

## II. DEVELOPMENTS IN INDIVIDUAL OECD COUNTRIES AND SELECTED NON-MEMBER ECONOMIES

### United States

*Output has grown at a solid pace, underpinned by robust productivity growth, buoyant house prices, and fiscal and monetary stimulus. The continuation of several of these factors, together with the economy's inherent momentum, suggests that the recovery will maintain a relatively smooth trajectory – despite damaging hurricanes and large increases in oil prices. There has been little sign so far of increases in energy prices feeding into the general level of wages or non-energy consumer prices. Nevertheless, a moderate acceleration in core prices is expected during the next few quarters.*

*As the last signs of slack in the economy disappear, the large monetary stimulus delivered in recent years is no longer desirable and is being removed. Short-term interest rates are approaching a neutral position and will need to turn restrictive should increases in energy prices start being built into underlying inflation. The federal government's financial position has improved, thanks to an unexpected increase in revenues. But much of this windfall is being spent on large hurricane and military-related expenditures. This highlights the importance of fiscal discipline in the face of longer-term spending pressures and the risks posed by the large external deficit.*

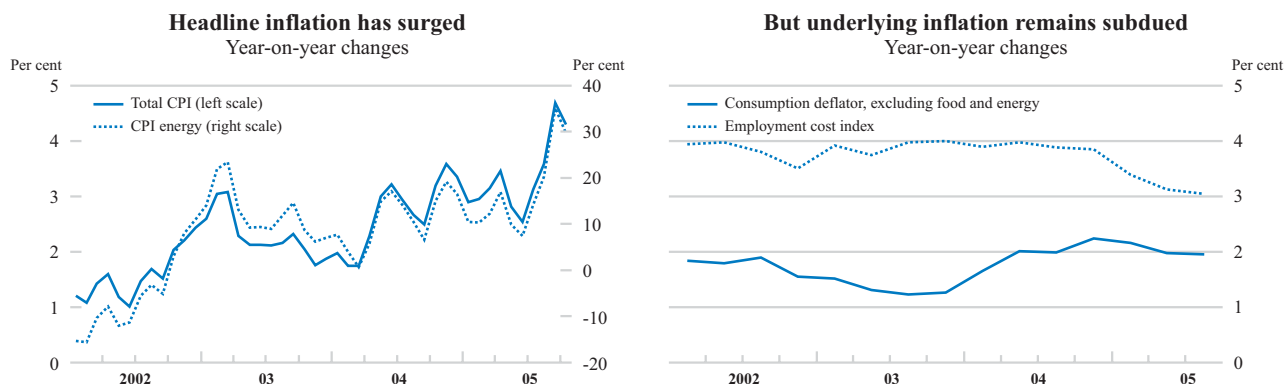
Economic conditions were relatively buoyant in the spring and early summer of 2005. Private demand was brisk, reflecting strong sales of motor vehicles, a continuing housing boom and recovering net exports. Employment grew steadily and quickly. The unemployment rate was falling, dropping to near its equilibrium level.

*The economy was growing strongly...*

Headline inflation has risen dramatically, by the standard of the past decade, reflecting large increases in oil prices. However, underlying inflation has been well-contained. Indeed, increases in consumer prices, excluding food and energy, have slowed since early 2005. Moreover, overall nominal wages do not seem to be responding to the higher energy prices.<sup>1</sup> This encouraging response may reflect low

*... with little reaction to oil prices...*

### United States



Source: US Bureau of Economic Analysis, US Bureau of Labor Statistics.

1. Although the widely used measure of compensation from the Productivity and Cost report spiked up at the end of 2004, that series is erratic and distorted (as a measure of labour costs) by stock option exercises. Movements in two less volatile series, the Employment Cost Index and Average Hourly Earnings, have remained low.

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**United States: Employment, income and inflation**


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Percentage changes from previous period

	2003	2004	2005	2006	2007
Employment <sup>1</sup>	0.0	1.1	1.6	1.5	1.2
Unemployment rate <sup>2</sup>	6.0	5.5	5.1	4.8	4.7
Employment cost index	4.0	3.9	3.1	3.7	4.6
Compensation per employee <sup>3</sup>	3.6	4.6	5.4	4.5	5.0
Labour productivity <sup>3</sup>	2.9	3.4	2.1	2.2	2.0
Unit labour cost <sup>3</sup>	0.6	1.2	3.2	2.2	2.9
GDP deflator	2.0	2.6	2.7	2.5	2.3
Consumer price index	2.3	2.7	3.4	2.8	2.5
Core PCE deflator <sup>4</sup>	1.3	2.0	2.0	2.1	2.2
Private consumption deflator	1.9	2.6	2.8	2.4	2.1
Real household disposable income	2.4	3.4	1.6	3.6	3.7

1. Whole economy, for further details see *OECD Economic Outlook Sources and Methods*, (<http://www.oecd.org/eco/sources-and-methods>).

2. As a percentage of labour force.

3. In the business sector.

4. Price index for personal consumption expenditure excluding food and energy.

Source: OECD Economic Outlook 78 database.

Statlink: <http://dx.doi.org/10.1787/563788335667>

expectations of future inflation, increased market discipline arising from foreign competition, or further reductions in the structural rate of unemployment.

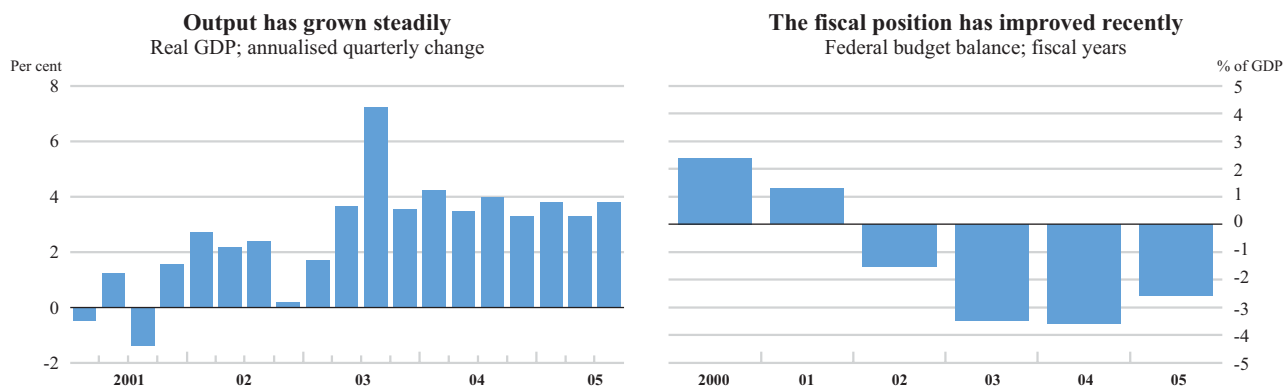
*... when the hurricanes hit*

The economy was thus in fine form when two large hurricanes hit in late August and early September. The storms stopped much production around New Orleans and the Gulf of Mexico, with oil, natural gas and petroleum products processing and transportation facilities particularly badly affected. Employment fell by about 200 000 (as of mid-September) as a result. Against this, activity is expected to be supported by spending on recovery and reconstruction. The net effect has been estimated to be a reduction in GDP growth of half a percentage point (at an annual rate) in the second half of 2005. But overall activity is expected to return to trend in early 2006 and then be somewhat higher.

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**United States**


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Source: OECD Economic Outlook 78 database and US Congressional Budget Office.

## United States: Financial indicators

	2003	2004	2005	2006	2007
Household saving ratio <sup>1</sup>	2.1	1.8	-0.2	0.4	0.7
General government financial balance <sup>2</sup>	-5.0	-4.7	-3.7	-4.2	-3.9
Current account balance <sup>2</sup>	-4.7	-5.7	-6.5	-6.7	-7.0
Short-term interest rate <sup>3</sup>	1.2	1.6	3.5	4.8	4.9
Long-term interest rate <sup>4</sup>	4.0	4.3	4.3	4.7	4.8

1. As a percentage of disposable income.

2. As a percentage of GDP.

3. 3-month euro-dollar.

4. 10-year government bonds.

Source: OECD Economic Outlook 78 database.

Statlink: <http://dx.doi.org/10.1787/563788335667>

With these disruptions having relatively small effects, monetary policy has not changed course. The nominal federal funds rate has continued to be moved up in regular 25 basis-point increments, as previously foreshadowed by the Federal Reserve and as expected by the financial markets. Reflecting this, long term nominal interest rates have been edging up but remain unusually low in real terms. The Federal Reserve has signalled its expectation that short-term interest rates will continue to rise toward a neutral level. Further increases will be necessary if higher energy prices flow through to rising core inflation.

*Monetary stimulus is being removed*

The news on fiscal policy has been mixed. The federal deficit for fiscal year 2005 came in at 2.6% of GDP, a noticeable improvement relative to both expectations and previous years. The improvement reflected a large increase in revenue, particularly corporate income taxes. This more than offset increased outlays, notably on military operations in Afghanistan and Iraq. The decline in the deficit is not

*Government spending is rising*

## United States: Demand and output

	2002	2003	2004	2005	2006	2007
	Current prices \$ billion	Percentage changes, volume (2000 prices)				
Private consumption	7 350.8	2.9	3.9	3.5	2.8	3.4
Government consumption	1 616.9	3.0	2.1	1.6	1.2	0.9
Gross fixed investment	1 914.5	3.3	8.4	7.2	6.4	4.5
Public	344.3	2.0	2.3	3.4	7.1	4.5
Residential	503.9	8.4	10.3	7.1	3.3	0.4
Non-residential	1 066.3	1.3	9.4	8.3	7.9	6.7
Final domestic demand	10 882.1	3.0	4.4	3.9	3.3	3.2
Stockbuilding <sup>1</sup>	11.9	0.0	0.3	-0.3	0.2	0.1
Total domestic demand	10 894.0	3.0	4.7	3.6	3.4	3.3
Exports of goods and services	1 005.9	1.8	8.4	7.1	8.3	8.5
Imports of goods and services	1 430.3	4.6	10.7	5.8	6.0	7.0
Net exports <sup>1</sup>	- 424.4	-0.5	-0.7	-0.2	-0.1	-0.2
GDP at market prices	10 469.6	2.7	4.2	3.6	3.5	3.3

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook Sources and Methods*, (<http://www.oecd.org/eco/sources-and-methods>).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

Source: OECD Economic Outlook 78 database.

Statlink: <http://dx.doi.org/10.1787/563788335667>

## United States: External indicators

	2003	2004	2005	2006	2007
	\$ billion				
Goods and services exports	1 045.7	1 173.8	1 304.1	1 442	1 593
Goods and services imports	1 546.5	1 797.8	2 014.1	2 200	2 396
Foreign balance	- 500.9	- 624.0	- 710.0	- 758	- 803
Invisibles, net	- 18.8	- 44.1	- 95.7	- 132	- 177
Current account balance	- 519.7	- 668.1	- 805.7	- 890	- 980
	Percentage changes				
Goods and services export volumes	1.8	8.4	7.1	8.3	8.5
Goods and services import volumes	4.6	10.7	5.8	6.0	7.0
Export performance <sup>1</sup>	- 2.5	- 1.8	- 0.7	- 0.2	0.2
Terms of trade	- 1.2	- 1.4	- 2.0	- 0.9	0.0

1. Ratio between export volume and export market of total goods and services.

Source: OECD Economic Outlook 78 database.

Statlink: <http://dx.doi.org/10.1787/563788335667>

expected to continue. In the projection, the federal deficit fluctuates around 3% of GDP (in national accounts terms). Expenditure rises in 2006 due to the prescription-drug programme. In addition, Congress has recently approved \$62 billion (approximately ½ per cent of GDP) for relief and reconstruction following the hurricanes. Further hurricane-related spending has been proposed and may be forthcoming in the months ahead. There appears to be little appetite within Congress for financing this through offsetting expenditure reductions or tax increases, although the President's 2006 budget made numerous proposals to save \$200 billion over the next ten years from both discretionary and mandatory programmes.

### *The outlook is favourable...*

Real GDP is estimated to be growing at an annualised rate of 3¾ per cent in the second half of 2005, the same rate of growth as in the previous seven quarters. Although the hurricanes and higher oil prices have depressed activity, their effect is expected to be offset by a large turnaround in stockbuilding. Thereafter, this robust rate of growth continues, albeit with a deceleration in 2007. Private consumption remains solid, reflecting large increases in house prices and real personal income. Real incomes, in turn, are supported by strong productivity growth and government transfers related to prescription drugs and hurricane assistance. With the price of new houses well above building costs, residential construction remains strong. Business spending also grows quickly, though moderating somewhat as the investment share of national income rises. Export growth is supported by respending of oil revenues by oil-producers. The current account deficit continues to grow, however, reaching 7% of GDP in 2007. Core inflation is expected to rise in 2006, largely reflecting the one-off effect of the pass-through of higher energy costs. As this effect passes, core inflation slows in the course of 2007, remaining relatively low.

### *... but could easily come undone*

Substantial uncertainty surrounds the effects of the large run-up in oil prices. Overall, the projection implies a more benign response on the part of both output and inflation than in the past. Although that assessment is consistent with the surprising resilience of the US economy to date, it remains to be fully tested. Should energy prices begin to feed substantially into core inflation – in particular, if nominal wage growth were to rise significantly – then large increases in long-term interest rates could occur, slowing economic growth substantially. A back-up in long-term rates could also materialise in the context of an abrupt shift in market sentiment concerning the sustainability of current account imbalances.

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**Conventional signs**

\$	US dollar	.	Decimal point
¥	Japanese yen	I, II	Calendar half-years
£	Pound sterling	Q1, Q4	Calendar quarters
€	Euro	Billion	Thousand million
mb/d	Million barrels per day	Trillion	Thousand billion
..	Data not available	s.a.a.r.	Seasonally adjusted at annual rates
0	Nil or negligible	n.s.a.	Not seasonally adjusted
–	Irrelevant		

## Summary of projections

	2005	2006	2007	2005		2006		2007		Fourth quarter			
				Q4	Q1	Q2	Q3	Q4	Q1	Q2	2005	2006	2007
	Per cent												
<b>Real GDP growth</b>													
United States	3.6	3.5	3.3	3.7	3.3	3.5	3.5	3.3	3.2	3.2	3.7	3.4	3.1
Japan	2.4	2.0	2.0	1.7	1.9	2.1	1.9	2.0	2.0	2.1	3.2	2.0	2.1
Euro area	1.4	2.1	2.2	2.2	1.9	2.0	2.2	2.1	2.2	2.2	1.8	2.1	2.2
Total OECD	2.7	2.9	2.9	3.1	3.0	2.8	2.6	2.9	3.2	2.9	3.0	2.8	2.9
<b>Inflation</b>													
United States	2.7	2.5	2.3	2.9	2.2	2.3	2.3	2.3	2.6	2.2	2.9	2.3	2.2
Japan	-1.1	-0.1	0.6	-0.2	0.0	0.1	0.3	0.5	0.6	0.7	-1.3	0.2	0.8
Euro area	1.8	1.7	1.9	1.9	1.5	1.5	1.5	1.8	2.0	2.1	1.9	1.6	2.0
Total OECD	2.1	1.9	1.9	1.5	1.4	2.1	2.4	2.0	1.7	1.8	1.9	2.0	1.9
<b>Unemployment rate</b>													
United States	5.1	4.8	4.7	5.0	4.9	4.9	4.8	4.8	4.7	4.7	5.0	4.8	4.7
Japan	4.4	3.9	3.5	4.3	4.1	4.0	3.9	3.8	3.7	3.5	4.3	3.8	3.3
Euro area	8.7	8.4	8.1	8.6	8.5	8.5	8.4	8.4	8.3	8.2	8.6	8.4	8.0
Total OECD	6.5	6.3	6.0	6.4	6.3	6.3	6.2	6.2	6.1	6.1	6.4	6.2	5.9
<b>World trade growth</b>	7.3	9.1	9.2	9.3	8.8	8.8	8.9	9.1	9.3	9.4	8.1	8.9	9.3
<b>Current account balance</b>													
United States	-6.5	-6.7	-7.0										
Japan	3.4	3.9	4.7										
Euro area	-0.2	-0.2	-0.1										
Total OECD	-1.8	-2.0	-2.0										
<b>Cyclically-adjusted fiscal balance</b>													
United States	-3.6	-4.2	-3.9										
Japan	-6.3	-6.1	-6.4										
Euro area	-2.2	-2.1	-2.0										
Total OECD	-3.1	-3.3	-3.2										
<b>Short-term interest rate</b>													
United States	3.5	4.8	4.9	4.2	4.6	4.9	4.9	4.9	4.9	4.9	4.2	4.9	4.9
Japan	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.3	0.6	0.0	0.0	1.0
Euro area	2.2	2.2	2.9	2.2	2.2	2.2	2.2	2.3	2.6	2.8	2.2	2.3	3.3

Note: Real GDP growth, inflation (measured by the increase in the GDP deflator) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day-adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. The unemployment rate is in per cent of the labour force while the current account balance is in per cent of GDP. The cyclically-adjusted fiscal balance is in per cent of potential GDP. Interest rates are for the United States: 3-month eurodollar deposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate.

Assumptions underlying the projections include:

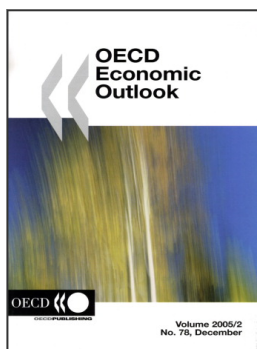
- no change in actual and announced fiscal policies;

- unchanged exchange rates as from 11 November 2005; in particular 1\$ = 118.00 yen and 0.85 euros;

The cut-off date for other information used in the compilation of the projections is 22 November 2005.

Source: OECD Economic Outlook 78 database.





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