OECD downgrades global growth forecast

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The Organisation for Economic Cooperation and Development has downgraded its forecast for global growth to the lowest level in five years and warned of "substantial" risks to the international financial system.

Releasing its first report for the year, the Paris-based organisation, comprising 34 major economies, reduced its prediction of global growth from 3.3 percent in November to 3 percent and said growth in 2017 would be 3.3 percent rather than 3.6 percent.

"Global growth prospects have practically flat-lined, recent data have disappointed and indicators point to slower growth in major economies and low interest rates," OECD chief economist Catherine Mann said in issuing the report.

The downturn is centred in the world's largest economies. Growth prospects have worsened over the past three months for every member of the G7 group of the world's major industrial economies—the US, the UK, Germany, Japan, Italy, France and Canada.

The OECD cut its forecast both for the US, the world's largest economy, and for Germany, the fourth largest, by 0.5 percentage points. The US is now expected to expand by 2 percent this year and 2.2 percent in 2017, with growth in Germany expected to come in at 1.3 percent and 1.7 percent respectively.

It said the US was facing "an intensification of headwinds, including a drag on exports from the stronger dollar and energy investment from low oil prices." It also cut the growth forecast for the Canadian economy, which has been hit by the slump in oil prices, from 2 percent to 1.4 percent this year.

Slow growth in the euro zone was a major drag on global economic recovery and left the world vulnerable to global economic shocks, the OECD said. It cut 0.4 percentage points off the growth forecast for 2016 and reduced its estimate for 2017 growth by 0.2 percentage points, lowering its estimates to 1.4 percent and 1.7 percent respectively.

The biggest reduction in growth estimates was for Brazil, the world's ninth-largest economy that was once touted as a new basis for world growth as part of the so-called BRICS group of countries. The OECD said its economy would contract by 4 percent this year, a downward revision from its previous forecast of negative growth of 2.8 percent, following a 3.8 percent recession last year.

This follows last month's downward revision by the International Monetary Fund which has forecast that the Brazilian economy will contract by 3.5 percent. Both organisations expect that Brazil's economy will not grow in 2017 after earlier forecasting expansion of 1.8 percent.

On Wednesday, the credit-rating agency Standard & Poor's downgraded Brazilian sovereign debt, saying that fiscal adjustment—government spending cuts—and political uncertainty were preventing the economy from resuming growth.

The OECD also added its voice to those warning of growing financial instability. "Financial instability risks are substantial," it said. "Some emerging markets are particularly vulnerable to sharp exchange-rate movements and the effects of high domestic debt."

Concern over financial stability and the realisation that the low-interest rate regime flowing from cuts in official rates by central banks, as well as their quantitative easing programs, is not bringing about an economic revival and is in fact increasing financial instability, prompted a major shift in the OECD's policy recommendations.

Previously, it has called for reductions in government spending—fiscalconsolidation—combinedwithso-called structural reforms, aimed at cutting working-class living standards, to boost growth. It has kept the call for structural reforms but, in a measure of how seriously it regards the fall in growth, has called for a boost to government spending.

"Monetary policy cannot work alone. Fiscal policy is now contractionary in many major economies. Structural reform momentum has slowed," the report said.

In a criticism of the reliance on monetary policy, Mann said: "Given the significant downside risks posed by financial sector volatility and emerging market debt, a stronger collective policy approach is urgently needed, focusing on a greater use of fiscal and pro-growth structural policies, to strengthen growth and reduce financial risks."

She said that with interest rates at very low levels "there is room for fiscal expansion to strengthen demand in a manner consistent with financial sustainability." According to the report, a "more supportive demand environment" would enable governments to proceed more vigorously with structural reforms, which are principally aimed at introducing more "flexibility" into labour markets.

Noting that budget policy in the US, the UK and Japan was "contractionary" and a number of developing countries had made budget decisions that would lower growth, the OECD called for a change of course. It said governments should now either lift their overall spending or undertake infrastructure projects that would make up for "the shortfall in investment following the cuts imposed across advanced economies in recent years."

However, there is no sign at all that major governments are going to make the "course correction" now urged by the OECD, which has also been advanced previously by some global economists. In the first phase of the global economic meltdown of 2008–2009, there was a certain turn to government stimulus measures. But this was reversed at a meeting of the G20 group in June 2010 when the emphasis was placed on "fiscal consolidation."

In an indication of the likely response from all major governments, a spokesman for the US Treasury, which has been instrumental in imposing major cuts, said the OECD's advice to Britain had not changed and "we have the right strategy and have made significant progress over the past five years."

Furthermore, the present crisis is not the result of a cyclical downturn, which can somehow be overcome by a turn to "demand management" of the kind practised in an earlier period, but is the outcome of deep-going forces within the global capitalist economy.

Economic and financial analyst Satyajit Das, who warned in 2006 of the key role played by derivatives and other complex financial instruments in creating the conditions for a financial crisis, noted at a recent financial conference that debt had only grown since 2008 and was crushing the ability of the global economy to resume growth. He said there was only a 0.5 percent chance of a bounce back in the world economy and a normalisation of interest rate policy.

Noting the longer-term changes in the global economy, he said that since the late 1980s only 15 to 20 percent of borrowed money had gone into productive investment, with the rest used to finance takeovers of companies, real estate or the financing of personal spending.

The most optimistic scenario in the present situation was for "managed depression," consisting of low growth and disinflation with monetary policy used to try to contain it, with a 30 percent chance of a major crisis that would lead to social breakdown.

"Essentially, you get overvalued assets, debt, capital flight as we see in China, deflation starts, emerging markets start to have problems, and then you get cross-contagion," he said. The response of financial authorities to the crisis was the crux of the problem, rather than the solution, because they had created a kind of Ponzi scheme in which nations and individuals needed to borrow ever-increasing amounts just to pay off existing debts.