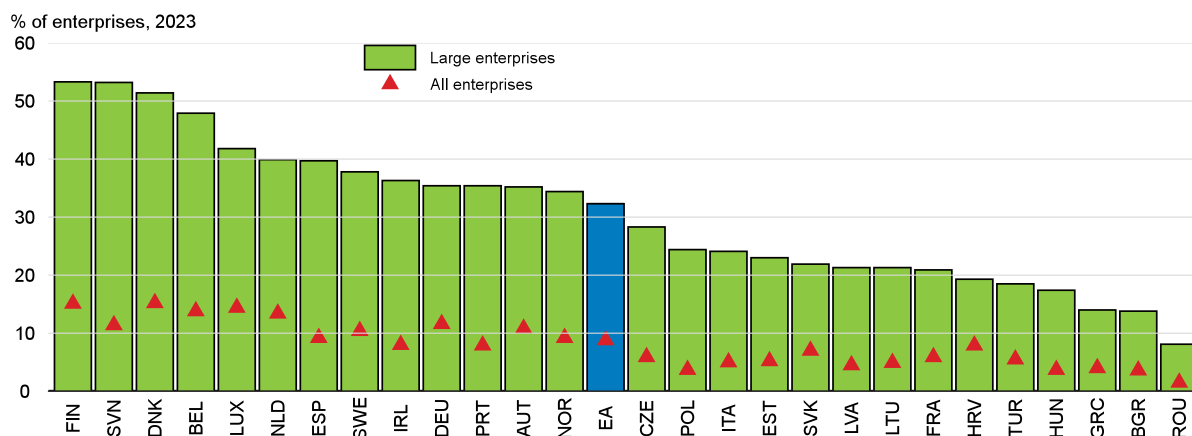
Figure 1.30. The share of researchers in total employment varies widely across countries



Note: “Researchers” denotes individuals employed in the public or the private sector to create new knowledge, products, processes and methods, as well as to manage the projects concerned.
Source: OECD Main Science and Technology Indicators; and OECD calculations.

https://stat.link/29yz1g

Figure 1.31. Use of artificial intelligence technologies varies widely across firms



Note: All enterprises cover enterprises with 10 employees or more. Large enterprises have 250 employees or more. Firms using at least one AI technology in 2023.
Source: Eurostat.

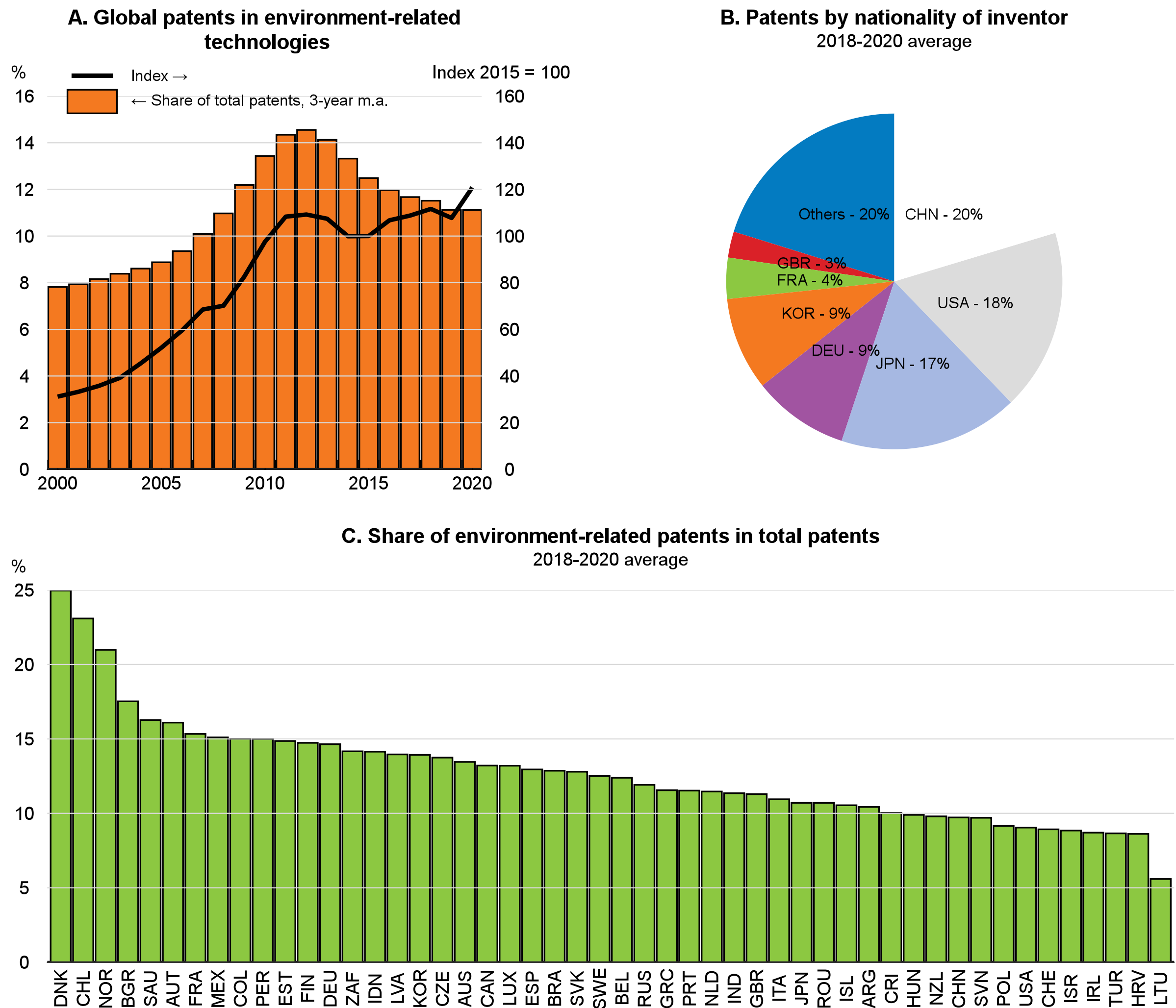
StatLink https://stat.link/jw9yek

Innovation is also an essential pillar of the green transition

Innovation is also a key element of the green transition as it can reduce the investment costs of emissions-reduction policies and new technologies. Rapid advances made in renewable energy technologies have helped make renewables increasingly cost-competitive with fossil fuels (OECD, 2023e). One concern in this respect is that the rate of growth of environment-related technology patents has slowed and the share of these patents in total patents has declined (Figure 1.32, Panel A). With just seven countries accounting for the bulk of new patenting in these fields (Figure 1.32, Panel B), and with most countries having a relatively low degree of specialisation in environment-related innovation (Figure 1.32, Panel C), the ability to access technologies developed abroad is crucial. This underlines the importance of open trade and investment regimes in this area, as well as ensuring adequate skills development. Other potential policy options to support innovation include additional funding to help with the scaling up of major low-carbon technology projects at the demonstration phase, and focusing funding on innovative projects providing public goods or offering large, but uncertain, future payoffs (OECD, 2023e).

Innovation can also facilitate the climate transition by accelerating the adoption of digital and low-carbon technologies. Despite some recent improvements, the International Energy Agency estimates that, on the basis of currently stated policies, green investment in 2030 would be barely half of what is required to meet the objective of net zero emissions by 2050 (IEA, 2023). Increasing green and digital infrastructure investment, strengthening standards to enable a reduction in emissions, and raising the scope and level of carbon pricing are all key for mitigating climate change, with priorities varying across countries. With current mitigation policies falling short of what is needed to limit the rise in global temperatures, adaptation policies and strategies are also becoming increasingly urgent to help minimise the economic costs of climate change.

Figure 1.32. Patenting of new environment-related technologies has slowed and is highly concentrated



Note: Patents of environment-related technologies filed under the Patent Co-operation Treaty. Data are by the inventor(s) country (countries) of residence.
Source: OECD Patent Statistics; and OECD calculations.

StatLink https://stat.link/3c5tks

Trade and industrial policies should ensure that markets are kept open

Trade, industrial and innovation policy are inherently linked given the nexus between international and domestic competition and the importance of ensuring the unencumbered sharing and circulation of knowledge across countries (Millot and Rawdanowicz, 2023). Rules-based trade enables opportunities for all countries, provides the predictability and certainty needed for the private sector to invest and create jobs, and strengthens competition (OECD, 2023f). National and supranational competition and trade authorities have traditionally played a key role in setting and enforcing rules that ensure a level playing

field among firms, industries and countries. One example is the reform of state aid, which provides a set of objective qualification criteria (OECD, 2021a).[19]

The ongoing adjustment of value chains, weaker commitment to multilateral trading frameworks and trade and geopolitical tensions have resulted in trade, industrial and investment policies becoming more focused on strengthening national security, self-reliance and providing support for domestic companies. Such policies include innovation support, local content requirements, export controls and, increasingly, more stringent foreign investment screening measures.[20] These approaches raise the risks of retaliatory measures and of foregoing the knowledge and products that might otherwise flow across national borders to strengthen domestic innovation and productivity.

[19] The OECD Guidelines for Recipient Country Investment Policies relating to National Security include the principles of non-discrimination, transparency, predictability, proportionality, and accountability in the application of safeguards for national security (OECD, 2009).

[20] International research cooperation, an avenue to acquire know-how outside of commercial acquisitions, is also being affected as foreign financing of research and the exchange of researchers comes under scrutiny (OECD, 2021b).

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

Fiscal policy settings for 2024-25 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. Unless otherwise announced, the phasing-out of any remaining energy-related support measures is assumed to be completed by end-2024 at the latest.

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 of spending across years and different expenditure categories and informed by officially announced plans where available. NGEU grants are assumed to be budget neutral, and 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 February and March 2024.

The projections assume unchanged exchange rates from those prevailing on 5 April 2024: one US dollar equals JPY 151.3, EUR 0.92 (or equivalently one euro equals USD 1.08) and 7.24 renminbi.

The price of a barrel of Brent crude oil is assumed to remain constant at USD 85 until the end of 2025. The TTF natural gas price is assumed to remain constant at EUR 25 MW/h until the end of 2025. Other commodity prices are assumed to be constant over the projection period at their average levels from March 2024. A technical assumption is made that the current disruptions to shipping in the Red Sea persist through 2024 and 2025.

The cut-off date for information used in the projections is 24 April 2024.

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.

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