OECD ECONOMIC OUTLOOK

Preliminary Edition

68

NOVEMBER 2000

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Summary of projections[a]

Seasonally adjusted at annual rates

	2000	2001	2002	2000 I	2000 II	2001 I	2001 II	2002 I	2002 II
				Percentage changes from previous period					
Real total domestic demand									
United States	5.8	3.6	3.4	6.5	4.0	3.5	3.3	3.4	3.5
Japan	1.3	2.4	1.8	3.4	1.4	3.5	1.0	2.0	2.0
Euro area[b]	2.8	2.6	2.7	3.2	2.5	2.7	2.7	2.7	2.7
European Union	2.9	2.7	2.7	3.2	2.6	2.7	2.7	2.7	2.6
Total OECD	4.2	3.2	3.0	4.9	3.3	3.4	2.9	3.0	3.1
Real GDP									
United States	5.2	3.5	3.3	5.9	3.7	3.5	3.2	3.3	3.4
Japan	1.9	2.3	2.0	4.5	1.5	3.3	1.3	2.2	2.3
Euro area[b]	3.5	3.1	2.8	3.7	3.3	3.0	3.0	2.8	2.7
European Union	3.4	3.0	2.7	3.5	3.4	2.8	2.8	2.7	2.6
Total OECD	4.3	3.3	3.1	5.0	3.5	3.3	2.9	3.1	3.1
				Per cent					
Inflation[c]									
United States	2.1	2.2	2.3	2.6	2.1	2.3	2.2	2.3	2.3
Japan	-1.5	-0.4	-0.2	-1.8	-0.8	-0.2	-0.4	-0.1	-0.1
Euro area[b]	1.2	1.9	2.0	1.1	1.8	2.0	2.0	2.1	2.1
European Union	1.4	2.0	2.2	1.2	1.8	2.1	2.1	2.2	2.2
Total OECD *less* high inflation countries[d]	1.3	1.8	1.9	1.4	1.6	1.9	1.8	1.9	1.8
Total OECD	2.6	2.4	2.3	2.6	2.6	2.5	2.3	2.4	2.3
				Per cent of labour force					
Unemployment									
United States	4.0	4.2	4.5	4.0	4.0	4.1	4.3	4.4	4.6
Japan	4.7	4.6	4.6	4.8	4.7	4.7	4.6	4.6	4.6
Euro area[b]	9.0	8.3	7.7	9.2	8.8	8.4	8.1	7.8	7.6
European Union	8.2	7.6	7.2	8.4	8.0	7.7	7.5	7.3	7.1
Total OECD	6.2	6.0	5.9	6.3	6.1	6.0	6.0	6.0	5.9
				Per cent of GDP					
Current account balances									
United States	-4.3	-4.5	-4.3	-4.2	-4.4	-4.5	-4.4	-4.4	-4.3
Japan	2.8	2.7	3.0	2.9	2.7	2.6	2.8	3.0	3.1
Euro area[b]	0.0	0.1	0.4	0.1	-0.1	0.0	0.2	0.3	0.5
European Union	-0.2	-0.2	0.0	-0.1	-0.3	-0.2	-0.2	0.0	0.1
Total OECD	-1.2	-1.3	-1.2	-1.1	-1.3	-1.3	-1.3	-1.2	-1.1
				Per cent					
Short-term interest rates[e]									
United States	6.5	7.0	7.0	6.3	6.7	6.9	7.1	7.1	6.9
Japan	0.2	0.6	0.9	0.1	0.3	0.5	0.8	0.9	0.9
Euro area[b]	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
				Percentage changes from previous period					
World trade[f]	13.3	9.7	8.0	14.3	12.6	9.0	8.2	8.0	7.7

a) Assumptions underlying the projections include:
- no change in actual and announced fiscal policies;
- unchanged exchange rates from 30 October 2000; in particular $1 = Y 108.80 and 1.189 euro;
- the cut-off date for other information used in the compilation of the projections was 7 November 2000.

b) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

c) GDP deflator, percentage changes from previous period.

d) High inflation countries are defined as countries which have had, on average, 10 per cent or more inflation in terms of the GDP deflator during the 1990s on the basis of historical data. Consequently, Greece, Hungary, Mexico, Poland and Turkey are excluded from the aggregate.

e) United States: 3-month eurodollars; Japan: 3 month CDs; euro area: 3-month interbank rates. See box on Policy and other assumptions underlying the projections.

f) Growth rate of the arithmetic average of world import volumes and world export volumes.

Source: OECD.

INTRODUCTION

The outlook overall remains broadly favourable…

Global economic growth appears to have peaked during the first half of 2000, but world economic prospects remain relatively bright, despite higher oil prices and a weakening in many equity markets. After reaching 4¼ per cent this year -- the fastest pace in more than a decade -- OECD-wide output growth is projected to slow to about 3¼ and 3 per cent in 2001 and 2002, respectively. Against a background of some modest further tightening in monetary policy in the United States and in the euro area, core inflation is likely to remain low in most OECD countries. Area-wide employment should continue to rise while unemployment may remain close to its present level, at about 6 per cent of the labour force. With a sharper and more widespread rebound in activity outside the OECD area than earlier expected, world output may rise by some 4¾ per cent this year, before slowing to a growth rate of 4 per cent in 2001 and 2002.

… provided oil prices do not rise further…

This broadly favourable outlook is particularly conditioned on the assumption that world oil prices ease back slightly from their recent levels -- some 60 per cent higher than the average price in 1999 -- and on the absence of turbulence in financial markets. Despite OPEC production increasing somewhat since the beginning of the year, the oil market will remain tight over the coming months, with strong demand, crude production close to capacity and stocks near historically low levels. This low stock situation, in particular for some refined oil products in certain regions, and the prospect of continuing political tensions in the Middle East has also resulted in an unusually volatile market. Given these market conditions, a relatively minor disruption to supply or a spike in demand, for instance in the event of an unusually cold winter, could lead to higher prices in the short run. The current situation, however is not a crisis of the same dimension as the oil price shocks in the 1970s, in part since oil intensity in the OECD area has halved and because production possibilities are such that demand trends are likely to be satisfied at lower prices, once the short-term tightness in oil markets dissipates.

The macroeconomic consequences of recent higher oil prices hinge critically on the extent to which they become embedded in the wage and price inflation process through attempts to restore lost real incomes. So far, and in contrast to previous episodes of oil price hikes, there has been no evidence of such behaviour. Both the greater importance attached to price stability as a goal of macroeconomic policy and the impact of increased product market competition on wage bargaining attitudes may account for this. Nevertheless, the situation may change if oil price increases are sustained or spike higher, with the possibility of relatively large consequences for output and inflation.

… and financial markets remain relatively calm

Against the background of turmoil in oil markets, financial market developments, so far, do not suggest turbulence or rising distress levels, but remain possible sources of risk to the outlook. In particular:

– The optimism attached to technology stocks at the beginning of the year has waned and risk premia in high-yield corporate bond markets have widened. If these developments were to intensify or generalise to all financial markets, then there would be adverse consequences on household wealth and on the ability for firms to obtain finance. This would impact on confidence and discourage private spending, especially in the United States, triggering a sharper than projected slowdown in activity.

– The lower value of the euro and of the currencies in some other OECD countries over the past year could lead to more inflation than projected in these areas, if for instance, the earlier exchange rate movements are increasingly considered to be permanent and result in larger than anticipated lagged price responses.

– Attractive rates of return and buoyant economic conditions in the United States have ensured that the record high current account deficit could be financed without difficulty. Ultimately, however, the current account deficit will require adjustment. It may take place smoothly, but a sudden reversal cannot be excluded. A change in sentiment, for instance, could slacken the pace of capital flows and lead to turbulence in foreign exchange markets with inflationary consequences, possibly requiring a monetary policy response. This in turn, would raise the possibility of a more abrupt slowing in the US economy.

– In a number of non-OECD emerging market countries, growth could be inhibited by continuing downward trends in equity prices, higher oil prices and the projected slowdown in the OECD area. This risk would rise, particularly in those economies that have not fully dealt with balance sheet problems in their corporate sectors, if significantly higher interest rates were required to ward off inflation in OECD countries.

The key policy issue in the United States is whether further tightening of monetary policy is required

A slowdown in the US economy is now underway, as private demand reacts to earlier tightening of monetary policy, recent declines in stock market prices and the real income effects of higher oil prices. This should help reduce excess demand that appears to have characterised the economy in recent years and ease the inflationary risks entailed by the jump in oil prices. The rebalancing process will be further assisted by the rise in underlying productivity and potential growth rates that has taken place in the latter part of the 1990s. But actual productivity growth is likely to come down as the economy slows, thus contributing to a lesser extent to restraining price increases, while continued tightness in the labour market may push up wage inflation. Against this background, the key issue is whether the tightening of monetary policy that has already been implemented is sufficient to check inflationary pressures. The OECD's assessment is that a further modest increase in the federal funds rate in 2001 may be necessary to help underpin a soft landing. With the output gap continuing to decline in 2002 and as the economy moves towards balance, there should be scope for the Federal Reserve to start reducing interest rates during the course of that year.

The US fiscal position should remain unchanged

As regards fiscal policy, and on the basis of existing legislation, the structural budget surplus is officially projected to continue to rise steadily. A new Administration taking over next year is unlikely to change this position immediately. In any case, given current economic conditions, a fiscal stimulus would not be desirable. For 2002 and beyond, however, a new Administration and Congress are likely to move forward with a policy agenda that appears likely to involve some combination of tax cuts and spending increases. The scope for such measures is sensitive to prospects for potential output and, in particular, the extent to which recent increases in trend productivity growth can be sustained. The uncertainties in this regard are substantial and it would be prudent to base any measures on conservative assumptions, while taking account of the spending pressures that population ageing will bring.

In the euro area, the challenge for policy is to avoid inflationary bottlenecks and prolong the expansion

The rise in oil prices and less supportive monetary conditions have already contributed to a moderate deceleration in the pace of activity in the euro area during the course of this year. Nonetheless, output is set to expand at rates above potential over the coming two years, with unemployment declining to a 20-year low. Underlying inflation trends have been surprisingly benign in the face of the oil price hike and the depreciation of the euro, but core inflation is projected to move up somewhat as spare capacity is exhausted and wage pressures start to emerge. The challenge for policy is to avoid inflationary bottlenecks and prolong the expansion. So far, there is no clear evidence that the euro area has succeeded in raising economy-wide productivity growth through the production or use of information and communication technology, although a key question is whether it is now the euro area's turn to deliver surprises in this area. A further key issue is the extent to which structural reforms in product and labour markets over the 1990s have contributed to strengthening aggregate supply. Monetary policy will need to be based on careful assessments of the current level and growth rate of potential output. In this context and provided the euro does not significantly appreciate in the short term, the ECB may need to raise interest rates somewhat further -- the OECD assessment is for a rise of 50 basis points -- to keep core inflation from settling durably above 2 per cent.

Any additional major easing of fiscal policy would be inappropriate at this stage

With respect to fiscal policy, the various tax and spending measures put into effect in 2000 and announced for 2001 and 2002 imply a broadly neutral stance overall during this three-year period, although projected changes in country structural positions vary across the euro area. While improved trends in the underlying fiscal position have provided room for tax cuts in some countries, additional major easing of fiscal policy would not be appropriate at present given limited spare capacity. Indeed, in most countries further progress in strengthening public finances is required in view of still large public indebtedness and future pension liabilities. This should not preclude further tax reforms that help to improve supply performance to the extent they are financed through expenditure restraint or implemented in a revenue neutral manner. Maintaining the momentum for structural reforms more generally still remains a priority.

In Japan, the policy mix should be rebalanced…

The Japanese economy has started a moderate recovery. Output is projected to grow at a rate of 2 to 2¼ per cent during the projection period and as the output gap closes slowly, deflation should gradually subside. Employment may increase modestly, though unemployment is likely to remain high as the labour force responds to the improved economic situation. Given a modest but sustained recovery underway and provided it continues, a re-balancing of policy needs to begin, with monetary policy continuing to support growth and fiscal consolidation starting gradually during 2002.

… within the context of a transparent medium-term macroeconomic policy framework

This re-balancing would be best implemented in the context of a transparent medium-term framework for macroeconomic policy. Without such a framework for the policy mix, there is a danger that confidence will not be restored and that long-term interest rates will rise, thereby reducing growth prospects and subjecting the financial sector to stress. Maintaining the credibility of monetary policy would be facilitated by an explicit medium-term monetary strategy, that made clearer the means to achieve the overall price stability objective. Similarly, the gradual start to fiscal adjustment should be part of a transparent and credible fiscal improvement plan aimed at stabilising, and ultimately reducing, the debt-to-GDP ratio over the medium term. Given the amount of tightening that this will involve, the government's commitment to a well-defined consolidation strategy would limit the restraining effects on the economy and ensure an orderly financing of budget deficits. Within this broad framework, priority will also need to be given to improving the efficiency of the public expenditure system, with spending decisions more systematically based on an overall assessment of economic returns. The third crucial element of the overall policy approach is the continued pursuit of efforts to restructure and liberalise the economy to enhance growth and efficiency.

"Old economy" mechanisms are still crucial to understanding the growth process

While global economic growth appears to have peaked, the outlook implies an unusually long expansion by historic standards in the United States and in a few other OECD economies. Coupled with the strong pick-up in productivity growth that occurred over the past five years in the United States, such performance has prompted much discussion on the sources of growth and the set of policies which favour a better growth performance. While the debate is dominated by “new economy” arguments emphasising the production and diffusion of information and communications technology, the evidence suggests that “old economy” mechanisms are still crucial to understanding the growth process. In particular, the accumulation of various kinds of capital -- physical and, especially, human -- as well as research and development are important for growth, and differences across countries in this respect contribute significantly to explain the observed variations in growth patterns.

Raising levels of *per capita* income in the long term requires a broad set of policies, including: sound macroeconomic management; a tax system that encourages work effort and entrepreneurship; openness to international trade and competition; and government expenditure programmes that emphasise investment and capital accumulation, including investment in infrastructure. Appropriate conditions in financial markets and product market regulations also have an important role in fostering innovation and productivity enhancement. The “new economy” does, however, raise some novel policy challenges, notably in respect of consumer protection, taxation and competition policy.

17 November 2000

I. GENERAL ASSESSMENT OF THE MACROECONOMIC SITUATION

THE GLOBAL SITUATION AND OUTLOOK

Global economic growth appears to have peaked

The current expansion of global economic activity is now maturing. Growth in most OECD countries is projected to slow following strong performance in late 1999 and the first half of 2000, although in Europe it will be fast enough to imply further declines in unemployment. Evidence of such slowing has appeared in the United States in recent months and seems to be emerging in some European countries. A major exception to this general picture is Japan, where a moderate recovery driven by strong profits and business investment is still gathering strength, but spare capacity, while being absorbed slowly, is nonetheless likely to persist for some time. Overall, following a projected 4¼ per cent increase in output in the OECD area in 2000, growth may slow to around 3¼ per cent in 2001 and 3 per cent in 2002 (Table I.1). Outside the OECD area, recoveries from the emerging markets crisis have gained momentum and inflation remains moderate. For the world as a whole, growth may slow from 4¾ per cent in 2000 to 4 per cent in 2001 and 2002.

Table I.1. **Output growth**

Percentage increase in real GDP over previous period

	1999	2000	2001	2002
United States	4.2	5.2	3.5	3.3
Japan	0.2	1.9	2.3	2.0
Euro area[a]	2.5	3.5	3.1	2.8
European Union	2.4	3.4	3.0	2.7
Total OECD	3.0	4.3	3.3	3.1
Memorandum items:				
Non-OECD area[b]	3.8	5.4	5.4	5.5
World[b]	3.3	4.7	4.1	4.1

a) Greece will enter the euro area on 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

b) The outlook for regions for which the OECD does not make projections is based on IMF and World Bank assessments, using weights based on purchasing power parities.

Source: OECD.

Box I.1. **Policy and other assumptions underlying the projections**

Fiscal policy assumptions are based on measures taken and stated policy intentions, where these are embodied in well-defined programmes.[1] For the OECD area as a whole, the outlook is for fiscal stances, as measured by changes in structural budget balances, to be broadly neutral in 2001 and in 2002 as the clearly restrictive stance in place over the past several years comes to an end. This, however, masks divergent trends across the area: there is a tightening of fiscal policy in the United States; a slight move towards some easing in Japan in 2001 and, once account is taken of one-off revenue increases related to taxation of interest income on postal deposits in 2000 and 2001, a tightening in 2002; and a broadly neutral strance in the European Union as a whole.

Policy-controlled interest rates are set in line with the stated objectives of the relevant monetary authorities with respect to inflation (and, in some cases, to supporting activity) or exchange rates. In the case of the United States, this is interpreted to imply that the federal funds rate will be increased by ½ percentage point during the first half of 2001 as inflation pressures intensify, but short-term interest rates should ease by the end of the projection period as the economy slows and inflation remains under control. Maintenance of price stability over the medium term is the primary objective in the euro area.[2] With headline inflation running ahead of the target and spare capacity disappearing throughout the region, the European Central Bank is assumed to raise its key policy rate by ½ percentage point during the first half of 2001 so that three-month money market rates reach 5½ per cent and stay there through 2002. In Japan, the zero-interest rate policy came to an end in August 2000, and policy rates are assumed to remain constant at current low levels throughout the projection period.

The projections assume unchanged exchange rates from those prevailing on 30 October 2000; in particular, one US dollar equals ¥ 108.8 and 1.19 euro. The fixed exchange rate assumption is modified for Hungary and Turkey to allow for continuous depreciation, reflecting the OECD interpretation of "official" exchange rate policies.

Oil prices have moved significantly above levels built into the projections finalised just six months ago, averaging $30 per barrel for Brent crude over the third quarter of 2000. In view of the unusually large amount of uncertainty surrounding the near-term course of oil prices as the winter heating season approaches, the technical assumption has been adopted that OECD oil import prices, which normally average around $1 less than Brent crude prices, remain at $30 per barrel until mid-2001. They are assumed to decline somewhat thereafter to $27 per barrel in the second half of 2002. Overall non-oil commodity prices, after having started to increase in the second half of 1999, are projected to rise further in 2001 as prices of metals and, to a lesser extent, agricultural raw materials respond to high global industrial activity. During 2002 non-oil commodity prices are assumed to move in line with prices of OECD manufactured exports.

The cut-off date for information used in the projections was 7 November 2000.

Oil and non-oil commodity prices

	1998	1999	2000	2001	2002
			Percentage changes		
OECD import oil price (cif)	-34.2	37.3	63.6	4.2	-6.8
Non-oil commodity prices[a]	-13.7	-7.2	9.5	3.9	1.2
Memorandum item:					
OECD import oil price (cif, $/barrel)[b]	12.6	17.3	28.3	29.5	27.5

a) Total Hamburg commodity price index, excluding energy. OECD estimate for 2000 and OECD projections for 2001 and 2002.
b) The historical data for the OECD crude oil import prices are average cif unit prices as calculated by the International Energy Agency, that is, they include cost, insurance and freight but exclude import duties. OECD estimate for 2000 and OECD projections for 2001 and 2002.

Source: Hamburg Institute for Economic Research (HWWA), International Energy Agency and OECD.

1. Details of assumptions for individual countries are provided in the corresponding country notes in Chapter II "Developments in Individual OECD Countries".
2. Price stability is defined as an annual increase of the harmonised index of consumer prices below 2 per cent.

Higher oil prices are slowing demand and activity

The rise in world oil prices to nearly double their average since their sharp fall in 1986, with benchmark Brent crude averaging close to $31 per barrel during October, has contributed to the apparent moderation in the overall pace of economic activity in the OECD area. By directly raising consumer prices in most countries during the past year and thus reducing the purchasing power of households, it is acting like an indirect tax increase, and reinforcing the restraining effect of the monetary tightening that began in the second half of 1999. So far, despite protests against higher oil-related costs in some countries, there is little evidence of inflationary wage and price adjustments designed to recover the lost real income. Thus, notwithstanding the rise in headline inflation, and unlike the experience during the oil price rises of the 1970s, core inflation (*i.e.* excluding food and energy) has risen only slowly and remains low in most countries.

But the outlook remains relatively favourable…

Monetary authorities appear to have responded by looking beyond the headline numbers and basing their actions on the medium-term outlook for inflation. Provided wage settlements continue to reflect core inflation, as is assumed in the projections, and central banks continue to focus on the medium term, there should be no repetition of the stagflation that followed previous large oil price rises. Indeed, the overall outlook remains relatively favourable: inflation should remain subdued and economic expansion should continue with the level of activity moving into line with potential in most countries.

… despite oil prices assumed to remain high

A key assumption underlying the projections is that world oil prices will stabilise around their recent high levels until mid-2001 and decline only slightly thereafter to end-2002 (Box I.1). On this basis, the negative effects of the oil price rise should pass fairly soon as the income transfer from OECD countries to oil exporters, so far mainly reflected in the large improvement in the current accounts of Africa and the Middle East (Table I.2), stops rising. Headline inflation will converge with, or even drop below, core inflation and, as oil producers eventually spend more of their revenues, rising exports will support activity in OECD countries. Large current account imbalances will remain in a number of countries, however, notably in the United States, although typically these reflect factors other than oil.

Financial markets have been comparatively steady

Against the background of turmoil in world oil markets and the likelihood of continuing tension in the Middle East, reports that conditions in financial markets are becoming tighter have been widespread. There is scattered evidence to support this: the latest Federal Reserve’s Senior Loan Officer Survey on Bank Lending Practices indicated that business lending practices are firming; some corporate borrowers have reportedly had trouble accessing capital markets, with a notable fall in initial public offerings in recent months; some spreads have widened in credit and bond markets; and prices of some richly valued technology stocks have fallen sharply following disappointing announcements of financial results. But it is not

Table I.2. **Current account balances**

	1999	2000	2001	2002
	Per cent of GDP			
United States	-3.6	-4.3	-4.5	-4.3
Euro area[a]	0.4	0.0	0.1	0.4
European Union	0.2	-0.2	-0.2	0.0
Japan	2.5	2.8	2.7	3.0
OECD	-0.8	-1.2	-1.3	-1.2
	Billion of dollars			
United States	-331.5	-432.8	-470.5	-483.3
Euro area[a]	29.6	-1.0	6.9	23.5
European Union	20.8	-15.0	-13.2	1.3
Japan	106.9	127.6	126.5	143.0
OECD	-204.0	-307.1	-338.2	-318.7
Memorandum items:				
China and other Asia	7.5	3.4	0.3	-5.6
Latin America	-35.6	-25.1	-26.4	-33.0
Africa, Middle East	-9.6	82.4	82.7	65.1
Former Soviet Union, Central and Eastern Europe	15.6	27.7	19.0	12.6
World	-154.1	-162.4	-205.5	-225.3

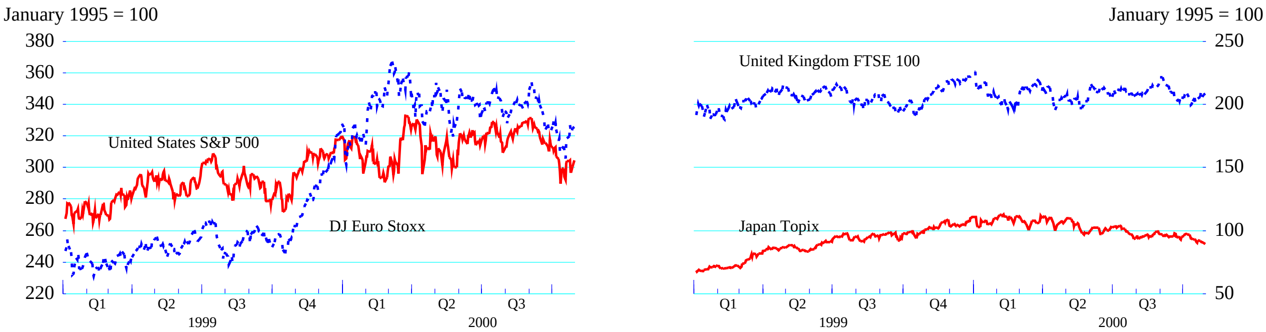
a) Greece will enter the euro area on 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.
Source: OECD.

clear how far these indications generalise. While there has evidently been a problem of indigestion arising from very high demands for capital from telecommunications companies, overall price trends in major financial markets since the *OECD Economic Outlook* 67 projections were finalised in May do not suggest major turbulence or rising distress levels.

– *Foreign exchange markets*. Since May, the euro has been recurrently weak, depreciating by 7½ and 8 per cent against the dollar and the yen, respectively, and around 4 per cent in effective terms by the time exchange rates underlying the projections were fixed at the end of October. This has contributed to modest effective appreciations of the dollar and the yen, amounting to 3 and 4 per cent, respectively. The continued weakness of the euro was of enough concern to lead G-7 countries to support it with market intervention on 22 September. After the European Central Bank resumed interventions in early November, it regained some of its lost ground.

– *Equity markets*. Stock markets in the United States and Europe have fluctuated without a clear direction, while the equity market in Japan has softened (Figure I.1). In the latter part of September and into October, a string of disappointing profit results and warnings sent stock markets around the world lower, with many technology shares being particularly hard hit. Although many markets recovered subsequently, in mid-November, the main markets were significantly below their peak early this year, easing concerns that wealth effects were fuelling excess demand in some countries, especially in the United States.

Figure I.1. Equity price developments

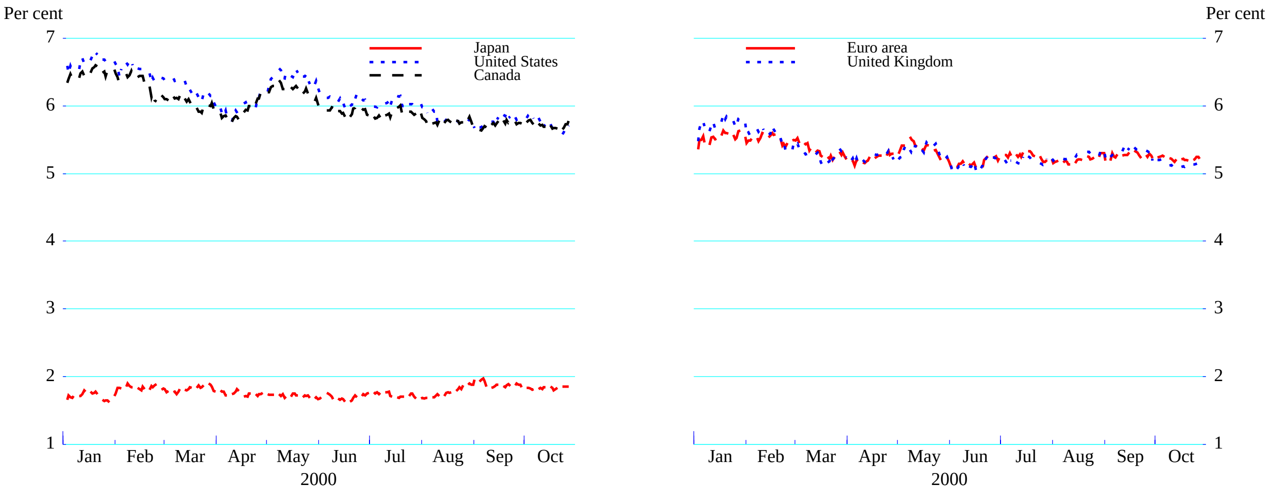


Source: Bloomberg.

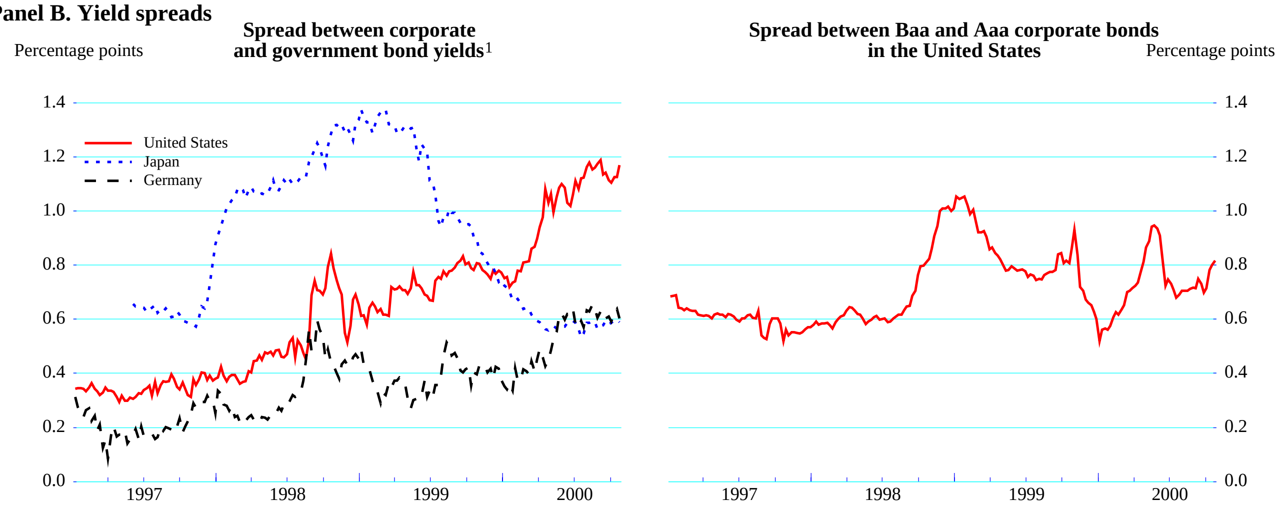
– *Bond markets*. Government bond yields have eased in the United States and remained steady in the euro area (Figure I.2), despite increases in policy-determined interest rates and the euro's weakness. In Japan, interest rates rose somewhat all along the yield curve following the abandonment of the "zero interest rate policy" in August. In the United States, the yield differential between AAA-rated private and government bonds has not risen significantly since May, although it is relatively high, reflecting *inter alia* supply conditions in the government bond market and continuing concerns about risks. The differential between AAA-grade and riskier corporate bonds was rather stable until mid-September,

Figure I.2. Long-term interest rates

Panel A. 10-year government bond yields



Panel B. Yield spreads



1. United States: AAA-rated paper; Japan: BAA bonds; Germany: Pfandbrief/kommunal 10-year. Government bond yields are for 10-year benchmark bonds, except for Japan: 5-year.
Sources: Bloomberg, Japanese Securities Dealers Association, Federal Reserve Board.

but spreads widened significantly thereafter, especially for "junk" bonds. In Europe, the differential between high-yielding private bonds and government securities has widened significantly in the past six months, primarily due to investors' concerns about deteriorating balance sheets of companies in the telecommunication sector.[1]

1. The spread of bonds in the "Euro High Yield Index" rose by around 250 basis points from May to October, see Merrill Lynch, *Bond-Indices - Europa*, November 2000.

Interest rates may rise moderately in most OECD countries

During the projection period it is assumed that policy-controlled and short-term market interest rates will rise further, though moderately, across much of the OECD area as pressure on capacity emerges or remains high. Long-term interest rates are broadly projected to follow. In the United States and some other countries, where expansions are already mature, a small further increase in policy-determined rates is assumed to take place in the near future. However, the phase of monetary tightening is assumed to come to an end as demand begins to converge towards sustainable supply, allowing declines in policy-determined rates before the end of the projection period. In the euro area, an additional increase in policy rates is projected to raise short-term market rates to 5½ per cent by mid-2001. In Japan, official rates are assumed to remain constant at their current levels, but market rates could firm somewhat as the recovery becomes better established. Changes in fiscal stance are not expected to be a major force operating on the OECD area (see below).

World trade growth is set to moderate

Following its steep increase in 1999 and 2000, the expansion of world trade is set to slow somewhat in coming years (Table I.3). The slowdown is likely to be most pronounced in trade within the OECD region,

Table I.3. **World trade summary**

Percentage changes from previous period

	1999	2000	2001	2002
Merchandise trade volume				
World trade[a]	5.9	13.3	9.7	8.0
of which: Manufactures	6.9	14.6	10.1	8.3
OECD exports	5.1	12.9	9.3	7.6
OECD imports	8.5	12.7	9.2	7.4
Non-OECD exports	6.5	15.0	10.2	9.0
Non-OECD imports	0.0	14.8	11.6	10.0
Memorandum items				
Intra-OECD trade[b]	7.4	12.3	8.9	7.1
OECD exports to non-OECD	1.7	15.1	11.4	9.5
OECD imports from non-OECD	7.3	14.4	9.9	8.5
Trade prices				
OECD exports[c]	-2.6	-3.9	-2.0	1.4
OECD imports[c]	-2.8	-1.4	-1.5	0.9
OECD terms-of-trade with rest of the world[d]	-0.8	-7.3	-1.4	1.2

a) Growth rates of the arithmetic average of world import volumes and world export volumes.
b) Arithmetic average of the intra-OECD import and export volumes implied by the total OECD trade volumes and the estimated trade flows between the OECD and the non-OECD areas based on the 1995 structure of trade values.
c) Average unit values in local currency.
d) The OECD terms of trade are calculated as the ratio of OECD export to OECD import prices, excluding intra-OECD trade.
Source: OECD.

where the rate of growth could be almost halved by 2002 (to 7 per cent) compared with 2000. The OECD area will continue to benefit from strong export growth to the non-OECD region. However, reflecting the increase in the oil price, the terms-of-trade of the OECD has deteriorated significantly and will improve only modestly with the slow decline in oil prices assumed from the middle of 2001.

Growth will slow in the United States…

The slowdown in the United States is being led by household spending on consumption and residential construction. Driving factors include monetary tightening since June 1999, higher mortgage rates since early 1999, the retreat of equity prices from their peaks and the impact of rising energy prices on real income. As profit growth eases and long-term borrowing rates remain high, business investment is also likely to slow. Exports should remain buoyant, however, and despite further monetary tightening, growth is projected to come down from 5¼ per cent in 2000 to a still-healthy 3½ per cent in 2001 and 3¼ per cent in 2002, only slightly below potential, while pressure on capacity remains high.

… and in Europe…

Growth in the euro area through the first part of 2000 was strong and broadly based across the region as buoyant domestic demand was reinforced by continued strength of exports. It may be expected to slow moderately from now on, however, reflecting less supportive monetary conditions and households' losses of purchasing power associated with the increase in energy prices. Notwithstanding this slowdown, growth is projected at about 3½ per cent in 2000 and 3 per cent in 2001, leading to the disappearance of the area's output gap. Indeed, the growing pressure on resources is already a concern in several Member countries where cyclical unemployment has been substantially reduced or fully eliminated. In the rest of the European Union, growth has been strong during 2000 but should also come down over the next two years.

… while a moderate recovery becomes established in Japan

The Japanese recovery is becoming established with growth projected to average just over 2 per cent during 2001 and 2002. Rising profits -- both actual and anticipated -- and increasing demand for information technology will continue to support business investment and to drive the expansion, although some sectors remain affected by restructuring. In this environment, private consumption should strengthen, supported by increases in wages and winter bonuses, falling consumer prices and a modest expansion of employment. The high volume of fixed term postal savings due to mature between October 2000 and May 2001 will provide considerable liquidity to the household sector and may stimulate consumption somewhat. At the same time, the oil price rise may have less effects on private consumption in Japan than elsewhere as it may be offset by lower profit margins of distributors since competition in this segment of the market has increased in the wake of regulatory reforms. The coming fiscal package, the outline of which is assumed to result in ¥ 2.5 trillion for public works (½ per cent of GDP), will provide additional support by boosting public investment during the first half of 2001. However, slower export growth, due to a decline in market growth and the lagged effects of the yen's appreciation during 1999, and progressive fiscal tightening as public works spending eventually begins to decline will act as restraining forces. Activity will remain below its potential level during 2002.

Growth in most other OECD countries should also slow in line with the general area trend

Growth in most remaining OECD countries is likely to slow somewhat. In a number of cases, including both advanced economies (Canada and Australia) and emerging market economies (Korea, Mexico and Turkey), it should remain in line with or above the area average. In others (New Zealand, Norway and Switzerland), it is projected to slow to more modest rates. The transition countries are exceptions to this picture, as growth is set to remain steady and robust in Hungary and Poland and will rise in the Czech Republic.

Employment growth will continue but at a reduced rate in most countries…

As demand and activity have strengthened during recent years, employment has grown strongly in most of the OECD area (Table I.4) and unemployment has fallen sharply (Japan remains the major exception). With growth set to slow, employment increases in the area as a whole will ease from their 2000 levels. Correspondingly, unemployment is projected to remain fairly stable around its current level, although there will be variations across regions. The largest employment gains are still expected in the European Union, pushing the unemployment rate down to just over 7 per cent, the lowest level in 20 years. In contrast, employment growth will slow to a rate below that of the labour force, leading to a modest rise in unemployment in North America, while employment growth will only be sufficient to stabilise unemployment at a high level in Japan.

… while, abstracting from energy prices, inflation will drift up slightly

Headline inflation has risen in response to higher energy prices with the notable exception of Japan. So far, however, underlying inflation remains relatively subdued in a majority of Member countries, even if it is drifting up in some. This reflects remaining margins of slack in some regions of the OECD area, notably in Japan and in parts of continental Europe. In the United States, it mirrors the favourable impact that exceptionally strong productivity growth has had on unit labour costs during the past year. However, spare capacity in most of the area either has already been eliminated or is projected to disappear during 2001. As a result, some upward pressure on core inflation is likely to continue in most regions even if inflationary wage rises aimed at compensating for higher energy prices are avoided. In the near term, this upward pressure may be masked at the consumer price level as oil prices stabilise.[2]

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2. The underlying upward pressure should be evident in most countries in slowly rising inflation as measured by GDP deflators. However, this does not apply to countries where oil production represents a large part of the economy. Mexico and, especially, Norway are the major cases in point.

Table I.4. **Unemployment, output gaps and inflation**

	1999	2000	2001	2002
	Per cent			
Employment growth				
United States	1.5	1.3	0.7	0.8
Japan	-0.8	-0.4	0.3	0.4
Euro area[a]	1.8	2.1	1.6	1.3
European Union	1.7	1.9	1.4	1.1
Total OECD	1.1	1.5	1.2	1.1
	Percentage of labour force			
Unemployment rate				
United States	4.2	4.0	4.2	4.5
Japan	4.7	4.7	4.6	4.6
Euro area[a]	9.9	9.0	8.3	7.7
European Union	9.1	8.2	7.6	7.2
Total OECD	6.7	6.2	6.0	5.9
	Millions			
Unemployment levels				
United States	5.9	5.7	6.0	6.5
Japan	3.2	3.2	3.1	3.2
Euro area[a]	13.6	12.4	11.5	10.8
European Union	15.7	14.4	13.4	12.8
Total OECD	33.7	31.7	31.0	30.8
	Per cent			
Output gaps[b]				
United States	1.3	2.5	1.7	1.1
Japan	-3.8	-3.2	-2.2	-1.7
Euro area[a]	-1.4	-0.3	0.3	0.6
European Union	-1.2	-0.2	0.4	0.6
Total OECD	-0.5	0.5	0.5	0.5
Inflation[c]				
United States	1.5	2.1	2.2	2.3
Japan	-0.9	-1.5	-0.4	-0.2
Euro area[a]	1.2	1.2	1.9	2.0
European Union	1.5	1.4	2.0	2.2
Total OECD *less* high inflation countries[d]	1.0	1.3	1.8	1.9
Total OECD	2.5	2.6	2.4	2.3

a) Greece will enter the euro area on 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.
b) Per cent of potential GDP.
c) Percentage change in the GDP deflator from previous period.
d) High inflation countries are defined as countries which have had 10 per cent or more inflation in terms of the GDP deflator on average during the 1990s. Consequently, Greece, Hungary, Mexico, Poland, and Turkey are excluded from the aggregate.
Source: OECD.

The major uncertainty facing most OECD economies at this stage is the outlook for oil prices, and the response of wage and price behaviour to higher headline inflation that proves to be temporary. Oil prices are now significantly higher than the levels built into the *OECD Economic Outlook* 67 projections in May, and the outcome over the next year could well differ considerably from the assumptions built into the projections reported here. Some of the key factors likely to influence oil prices and their impact on the global economy are considered below. In addition, a number of risks that have been extensively discussed in recent issues of the *OECD Economic Outlook* remain important. These include risks arising from financial market developments, notably a further substantial correction of equity markets in the United States. Moreover, the large and increasing external imbalance of the United States poses a potential risk to the dollar, which could lead to more inflation there than projected and to turbulence in foreign exchange markets more generally. Rising government indebtedness in Japan may also affect confidence and derail bond prices there, threatening some financial institutions and the continued expansion of output. Finally, emerging market recoveries are still fragile as suggested by the recent weakening of equity markets in several non-OECD economies in Asia. If on top of the oil price increase, financial conditions tighten in the OECD area by more than projected, this could have negative effects for growth prospects in many of these economies, particularly those that have not fully dealt with balance sheet problems in their corporate sectors.

WILL HIGH OIL PRICES DERAIL THE GLOBAL EXPANSION?

Oil market trends and prospects

High oil prices have induced a supply response

High oil prices have clearly induced a supply response: by October, OPEC production was nearly 15 per cent higher than at the beginning of the year, primarily due to increased oil production in Saudi Arabia.[3] Non-OPEC supplies rose considerably in the second half of 1999 but have remained fairly stable at a high level since then. Furthermore, in 2001 OPEC crude production capacity and non-OPEC oil supply are each expected to increase by around 1 per cent of global demand, which should work to reduce the pressure on prices next year.[4] Nevertheless, prices have remained high and volatile, and this has been reflected in prices of oil substitutes such as natural gas and, to a lesser extent, electricity in some countries.

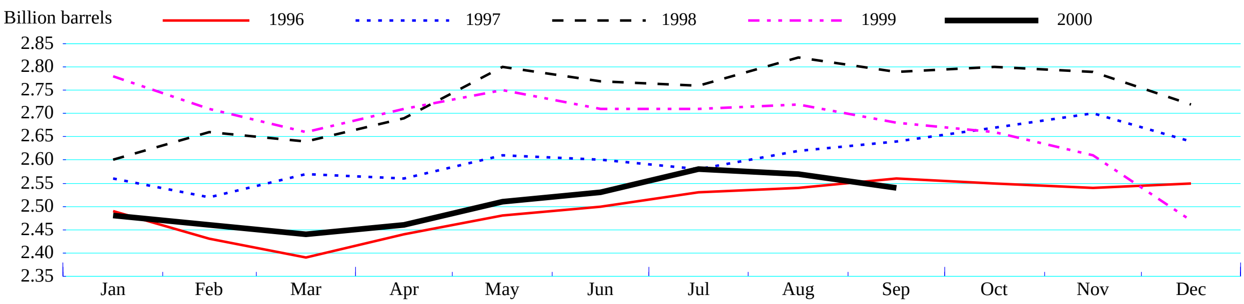
3. The International Energy Agency reports that as of early November only Saudi Arabia is estimated to have any significant spare capacity, amounting to 1½-2 million barrels per day. See IEA, *Monthly Oil Market Report*, November 2000.

4. Various estimates suggest that OPEC capacity will increase in the range of 0.6-0.9 million barrels per day, while the IEA expects non-OPEC supply to increase by 0.7-0.8 million barrels per day. See the International Energy Agency, *Monthly Oil Market Report*, September 2000, p. 18.

But stocks are low and the refining and distribution systems are stretched

Oil market uncertainty and volatility have been related to the fact that the market is stretched and lacks flexibility. Industry stocks of crude and refined products have been low during 2000, roughly in line with levels in 1996 (Figure I.3), when demand was 6 per cent below current levels. With so little margin to meet unexpected demand increases, the market is exposed to potential disruptions and the threat of regional supply imbalances. Indeed, even if crude oil is forthcoming in sufficient quantities to meet demand, bottlenecks for specific final products (such as heating oil) and in specific regions (*e.g.* the United States) may result from constraints on capacity to produce and transport petroleum products in the short term. The tightness of current stock levels in part reflects the fact that under present price structures -- with high spot prices and downward sloping future prices -- there is little commercial incentive for refiners to rebuild stocks, though stock data may be "distorted" by end-users building up inventories ahead of the approaching winter heating season.[5]

Figure I.3. OECD industry oil stocks[1]



1. Stocks are primary national territory stocks on land and include stocks held by industry to meet IEA, EU and national emergency commitments and are subject to government control in emergencies.

Source: The International Energy Agency, Monthly Oil Market Report, various issues.

Oil prices may remain high in the near term…

Given the tight demand/supply balance over the coming months, the oil market will remain vulnerable to any disturbance to supply or demand. Developments such as continuing political tensions in the Middle East, an important refinery outage or an unusually cold winter could result in oil prices well above recent peaks for an extended period of time. On the other hand, if such disturbances are avoided and inventories are restored to levels that provide the market with some margin of flexibility, prices could fall sharply once a seasonal easing of demand occurs around the second quarter of 2001. Against this background, the assumption adopted in the present set of projections is that oil prices will stay high at $30 per barrel

5. In response to public fears of heating oil shortages during the coming winter, the United States government decided to release some 30 million barrels of its Strategic Petroleum Reserve during a 30-day period. This is not a large amount in the global context (less than a day's oil consumption) but it may be significant in the context of speculative spot markets. This move has so far not been followed by other countries.

through to mid-2001, before a very mild decline occurs during the remainder of the projection period, leaving oil prices at about $27 in the second half of 2002.[6]

… but prices are likely to come down in the medium term

Beyond the short term, prices are likely to come down substantially due to underlying trends in demand and supply. In its new medium-term outlook,[7] the International Energy Agency (IEA) is assuming a constant crude oil price of $21 per barrel in today's money in 2000 to 2010, and increasing thereafter to $28 by 2020. This is judged by the IEA to reflect the full cost of expanding production, as it would provide an incentive to produce from existing fields, fields under development, probable and possible resources and new discoveries. With such a price scenario, increased oil supply, in particular from the OPEC countries, could satisfy medium-term oil demand trends, which are likely to continue much as observed in the recent past (Table I.5). Overall, world oil consumption is projected to increase by more than 2 per cent per year on average, rising substantially faster in non-OECD regions than in the OECD area (reflecting increasing industrialisation, rising per capita incomes and switching out of non-commercial fuels).

Governments should respond cautiously to pressure for cuts in taxation of oil products

The public reaction to the recent oil price hike in many countries has raised questions about the role that high levels of taxation of energy products should play in the future. Indeed, protests have prompted governments in a few European countries to reduce certain taxes on oil consumption with a view to assuming some of the burden of higher fuel costs (see Box I.2). Such measures should be taken very cautiously. Most especially, to the extent that this is successful in lowering oil prices for users, this is a step in the wrong direction in terms of environmental policies. In particular, most OECD governments have assumed obligations under the Kyoto Protocol to reduce greenhouse gas emissions, especially carbon dioxide associated with fossil fuel use. Compared with existing underlying trends, large cuts in energy consumption are inevitable if these targets are to be met, and the most cost-effective way to achieve this will involve substantial increases in post-tax prices of various forms of energy, including oil. Indeed, simulations with the OECD's "GREEN" model suggest that achieving the Kyoto targets efficiently (but without international trade in emission permits) might imply an increase in the price

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6. Oil futures are often used as a rough guide to how oil prices could develop over the coming quarters and they suggest that oil prices will decline moderately from a fourth quarter 2000 peak, but stay above $30 through the first quarter 2001, before falling back gradually towards $23½ per barrel at the end of 2002. However, forward markets are extremely thin and, in current conditions of market volatility and tight supply, forward prices may not be a good guide to wider market expectations. On the other hand, many market observers take a more bearish stance on prices than forward markets would suggest and see prices coming down to below $30 per barrel of Brent crude in the fourth quarter 2000 and to the low $20's by year-end 2001.

7. International Energy Agency, *World Energy Outlook – 2000*, Paris.

Table I.5. **Global oil market trends 1986-2020**

	1986	2000[a]	2010[b]	2020[b]
	Million barrels per day			
World demand[c]	**61.6**	**75.6**	**95.8**	**114.7**
OECD[d]	38.6	47.8	46.9	50.0
Former Soviet Union	8.9	3.5	5.8	7.4
Non OECD[d] (excluding FSU)	14.1	24.4	39.2	52.6
of which:				
China	2.0	4.8	7.6	11.0
Other Asia	3.3	7.3	14.2	19.8
Latin America[d]	3.3	4.8	8.7	10.9
Others	5.6	7.5	8.7	10.9
World supply	**62.0**	**76.2**	**95.8**	**114.7**
OECD[d]	19.7	22.0	15.7	13.1
Former Soviet Union	12.3	7.9	10.3	12.2
Non OECD[d] (excluding OPEC and FSU)	10.5	15.7	25.7	27.6
of which:				
Latin America[d]	2.3	3.8	9.2	10.0
Others	8.2	12.0	16.5	17.6
OPEC	19.5	30.5	44.1	61.8
Balancing item (Stock building)	0.4	0.3	..	..
Memorandum item:				
Shares in world oil supply	*Per cent*			
OECD[d]	31.8	28.9	16.4	11.4
Non OECD[d] (excluding OPEC and FSU)	16.9	20.6	26.8	24.1
Former Soviet Union	19.9	10.4	10.8	10.6
OPEC	31.4	40.1	46.0	53.9

a) OECD estimate.
b) Reference scenario as reported in International Energy Agency, *World Energy Outlook - 2000,* Paris, 2000.
c) Including bunkers and stockbuilding.
d) Mexico is included in the aggregate for Latin America for 2010 and 2020.

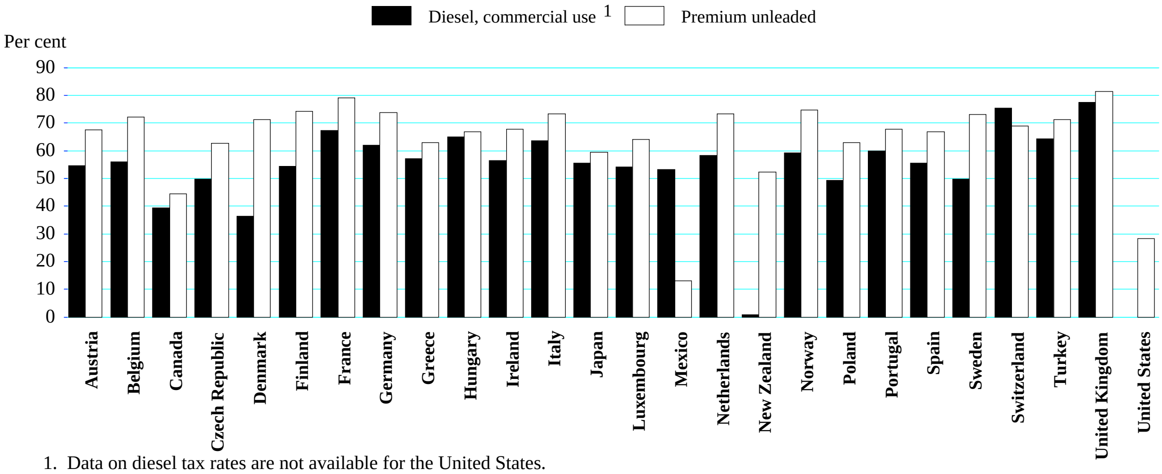
Source: International Energy Agency, *Monthly Oil Market Report,* various issues, *and World Energy Outlook - 2000,* Paris, 2000.

Box I.2. **The lowering of energy taxes in response to higher oil prices**

The recent increase in oil prices has attracted attention to the heavy taxation of oil use in most OECD countries. Taxes as a share of the final price of oil differ significantly across the OECD countries and within countries depending on the type of oil product and the user of the fuel (see figure below). For example, taxes as a share of the final price of premium unleaded gasoline range from less than 30 per cent (Mexico and United States) to more than 80 per cent (United Kingdom). Similarly, the tax component in the final price of automotive diesel fuel for commercial use ranges from close to zero (New Zealand) to more than 60 per cent in several countries.

Tax rates on motor fuel in OECD countries, 1999

Per cent of final use price



1. Data on diesel tax rates are not available for the United States.

Source: International Energy Agency, Energy Prices and Taxes - Quarterly Statistics, 1st Quarter 2000.

In the wake of protests due to rising oil prices, taxes have been lowered on oil products in a few OECD countries including:

- *France.* In August and September, the government reduced excise taxes on gasoline for selected activities and reduced other taxes for other groups hard hit by the increase in oil prices. In addition, as from October 2001, the excise tax for gasoline is to vary in order to keep the combined excise tax and VAT on the product constant. These measures are expected to cost the budget in 2000 and 2001 around FF 3 billion per year (around 0.03 per cent of GDP), but will be mostly covered by a special profit surtax on petroleum companies of FF 5½ billion.

- *Italy.* The excise tax on oil and some of its derivatives was reduced in November 1999 and further cuts were implemented in 2000. In addition, a mineral oil excise that was planned in connection with the introduction of a carbon tax has been delayed. The estimated budgetary cost is 0.15 per cent of GDP for 2000.

- *Belgium.* The introduction of a subsidy for oil consumption of low-income households may cost the budget less than 0.01 per cent of GDP in 2000. As several further oil cost relief measures will be implemented in 2001, the overall budgetary cost could be 0.05 per cent of GDP next year.

- *Netherlands.* In September, the government increased tax rebates on fuel used by selected groups, and further cuts will be implemented next year. The measures are estimated to cost the budget around 0.05 per cent of GDP annually.

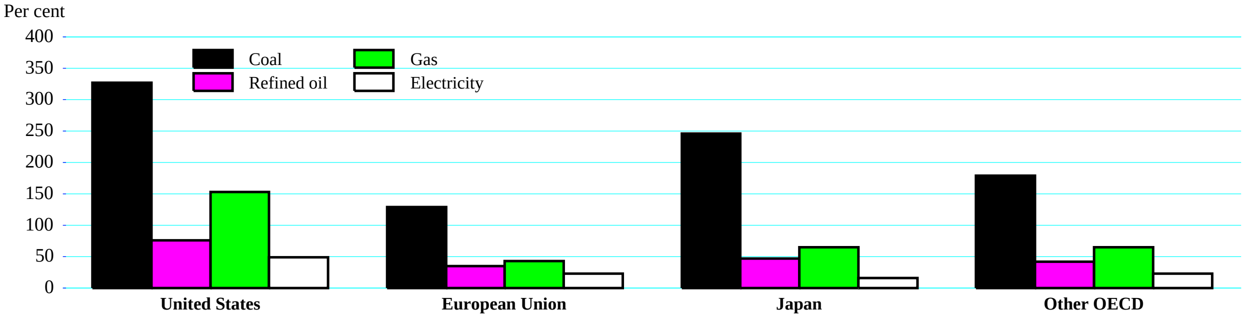
- *Portugal.* The long-standing policy of varying excise taxes to smooth fluctuations in the international price of oil implies that government energy tax revenues are likely to be lower by ½ per cent of GDP in 2000 than originally budgeted.

- *Spain.* Different types of budgetary compensations for various groups hard hit by the increase in the oil price are likely to amount to 0.12 per cent of GDP in 2000.

Other countries may also make some adjustments to energy taxation in the near future with the aim of reducing the price for selected users. Overall, the reductions have so far been small, involving minimal fiscal implications, and are unlikely to have much effect in the international oil market. But they do suggest a change in direction of policies in this area, in particular if the tax cuts are not reversed as oil prices come down in the future.

of refined oil products by 35 to 75 per cent in 2010 compared with a baseline that is broadly in line with the IEA scenarios described above (Figure I.4).[8]

Figure I.4. Energy price increases in 2010 required to implement the Kyoto Protocol
Difference in prices to end users from Business as Usual scenario



Source: Simulations from the OECD's GREEN Model, version with 3 gases and assuming no use of flexibility mechanisms.
See J.M. Burniaux (2000), 'A multigas assessment of the Kyoto Protocol' OECD Economics Department Working Paper, No. 270, Paris.

There are other reasons for assessing energy tax cuts carefully before proceeding. First, the revenue foregone with tax cuts must be made up elsewhere, either by cutting expenditure or by raising other taxes. All feasible options entail some costs which need to be factored into the decision-making process.[9] Second, until additional supply is forthcoming in the medium term, the main benefits are likely to accrue to producers, *i.e.* OPEC and the oil industry, rather than to the consumers for whose benefit the policies are intended. Third, the logic of cutting taxes to stabilise prices and thereby cushioning the impact of rising oil prices on users suggests that taxes should rise again when producer prices fall. This may be politically difficult. To the extent that it is desirable to insulate users of oil products from the impact of price fluctuations, direct support for incomes is likely to be more efficient than trying to stabilise prices themselves.

8. See J.M. Burniaux,"A multigas assessment of the Kyoto Protocol", *OECD Economics Department Working Paper*, No. 270, Paris, 2000.

9. In particular, energy taxation must be considered in the context of overall design of the tax system. It may be noted, however, that where taxation of energy products is high, specific duties would operate to cushion the economy-wide implications of oil price fluctuations whereas *ad valorem* taxes would tend to amplify them.

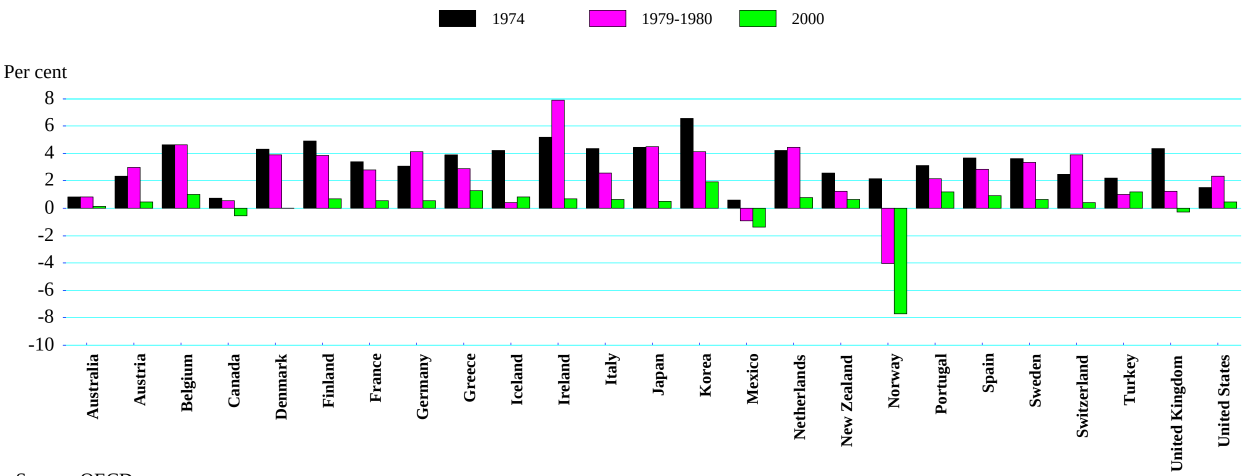
The macroeconomic impact of higher oil prices

The oil price increase involves a significant redistribution of world income

The increase in oil prices since 1999 has entailed a redistribution of world income. During 2000, the OECD area as a whole is likely to suffer a real income loss of around ½ per cent of GDP. With the exceptions of the United Kingdom, Canada, Mexico and, most significantly, Norway, all OECD countries have been affected by this loss, which ranges from negligible in Australia to as much as 2 per cent of GDP in Korea (Figure I.5). While this is a sizeable increase in the net oil import bill, it is much less than the loss of 2¾ per cent of GDP in 1974 and 2½ per cent in 1979-80. This essentially reflects the sharp reduction in the oil intensity of

Figure I.5. Terms of trade losses due to oil price increases in OECD countries

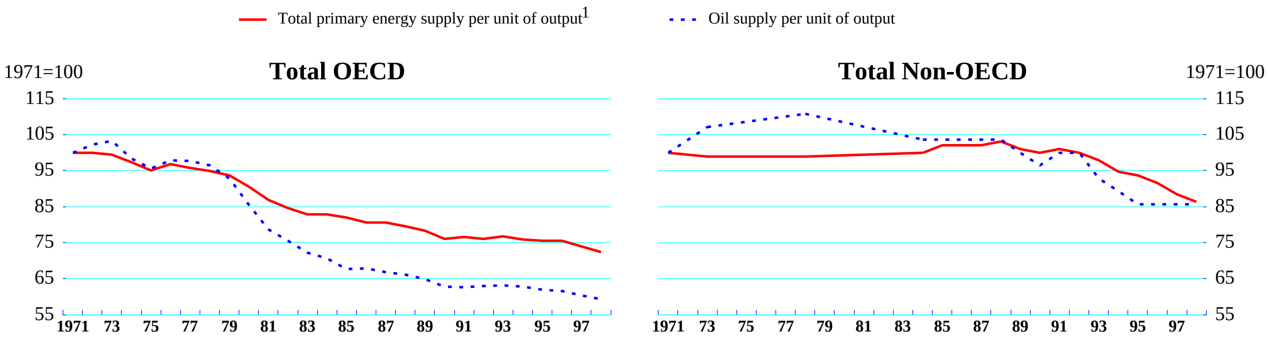
Per cent of GDP



Source: OECD.

OECD economies by nearly 50 per cent since the early 1970s (Figure I.6) due to the high price of oil that prevailed between 1974 and 1986, and the consequent reduction in dependence on net imports of oil. Outside the OECD, there have been both gainers and losers among non-OPEC countries: the former Soviet Union area has benefited from higher oil prices, while some other countries, notably the emerging economies in Asia, have experienced major oil-induced cuts in real income (Table I.6). The principal beneficiaries of the oil price hike are of course the OPEC countries, which are likely to get additional oil export revenues of around $80 to $100 billion in 2000.

Figure I.6. Energy and oil intensity



1. Primary energy is measured in tons of oil equivalent.
Sources: International Energy Agency; OECD.

Table I.6. **The direct impact of the oil price rise on selected non-OECD countries**

	Increase in cost of crude oil to users		Implied terms of trade loss[a]	
	$billion	Per cent of GDP	$billion	Per cent of GDP
Argentina	2.1	0.7	-1.6	-0.6
Brazil	8.4	1.1	3.4	0.5
China	16.9	1.7	4.0	0.4
Former Soviet Union	15.0	3.2	-14.4	-3.1
India	7.4	1.7	4.4	1.0
Malaysia	1.8	2.3	1.1	1.4
Phillipines	1.5	2.0	1.5	2.0
Singapore	2.6	2.7	3.2	3.4
South Africa	1.8	1.4	1.5	1.1
Thailand	2.8	2.3	2.4	2.0

Note: The increase in cost of crude oil to users equals oil demand (million barrels per year) in 1998 (the latest year for which data are available) times the estimated increase in the price of oil per barrel in 2000 ($28.3) compared with 1999 ($17.3). The terms of trade loss equals net oil imports times the increase in the oil price.

a) Negative sign implies gain.

Source : OECD, International Energy Agency, World Bank.

OPEC countries may use some of their windfall gains to strengthen their financial positions

So far, the limited evidence available suggests that OPEC countries are using a significant part of their higher revenues to strengthen their external financial positions. Some improvement in positions *vis-à-vis* international banks was registered by the Gulf states in the first quarter of 2000, following a significant deterioration of their net financial positions in the preceding three years (Table I.7). Moreover, the Gulf states made net purchase of US securities of more than $13 billion in the first half of 2000, a substantially faster pace than in the recent past.[10] As recently as the first half of 2000, exports from OECD countries to the OPEC area had not recovered from their decline following the collapse in revenues that OPEC countries experienced in 1998.[11] However, at some stage in the near future OPEC spending is likely to strengthen, although it may not entail full respending

Table I.7. **Net position of OPEC *vis-à-vis* BIS reporting banks**

$ billion, end of period

	1996	1997	1998	1999	2000,q1
Gulf States	87.5	72.2	75.5	53.8	57.8
of which:					
Iran	-0.1	-1.0	-2.5	-1.0	1.3
Iraq	-3.6	-3.2	-3.3	0.1	0.0
Kuwait	9.0	7.4	7.1	7.9	9.7
Qatar	-1.3	-2.5	-3.3	-3.2	-3.3
Saudi Arabia	49.3	36.2	43.6	23.3	22.9
United Arab Emirates	34.2	35.3	33.9	26.7	27.2
Indonesia	-44.2	-52.5	-38.1	-32.8	-31.5
Other OPEC members	13.1	19.7	21.3	21.2	25.1
of which:					
Algeria	-6.6	-1.6	-1.0	-0.7	0.1
Libya	5.5	6.8	6.8	6.6	7.5
Nigeria	1.3	2.5	1.8	3.0	3.9
Venezuela	12.9	12.0	13.7	12.3	13.6
OPEC	69.5	59.1	80.0	63.4	76.5

Source: Bank for International Settlements, *Quarterly Review: International Banking and Financial Market Developments* (various issues).

10. The Gulf states made a net purchase of around $3 billion during all of 1999. In 1998, the Gulf states were net sellers of securities worth $13 billion. In the preceding two years they had been net buyers of some $10 billion per year. See Table CM-V-3 in US Treasury, *Treasury Bulletin* (various issues).

11. The monthly rate of exports from the G-7 countries to the OPEC area fell from $6.7 billion in 1998 to $5.8 billion in 1999 and $5.5 billion in the second quarter of 2000.

of the higher revenues. In its central projections, the OECD has assumed, in line with past experience, that, after three years, around 75 per cent of the increase in oil export revenues of the OPEC countries will be spent on higher imports, mainly from OECD countries.

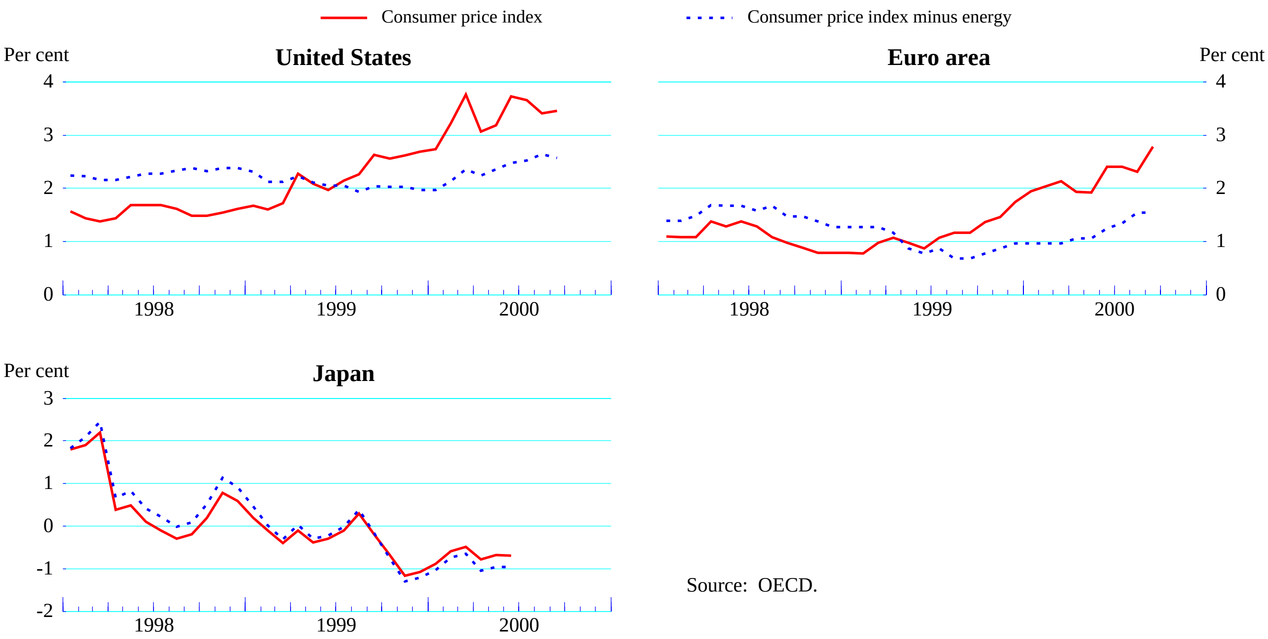
The oil price rise has already weakened activity in the OECD area

The partial and delayed spending of OPEC's increased oil revenues implies that the oil price hike will weaken world demand for goods and services, since the pressure on oil users to reduce expenditures in line with lost income does not have a full counterpart in higher expenditure by oil producers. On the basis of simulation analysis by the OECD, the rise in oil prices that has occurred since the beginning of this year may reduce output growth in the OECD area during 2000 and 2001, cumulatively, by around 0.2 of a percentage point (Table I.8).

The inflationary effects of the oil price rise have been rather small…

Given the extent to which it has raised costs throughout the economy, the rise in the oil price since early 1999 has so far had rather little effect on underlying inflation trends. It has significantly raised headline consumer price inflation in the United States and the euro area (Figure I.7), and, to a much lesser extent, it has worked to limit the extent of deflation in Japan. However, the year-on-year increase in consumer prices excluding energy has drifted up only slightly in both the United States and the euro area. At the same time, oil price developments do not appear to have given a

Figure I.7. Consumer price indices with and without energy
Year-on-year percentage change



Source: OECD.

Table I.8**. The impact on the economic outlook of the rise in oil prices since early 2000**[a]

Differences between central projections and scenario in which the oil price remains constant at its end-1999 level of around $25

	2000	2001
Real GDP level	*Per cent*	
United States	-0.1	-0.2
Japan	-0.2	-0.3
Euro area[b]	-0.2	-0.2
OECD total	-0.1	-0.2
Consumer price inflation[c]	*Percentage points*	
United States	0.2	0.2
Japan	0.2	0.1
Euro area[b]	0.2	0.2
OECD total[d]	0.2	0.2
Current external account	*Per cent of GDP*	
United States	-0.1	-0.1
Japan	-0.1	-0.2
Euro area[b]	-0.1	-0.1
OECD total	-0.1	-0.1
Memorandum item:		
The level of oil prices	*$ per barrel*	
Assumption in central projections	28.3	29.5
Assumption in this simulation	25.0	25.0

a) The effects of holding the oil price unchanged from its end-1999 level are simulated using the OECD's global macroeconomic model, INTERLINK. The simulation assumes that oil exporting countries spend around 1/3 of their additional export revenues on imports the first year and around half the second year. Real interest rates and nominal exchange rates are kept unchanged from central projections.

b) Greece will enter the euro area on 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

c) Private consumption deflator.

d) Excluding high inflation countries.

Source: OECD.

push to wages. In the United States, despite a tight labour market, the growth rate of hourly earnings has not shown any significant upward movements, although the employment cost index has risen somewhat faster. In the euro area, year-on-year hourly wages have risen only moderately, and have so far shown little signs of responding to higher oil prices. There are also no signs of higher longer-term inflation expectations as derived from the difference in yields on index-linked and conventional bonds. In the United States, the hike in the oil price has not prompted professional forecasters to revise up their projections for the average consumer price inflation over the coming ten years.[12] Similarly, in Europe there have only been modest upward revisions to long-term inflation forecasts, mostly confined to some smaller countries where pressures on resources are currently high.[13]

… partly because of structural and macroeconomic policy reforms

These benign inflationary effects are in marked contrast to the earlier episodes of oil price hikes, when a wage-price spiral was quickly put in motion. In addition to the substantial reduction in oil intensity noted earlier, several factors can account for the weaker inflation effects at present:

– The abolition of formal or informal backward-looking wage indexation arrangements removed the mechanism that proved to be particularly destabilising in the wake of past oil shocks. Since the ending of the *scala mobile* in Italy in 1992, wage indexation is not an important feature in any of the major OECD countries.

– The strengthening of competition in product markets has slowed down and/or limited the extent to which oil prices and induced wage effects can be passed on to customers. For example, the small effect of the increase in crude oil prices on consumer price inflation in Japan is reportedly due to some extent to more intense competition among oil distributors, and hence lower margins, in the wake of regulatory reforms in the industry. Also, road haulage companies have reportedly found it difficult to pass higher costs on to prices in the current deregulated environment.

– The greater importance attached to price stability as a goal of macroeconomic policy implies that oil-induced wage-price spirals are not underwritten or encouraged by an accommodative policy stance. The easing of policy in the aftermath of the first oil shock played an important role in driving up inflation, and that will not be repeated with stability-oriented macroeconomic policy.

12. According to forecasters surveyed by the Federal Reserve Bank of Philadelphia, the projected average annual consumer price inflation in the coming ten years has been constant a 2½ per cent since the second quarter of 1999. See Federal Bank of Philadelphia, *Survey of Professional Forecasters*, available at Internet address: www.phil.frb.org/files/spf.

13. See Consensus Economics Inc., *Consensus Forecasts* (various issues).

Table I.9. **Oil price scenarios**

Deviations from central projections

	Oil price falls to $17.5[a]		Oil price increases to $38.5[a]	
	2001	2002	2001	2002
Real GDP level	*Per cent*			
United States	0.3	0.3	-0.3	-0.2
Japan	0.4	0.6	-0.4	-0.4
Euro area[b]	0.4	0.4	-0.4	-0.2
OECD total	0.3	0.4	-0.3	-0.2
Consumer price inflation	*Percentage points*			
United States	-0.5	-0.3	0.5	0.2
Japan	-0.5	-0.2	0.4	0.1
Euro area[b]	-0.5	-0.4	0.5	0.2
OECD total	-0.5	-0.3	0.5	0.2
Current external account	*Per cent of GDP*			
United States	0.1	0.1	-0.1	-0.1
Japan	0.2	0.3	-0.2	-0.3
Euro area[b]	0.3	0.2	-0.2	-0.2
OECD total	0.1	0.1	-0.1	-0.1
Memorandum item:				
The level of oil prices	*$ per barrel*			
Assumption in central projections	29.5	27.5	29.5	27.5
Assumption in this simulation	20.7	17.5	38.5	38.5

a) The effects of the oil price changes are simulated using the OECD's global macroeconomic model, INTERLINK. They indicate changes to GDP, consumer price inflation and the current account relative to a baseline scenario where the oil price stays at $30 until summer 2001 and then gradually falls back to $27 by the end of 2002. The price increase scenario assumes that the oil price increases gradually to $38.5 from October to January 2001 and then stays at this level throughout 2002. The price fall scenario assumes that the oil price stays at $30 until the second quarter of 2001, where it drops to $17.5 and stays there throughout 2002. The oil exporting countries are assumed to spend around 1/3 or their additional export revenues on imports the first year and around half in the second year. Real interest rates and nominal exchange rates are kept constant.

b) Greece will enter the euro area on 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD.

Changes in oil prices could have significant impact on the short-term outlook

The OECD has examined the implications of oil prices being substantially higher or lower than assumed in the central projection (Table I.9). Should the oil price rise again to its previous peak in 2000 of $38.50 per barrel and remain there until end-2002, the level of real GDP could be lower by 0.2 to 0.4 per cent in the main OECD areas by the end of the projection period. In 2001, the inflation rate could rise by ½ percentage point, while second-round effects would imply that inflation would remain higher than in the central projections in 2002. On the other hand, if oil prices were to drop to $17.50, a level around the average of the past 15 years that appears to be more in line with longer term fundamentals in the oil market, economic activity would strengthen and inflation would be lower in all regions.

FISCAL ISSUES IN THE SHORT AND MEDIUM TERM

As fiscal positions have improved, many countries are cutting taxes or boosting spending

The improvements in overall fiscal positions that most OECD countries have experienced in recent years have continued during 2000. In terms of the general government finance balance, the OECD area as a whole is projected to achieve a surplus this year for the first time since 1969 and to maintain it in 2001-02 (Table I.10). Against the background of surprisingly strong revenue growth, there has been a widespread tendency to reduce taxes and boost public spending in many countries, especially in Europe (Table I.11).

While fiscal policies are not pro-cyclical, the long phase of restraint is ending

At this stage, on the basis of the announced tax and spending policies reflected in the projections, the clearly restrictive fiscal stance on an area-wide basis that has been in place for several years is coming to an end. Abstracting from some large one-off revenue gains, notably associated with the sale of mobile telephone licenses (Box I.3), the underlying structural budget position is projected to stabilise on an area-wide basis during 2001 and to tighten only marginally in 2002. Although relatively few countries appear so far to have shifted to an expansionary course, the trend toward cutting taxes and increasing spending, if it persists, will entail a possibility that fiscal policies become pro-cyclical. In the United States the underlying structural budget position is still projected to continue to tighten steadily, but the outlook for 2002 could be affected by changes implemented by a new administration. In the European Union, the various measures put into effect in 2000 and announced for 2001 and 2002 imply a broadly neutral stance overall during this three-year period, although a slight stimulus is on track for 2001. This mainly reflects the tax reform package in Germany. In Japan, the underlying budget deficit may come down (abstracting from one-off revenues from the taxation of cumulated interest on postal saving deposits) although, as explained in Box I.3, the shift toward tightening is not projected until 2002.

Four main factors explain why cuts in taxes and increased public expenditures can be accommodated in so many countries without seriously weakening estimated underlying fiscal positions:

Table I.10. **General government financial balances**[a]

Per cent of GDP / Potential GDP

	1998	1999	2000	2001	2002
United States					
Actual balance	0.3	1.0	2.3	2.6	2.7
Structural balance	0.0	0.7	1.7	2.2	2.5
Primary structural balance	3.2	3.5	4.4	4.6	4.7
Japan					
Actual balance	-5.0 [b]	-7.0	-6.0 [c]	-6.0 [c]	-5.7
Structural balance	-4.2 [b]	-6.0	-5.2 [c]	-5.4 [c]	-5.3
Primary structural balance	-3.1 [b]	-4.7	-3.8 [c]	-4.0 [c]	-3.8
Euro area[d]					
Actual balance	-2.2	-1.3	0.3	-0.5	-0.3
Structural balance	-1.3	-0.6	-0.6	-0.8	-0.6
Primary structural balance	2.9	3.2	3.0	2.7	2.8
European Union[d]					
Actual balance	-1.6	-0.8	0.7	0.0	0.1
Structural balance	-1.0	-0.2	-0.1	-0.3	-0.2
Primary structural balance	3.1	3.4	3.4	3.0	3.0
OECD[d]					
Actual balance	-1.2	-0.8	0.5	0.4	0.5
Structural balance	-1.0	-0.6	0.0	0.0	0.2
Primary structural balance	2.2	2.3	2.7	2.6	2.7

a) Actual balances are as a per cent of nominal GDP. Structural balances are as a per cent of potential GDP. The structural balance excludes one-off revenues from the sale of mobile telephone licences. The primary structural balance is the structural balance less net debt interest payments.
b) Excludes the budgetary impact of the debt take-over of Japan National Railways Settlement Corporation and National Forest Special Account (5.4 percentage points of GDP).
c) Includes deferred tax payments on postal saving accounts amounting to 0.8 and 0.9 per cent of GDP in 2000 and 2001 respectively.
d) Euro area and European Union figures exclude Luxembourg. Total OECD figures for the actual balance exclude, in addition, Mexico, Switzerland and Turkey and those for the structural balance further exclude the Czech Republic, Hungary, Iceland, Korea and Poland.
Source: OECD.

– Reduced interest payments on public debt are acting to strengthen the non-cyclical budget position in almost all Member countries. In Greece, the Netherlands and Sweden, net debt interest payments are likely to fall by more than a full percentage point of GDP between 1999 and 2002; the reduction could amount to between ½ and 1 percentage point for Australia, Belgium, Canada, Denmark, Finland, Iceland, Ireland, Italy and the United States.

Box I.3. **Assessing the underlying fiscal position**

Assessing the underlying fiscal position for some OECD countries in 2000 and, prospectively, in 2001 is unusually complicated by large one-off revenues. The most important are the one-off up-front payments associated with the sale of third-generation mobile telephone licenses in some European countries. Rapid technological progress in the telecommunication industries and the increasing demand for high-quality multimedia mobile services have made the allocation of electromagnetic spectrum for the UMTS (universal mobile telecommunications systems) to operating companies a high priority in many countries.[1] OECD Member countries have taken different approaches to making these allocations and, where this has involved sales or licensing fees, to recording the revenues. Since the amounts involved turn out or are expected to be substantial for some countries, how to book these revenues has become an important issue for fiscal reporting and analysis. The SNA93 (System of National Accounts) does not provide specific guidance on the treatment of mobile phone license receipts in government appropriation accounts, but three approaches have been considered or adopted in this regard:

- A widely accepted approach is to consider the license to be an *intangible non-financial non-produced asset*. In this approach, the proceeds from the sale of the licenses are recorded as revenues at the time the license is allocated, and have an immediate direct impact on government net lending/borrowing. The majority of EU member countries concerned and the IMF are proponents of this view, and Eurostat recommends that all EU members implement it unless the contract duration is less than five years or the full purchase price is not agreed in the lease contract.

- An alternative approach is to treat the sale of licenses as the prepayment of a rent for the use of a *tangible non-financial non-produced asset* -- electromagnetic spectrum -- whereby receipts are recorded as a purely financial transaction that does not affect government net lending immediately. This prepayment is amortised over the life of the license following accrual-based principles, which affects the government net lending/borrowing by relatively small amounts each year during the period in which the license contract is in force. The United Kingdom supports this approach, arguing that the sprectrum itself, rather than the license, is the asset.

- The third approach is to consider the sale of licenses to be one-off indirect tax akin to broadcasting licenses or passport fees. Canada, where only a small amount is involved, has adopted this approach.

The estimates for the government financial balances as reported in the *OECD Economic Outlook* are in accordance with the approaches adopted by the various countries. Therefore, care must be taken with the cross-country comparison since the figures are based on different treatments of the UMTS licensing sales. Estimates for those member countries where the revenues from the UMTS licensing are most substantial are shown below.

Estimated revenues from the UMTS licensing

	Germany	United Kingdom[a]	Italy	France	Netherlands
Estimated revenue (% of GDP)	2.5	2.4	1.2	1.1	0.7
Year in which the licenses are sold	2000	2000	2001	2001	2000

a) The actual impact on recorded current government revenues is spread out over two decades, in line with the second approach described above.

Box I.3. **Assessing the underlying fiscal position** (continued)

It should be observed, however, that the revenues from the sales of licenses are similar to pure financial transactions in that they have no counterpart in claims on real resources and will only involve claims on operators' income as they are amortised in the future. Thus, their inclusion as receipts in the budgetary accounts obscures the underlying fiscal position and its impact on the flow of incomes and expenditures in the economy. To deal with this, the OECD has adjusted the general government structural balance, which is an indicator of the *fiscal stance*, for those countries that adopted the first approach, by subtracting UMTS-related revenues from the structural balance. In computing the structural balance of the United Kingdom, which adopted the second approach, no such adjustment is necessary because only rental receipts for the use of spectrum are recorded in the financial balance. For Canada, which followed the third approach, no adjustment is made since the revenue from license sales is negligible in macroeconomic terms (0.02 per cent of GDP).

Another significant one-off item without any counterpart in terms of claims on real resources is the deferred tax receipts associated with fixed-term postal savings deposits maturing in Japan. Substantial investments in ten-year postal saving deposits were made in the early 1990s because those financial instruments provided not only a high fixed interest rate (about 6 per cent), but also flexibility allowing depositors to withdraw their money after six months without penalty. As a result, those savings deposits will mature in 2000 and 2001, and deferred payment of accumulated tax liabilities on interest incomes will be made and recorded. These deferred tax payments are expected to amount to 0.8 per cent and 0.9 per cent of GDP for 2000 and 2001, respectively. The improvement in the government financial balance, expressed as percentage of GDP, in 2000 and 2001 will be mainly due to the revenue increase from those deferred tax payments, since tax payments are recorded on a cash basis while the interest incomes being taxed were recorded on an accrual basis in both government and household accounts during the previous decade. The OECD has made no adjustment for these tax receipts in the calculation of the structural balance, but the effect on the structural balance if this were done is shown below.

Fiscal stance in Japan
Per cent of GDP

	1999	2000	2001	2002
Net lending	-7.0	-6.0	-6.0	-5.7
Cyclically-adjusted net lending	-6.0	-5.2	-5.4	-5.3
(Effects of taxes on postal savings)		(0.8)	(0.9)	
Underlying cyclically-adjusted net lending	-6.0	-6.0	-6.3	-5.3

1. Most EU countries aim to introduce commercial services by 1 January 2002, in compliance with the EU decision. On the other hand, Canada, New Zealand and the United States have left these decisions to the existing and potential operators, expecting that they will upgrade their systems in response to consumer demand. Some Eastern European countries, Japan and Korea will also launch commercial UMTS services during 2001 and 2002.

Table I.11. **Major fiscal policy initiatives for 2000 and 2001 in selected countries**

(The packages listed below are estimated by the OECD to cost around ½ per cent of GDP or more)

Germany	2001	Reform of income and company taxation, including further reduction in statutory personal and corporate income tax rates and an increase in the basic income tax allowance; broadening the tax base.
France	2000	A reduction in VAT rate by one percentage point; reduction in the VAT rate on dwelling improvement; cuts in income tax rates; abolition of a surtax on corporate profits, cuts in real estate tax. These are partially offset by increases in social security contribution on profits and in a general tax on polluting activities.
	2001	A cut in personal income taxes; reduced social security contribution rates for low-wage workers; reduction in gasoline taxes. Pension income and social benefit revaluation, job creation by local governments.
Italy	2001	Tax cuts, mainly for low-income earners; lower social security contributions; reduced corporate income taxes. Increased spending for infrastructure and social transfers.
United Kingdom	2000-01	A reduction in the basic income tax rate; lowering of taxes for small and medium-sized enterprises; reduction in national insurance contribution. These will be partially offset by an introduction of a new climate change levy and increased tobacco duties. Increases in spending on public health. Broadening the tax base and improving tax compliance.
Canada	2000-01	Full indexation of the income tax system, cuts in personal and corporate income taxes.
Belgium	2000	Acceleration in the multi-annual reduction in social security contributions.
Finland	2000-01	Income tax cuts and reduction in social security contributions.
Ireland	2000	A cut in taxes on labour income, a move towards the application of unified tax rates on traded and non-traded goods industries. Increased general infrastructure spending (1 per cent of GDP).
	2001	Continued tax reform. Increased general infrastructure spending (1 per cent of GDP).
Netherlands	2001	A reduction in tax rates and an increase in earned income tax credits. These will be partially offset by reduced scope for tax deductions; an increase in environmental levies and VAT rates; higher taxes on imputed income from wealth.
Sweden	2000-01	Income tax cuts.

Source: OECD.

– The widespread practice of indexing the tax system to prices rather than to earnings implies an automatic strengthening of fiscal positions in the absence of offsetting discretionary measures. For example, the annual fiscal drag in France and Germany may be as high as ½ percentage point of GDP.[14]

– Improved underlying labour market conditions are increasing the level of potential output, and hence the level of structural government revenues. This effect is set to be particularly strong in Ireland, Spain, Italy and the Netherlands.

– Improvements in tax collection systems and greater efforts to limit tax evasion are increasing structural revenues in some countries (Greece, Italy, Portugal, Spain, United Kingdom).

Fiscal prudence is warranted in the light of uncertainty about underlying improvements…

In a longer-term perspective, there are several reasons for fiscal prudence in a number of European countries, and, eventually, in Japan. First, there is some uncertainty about the underlying strength of fiscal positions. While OECD estimates of cyclically adjusted budget balances suggest that improvements in budget positions amounting to some 4 per cent of GDP since the early 1990s in the European Union, and more than this in most other OECD countries except Japan, appear to be structural, there may be some doubts about the durability of certain improvements. For example, the increase in taxes on businesses has played a disproportionate role in improving public finances since the mid-1990s (Figure I.8). The separation of total business-tax revenues into cyclical and non-cyclical components is subject to a particularly large margin of error,[15] and some of the extraordinary increase in business tax receipts in recent years may have been erroneously attributed to a structural improvement. Indeed, cyclical peaks in the past have been associated with unusually high estimates of structural business taxes in some countries, and these recorded structural receipts have fallen in the ensuing downturn.[16] There may also be some doubt about the sustainability of structural revenue increases that are based on rising asset prices, in particular in countries where employee share options have become a significant part of total remuneration, or on strong increases in sales of heavily taxed goods.

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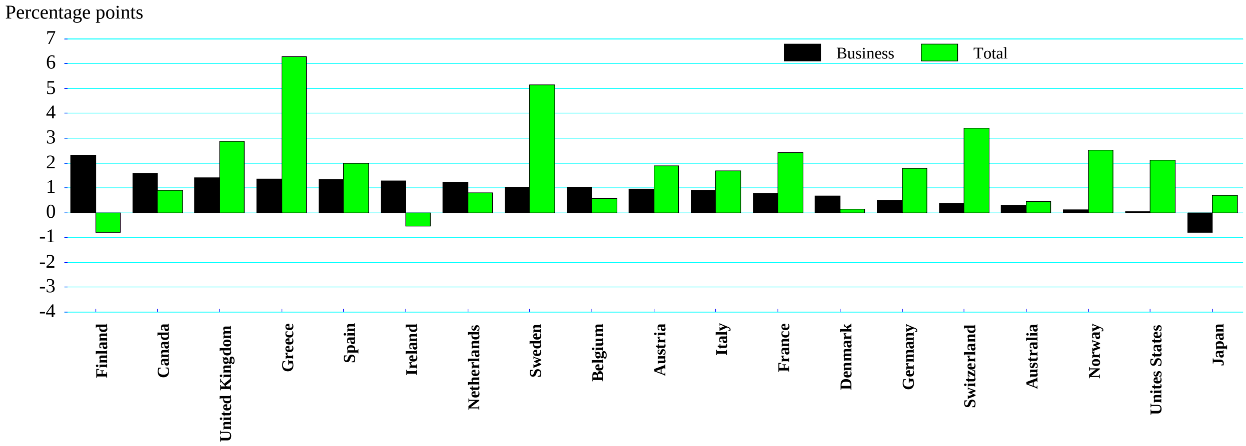
14. For France, see Ministère de l'Économie, des Finances et de l'Industrie, *Projet de loi de finances pour 2001*, Paris, 2000. For Germany, the tax elasticity with respect to household revenues is estimated to be 1.85; see A. Boss and T. Elendner, "Ein Modell zur Simulation des Lohnsteueraufkommens in Deutschland", *Kieler Arbeitspapiere* No. 988, June 2000. With households' income rising by 4 per cent, this translates into government revenue gains of around 0.5 per cent of GDP.

15. See *e.g.* P. van den Noord, "The size and role of automatic fiscal stabilisers in the 1990s and beyond", *OECD Economics Department Working Papers,* No. 230, Paris, 2000.

16. For example, structural business tax receipts fell by more than 1 percentage point of potential GDP in the downturns in the early 1990s in the United Kingdom, Spain, Finland and Sweden.

Figure I.8. Cyclically adjusted total and business tax revenues as a per cent of potential GDP: Changes from 1995 to 2000



Note: Data for Norway refer to Mainland Norway.
Source: OECD.

… and debt positions that remain high

Second, while improved budget positions have led to declining government debt-to-GDP ratios nearly everywhere (Figure I.9), the pace of improvement in the larger European countries has been slow. As a result, even assuming that the projected declines in this ratio occur, it will remain substantially higher in 2002 in both the European Union and the euro area than it was when the Maastricht Treaty was signed in 1991. In Japan, the debt-to-GDP ratio shows no sign of stabilising and will require policy action as soon as the overall economic situation permits (see below). Looking further ahead, provided that the fiscal positions remain broadly stable as assumed in the OECD's Medium-Term Reference Scenario, most Member countries will make continued progress in reducing their public debt ratio in the period to 2006 (Box I.4). Japan remains the most notable exception to this trend, even though the reference scenario embodies significant adjustments to offset rising ageing-related spending. As a result, its gross debt-to-GDP ratio rises by 15 percentage points, to 140 per cent of GDP by 2006.

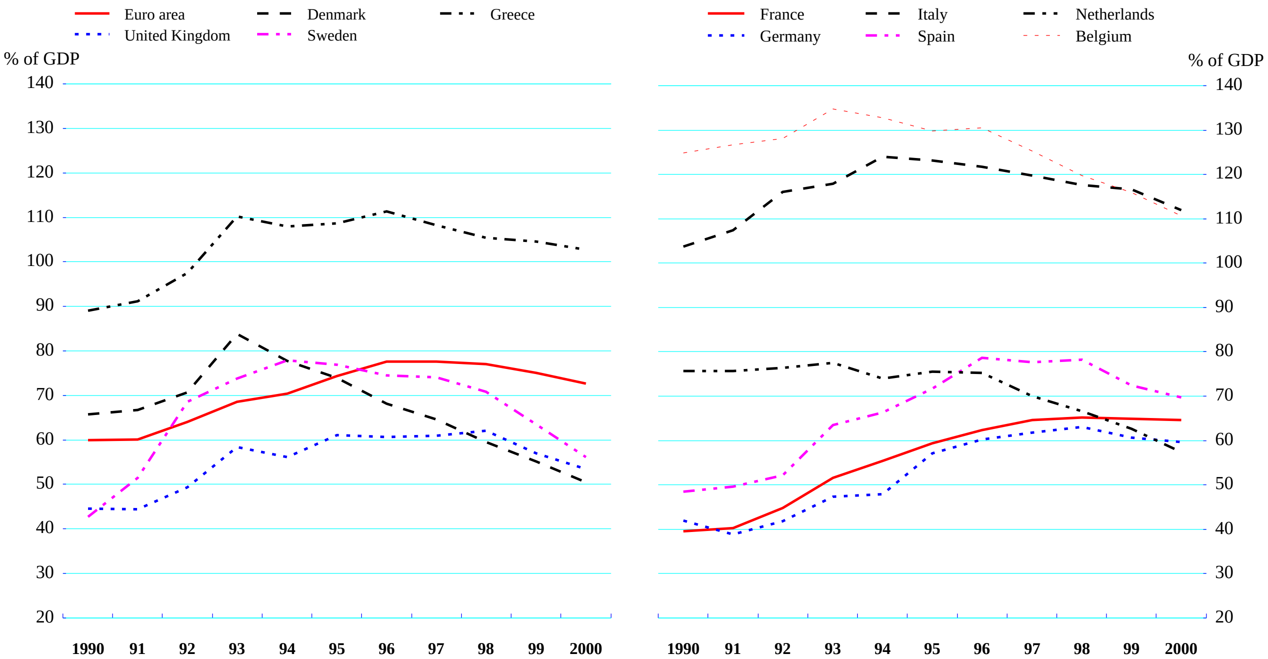
If spending is adequately restrained, tax reductions that increase efficiency are welcome

Provided spending is adequately restrained to ensure that underlying fiscal positions are satisfactory, tax reductions are welcome in view of the scope they provide for improving incentive structures in the economy. A positive aspect of the tax cuts that have been implemented or announced is that in some countries they have been designed with a view to taking strong advantage of this scope. Though differing to some extent from country to country, there are several common features across many of these reforms:

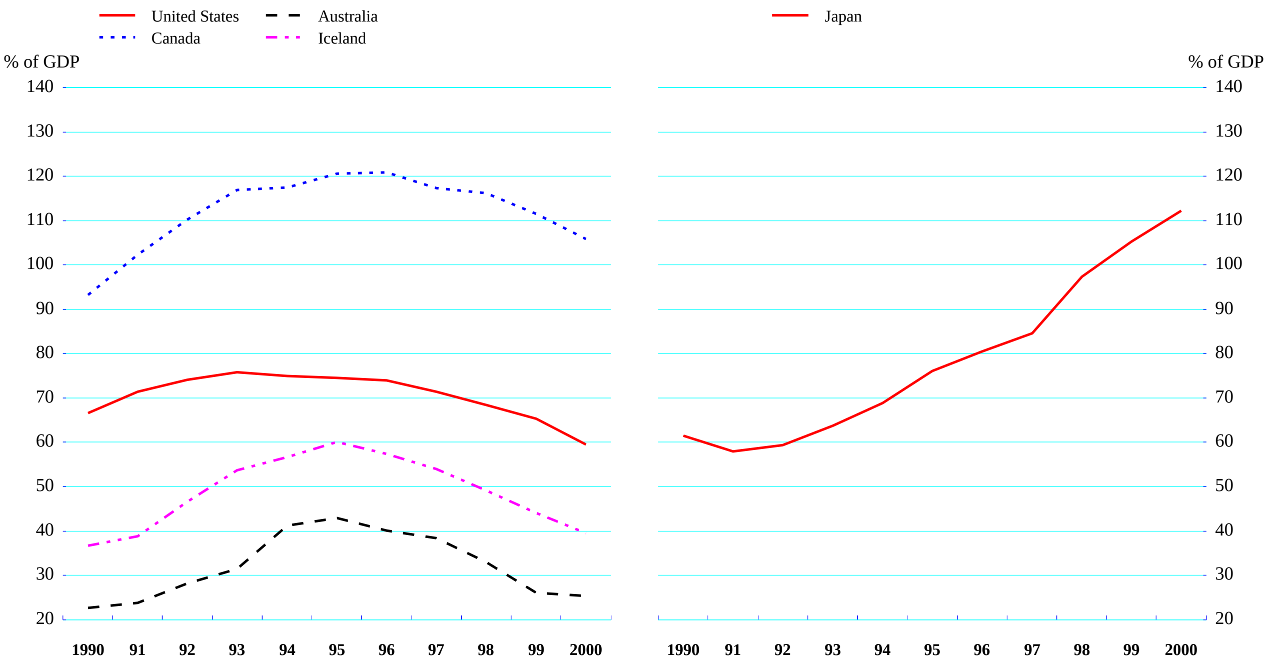
– Social security contribution rates paid by employers are being reduced for all workers (Finland, Germany), for workers at the lower end of the wage scale (Belgium, France, Italy, Netherlands, and United Kingdom), for new staff (Greece,

Figure I.9. General government gross financial liabilities[1]

European Union countries



Other OECD countries



1. Based on System of National Accounts (SNA) data. For European Union countries, these data include liabilities not included in the Maastricht definition of debt, for which a long time series is not available. The 2000 data are OECD estimates.
Source: OECD.

Box I.4. **The medium-term reference scenario**

The OECD's medium-term reference scenario, which extends the short-term projections to 2006 (table below), is conditional on the following assumptions for the period beyond the short-term projection horizon:

- The gaps between actual and potential output are broadly eliminated by 2006.
- Commodity prices and most exchange rates remain broadly unchanged in real terms.
- Monetary policies are directed at keeping inflation low, or bringing it down in line with medium-term objectives.
- Fiscal policies are assumed to remain broadly unchanged, i.e. the cyclically-adjusted primary budget balance is held approximately constant. This implies that the authorities take measures to offset underlying changes of the structural primary balance. These assumptions result in falling debt-to-GDP ratios in most countries (table on opposite page).

Medium-term reference scenario summary

Per cent

	Real GDP growth	Inflation rate[a]		Unemployment rate[b]		Current balance[c]		Long-term interest rate	
	2002-2006	2002	2006	2002	2006	2002	2006	2002	2006
Australia	3.7	2.6	2.2	6.1	6.0	-4.0	-3.0	6.8	6.4
Austria	2.2	1.8	1.8	4.0	4.4	-2.0	-1.7	6.0	5.8
Belgium	2.4	1.9	1.7	7.6	7.1	6.0	6.4	6.0	5.8
Canada	2.8	2.0	2.1	6.7	6.8	2.2	2.3	6.3	6.3
Czech Republic	3.5	4.3	2.6	9.0	7.7	-5.4	-5.7	8.0[d]	6.7[d]
Denmark	2.1	2.6	2.0	5.1	5.9	2.7	3.4	6.3	6.1
Finland	3.3	2.1	2.5	8.4	8.0	8.0	8.6	6.0	5.8
France	2.3	2.3	1.7	8.2	8.8	2.4	2.4	5.8	5.7
Germany	1.8	1.4	1.7	6.3	6.2	0.0	1.3	5.7	5.6
Greece	3.4	2.6	2.6	10.0	9.7	-4.4	-2.2	5.5[d]	5.5[d]
Hungary	4.7	5.7	3.4	6.2	5.8	-4.2	-2.9	10.5[d]	7.5[d]
Iceland	2.4	5.2	4.9	2.6	3.8	-9.2	-8.0	11.4[d]	10.1[d]
Ireland	7.1	3.8	5.0	3.6	5.0	-1.0	-1.6	6.0	6.0
Italy	2.5	2.0	1.8	9.4	9.2	-0.6	1.0	5.9	5.7
Japan	1.9	-0.2	0.2	4.6	4.3	3.0	3.4	2.3	3.8
Korea	5.7	1.5	2.5	3.5	3.5	2.3	-0.5	9.0	8.5
Mexico	4.8	5.8	3.9	2.8	3.0	-4.2	-4.8	12.8	10.0
Netherlands	2.3	2.6	2.8	2.3	3.0	5.1	4.1	5.9	5.8
New Zealand	2.8	2.0	2.0	6.0	5.8	-4.0	-2.0	7.5	6.0
Norway	1.3	1.0	2.5	3.4	3.6	19.7	16.0	6.8	6.6
Poland	4.9	9.5	3.8	15.0	12.0	-6.0	-4.8	13.1[d]	8.8[d]
Portugal	3.2	3.1	2.8	4.2	4.1	-12.0	-10.9	6.1	6.1
Spain	2.6	2.9	2.4	12.2	11.0	-3.8	-3.8	5.9	5.8
Sweden	2.0	2.7	2.9	3.7	5.6	1.1	1.5	5.8	6.0
Switzerland	1.8	1.8	1.8	1.8	1.8	12.9	12.7	4.4	4.3
Turkey	5.6	15.8	10.0	6.8	6.1	-3.4	-3.2	26.8	21.0
United Kingdom	2.2	2.6	2.4	5.5	6.0	-1.9	-1.9	5.7	6.0
United States	3.6	2.3	2.3	4.5	5.0	-4.3	-3.9	6.5	6.4
Euro area	2.4	2.0	2.0	7.7	7.7	0.4	1.1	5.8	5.7
European Union	2.3	2.2	2.0	7.2	7.3	0.0	0.6	5.8	5.8
Total of above OECD countries	3.0	2.1[e]	2.0[e]	5.9	5.9	-1.2	-0.9	6.0[e]	6.0[e]

Note: For further details see *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/out/source.htm).*
a) Percentage change from the previous period in the GDP deflator.
b) Per cent of labour force.
c) Per cent of nominal GDP.
d) Short-term interest rate.
e) Excluding Turkey.

Box I.4. **The medium-term reference scenario** (continued)

The current version features a continuation of the short-term area-wide expansion, with medium-term growth of around 3 per cent and growth in world trade at around 7 per cent. Area-wide inflation remains stable at around 2 per cent; the average unemployment rate remains broadly stable over the period but remains high in a number of European countries. In spite of the closure of output gaps, the present levels of current account imbalances between major OECD countries and regions persist over the medium-term, reflecting mostly underlying structural factors.

Fiscal trends in the medium-term reference scenario

As a percentage of nominal GDP

	Financial balances[a]		Net financial liabilities[b]		Gross financial liabilities[c]		Gross public debt (Maastricht definition)[d]	
	2002	2006	2002	2006	2002	2006	2002	2006
Australia	1.0	1.6	9	2	24	17	..	..
Austria	0.0	0.1	45	38	60	53	60	53
Belgium	0.7	1.2	91	74	100	83	100	83
Canada	1.9	1.9	56	39	96	79	..	..
Czech Republic	-7.5	-7.7	..	..	..	..	..	..
Denmark	3.1	2.9	18	4	42	28	40	26
Finland	5.3	4.8	-37	-48	36	25	36	25
France	-0.8	-0.1	40	35	63	58	57	53
Germany	-1.2	-0.3	40	37	58	55	58	55
Greece	0.3	1.4	..	..	96	83	96	83
Hungary	-2.5	-1.7	..	..	..	..	..	..
Iceland	2.5	3.5	15	0	30	15	..	..
Ireland	7.3	5.9	..	..	17	0	17	0
Italy	-0.8	0.4	93	78	105	90	104	89
Japan	-5.7	-4.8	54	69	125	140	..	..
Korea	5.0	5.3	-32	-42	8	0	..	..
Netherlands	1.3	0.5	37	27	49	40	49	40
New Zealand	1.2	1.5	..	..	..	..	..	..
Norway	14.4	14.1	-78	-121	24	23	..	..
Poland	-2.3	-1.4	..	..	..	..	..	..
Portugal	-1.3	0.0	..	..	52	42	52	42
Spain	0.4	1.0	37	28	64	54	56	48
Sweden	3.8	2.1	-9	-18	41	32	43	34
United Kingdom	1.8	0.6	26	18	47	39	38	31
United States	2.7	3.3	33	15	50	32	..	..
Euro area	-0.3	0.4	51	43	68	60	68	60
European Union	0.1	0.4	45	37	65	57	62	55
Total of above OECD countries	0.5	1.0	38	29	66	58		

Note : For further details see *OECD Economic Outlook* Sources and Methods *(http://www.oecd.org/eco/out/source.htm)*

a) General government fiscal surplus (+) or deficit (-) as a percentage of GDP.

b) Includes all financial liabilities minus financial assets, as defined by the System of National Accounts (where data availability permits) and covers the general government sector, which is a consolidation of central government, state and local government and the social security sector.

c) Includes all financial liabilities, as defined by the System of National Accounts (where data availability permits) and covers the general government sector, which is a consolidation of central government, state and local government and the social security sector.

d) Debt ratios are based on debt figures for 1999, provided by Eurostat, and GDP figures from national authorities, projected forward in line with the OECD projections for GDP and general government financial liabilities.

Italy and Portugal) and for persons on new permanent contracts (Spain). As indicated by the experience of some of the countries that have employed such measures in the past, the targeted cuts may increase the demand for low-productivity workers.[17]

- Personal income taxes are being reduced in general (Australia, Canada, Finland, France, Germany, Greece, Ireland, Netherlands, Spain and Sweden) and/or targeted at low income earners (Austria, Germany, Ireland, Italy, the Netherlands, Portugal, and the United Kingdom). Targeted reductions that have increased the after-tax gain from work have been found to encourage labour force participation and, to a smaller extent, overall labour supply.

- Corporate tax rates are being reduced in general in Canada, Denmark, Germany, Greece, Ireland, Italy and Portugal, encouraging better resource allocation.

These measures will contribute to economy-wide efficiency improvements and raise potential output over the longer term, but they will take time to have their full effects; over the short run their impact is likely to be modest.

POLICY REQUIREMENTS IN OECD COUNTRIES

The United States

The key policy issue in the United States is whether further tightening of monetary policy is required

As noted above, the long-awaited slowing of the US economy is now under way. This should help to reduce the excess demand that appears to have characterised the economy in recent years, and this re-balancing process will be further assisted by the rise in potential growth rates that has taken place in the latter part of the 1990s. Indeed, it now looks as if the potential growth rate has risen to 4 per cent, a full percentage point higher than the OECD's estimate in June 1999, and that excess demand is less than previously thought.

The key issue remains whether the tightening of monetary policy that has already been implemented is sufficient to bring about a soft landing. The possibility that the oil price hike may lead to responses that have adverse effects on core inflation further complicates the task of the monetary authorities in maintaining price stability. Even taking account of the increase in the potential growth rate, the OECD's current assessment is

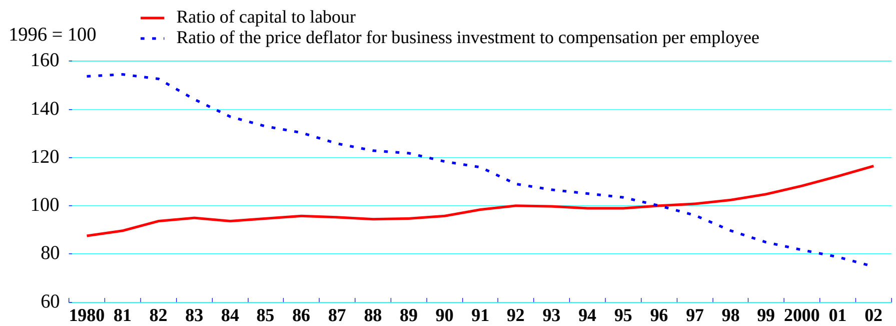
17. See Chapter V, "Making Work Pay" in *OECD Economic Outlook* 66, December 1999, and articles in *OECD Economic Studies*, No. 31, 2000/2.

that some further tightening will be necessary. However, a rise of only 50 basis points in the federal funds rate is estimated to be sufficient in 2001 to arrest increases in the inflation rate. With the pressures on resources continuing to decline, there would then be some scope for the Federal Reserve Board to start reducing interest rates in the second half of 2002.

Inflationary tensions may emerge as productivity growth falls for cyclical reasons and wage inflation edges up

The remarkable surge in productivity growth in the first half of 2000 has limited some inflationary pressures originating in tight labour markets. The rise in productivity growth was importantly related to the continued strong increase in the capital stock (Figure I.10), as businesses took advantage of the persistent dramatic fall in the price of computer equipment to invest in new technology. Though future underlying productivity trends are inherently uncertain, the OECD expects recent trends to continue for some time as there is no evidence to suggest that the rate of fall in computer prices will ease in the near future. However, actual productivity growth is likely to come down as the economy slows, so productivity developments in the short run may not be as helpful in moderating price increases as in the recent past. At the same time, continued pressures in the labour market may push up wage inflation.

Figure I.10. United States: Capital-labour ratio and relative factor prices in the business sector



Source: OECD.

The higher potential growth rate has reduced risks associated with the stock market and the current account deficit…

Provided higher rates of potential output growth in the United States are sustained, some long-standing risks to the economy would seem to have become less serious in the short term:

– *Stock market correction*. As highlighted in previous issues of *OECD Economic Outlook*, a sharp correction of the apparently highly valued stock market has been considered to be a major risk for the United States and the world economy. However, if long-term dividend growth expectations have risen in line with estimated potential output growth to 4 per cent, the extent of the over-valuation of stock prices is much less than if a backward-looking dividend growth record is used to assess fundamental values.[18] Even so, equity prices remain vulnerable to shifts in investors' sentiments, as demonstrated by recent falls in technology stocks.

– *The current-account deficit*. Concerns about the external financing requirements associated with the large current-account deficit in the United States are widely seen to make the possibility of a disorderly fall in the dollar a major downside risk. However, as expected rates of return on capital have risen with higher potential growth rates, foreigners have sought to acquire claims on future profit streams through mergers with and acquisition of US companies and the buying of shares. Indeed, increased net direct investment inflows and net flows into corporate stocks have covered around a half of the additional financing needs due to the widening of the current-account deficit since 1997 (Table I.12).

… and has major implications for public finances in the long term

Provided that the higher potential growth rate is durable, there will also be major implications for public finances in the longer term. Official projections for the period 2000-10, based on average growth rates of only a little less than 3 per cent, suggest that total budget surpluses could be on average 3½ per cent of GDP and add up to $4.5 trillion in the period.[19] If instead the average growth rates were to increase to the currently estimated potential growth rate of 4 per cent, cumulative surpluses could be much higher than the baseline estimates.[20] This would imply that there could be significant scope to reduce taxes or increase public spending over the medium term without weakening the underlying budget surplus. Alternatively, refraining from such policy easing would significantly strengthen the capacity of the authorities to meet the added public spending related to the ageing of the population after 2008.

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18. Within the framework of the standard dividend discount model, the extent of the over-valuation of equities is often measured by the implicit risk premium demanded by investors to hold stocks instead of risk-free bonds, an unusually low risk premium signalling an over-valuation (see Chapter V "Recent Equity Market Developments and Implication" in *OECD Economic Outlook* 64, December 1998). In the current year, the implied risk premium is around 2.2 per cent if dividends are expected to grow at 4 per cent in real terms, the return to equity holders from dividends and net share repurchases is 2.2 per cent, and the real interest rate is 4 per cent. If dividends were instead expected to grow at the average potential growth rate over the 1986-93 period of only 2.7 per cent, the implicit risk premium would be only 0.9 per cent. The implicit risk premium over the 1986-93 period was 2.9 per cent.

19. See Congressional Budget Office, *The Budget and Economic Outlook: An Update*, July 2000. The figures referred to in the text are based on the assumption that discretionary spending grows at the same rate as the inflation rate.

20. Sensitivity analysis suggests that an increase in the average GDP growth rate over the 2000-10 period of only 0.4 percentage points could more than double cumulative surpluses over the period, see Chapter 5 in Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2001-2010*, January 2000.

Table I.12. **The US current account deficit and its financing**

$ billion

	1996	1997	1998	1999	2000 I[a]
Current account balance	-123.3	-140.5	-217.1	-331.4	-415.2
Direct investment flows, net	-5.4	1.0	40.2	124.6	96.3
Inflows from abroad	86.5	106.0	186.3	275.5	257.3
US purchases abroad	91.9	105.0	146.1	150.9	161.0
Corporate stocks, net	-71.1	10.2	-59.3	-16.3	77.2
Inflows from abroad	11.1	67.8	41.9	98.1	176.4
US puchases abroad	82.2	57.6	101.2	114.4	99.2
Bonds, net	329.1	212.8	182.8	232.2	258.6
Inflows from abroad	396.1	274.2	217.6	246.4	266.7
US purchases abroad	67.0	61.4	34.8	14.2	8.1
Other identified flows	-94.1	44.4	-16.3	-20.6	-18.1
Statistical discrepancy	-35.2	-127.9	69.7	11.5	1.2

a) Annual rate, first half of 2000.
Source: Bureau of Economic Analysis and Federal Reserve Board.

There are, however, uncertainties about the future evolution of the potential growth rate

There are, however, uncertainties about the evolution of potential growth rates in the short and long run. Given the pivotal role of technological advance in the information and communication industries in raising dynamism in the 1990s, high trend output growth in the future will depend critically on continued high rates of innovation and product development in these sectors. As has been the case with major innovations in the past, technological advance in the computer industry will eventually slow down. However, so far there are no signs of this taking place, and falling computer prices will continue to induce businesses to use capital equipment more intensively in the medium term. On the other hand, the diffusion of these innovations may temporarily slow down if the economy turns down, as past experience shows that business investment is sensitive to companies' cash-flows and profit positions.

The euro area

Growth is set to be above potential in the euro area in the coming two years

The euro area looks set to grow at rates above potential over the coming two years, with unemployment declining to a 20-year low and some excess demand pressure emerging (Table I.13). Growth in 2000 has been supported by the weakening of the euro, and the depreciation that has already taken place will continue to have positive effects on activity in the short term. Underlying inflation trends have been remarkably benign in the face of the oil price hike and the depreciation of the euro, but core inflation

Table I.13. **Euro area**
Summary of projections

	1999		1999	2000	2001	2002
	current prices		Percentage changes, volume (1995 prices)			
	Billion euro	Per cent of GDP				
Private consumption	3 558.6	57.0	2.8	2.5	2.6	2.6
Government consumption	1 245.7	20.0	1.4	1.3	1.1	1.1
Gross fixed capital formation	1 303.4	20.9	5.4	5.0	4.4	4.3
Residential	358.7	5.7	3.2	2.7	1.8	1.8
Business	789.0	12.6	6.5	6.4	5.9	5.7
Government	155.7	2.5	4.6	2.8	2.6	2.6
Final domestic demand	6 107.7	97.9	3.0	2.8	2.7	2.7
Stockbuilding[a]	36.9	0.6	-0.1	0.0	0.0	0.0
Total domestic demand	6 144.6	98.4	2.9	2.8	2.6	2.7
Exports of goods and services[b]	1 098.4	17.6	4.5	13.2	10.1	7.6
Imports of goods and services[b]	1 001.6	16.0	7.8	10.0	8.5	7.5
Net exports[a]	96.8	1.6	-0.4	0.7	0.5	0.2
GDP at constant prices			2.5	3.5	3.1	2.8
GDP at current prices	6 241.5	100.0	3.7	4.7	5.0	4.9
Memorandum items						
Private consumption deflator			1.2	2.2	2.3	2.0
Total employment			1.8	2.1	1.6	1.3
Unemployment rate			9.9	9.0	8.3	7.7
General government financial balance[c]			-1.3	0.3	-0.5	-0.3
Current account balance[c]			0.4	0.0	0.1	0.4
Household saving ratio[d]			9.9	9.7	9.9	9.8
Output gap[e]			-1.4	-0.3	0.3	0.6

Note: Greece will enter the euro area on 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.
a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) Excluding intra-area trade.
c) As a percentage of GDP.
d) As a percentage of disposable income.
e) As a percentage of potential GDP.
Source: OECD.

is likely to move up somewhat as spare capacity is exhausted. There will be some tendency for convergence in cyclical positions across individual countries in the euro area, with all but Italy and Portugal expected to be operating above potential in 2002.

The strength of the supply side is uncertain

Important issues in the context of assessing monetary policy priorities are the current level and growth rate of potential output in the euro area. As noted above, the strength of the supply side of the US economy has been revised up in recent years, and the question arises whether it is now the euro area's turn to deliver positive surprises in this area.

There is little evidence of new technology raising productivity growth rates…

There is no clear evidence that the euro area has succeeded in raising aggregate productivity growth through the creation and use of information and communication technology. Companies in the euro area have taken the lead in some areas of new technology, and the interest in acquiring licences for operating third-generation mobile telephones bears witness to the vibrancy of this segment of the industry. However, the information technology sector is small in many countries of the euro area, and, although investment in new technology has increased, there has not been any significant acceleration in aggregate investment. Nevertheless, it would be surprising if productivity growth trends in the euro area did not eventually benefit from the creation and diffusion of new technology. The process could be accelerated by improving framework conditions in the business sector.[21]

… but sustainable resource utilisation rates have risen

There is firmer evidence that structural reforms over the past decade have raised sustainable resource utilisation rates.[22] For example, the area-wide structural employment-to-population ratio is estimated to have risen by close to 2 percentage points from 1995 to 2000, due to the combined effect of lower structural unemployment rates and higher trend participation rates. These structural improvements have played a key role in the unusually rapid employment growth observed since 1997. Moreover, the extent of these improvements has continued to surprise on the upside. Such surprises will recur if past and future reforms are more effective than currently anticipated in improving conditions in the labour and product market.

Some inflationary tensions in the short term call for a modest rise in interest rates…

Against the background of modest excess demand emerging in 2002 and the possibility that potential output is higher than generally recognised, the monetary authorities may have to raise interest rates only modestly to ensure that inflation stays below the upper limit of 2 per cent in the medium term. The OECD's projections assume that the average refinancing rate will rise by a further 50 basis points by mid-2001, and remain constant thereafter. Coming on top of a cumulative increase in the policy rate of 225 basis points since November 1999, this would continue the process of making the monetary policy stance less supportive of demand. However, two upside risks to inflation could put pressure on macroeconomic policy were they to materialise.

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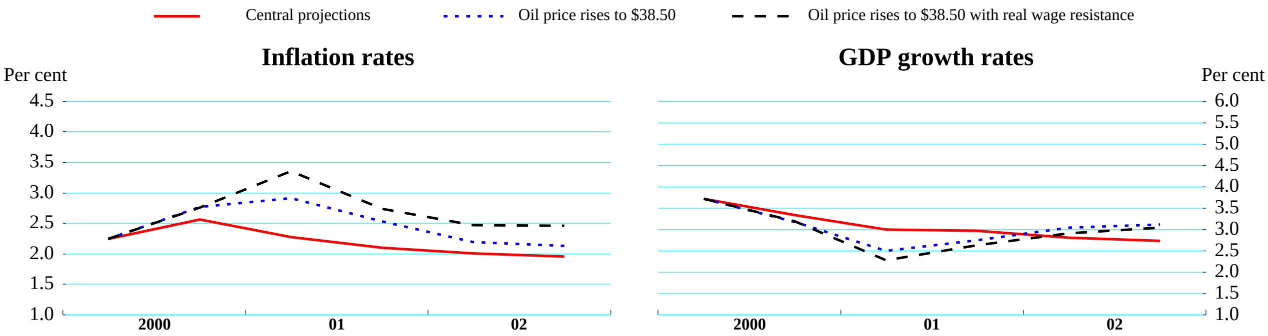
21. See Chapter IV "Links between policy and growth: cross-country evidence" in *OECD Economic Outlook* 68 (forthcoming in December).

22. For a discussion of the evolution of structural unemployment rates in Member countries, see Chapter V "Revised OECD Measures of Structural Unemployment", in *OECD Economic Outlook* 68 (forthcoming in December).

… but stronger policy responses would be required if oil prices were to have larger effects on wages…

First, interest rates would have to rise further if wage earners or producers attempt to recover oil-induced losses in real income. The wage response has so far been muted, but the real test will come when existing wage contracts are renegotiated. The central projections assume that wage moderation will continue, but there is a risk that the strengthening of the labour market may induce workers to demand higher wages. Simulation analysis by the OECD illustrates the deleterious macroeconomic effects of a combined increase in oil prices to $38.50 (*i.e.* the peak attained this year) and nominal wages adjusting in an attempt to offset the direct impact on real income. Assuming that real interest rates would remain constant, the effect would be stagflationary relative to the central projection, with output lower and inflation higher (Figure I.11). In such an unfavourable environment, monetary policy would have to react strongly to maintain price stability.

Figure I.11. The effect of higher oil prices with real wage resistance in the Euro area



Note. The average price of imported oil is assumed in these scenarios to rise to $38.50 by the end of 2000 and to stay there throughout 2001 and 2002.
The wage resistance scenario assumes that nominal wages adjust to recuperate the direct impact of the higher oil price on consumer prices.
Source: OECD.

… or if the euro were to continue its decline

Second, continued declines in the value of the euro would directly add to inflation and increase the risk of overheating in the area. This would require corrective monetary policy action by the European Central Bank. The prospects for the euro are highly uncertain, in particular since the reasons for its sharp drop thus far are not well understood. In fact, there does not seem to be any single explanation for the fall applicable for the whole period since January 1999 and for movements against both the dollar and the yen. Concerns about the continued decline in the value of the euro has prompted intervention in foreign exchange markets to provide support on several occasions since September.

Japan

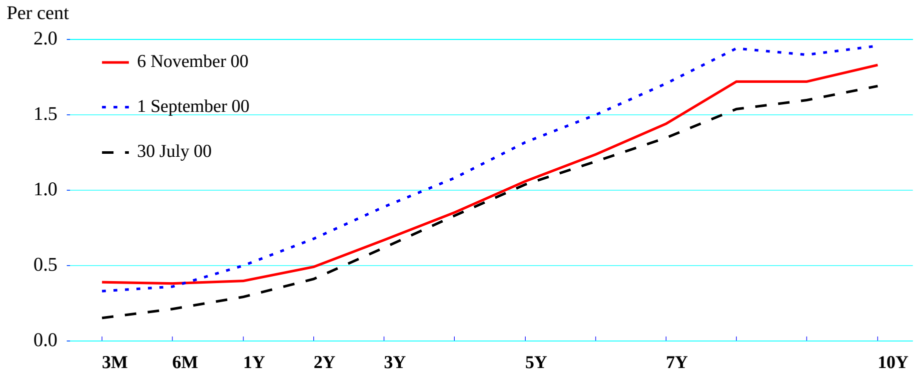
The focus of policy is shifting from crisis to recovery management…

Although there is still some uncertainty about the robustness of the expansion in Japan, the focus of policy making is shifting from crisis to recovery management. In August, the Bank of Japan raised its overnight lending rate from practically zero to ¼ percentage point, signalling that the monetary authorities no longer considered emergency measures to be appropriate in the light of the recovery. Reflecting somewhat greater concern about the fragility of the economy in the near term, the government has announced another supplementary budget. However, this tenth supplementary budget since the downturn in the early 1990s is comparatively modest, little more than offsetting the automatic tightening of the fiscal stance due to declines in public spending from abnormally high levels in the absence of any new initiatives.

… but the transition has not been smooth

While markets had been prepared for the termination of "the zero interest rate" policy, the raising of the overnight rate by 25 basis points was quickly transmitted throughout the yield curve (Figure I.12). At the short end of the maturity spectrum, this appears to have been related to perceived risks of continued rises in policy rates in the absence of a clear monetary framework. As for longer-dated instruments, the increase in yields was related to expectations of strong second quarter GDP figures and to the risk of fiscal policy turning more expansionary to offset the impact of less supportive monetary conditions. Indeed, the government was in an open disagreement with the Bank of Japan's decision to terminate the "zero interest rate policy", emphasising instead the fragility of the recovery. Though long-term government bond rates have come down since mid-August, they still remain slightly above their level prior to the raising of the overnight rate.

Figure I.12. Yield curves in Japan [1]



1. The curves refer to yields on government financial instruments.
Source: Bloomberg.

The macroeconomic policy mix will have to change as the recovery becomes firmly established

As the economic recovery becomes firmly established, the priority of fiscal policy will have to shift towards budget consolidation and debt stabilisation. This could slow the return of the economy to normal rates of resource utilisation. In this environment, the role of monetary policy is to provide continued strong support to growth, refraining from any tightening of policy unless there are clear indications that the price stability objective is at risk.

There is no need for further tightening of monetary policy…

At this stage, there is no indication of any inflationary pressures that would warrant tighter policies, and it is assumed in the projections that no further increase in policy rates will take place in the coming two years. To avoid excessive risk premia being built into market rates because of uncertainty about monetary policy actions, the monetary authorities need to introduce a transparent medium-term monetary strategy[23] that would provide greater clarity about their inflation objective and their use of instruments. In particular, such a framework would need to specify what inflation rate or range is considered to be compatible with the broad goal of price stability. This would involve making monetary policy in Japan more transparent than judged to be necessary in some other OECD areas, but this would seem to be justified by the critical need in the case of Japan to provide strong monetary support for the economy.

… but fiscal policy will have to shift towards restriction

In view of the projected recovery, the authorities are assumed to begin budget consolidation in 2002. This tightening of the underlying budget position by 1 percentage point is but a step to stabilise the debt-to-GDP ratio. Indeed, stabilising the debt ratio by 2010 in the face of ageing-related pressure on spending might possibly require budget consolidation of as much as 10 per cent of GDP. A tightening of this size would have to be spread out over a long period in order to limit the restraining effects on the economy. However, investors may be hesitant to finance persistent, even if gently declining, budget deficits unless they are in the context of a clear and a credible medium-term consolidation plan. The maintenance of investors' confidence is a pre-requisite for an orderly return to stable public finances, and government commitments about the future path of consolidation and the possible reaction to adverse shocks could help in this respect.

Restructuring of the economy is being facilitated by changes in framework conditions…

Restructuring of the Japanese economy is progressing, aided by changes in the legal framework governing the transfer of resources between companies and sectors. Accounting reforms have made it easier to identify loss-making activities, and the increased transparency has acted to stimulate

23. In October, the Bank of Japan announced several changes to increase transparency. It has begun to publish half-yearly reports where the range of forecasts by policy board members for inflation (consumer and wholesale price indices) are presented for the current fiscal year. The views of its policy board members concerning risks to inflation for the coming year are also outlined. However, the inflation objective of the Bank has not been clarified.

better resource allocation. The simplification of procedures for merging and splitting companies has also encouraged this process. The new reorganisation law is a major step forward in facilitating restructuring in an orderly way, providing protection of vital assets from secured creditors in exchange for more effective implementation of restructuring plans.

… but it has had adverse effects on the banking system

The restructuring process has inevitably had adverse effects on the banking system. The re-capitalisation of the banking system in 1999 with public funds allowed banks to write off large amounts of bad debt. However, the introduction of better accounting rules has highlighted the extent of continuing problems in troubled sectors, notably property-related industries and retailing. The banking system therefore continues to be saddled with high levels of bad debts and very low profits (Table I.14). Moreover, costs related to bad debt may well increase in the future as troubled clients are increasingly asking for debt forgiveness. For the management of individual banks it may be expedient to accede to such requests, as partial debt forgiveness may delay having to classify the whole debt of a company as non-recoverable. However, this will tend to delay restructuring in the economy and could ultimately result in costs for the government. To avoid "easy" debt forgiveness, the authorities need to monitor such practices and insist on strict loan classification and provisioning rules. As demonstrated by recent bankruptcies in the insurance industry, serious problems remain in other segments of the financial sector and need to be addressed.

Table I.14. **Income statements for Japanese banks, 1996-99**

Financial years beginning 1 April

	1996	1997	1998	1999
	Trillion yen			
Operating profits	5.9	5.1	3.8	4.6
of which:				
"Core" operations	5.2	4.7	4.8	5.0
Bonds	0.4	0.7	0.9	-0.1
Current profits	0.5	-4.7	-7.2	2.4
of which:				
Capital gains on equities	1.0	2.7	0.8	3.8
Write-offs	-6.9	-12.3	-11.9	-6.0
Final profits, after-tax[a]	0.3	-4.3	-4.4	0.9
Memorandum item:				
Bad loans[b]	..	65.7	64.3	63.4

a) Includes capital gains/losses on real estate.
b) Loans against which provision is required.
Source : Bank of Japan, *Research Monthly*, August 2000 (in Japanese).

It is essential to continue structural reforms

Beyond the short term, it is essential that structural reform efforts continue as the economic recovery becomes better established. Further progress in implementing the reform agenda contained in last year's *OECD Review of Regulatory Reform* in Japan would make the economy more dynamic and strengthen its capacity to take advantage of technological advances. A particular emphasis should be placed on adjusting regulatory structures in the telecommunication sector with the aim of encouraging new entry and rapid diffusion of new modes of communications. But there is also a need to address structural problems that have emerged in the course of recession, notably the appearance of marginalisation of youth in the labour market and the increase in unemployment among older workers. So far, the authorities have responded to these developments by increasing income support and expanding traditional active labour market measures. However, a solution to these labour-market problems might have to involve the relaxation of *de facto* strict employment protection for insiders, the adjustment of the incentive structure embedded in unemployment benefit systems for older workers, and new measures to entitle unemployed youth to employment-relevant training.

ANNEX: BACKGROUND STATISTICS

The process of accession of the Slovak Republic to the OECD is in its final stage. On 28 September 2000, the OECD and the Slovak Republic signed the Agremeent on the invitation to the Slovak Republic to accede to the Convention on the OECD. It was ratified by the Slovak Parliament on the 26 October. However, until the Slovak Republic has deposited its instrument of accession with the French authorities, depository of the OECD Convention, the process will not be complete. Therefore, in this Preliminary Edition of the OECD Economic Outlook the tables contained in this annex do not include the Slovak Republic. A note on the Slovak Republic, including forecasts, appears in Chapter III, “Developments in Selected Non-Member Economies”.

Other points to note about the tables contained in this annex are:

– Greece will enter the euro area on 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

– For the Czech republic, Hungary and Poland data are available from 1993 onwards. In tables showing percentage changes from the previous year, the Czech Republic, Hungary and Poland are included from 1994 onwards.

Real GDP

Percentage changes from previous period, seasonally adjusted at annual rates

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	2.6	3.8	5.0	4.4	3.7	3.8	5.6	4.7	4.2	3.7	3.7
Austria	1.3	0.5	2.4	1.7	2.0	1.2	2.9	2.1	3.6	2.9	2.6
Belgium	1.6	-1.5	3.0	2.6	1.2	3.4	2.4	2.7	3.8	3.1	2.9
Canada	0.9	2.3	4.7	2.8	1.5	4.4	3.3	4.5	4.8	3.4	3.0
Czech Republic	..	..	2.6	5.9	4.8	-1.0	-2.2	-0.2	2.5	3.3	3.2
Denmark	0.6	0.0	5.5	2.8	2.5	3.1	2.5	1.7	2.8	2.5	2.5
Finland	-3.3	-1.1	4.0	3.8	4.0	6.3	5.5	4.0	5.4	4.6	4.2
France	1.3	-0.9	1.8	1.8	1.1	1.9	3.2	2.9	3.3	2.9	2.5
Germany	2.2	-1.1	2.3	1.7	0.8	1.4	2.1	1.6	3.0	2.7	2.5
Greece	0.0	-1.6	2.0	2.1	2.4	3.5	3.1	3.4	4.0	4.6	4.4
Hungary	..	..	2.9	1.5	1.3	4.6	4.9	4.5	5.5	5.5	5.1
Iceland	-3.3	0.6	4.5	0.1	5.2	4.8	4.5	4.3	3.6	1.3	2.4
Ireland	3.3	2.7	5.8	9.7	7.7	10.7	8.6	9.8	11.0	7.9	7.0
Italy	0.8	-0.9	2.2	2.9	1.1	1.8	1.5	1.4	2.8	2.7	2.6
Japan	1.0	0.3	0.6	1.5	5.1	1.6	-2.5	0.2	1.9	2.3	2.0
Korea	5.4	5.5	8.3	8.9	6.8	5.0	-6.7	10.7	8.9	5.8	5.6
Luxembourg	4.5	8.7	4.2	3.8	2.9	7.3	5.0	7.5	8.1	6.2	5.5
Mexico	3.6	2.0	4.5	-6.2	5.1	6.8	4.8	3.7	7.0	5.0	4.8
Netherlands	2.0	0.8	3.2	2.3	3.0	3.8	4.1	3.9	4.5	3.9	3.4
New Zealand	0.6	4.9	6.1	3.4	2.6	2.9	-0.6	3.7	3.6	2.9	2.8
Norway	3.3	3.1	5.5	3.8	4.9	4.7	2.0	0.9	3.1	2.4	1.9
Poland	..	..	5.3	7.0	6.0	6.8	4.9	4.0	5.1	4.9	5.0
Portugal	2.5	-1.1	2.2	2.9	3.6	3.7	3.5	3.0	3.2	3.0	2.9
Spain	0.7	-1.2	2.3	2.7	2.4	3.9	4.3	4.0	4.1	3.5	3.1
Sweden	-1.6	-2.4	4.1	3.7	1.1	2.0	3.0	3.8	4.0	3.2	2.4
Switzerland	-0.1	-0.5	0.5	0.5	0.3	1.7	2.3	1.5	3.3	2.4	2.0
Turkey	6.0	8.0	-5.5	7.2	7.0	7.5	3.1	-5.0	7.0	4.9	4.4
United Kingdom	0.1	2.3	4.4	2.8	2.6	3.5	2.6	2.2	3.0	2.6	2.3
United States	3.1	2.7	4.0	2.7	3.6	4.4	4.4	4.2	5.2	3.5	3.3
Euro area[a]	1.4	-0.8	2.3	2.2	1.4	2.3	2.8	2.5	3.5	3.1	2.8
European Union	1.1	-0.4	2.7	2.4	1.7	2.5	2.7	2.4	3.4	3.0	2.7
Total OECD	2.1	1.4	3.1	2.5	3.2	3.5	2.5	3.0	4.3	3.3	3.1

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD

Real private consumption expenditure

Percentage changes from previous period, seasonally adjusted at annual rates

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	2.7	1.8	4.0	5.0	3.3	3.9	4.6	5.2	3.7	3.5	3.2
Austria	3.0	0.7	1.8	2.9	3.2	0.1	1.5	2.7	3.0	2.3	2.3
Belgium	2.2	-1.0	2.0	1.0	0.7	2.1	3.3	1.9	2.6	2.4	2.2
Canada	1.8	1.8	3.1	2.1	2.5	4.4	2.9	3.5	3.6	2.8	2.6
Czech Republic	..	..	5.3	5.9	6.9	1.9	-2.6	1.2	1.2	2.4	3.0
Denmark	1.9	0.5	6.5	1.2	2.5	3.7	3.5	0.6	0.5	1.4	1.7
Finland	-4.4	-3.1	2.6	4.4	4.2	3.5	4.9	3.6	3.3	2.5	2.4
France	0.7	-0.1	0.6	1.6	1.3	0.1	3.4	2.3	2.6	2.3	2.2
Germany	2.7	0.1	1.0	2.0	1.0	0.7	2.0	2.6	1.7	2.6	2.4
Greece	2.4	-0.8	2.0	2.7	2.4	2.8	3.1	2.9	2.9	3.0	3.2
Hungary	..	..	0.2	-7.1	-4.3	1.9	4.8	5.1	4.4	5.4	5.1
Iceland	-3.1	-4.7	2.9	2.2	5.4	5.5	10.0	6.9	4.0	2.0	2.5
Ireland	2.9	3.0	4.4	4.3	6.3	7.4	7.8	7.7	8.7	8.0	8.0
Italy	1.9	-3.7	1.5	1.7	1.2	3.0	2.3	1.7	2.0	1.8	2.3
Japan	2.1	1.2	1.9	2.1	2.9	0.5	-0.5	1.2	1.6	2.1	2.2
Korea	5.5	5.6	8.2	9.6	7.1	3.5	-11.4	10.3	7.0	5.0	5.0
Luxembourg	-0.9	1.7	2.4	2.4	4.4	3.8	2.3	4.1	3.5	5.5	5.0
Mexico	4.7	1.5	4.6	-9.5	2.2	6.5	5.4	4.3	8.0	5.5	4.8
Netherlands	2.5	1.0	2.2	1.8	4.0	3.0	4.4	4.4	4.1	4.3	3.5
New Zealand	-0.1	2.3	5.6	4.6	4.3	2.8	1.7	2.4	1.8	1.7	1.7
Norway	2.2	2.3	4.0	3.4	5.3	3.6	3.3	2.4	2.9	2.0	2.0
Poland	..	..	3.9	3.7	8.6	6.8	4.8	5.1	4.6	4.2	4.4
Portugal	4.3	1.5	2.2	1.6	4.0	2.9	5.4	4.8	3.3	2.9	2.8
Spain	2.2	-2.2	0.9	1.6	2.2	3.1	4.5	4.7	4.1	3.3	3.3
Sweden	-1.4	-3.1	1.8	0.6	1.4	1.7	2.4	4.1	5.0	4.8	3.0
Switzerland	0.1	-0.9	1.0	0.6	0.7	1.4	2.2	2.2	2.1	2.0	1.9
Turkey	3.2	8.6	-5.4	4.8	8.5	8.4	0.6	-3.1	6.0	3.2	3.5
United Kingdom	0.5	2.9	2.9	1.7	3.6	3.9	4.0	4.3	3.5	2.4	2.2
United States	2.9	3.4	3.8	3.0	3.2	3.6	4.7	5.3	5.4	3.6	3.0
Euro area[a]	1.9	-0.9	1.2	1.9	1.6	1.5	2.9	2.8	2.5	2.6	2.6
European Union	1.7	-0.3	1.6	1.8	2.0	2.0	3.2	3.0	2.7	2.6	2.5
Total OECD	2.4	1.7	2.7	2.3	2.9	2.8	2.8	3.8	3.9	3.1	2.8

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD

Real total gross fixed capital formation

Percentage changes from previous period, seasonally adjusted at annual rates

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	3.2	4.9	11.6	3.2	4.9	11.0	7.5	6.5	3.6	4.8	4.4
Austria	0.1	-2.0	8.4	1.2	2.1	0.8	6.8	2.9	3.6	3.5	3.4
Belgium	1.7	-3.1	-0.1	4.9	0.8	6.7	4.6	4.8	4.5	2.5	2.7
Canada	-1.3	-2.7	7.4	-1.9	5.8	15.4	3.4	10.1	11.8	6.4	6.1
Czech Republic	..	..	17.3	19.8	8.2	-2.9	-3.9	-5.5	5.0	6.5	5.5
Denmark	-2.0	-4.0	7.6	11.6	4.0	8.0	6.7	0.3	7.9	2.3	3.3
Finland	-16.7	-16.6	-2.7	10.6	8.4	11.9	9.4	4.6	5.4	6.0	5.1
France	-1.7	-6.5	1.5	2.1	-0.1	0.0	6.6	7.2	6.0	4.6	4.8
Germany	4.5	-4.5	4.0	-0.7	-0.8	0.6	3.0	3.3	2.4	2.8	2.7
Greece	-3.2	-3.5	-2.8	4.2	8.4	7.8	11.8	7.3	7.8	9.1	9.7
Hungary	..	..	12.5	-4.3	6.7	9.2	13.3	6.6	6.0	6.5	7.5
Iceland	-11.1	-10.7	0.6	-1.1	25.7	9.6	26.6	-0.8	11.1	0.5	1.7
Ireland	-1.8	-3.5	12.0	12.7	16.4	17.9	15.5	13.0	11.3	9.5	10.1
Italy	-1.4	-10.9	0.1	6.0	3.6	1.2	4.1	4.4	6.9	4.7	5.2
Japan	-1.5	-2.0	-0.8	1.7	11.1	-0.8	-7.4	-1.2	0.6	2.8	1.2
Korea	-0.7	6.3	10.7	11.9	7.3	-2.2	-21.2	4.1	12.0	4.0	3.0
Luxembourg	-9.0	28.4	-14.9	3.5	-3.5	10.5	1.5	26.6	0.1	3.2	4.0
Mexico	10.8	-2.5	8.4	-29.0	16.4	21.0	10.3	5.8	10.6	9.7	9.2
Netherlands	0.6	-2.8	2.2	5.0	6.3	6.6	4.1	6.5	6.6	4.1	4.3
New Zealand	1.4	14.8	16.7	12.2	7.0	3.8	-1.9	8.4	6.2	3.5	4.4
Norway	-3.1	3.8	4.5	3.4	9.9	13.9	5.8	-5.6	-2.2	-2.2	0.9
Poland	..	..	9.2	16.6	19.7	21.5	14.4	6.9	6.5	5.0	8.0
Portugal	4.8	-6.0	3.4	4.8	3.4	13.5	8.7	6.0	5.8	6.0	5.8
Spain	-4.4	-10.5	2.5	8.2	2.1	5.0	9.7	8.9	6.1	6.6	5.0
Sweden	-10.8	-17.2	6.1	9.4	5.0	-2.2	9.4	8.1	4.9	6.4	5.9
Switzerland	-6.6	-2.7	6.5	1.8	-2.4	1.5	4.5	1.8	6.2	4.6	4.5
Turkey	6.4	26.4	-16.0	9.1	14.1	14.8	-3.9	-16.0	16.2	7.0	5.3
United Kingdom	-0.7	0.8	3.6	2.9	4.9	7.5	10.1	6.1	2.4	3.8	3.0
United States	5.3	5.9	7.4	5.5	8.4	8.9	10.7	9.2	9.0	5.1	5.4
Euro area[a]	0.1	-6.6	2.5	2.6	1.3	2.3	5.3	5.4	5.0	4.4	4.3
European Union	-0.3	-5.8	2.6	3.5	2.3	3.2	6.3	5.5	4.7	4.3	4.2
Total OECD	2.0	0.4	4.6	3.4	6.9	6.0	5.1	5.5	6.5	4.7	4.5

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD

Real total domestic demand

Percentage changes from previous period, seasonally adjusted at annual rates

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	3.0	3.0	5.3	4.8	3.2	3.4	7.0	5.7	4.0	3.9	3.4
Austria	1.4	0.8	3.3	1.8	2.0	0.5	2.7	1.7	2.5	2.2	2.1
Belgium	1.8	-1.5	2.1	1.9	0.9	2.6	3.9	2.1	2.7	2.2	2.2
Canada	0.9	1.4	3.2	1.7	1.4	6.2	2.2	4.2	5.4	3.4	3.2
Czech Republic	..	..	6.4	8.4	7.9	-0.9	-3.0	-0.4	2.1	3.7	3.7
Denmark	0.9	-0.3	7.0	4.2	2.2	4.4	4.3	-0.4	2.3	1.6	1.9
Finland	-5.8	-5.7	3.7	4.4	2.9	6.0	5.7	2.8	3.1	2.7	2.6
France	0.6	-1.6	1.8	1.8	0.7	0.6	3.9	2.9	3.0	2.5	2.5
Germany	2.8	-1.1	2.3	1.7	0.3	0.6	2.4	2.4	1.9	2.1	2.1
Greece	-0.6	-0.9	1.1	3.9	3.3	3.6	4.7	2.9	3.7	4.0	4.4
Hungary	..	..	2.0	-3.0	0.6	4.0	7.8	4.3	4.1	4.9	5.0
Iceland	-4.6	-4.2	2.5	2.2	7.2	5.7	12.3	4.6	5.4	1.8	2.1
Ireland	-0.3	1.1	5.6	7.2	7.8	9.8	9.4	6.3	8.6	7.8	7.9
Italy	0.9	-5.1	1.7	2.0	0.9	2.5	2.9	2.5	2.2	2.2	2.7
Japan	0.4	0.1	1.0	2.3	5.7	0.2	-3.1	0.5	1.3	2.4	1.8
Korea	3.2	4.6	9.6	9.3	7.8	-0.8	-19.6	14.3	7.3	5.5	4.0
Luxembourg	-2.6	8.3	-2.8	2.6	2.7	5.6	2.3	11.5	2.5	4.5	4.4
Mexico	6.0	1.1	5.6	-14.0	5.6	9.6	6.0	3.4	8.6	5.9	5.5
Netherlands	1.5	-1.1	2.9	1.9	2.8	3.9	4.2	4.2	4.4	3.8	3.4
New Zealand	2.0	4.9	6.9	5.1	4.1	3.3	-0.2	5.8	1.7	2.1	2.2
Norway	1.7	3.5	3.8	4.3	4.2	6.4	5.4	-0.9	1.8	1.0	1.6
Poland	..	..	4.3	7.5	9.7	9.3	6.6	4.7	4.8	4.1	5.1
Portugal	4.3	-1.2	2.7	2.8	3.0	4.7	6.0	4.8	3.7	3.4	3.5
Spain	0.8	-3.5	1.3	2.9	1.9	3.4	5.6	5.5	4.2	3.7	3.4
Sweden	-2.0	-5.6	3.0	1.9	0.7	0.8	3.9	3.6	3.3	4.1	3.2
Switzerland	-2.7	-1.0	2.7	1.8	0.4	1.3	4.3	1.4	2.6	2.4	2.3
Turkey	5.6	14.2	-12.5	11.4	7.6	9.0	0.6	-4.0	8.3	4.1	3.8
United Kingdom	0.8	2.2	3.4	1.8	3.0	3.8	4.6	3.7	3.4	2.9	2.6
United States	3.1	3.2	4.4	2.5	3.7	4.7	5.5	5.2	5.8	3.6	3.4
Euro area[a]	1.3	-2.1	2.1	2.0	1.1	1.7	3.4	2.9	2.8	2.6	2.7
European Union	1.2	-1.6	2.4	2.1	1.4	2.2	3.7	3.1	2.9	2.7	2.7
Total OECD	2.1	1.2	3.1	2.3	3.4	3.3	2.8	3.8	4.2	3.2	3.0

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD

Contributions to changes in real GDP in OECD countries

As a per cent of real GDP in the previous period

	1999	2000	2001	2002
Australia				
Final domestic demand	5.6	4.2	3.9	3.6
Stockbuilding	0.3	-0.1	0.1	0.0
Net exports	-1.1	-0.1	0.1	0.0
GDP	4.7	4.2	3.7	3.7
Austria				
Final domestic demand	2.4	2.6	2.1	1.9
Stockbuilding	-0.7	-0.1	0.0	0.1
Net exports	0.7	1.1	0.7	0.5
GDP	2.1	3.6	2.9	2.6
Belgium				
Final domestic demand	2.8	2.5	2.1	2.0
Stockbuilding	-0.7	0.1	0.0	0.0
Net exports	0.7	1.2	1.0	0.9
GDP	2.7	3.8	3.1	2.9
Canada				
Final domestic demand	4.2	4.9	3.3	3.1
Stockbuilding	-0.2	0.4	0.0	0.0
Net exports	0.4	-0.4	0.1	-0.1
GDP	4.5	4.8	3.4	3.0
Czech Republic				
Final domestic demand	-1.1	2.4	3.9	3.9
Stockbuilding	0.8	-0.2	0.0	0.0
Net exports	0.1	0.3	-0.6	-0.8
GDP	-0.2	2.5	3.3	3.2
Denmark				
Final domestic demand	0.8	2.1	1.5	1.8
Stockbuilding	-1.2	0.1	0.0	0.0
Net exports	2.1	0.6	1.0	0.7
GDP	1.7	2.8	2.5	2.5
Finland				
Final domestic demand	3.1	2.8	2.5	2.3
Stockbuilding	-0.5	0.0	-0.1	0.0
Net exports	1.6	2.6	2.2	2.0
GDP	4.0	5.4	4.6	4.2
France				
Final domestic demand	3.2	2.9	2.5	2.5
Stockbuilding	-0.4	0.0	0.0	0.0
Net exports	0.1	0.4	0.4	0.0
GDP	2.9	3.3	2.9	2.5
Germany				
Final domestic demand	2.2	1.7	2.2	2.0
Stockbuilding	0.2	0.2	-0.2	0.0
Net exports	-0.8	1.1	0.7	0.5
GDP	1.6	3.0	2.7	2.5
Greece				
Final domestic demand	3.7	4.0	4.4	4.7
Stockbuilding	-0.5	0.0	0.0	0.0
Net exports	0.2	0.0	0.2	-0.3
GDP	3.4	4.0	4.6	4.4
Hungary				
Final domestic demand	4.6	3.9	4.7	4.9
Stockbuilding	-0.2	0.2	0.2	0.2
Net exports	0.1	1.3	0.5	0.1
GDP	4.5	5.5	5.5	5.1
Iceland				
Final domestic demand	5.0	5.9	1.9	2.2
Stockbuilding	-0.1	-0.1	0.1	0.1
Net exports	-0.6	-2.1	-0.6	0.1
GDP	4.3	3.6	1.3	2.4
Ireland				
Final domestic demand	7.5	7.4	6.6	6.7
Stockbuilding	-1.9	0.0	0.0	0.0
Net exports	4.5	2.7	1.4	0.4
GDP	9.8	11.0	7.9	7.0
Italy				
Final domestic demand	2.0	2.8	2.2	2.6
Stockbuilding	0.4	-0.6	0.0	0.0
Net exports	-1.0	0.6	0.5	-0.1
GDP	1.4	2.8	2.7	2.6
Japan				
Final domestic demand	0.5	1.1	2.1	1.7
Stockbuilding	0.1	0.1	0.2	0.0
Net exports	-0.3	0.7	0.0	0.3
GDP	0.2	1.9	2.3	2.0
Korea				
Final domestic demand	6.4	6.9	3.7	3.4
Stockbuilding	5.5	-0.6	1.0	0.0
Net exports	-0.8	2.6	1.1	2.3
GDP	10.7	8.9	5.8	5.6

Note : Totals may not add-up due to statistical discrepancy.

Source: OECD

Contributions to changes in real GDP in other OECD countries

As a per cent of real GDP in the previous period

	1999	2000	2001	2002		1999	2000	2001	2002
Luxembourg					**Sweden**				
Final domestic demand	9.4	2.3	3.6	3.6	Final domestic demand	3.8	3.0	3.8	3.0
Stockbuilding	0.1	-0.1	0.0	0.0	Stockbuilding	-0.5	0.1	-0.1	0.0
Net exports	-1.9	6.0	2.6	2.0	Net exports	0.5	1.3	-0.3	-0.4
GDP	7.5	8.1	6.2	5.5	GDP	3.8	4.0	3.2	2.4
Mexico					**Switzerland**				
Final domestic demand	4.2	7.9	5.9	5.6	Final domestic demand	1.7	2.8	2.4	2.3
Stockbuilding	-0.8	0.7	0.2	0.0	Stockbuilding	-0.2	-0.2	0.0	0.0
Net exports	0.3	-1.7	-1.0	-0.8	Net exports	0.1	0.7	-0.1	-0.4
GDP	3.7	7.0	5.0	4.8	GDP	1.5	3.3	2.4	2.0
Netherlands					**Turkey**				
Final domestic demand	4.1	4.3	3.6	3.3	Final domestic demand	-6.2	8.7	4.3	4.0
Stockbuilding	-0.2	-0.1	0.0	0.0	Stockbuilding	2.1	0.0	0.0	0.0
Net exports	-0.1	0.3	0.3	0.2	Net exports	-0.9	-1.7	0.6	0.3
GDP	3.9	4.5	3.9	3.4	GDP	-5.0	7.0	4.9	4.4
New Zealand					**United Kingdom**				
Final domestic demand	4.8	1.8	2.2	2.3	Final domestic demand	4.6	3.2	3.2	2.7
Stockbuilding	1.1	-0.1	0.0	0.0	Stockbuilding	-0.7	0.4	-0.1	0.0
Net exports	-2.2	1.8	0.7	0.5	Net exports	-1.6	-0.6	-0.5	-0.3
GDP	3.7	3.6	2.9	2.8	GDP	2.2	3.0	2.6	2.3
Norway					**United States**				
Final domestic demand	0.4	1.5	1.0	1.5	Final domestic demand	5.7	5.8	3.8	3.5
Stockbuilding	-1.2	0.2	-0.1	0.0	Stockbuilding	-0.4	0.2	-0.1	-0.1
Net exports	1.8	1.5	1.1	0.2	Net exports	-1.2	-0.9	-0.3	-0.3
GDP	0.9	3.1	2.4	1.9	GDP	4.2	5.2	3.5	3.3
Poland					**Euro area**[a]				
Final domestic demand	5.1	5.0	4.3	5.2	Final domestic demand	2.9	2.8	2.6	2.6
Stockbuilding	-0.2	0.1	0.1	0.1	Stockbuilding	-0.1	0.0	0.0	0.0
Net exports	-1.2	0.2	0.8	-0.1	Net exports	-0.4	0.7	0.5	0.2
GDP	4.0	5.1	4.9	5.0	GDP	2.5	3.5	3.1	2.8
Portugal					**European Union**				
Final domestic demand	5.2	4.2	3.9	3.9	Final domestic demand	3.2	2.9	2.7	2.6
Stockbuilding	0.0	-0.1	-0.1	0.0	Stockbuilding	-0.2	0.0	-0.1	0.0
Net exports	-2.2	-0.9	-0.7	-1.1	Net exports	-0.6	0.5	0.3	0.1
GDP	3.0	3.2	3.0	2.9	GDP	2.4	3.4	3.0	2.7
Spain					**Total OECD**				
Final domestic demand	5.4	4.1	3.9	3.5	Final domestic demand	3.7	4.1	3.2	3.0
Stockbuilding	0.2	0.2	-0.1	0.0	Stockbuilding	0.0	0.2	0.0	0.0
Net exports	-1.5	-0.2	-0.3	-0.3	Net exports	-0.7	0.0	0.0	0.0
GDP	4.0	4.1	3.5	3.1	GDP	3.0	4.3	3.3	3.1

Note: Totals may not add-up due to statistical discrepancy.

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD

GDP deflators

Percentage changes from previous period, seasonally adjusted at annual rates

	Average 1982-91	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	6.3	1.3	1.6	0.8	1.5	2.2	1.6	0.1	1.0	3.4	2.8	2.6
Austria	3.1	4.3	2.8	2.8	2.3	1.3	1.6	0.6	0.9	0.5	1.5	1.8
Belgium	3.6	3.6	3.7	1.8	1.8	1.2	1.3	1.6	1.0	1.7	2.0	1.9
Canada	3.7	1.3	1.5	1.1	2.3	1.7	1.0	-0.6	1.6	3.3	2.4	2.0
Czech Republic	..	..	..	11.0	10.2	8.6	7.2	10.2	2.4	1.9	3.4	4.3
Denmark	4.6	2.9	1.4	1.7	1.8	2.5	1.6	2.1	2.7	2.8	2.7	2.6
Finland	5.8	0.9	2.3	2.0	4.1	-0.2	2.1	3.1	0.7	1.3	2.1	2.1
France	4.7	2.0	2.4	1.8	1.7	1.4	1.2	0.8	0.3	0.9	1.7	2.3
Germany	2.6	5.0	3.7	2.5	2.0	1.0	0.8	1.1	0.9	0.0	1.0	1.4
Greece	17.7	14.9	14.4	11.2	9.8	7.4	6.8	5.2	2.9	3.0	2.4	2.6
Hungary	..	..	..	19.5	25.6	21.2	18.5	12.6	9.0	7.9	6.6	5.7
Iceland	26.1	3.7	2.3	1.9	2.7	1.9	3.5	5.3	3.8	4.2	4.8	5.2
Ireland	4.5	2.8	5.2	1.7	3.0	2.3	4.4	5.8	3.8	4.8	4.6	3.8
Italy	8.7	4.5	3.9	3.5	5.0	5.3	2.4	2.7	1.5	1.8	2.2	2.0
Japan	1.8	1.7	0.6	0.2	-0.6	-1.4	0.3	0.3	-0.9	-1.5	-0.4	-0.2
Korea	6.5	7.7	7.0	7.6	7.1	3.9	3.1	5.1	-1.6	-0.9	2.0	1.5
Luxembourg	3.3	2.6	0.6	4.8	0.3	1.7	3.3	1.5	2.3	2.6	2.8	2.1
Mexico	62.6	14.4	9.5	8.5	38.0	30.6	17.7	15.5	15.9	10.1	7.7	5.8
Netherlands	1.3	2.3	1.9	2.3	1.8	1.2	2.0	2.0	1.6	3.0	3.9	2.6
New Zealand	8.1	1.7	2.7	1.5	2.7	1.8	0.0	1.7	0.1	2.2	2.9	2.0
Norway	4.6	-0.4	1.8	-0.2	3.1	4.3	3.0	-0.8	6.6	16.1	7.5	1.0
Poland	..	..	..	37.2	28.0	18.7	14.0	11.8	7.1	10.0	9.2	9.5
Portugal	16.6	10.0	6.7	6.3	5.1	3.3	3.0	4.0	2.7	2.3	3.0	3.1
Spain	8.3	6.9	4.3	4.0	4.8	3.5	2.2	2.3	2.9	2.9	2.9	2.9
Sweden	7.4	1.3	2.7	2.4	3.5	1.4	1.2	1.3	0.5	0.7	1.9	2.7
Switzerland	3.4	2.7	2.7	1.6	1.1	0.4	-0.2	0.2	0.6	1.0	1.6	1.8
Turkey	50.2	63.7	67.8	106.5	87.2	77.8	81.5	75.7	56.0	50.1	22.4	15.8
United Kingdom	5.7	4.0	2.7	1.5	2.5	3.3	2.9	3.0	2.5	2.0	2.5	2.6
United States	3.4	2.4	2.4	2.1	2.2	1.9	1.9	1.3	1.5	2.1	2.2	2.3
Euro area[a]	5.2	4.4	3.6	2.8	2.9	2.1	1.6	1.7	1.2	1.2	1.9	2.0
European Union	5.7	4.3	3.5	2.7	3.0	2.5	1.9	2.0	1.5	1.4	2.0	2.2
Total OECD	6.9	4.5	4.0	4.6	5.2	4.2	3.7	3.3	2.5	2.6	2.4	2.3
Memorandum items												
Total OECD *less* high inflation countries[b]	4.1	3.0	2.6	2.1	2.2	1.7	1.7	1.4	1.0	1.3	1.8	1.9

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

b) High inflation countries are defined as countries which have had, on average, 10 per cent or more inflation in terms of the GDP deflator during the 1990s on the basis of historical data. Consequently, Greece, Hungary, Mexico, Poland and Turkey are excluded from the aggregate.

Source: OECD

Private consumption deflators

Percentage changes from previous period, seasonally adjusted at annual rates

	Average 1982-91	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	6.9	2.3	2.4	1.0	2.0	2.0	1.6	1.0	0.6	4.0	3.4	2.8
Austria	2.8	3.9	3.3	3.3	1.5	2.3	1.8	0.7	0.7	2.1	1.9	1.8
Belgium	3.3	1.9	2.7	2.5	1.7	2.2	1.6	1.0	1.2	2.6	1.9	1.6
Canada	4.4	1.5	2.3	0.9	1.2	1.7	1.8	1.0	1.3	1.7	2.3	2.1
Czech Republic	..	..	..	10.7	9.2	8.1	7.7	9.6	2.0	4.0	4.2	4.2
Denmark	4.4	1.9	2.0	3.0	1.9	2.1	2.0	1.8	2.6	2.9	2.7	2.6
Finland	5.3	4.1	3.9	0.9	0.4	1.4	1.3	1.9	1.7	3.2	2.6	2.2
France	4.8	2.5	2.5	2.2	2.0	1.9	1.4	0.7	0.7	1.5	2.1	2.0
Germany	2.0	4.4	3.9	2.6	1.9	1.7	2.0	1.1	0.3	1.5	1.6	1.6
Greece	17.7	15.7	14.2	11.0	8.9	8.2	5.5	4.5	2.4	2.9	2.7	2.5
Hungary	..	..	..	19.4	27.7	23.4	18.0	13.3	10.5	9.6	7.8	5.8
Iceland	26.9	3.6	3.6	1.4	1.9	2.4	1.9	1.0	3.3	5.0	5.9	4.9
Ireland	4.6	3.0	2.2	2.8	2.8	2.6	2.6	3.8	3.3	6.5	4.8	3.8
Italy	8.1	5.5	5.5	4.9	6.0	4.4	2.2	2.1	2.2	2.7	2.5	2.0
Japan	1.7	1.9	1.2	0.7	-0.5	0.1	1.7	0.2	-0.5	-0.5	0.0	-0.1
Korea	5.3	8.9	8.0	9.7	7.0	5.7	5.5	7.8	0.4	2.5	3.5	2.8
Luxembourg	2.7	2.6	2.5	3.6	1.1	1.7	1.7	1.7	1.4	3.1	2.3	2.1
Mexico	64.7	15.4	10.1	7.6	34.1	30.4	16.5	20.5	16.4	9.3	7.2	5.5
Netherlands	1.6	3.1	2.1	2.8	1.6	1.9	2.0	1.8	1.9	3.0	4.1	2.5
New Zealand	8.8	1.4	1.8	1.7	2.5	2.0	1.0	2.0	1.2	1.8	2.9	2.0
Norway	6.1	2.7	1.9	1.2	2.4	1.5	2.5	2.7	2.2	3.0	2.8	2.6
Poland	..	..	..	37.9	27.2	20.0	14.8	11.5	7.2	10.2	8.4	7.2
Portugal	16.2	9.7	6.6	5.6	4.5	3.0	2.1	2.6	2.3	2.7	3.0	2.9
Spain	7.9	6.4	5.6	4.9	4.7	3.5	2.4	2.0	2.4	3.4	3.2	2.9
Sweden	7.7	2.2	5.7	2.8	2.9	1.4	2.2	1.0	0.7	1.0	1.8	2.3
Switzerland	3.1	4.2	3.4	1.1	1.7	1.1	0.6	-0.3	0.3	1.7	1.8	1.7
Turkey	51.1	65.6	65.9	108.9	92.4	67.8	82.1	83.0	60.7	54.3	22.5	11.8
United Kingdom	5.6	4.7	3.5	2.2	2.9	3.2	2.5	2.4	2.0	1.4	2.4	2.3
United States	3.8	3.1	2.4	2.0	2.3	2.1	1.9	1.1	1.8	2.5	2.1	2.2
Euro area[a]	5.0	4.6	4.2	3.4	3.0	2.5	2.0	1.4	1.2	2.2	2.3	2.0
European Union	5.4	4.5	4.1	3.3	3.1	2.7	2.1	1.6	1.4	2.1	2.3	2.1
Total OECD	7.0	5.0	4.3	5.0	5.2	4.4	4.1	3.5	2.8	3.1	2.6	2.2
Memorandum items												
Total OECD *less* high inflation countries[b]	4.2	3.5	2.9	2.5	2.3	2.1	2.1	1.4	1.2	1.9	2.0	1.9

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

b) High inflation countries are defined as countries which have had, on average, 10 per cent or more inflation in terms of the GDP deflator during the 1990s on the basis of historical data. Consequently, Greece, Hungary, Mexico, Poland and Turkey are excluded from the aggregate.

Source: OECD

Output gaps[a]

Deviations of actual GDP from potential GDP as a percentage of potential GDP

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	-4.6	-3.6	-1.6	-0.8	-0.4	-0.4	0.8	1.2	1.4	1.1	0.8
Austria	2.0	-0.7	-0.6	-0.8	-0.7	-1.1	-0.5	-0.8	0.3	0.6	0.8
Belgium	1.4	-2.5	-2.4	-2.2	-3.4	-2.2	-2.1	-1.7	-0.6	-0.2	0.1
Canada	-5.0	-5.0	-2.5	-2.0	-2.9	-1.8	-1.6	-0.3	0.9	0.9	0.7
Denmark	-4.1	-5.5	-2.5	-2.1	-1.5	-0.5	0.1	-0.1	0.3	0.4	0.5
Finland	-9.0	-11.3	-9.3	-7.7	-6.4	-3.8	-2.3	-1.8	0.1	1.0	1.5
France	0.0	-2.4	-2.2	-2.3	-3.1	-3.2	-2.1	-1.2	0.3	1.0	1.3
Germany	1.2	-1.9	-1.3	-1.1	-1.9	-2.1	-1.7	-1.8	-0.7	0.1	0.6
Greece	0.4	-2.4	-2.7	-2.7	-2.4	-1.3	-2.2	-1.7	-0.8	0.3	0.9
Ireland	-2.5	-5.2	-5.5	-3.2	-3.0	-0.4	1.5	2.9	5.5	5.3	4.1
Italy	-0.4	-2.8	-2.2	-0.7	-1.3	-1.5	-1.8	-2.3	-1.6	-1.2	-0.8
Japan	1.1	-0.7	-1.8	-2.3	0.9	1.0	-2.9	-3.8	-3.2	-2.2	-1.7
Netherlands	0.5	-1.1	-0.4	-0.8	-0.7	-0.4	0.2	0.7	1.6	2.0	2.0
New Zealand	-5.4	-2.3	0.7	1.2	1.2	0.5	-2.0	-0.9	0.0	0.2	0.1
Norway[b]	-3.2	-2.6	-1.0	-0.8	0.1	1.1	1.9	0.8	1.0	0.8	0.8
Portugal	2.5	-1.3	-1.8	-1.7	-1.0	-0.3	0.1	0.0	0.1	0.0	-0.2
Spain	-0.7	-4.5	-4.9	-5.4	-6.3	-5.1	-3.2	-1.3	-0.4	0.2	0.6
Sweden	-2.2	-5.3	-3.0	-1.3	-2.0	-2.1	-1.5	-0.3	1.0	1.8	1.8
Switzerland	-0.1	-1.8	-2.3	-2.4	-3.2	-2.5	-1.8	-2.0	-0.6	-0.1	0.1
United Kingdom	-4.0	-3.7	-1.8	-1.4	-1.0	0.2	0.4	0.3	0.8	0.9	0.8
United States	-1.8	-1.6	-0.2	-0.2	0.2	0.7	1.2	1.3	2.5	1.7	1.1
Euro area[c]	0.2	-2.6	-2.2	-1.9	-2.5	-2.4	-1.8	-1.4	-0.3	0.3	0.6
European Union	-0.5	-2.9	-2.2	-1.8	-2.2	-1.9	-1.4	-1.2	-0.2	0.4	0.6
Total OECD	-1.0	-2.1	-1.3	-1.2	-0.8	-0.4	-0.6	-0.5	0.5	0.5	0.5

a) For further details, see Giorno *et al* ., "Potential output, output gaps and structural budget balances", *OECD Economic Studies* , No. 24, 1995/I.
b) Mainland Norway.
c) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.
Source: OECD

Unemployment rates in the OECD area

	1997 Unemployment (thousands)	1992	1993	1994	1995	1996	1997	1998	1999	stimates and projections 2000	2001	2002
Australia	793	10.7	10.9	9.7	8.5	8.5	8.6	8.0	7.2	6.6	6.3	6.1
Austria	234	4.7	5.4	5.2	5.2	5.6	5.6	5.7	5.2	4.6	4.2	4.0
Belgium	396	7.2	8.8	10.0	9.9	9.7	9.4	9.5	9.0	8.2	7.9	7.6
Canada	1 377	11.2	11.4	10.3	9.4	9.6	9.1	8.3	7.6	6.7	6.7	6.7
Czech Republic	248	..	4.3	4.4	4.1	3.9	4.8	6.5	8.8	9.0	9.1	9.0
Denmark	159	9.2	10.2	8.2	7.3	6.8	5.6	5.2	5.2	5.2	5.1	5.1
Finland	314	11.8	16.4	16.7	15.5	14.6	12.7	11.4	10.2	9.6	8.8	8.4
France	3 209	10.4	11.7	12.2	11.6	12.3	12.4	11.8	11.1	9.7	8.8	8.2
Germany	3 888	6.3	7.6	8.2	7.9	8.6	9.5	8.9	8.3	7.7	6.9	6.3
Greece	409	8.7	9.7	9.6	10.0	9.8	9.7	11.2	12.0	11.4	10.7	10.0
Hungary	349	..	12.1	11.0	10.4	10.1	8.9	8.0	7.1	6.7	6.4	6.2
Iceland	5	3.0	4.4	4.8	5.0	4.3	3.9	2.8	1.9	1.3	1.8	2.6
Ireland	159	15.1	15.7	14.7	12.2	11.7	10.4	7.6	5.6	4.2	3.6	3.6
Italy	2 688	8.8	10.2	11.2	11.7	11.7	11.8	11.9	11.5	10.8	10.1	9.4
Japan	2 304	2.2	2.5	2.9	3.1	3.4	3.4	4.1	4.7	4.7	4.6	4.6
Korea	556	2.4	2.8	2.4	2.0	2.0	2.6	6.8	6.3	4.0	3.7	3.5
Luxembourg	6	1.6	2.1	2.7	3.0	3.3	3.6	3.1	2.9	2.7	2.5	2.3
Mexico	690	2.9	3.5	3.7	6.4	5.7	3.7	3.2	2.6	2.4	2.6	2.8
Netherlands	375	5.4	6.6	7.6	7.1	6.6	5.5	4.2	3.2	2.8	2.5	2.3
New Zealand	124	10.3	9.5	8.1	6.3	6.1	6.6	7.5	6.8	6.1	6.0	6.0
Norway	92	5.9	6.0	5.4	4.9	4.8	4.0	3.2	3.2	3.3	3.3	3.4
Poland	1 923	..	14.0	14.4	13.3	12.3	11.2	10.6	13.9	15.1	15.0	15.0
Portugal	313	4.1	5.5	6.9	7.2	7.3	6.8	5.1	4.5	4.1	4.1	4.2
Spain	3 356	17.9	22.2	23.7	22.7	22.2	20.8	18.8	15.9	14.1	12.9	12.2
Sweden	342	5.3	8.2	8.0	7.7	8.0	8.0	6.5	5.6	4.7	4.1	3.7
Switzerland	188	2.5	4.5	4.7	4.2	4.7	5.2	3.9	2.7	2.0	1.8	1.8
Turkey	1 440	8.1	7.8	8.1	6.9	6.0	6.4	6.3	7.3	7.1	7.0	6.8
United Kingdom	1 873	10.2	10.3	9.4	8.5	7.9	6.5	5.9	6.0	5.5	5.4	5.5
United States	6 725	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.2	4.0	4.2	4.5
Euro area[a]	15 348	9.0	10.7	11.5	11.2	11.5	11.5	10.8	9.9	9.0	8.3	7.7
European Union	17 722	9.1	10.6	11.0	10.6	10.7	10.4	9.8	9.1	8.2	7.6	7.2
Total OECD	34 536	7.1	7.8	7.7	7.4	7.3	7.0	6.8	6.7	6.2	6.0	5.9

a) Greece w ill enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout

Source: OECD

Short-term interest rates

	1998	1999	2000	2001	2002	2000 I	2000 II	2001 I	2001 II	2002 I	2002 II
Australia	5.0	5.0	6.2	6.7	6.7	6.0	6.4	6.7	6.7	6.7	6.7
Austria	3.6	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Belgium	3.6	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Canada	5.0	4.9	5.7	6.2	6.2	5.6	5.8	6.0	6.3	6.3	6.1
Czech Republic	14.3	6.9	5.4	7.3	8.0	5.2	5.6	6.9	7.6	7.9	8.1
Denmark	4.1	3.3	5.0	5.9	5.9	4.4	5.5	5.8	5.9	5.9	5.9
Finland	3.6	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
France	3.6	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Germany	3.5	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Greece	11.6	8.9	6.0	5.4	5.5	6.3	5.7	5.3	5.5	5.5	5.5
Hungary	18.0	14.7	10.8	11.6	10.5	11.0	10.5	11.3	11.8	11.0	10.0
Iceland	7.4	8.6	11.1	11.9	11.4	10.6	11.6	11.9	11.9	11.6	11.2
Ireland	5.4	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Italy	5.0	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Japan	0.7	0.2	0.2	0.6	0.9	0.1	0.3	0.5	0.8	0.9	0.9
Korea	15.2	6.8	7.2	7.4	7.8	7.1	7.3	7.3	7.5	7.8	7.8
Mexico	26.1	22.4	16.0	14.2	12.0	15.8	16.2	15.0	13.4	12.4	11.6
Netherlands	3.5	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
New Zealand	7.3	4.8	6.5	6.9	7.0	6.5	6.5	6.8	7.0	7.0	7.0
Norway	5.8	6.5	6.7	7.4	7.2	6.6	6.8	7.3	7.5	7.3	7.1
Poland	19.1	13.1	16.5	14.7	13.1	17.0	16.0	15.0	14.4	13.2	13.0
Portugal	4.3	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Spain	4.2	3.0	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5
Sweden	4.2	3.1	3.8	5.0	5.3	3.9	3.6	4.8	5.2	5.3	5.2
Switzerland	1.5	1.4	3.2	4.1	4.2	2.9	3.6	4.0	4.2	4.2	4.2
Turkey	115.7	89.2	37.5	25.0	23.9	40.5	34.5	26.5	23.5	24.8	23.0
United Kingdom	7.3	5.4	6.3	6.6	6.3	6.2	6.4	6.6	6.5	6.4	6.2
United States	5.5	5.4	6.5	7.0	7.0	6.3	6.7	6.9	7.1	7.1	6.9
Euro area[a]	4.0	3.1	4.4	5.4	5.5	3.9	4.9	5.3	5.5	5.5	5.5

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.
Source: OECD

Long-term interest rates

	1998	1999	2000	2001	2002	2000 I	2000 II	2001 I	2001 II	2002 I	2002 II
Australia	5.5	6.1	6.4	6.7	6.8	6.4	6.5	6.7	6.8	6.8	6.8
Austria	4.7	4.7	5.7	6.0	6.0	5.6	5.7	5.9	6.0	6.0	6.0
Belgium	4.7	4.7	5.7	5.9	6.0	5.5	5.9	5.9	6.0	6.0	6.0
Canada	5.5	5.7	5.9	6.2	6.3	6.1	5.8	6.1	6.3	6.3	6.3
Denmark	4.9	5.0	5.9	6.3	6.3	5.7	6.1	6.2	6.3	6.3	6.3
Finland	4.8	4.7	5.7	6.0	6.0	5.6	5.8	5.9	6.0	6.0	6.0
France	4.7	4.6	5.5	5.8	5.8	5.5	5.5	5.7	5.8	5.8	5.8
Germany	4.6	4.5	5.4	5.7	5.7	5.4	5.4	5.6	5.7	5.7	5.7
Iceland	7.7	8.5	11.0	11.6	11.3	10.6	11.5	11.7	11.5	11.4	11.2
Ireland	4.7	4.8	5.6	5.9	6.0	5.6	5.6	5.9	5.9	5.9	6.0
Italy	4.9	4.7	5.7	5.9	5.9	5.6	5.7	5.8	5.9	5.9	5.9
Japan	1.5	1.7	1.8	2.1	2.3	1.7	1.9	2.1	2.2	2.3	2.4
Korea	12.8	8.7	9.2	9.1	9.0	9.2	9.2	9.3	9.0	9.0	9.0
Mexico	24.8	24.1	16.9	15.0	12.8	17.3	16.5	15.8	14.2	13.2	12.4
Netherlands	4.6	4.6	5.5	5.8	5.9	5.5	5.6	5.8	5.9	5.9	5.9
New Zealand	6.3	6.4	7.0	7.4	7.5	7.1	6.9	7.3	7.5	7.5	7.5
Norway	5.4	5.5	6.4	6.7	6.8	6.2	6.6	6.7	6.7	6.7	6.8
Portugal	4.9	4.8	5.8	6.0	6.1	5.7	5.8	6.0	6.1	6.1	6.1
Spain	4.8	4.7	5.6	5.9	5.9	5.5	5.6	5.8	5.9	5.9	5.9
Sweden	5.0	5.0	5.5	5.7	5.8	5.5	5.4	5.6	5.8	5.8	5.8
Switzerland	2.8	3.0	4.1	4.4	4.4	4.1	4.1	4.3	4.4	4.4	4.4
Turkey	113.6	97.4	35.1	27.6	26.8	36.4	33.7	28.7	26.4	27.8	25.7
United Kingdom	5.5	5.1	5.5	5.7	5.7	5.5	5.5	5.7	5.7	5.7	5.7
United States	5.3	5.6	6.1	6.4	6.5	6.3	5.9	6.3	6.5	6.5	6.5
Euro area[a]	4.8	4.7	5.5	5.8	5.8	5.5	5.6	5.7	5.8	5.8	5.8

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.
Source: OECD

General government financial balances

Surplus (+) or deficit (-) as a percentage of nominal GDP

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	-6.0	-5.5	-4.6	-3.7	-2.1	-0.5	0.6	1.9	0.9	0.7	1.0
Austria	-2.0	-4.2	-5.0	-5.1	-3.8	-1.7	-2.3	-2.1	-1.6	-0.7	0.0
Belgium	-8.0	-7.3	-5.0	-4.3	-3.8	-1.9	-0.9	-0.7	-0.1	0.3	0.7
Canada	-9.2	-8.7	-6.7	-5.4	-2.8	0.2	0.2	2.2	2.5	2.1	1.9
Czech Republic	..	4.6	3.6	1.3	0.6	-2.0	-2.3	-4.9	-7.7	-6.5	-7.5
Denmark	-2.2	-2.9	-2.4	-2.3	-1.0	0.5	1.2	2.8	2.7	2.9	3.1
Finland	-5.6	-7.3	-5.7	-3.7	-3.2	-1.5	1.3	1.9	4.0	4.8	5.3
France	-4.2	-6.0	-5.5	-5.6	-4.1	-3.0	-2.7	-1.8	-1.4	-0.1	-0.8
Germany[a]	-2.5	-3.1	-2.4	-3.3	-3.4	-2.7	-2.1	-1.4	1.4	-1.7	-1.2
Greece	-12.8	-13.8	-10.0	-10.2	-7.4	-4.0	-2.5	-1.8	-1.0	-0.4	0.3
Hungary	..	-6.6	-11.0	-7.6	-5.7	-7.0	-6.1	-5.3	-4.3	-3.4	-2.5
Iceland	-2.8	-4.5	-4.7	-3.0	-1.6	0.0	0.5	2.0	2.8	2.4	2.5
Ireland	-3.0	-2.7	-2.0	-2.2	-0.1	0.7	2.2	2.7	5.6	6.5	7.3
Italy	-9.5	-9.4	-9.1	-7.6	-7.1	-2.7	-2.8	-1.9	-0.1	-1.0	-0.8
Japan[b]	1.5	-1.6	-2.3	-3.6	-4.2	-3.3	-5.0	-7.0	-6.0	-6.0	-5.7
Korea	1.4	2.5	3.1	4.2	3.8	3.6	1.9	3.3	4.0	4.7	5.0
Netherlands	-4.4	-3.6	-4.2	-4.2	-1.8	-1.1	-0.7	1.0	1.6	1.0	1.3
New Zealand	-3.3	-0.6	3.0	3.1	3.0	2.0	1.4	0.3	0.5	1.0	1.2
Norway	-1.7	-1.4	0.4	3.5	6.6	7.9	3.6	4.9	14.0	14.8	14.4
Poland	..	-4.5	-3.1	-2.5	-2.8	-2.7	-2.3	-3.2	-2.8	-1.5	-2.3
Portugal	..	..	..	-4.6	-4.0	-2.6	-2.3	-2.0	-1.5	-1.4	-1.3
Spain	-4.0	-6.7	-6.1	-6.6	-4.9	-3.2	-2.6	-1.1	-0.3	0.2	0.4
Sweden	-7.4	-11.9	-10.8	-7.9	-3.4	-2.0	1.9	1.9	3.4	3.3	3.8
United Kingdom	-6.5	-8.0	-6.8	-5.8	-4.4	-2.0	0.4	1.3	2.7	2.2	1.8
United States	-5.9	-5.0	-3.6	-3.1	-2.2	-0.9	0.3	1.0	2.3	2.6	2.7
Euro area[c]	-4.8	-5.6	-5.0	-5.0	-4.3	-2.6	-2.2	-1.3	0.3	-0.5	-0.3
European Union	-5.3	-6.3	-5.6	-5.4	-4.3	-2.5	-1.6	-0.8	0.7	0.0	0.1
Total OECD	-4.4	-4.8	-4.0	-3.8	-3.1	-1.7	-1.2	-0.8	0.5	0.4	0.5

Note: Fiscal policy assumptions are based on announced measures and stated policy intentions, w here they are embodied in w ell defined programmes. Detailed assumptions for individual countries are provided in the country notes. Further details can also be found in "Sources and Methods" *(http://www.oecd.org/eco/out/source.htm).*

a) Includes balances of the German Railw ays Fund from 1994 onw ards and the Inherited Debt Fund from 1995 onw ards.

b) The 1998 outlays w ould have risen by 5.4 percentage points of GDP if account w ere taken of the assumption by the central government of the debt of the Japan Railw ay Settlement Corporation and the National Forest Special Account.

c) Greece w ill enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout

Source: OECD

General government structural balances

Surplus (+) or deficit (-) as a percentage of potential GDP

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	-4.6	-4.5	-4.1	-3.5	-2.0	-0.4	0.3	1.6	0.6	0.5	0.8
Austria	-2.5	-4.0	-4.8	-4.9	-3.6	-1.4	-2.1	-1.9	-1.7	-0.9	-0.2
Belgium	-8.9	-5.7	-3.5	-2.9	-1.6	-0.5	0.3	0.4	0.3	0.4	0.7
Canada	-6.6	-6.2	-5.6	-4.4	-1.6	1.0	0.9	2.3	2.1	1.7	1.6
Denmark	0.9	1.5	-0.4	-0.6	0.2	0.9	1.2	2.9	2.5	2.6	2.8
Finland	1.2	1.4	1.6	1.8	1.5	1.1	2.7	3.0	3.9	4.2	4.4
France	-4.2	-5.0	-4.6	-4.6	-2.8	-1.7	-1.8	-1.3	-1.6	-1.6	-1.4
Germany	-3.1	-2.2	-1.8	-2.7	-2.4	-1.6	-1.2	-0.5	-0.7	-1.7	-1.5
Greece	-13.0	-12.6	-8.8	-8.9	-6.4	-3.5	-1.5	-1.0	-0.6	-0.5	-0.1
Ireland	-2.0	-0.8	0.1	-1.0	0.9	0.8	1.8	1.9	4.1	5.2	6.3
Italy	-9.3	-7.9	-8.0	-7.2	-6.5	-2.0	-2.0	-0.8	-0.6	-0.5	-0.4
Japan	1.2	-1.5	-1.9	-3.1	-4.4	-3.6	-4.2	-6.0	-5.2	-5.4	-5.3
Netherlands	-4.8	-2.7	-3.9	-3.6	-1.4	-0.9	-0.8	0.5	-0.1	-0.2	0.1
New Zealand	-0.2	0.6	2.6	2.5	2.4	1.7	2.5	0.7	0.5	0.9	1.1
Norway[a]	-6.0	-6.3	-5.2	-1.9	-1.7	-0.9	-2.1	-1.9	-1.4	-1.2	-1.4
Portugal	..	..	..	-3.9	-3.6	-2.5	-2.3	-2.0	-2.0	-1.4	-1.3
Spain	-3.7	-4.7	-3.9	-4.3	-2.3	-1.1	-1.2	-0.6	-0.1	0.1	0.2
Sweden	-5.8	-7.7	-8.5	-6.9	-1.9	-0.5	2.9	2.1	2.7	2.1	2.7
United Kingdom	-4.2	-5.9	-5.8	-5.0	-3.8	-2.1	0.2	1.1	2.4	1.8	1.5
United States	-5.3	-4.5	-3.6	-3.0	-2.3	-1.1	0.0	0.7	1.7	2.2	2.5
Euro area[b]	-4.9	-4.3	-3.9	-4.1	-3.0	-1.4	-1.3	-0.6	-0.6	-0.8	-0.6
European Union	-4.9	-4.7	-4.5	-4.5	-3.2	-1.6	-1.0	-0.2	-0.1	-0.3	-0.2
Total OECD	-4.2	-4.2	-3.7	-3.6	-2.9	-1.6	-1.0	-0.6	0.0	0.0	0.2

Note: Fiscal policy assumptions are based on announced measures and stated policy intentions, where they are embodied in well defined programmes. Detailed assumptions for individual countries are provided in the country notes. Further details can be found in "Sources and Methods" *(http://www.oecd.org/eco/out/source.htm).*

a) As a percentage of mainland potential GDP. The financial balances shown exclude revenues from oil production.

b) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD

Balance on current account

Percentage of GDP

	1992	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	-3.7	-3.3	-5.1	-5.4	-3.9	-3.1	-5.0	-5.8	-4.8	-4.4	-4.0
Austria	-0.4	-0.8	-1.6	-2.6	-2.3	-3.1	-2.5	-2.8	-3.0	-2.5	-2.0
Belgium	2.5	4.1	4.2	4.1	4.2	4.8	4.1	3.9	4.2	5.1	6.0
Canada	-3.6	-3.9	-2.3	-0.8	0.6	-1.6	-1.8	-0.4	1.8	2.2	2.2
Czech Republic	..	1.3	-1.9	-2.6	-7.4	-6.1	-2.4	-2.0	-3.9	-5.0	-5.4
Denmark	2.6	3.3	1.8	1.0	1.8	0.7	-0.6	1.8	1.4	2.2	2.7
Finland	-4.7	-1.3	1.1	4.0	3.9	5.5	5.7	5.4	5.5	6.5	8.0
France	0.4	0.8	0.5	0.7	1.3	2.7	2.6	2.6	2.3	2.3	2.4
Germany	-0.7	-0.5	-1.1	-0.8	-0.3	-0.1	-0.2	-0.9	-0.9	-0.6	0.0
Greece	-2.8	-1.4	-0.7	-3.0	-4.2	-4.1	-3.2	-4.2	-4.6	-4.6	-4.4
Hungary	..	-9.0	-9.5	-5.5	-3.8	-2.1	-4.9	-4.3	-3.2	-4.1	-4.2
Iceland	-2.3	0.8	1.9	0.8	-1.8	-1.7	-6.9	-6.9	-9.1	-10.0	-9.2
Ireland	1.0	3.7	2.7	2.6	2.8	2.4	0.9	0.7	0.9	0.3	-1.0
Italy	-2.4	0.8	1.2	2.3	3.2	2.8	1.8	0.6	-0.9	-0.7	-0.6
Japan	3.0	3.1	2.8	2.2	1.4	2.2	3.2	2.5	2.8	2.7	3.0
Korea	-1.2	0.3	-1.0	-1.7	-4.4	-1.5	12.8	6.0	2.5	1.7	2.3
Mexico	-6.7	-5.8	-7.1	-0.5	-0.7	-1.9	-3.8	-2.9	-3.4	-3.8	-4.2
Netherlands	2.1	4.1	4.9	6.2	5.6	7.5	6.3	5.3	5.1	5.2	5.1
New Zealand	-3.5	-2.4	-3.8	-5.0	-6.1	-6.7	-4.1	-6.7	-5.7	-4.7	-4.0
Norway	3.5	3.0	3.0	3.3	6.5	5.6	-1.3	3.9	15.4	20.5	19.7
Poland	..	-5.2	1.0	0.7	-2.3	-4.0	-4.4	-8.0	-7.6	-7.1	-6.0
Portugal	-0.2	0.4	-2.4	-0.1	-4.0	-5.2	-6.5	-8.9	-10.6	-11.5	-12.0
Spain	-3.6	-1.2	-1.3	0.0	0.0	0.4	-0.2	-2.1	-3.3	-3.7	-3.8
Sweden	-2.9	-1.3	1.2	3.0	2.8	3.1	2.8	2.5	2.4	1.6	1.1
Switzerland	6.2	8.2	6.7	6.9	7.4	10.0	9.8	11.6	12.7	12.7	12.9
Turkey	-0.6	-3.6	2.2	-1.5	-1.3	-1.3	1.1	-0.9	-4.6	-4.2	-3.4
United Kingdom	-1.7	-1.7	-0.2	-0.5	-0.1	0.8	0.0	-1.2	-1.5	-1.9	-1.9
United States	-0.8	-1.2	-1.7	-1.5	-1.6	-1.7	-2.5	-3.6	-4.3	-4.5	-4.3
Euro area[a]	-0.9	0.4	0.2	0.7	1.1	1.5	1.2	0.4	0.0	0.1	0.4
European Union	-1.0	0.1	0.2	0.6	1.0	1.5	1.0	0.2	-0.2	-0.2	0.0
Total OECD	-0.3	0.1	-0.1	0.2	0.0	0.2	0.0	-0.8	-1.2	-1.3	-1.2

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD

Balance on current account

Seasonally adjusted, $ billion

	1993	1994	1995	1996	1997	1998	1999	Estimates and projections 2000	2001	2002
Australia	-9.8	-17.2	-19.6	-15.9	-12.7	-18.3	-22.8	-18.5	-16.2	-15.8
Austria	-1.4	-3.3	-6.1	-5.4	-6.5	-5.2	-5.8	-5.5	-4.5	-3.8
Belgium	8.9	9.7	11.4	11.3	11.7	10.3	9.8	9.4	11.1	13.6
Canada	-21.7	-13.0	-4.4	3.4	-10.0	-11.0	-2.3	12.6	15.7	16.7
Czech Republic	0.5	-0.8	-1.4	-4.3	-3.3	-1.4	-1.1	-1.9	-2.5	-2.9
Denmark	4.5	2.8	1.7	3.2	1.2	-1.1	3.0	2.3	3.4	4.4
Finland	-1.1	1.1	5.2	5.0	6.7	7.3	7.0	6.6	7.6	10.0
France	9.6	7.4	11.0	20.8	37.8	38.2	37.5	30.0	27.9	31.5
Germany	-9.7	-24.3	-20.7	-7.9	-3.1	-4.6	-19.3	-17.7	-10.6	-0.3
Greece	-1.3	-0.7	-3.5	-5.2	-5.0	-3.8	-5.2	-5.1	-5.0	-5.1
Hungary	-3.5	-4.0	-2.5	-1.7	-1.0	-2.3	-2.1	-1.5	-1.9	-2.1
Iceland	0.0	0.1	0.1	-0.1	-0.1	-0.6	-0.6	-0.8	-0.8	-0.8
Ireland	1.8	1.5	1.7	2.0	1.9	0.7	0.7	0.9	0.3	-1.1
Italy	7.7	12.8	24.9	39.4	32.4	21.8	6.6	-9.2	-7.4	-6.3
Japan	131.9	130.3	111.2	65.8	94.3	120.9	106.9	127.6	126.5	143.0
Korea	1.0	-3.9	-8.5	-23.0	-8.2	40.4	24.5	11.7	8.6	12.1
Mexico	-23.4	-29.7	-1.6	-2.3	-7.4	-16.1	-14.1	-19.4	-24.4	-30.0
Netherlands	13.2	17.3	25.9	23.0	28.3	24.9	21.0	18.6	18.8	19.7
New Zealand	-1.0	-1.9	-3.0	-4.0	-4.4	-2.2	-3.6	-2.8	-2.2	-2.0
Norway	3.6	3.8	4.9	10.2	8.7	-1.9	6.0	24.8	34.5	34.1
Poland	-4.6	1.0	0.9	-3.3	-5.7	-6.9	-12.5	-12.3	-12.3	-12.1
Portugal	0.3	-2.3	-0.2	-4.5	-5.5	-7.2	-9.9	-10.8	-11.4	-12.7
Spain	-6.0	-6.7	0.2	0.2	2.3	-1.5	-12.7	-18.3	-20.0	-22.0
Sweden	-2.6	2.5	7.1	7.2	7.5	6.6	5.9	5.3	3.3	2.5
Switzerland	19.5	17.5	21.4	21.9	25.5	25.8	29.9	30.3	29.6	31.2
Turkey	-6.4	2.6	-2.3	-2.4	-2.6	2.0	-1.4	-9.1	-9.1	-8.2
United Kingdom	-15.9	-2.1	-5.9	-0.8	10.8	-0.2	-17.8	-21.5	-26.8	-29.0
United States	-82.7	-118.6	-109.5	-123.3	-140.5	-217.1	-331.5	-432.8	-470.5	-483.3
Euro area	22.0	12.6	49.9	78.6	101.1	80.9	29.6	-1.0	6.9	23.5
European Union	8.0	15.7	52.8	88.2	120.5	86.3	20.8	-15.0	-13.2	1.3
Total OECD	11.3	-18.1	38.2	9.3	53.1	-2.4	-204.0	-307.1	-338.2	-318.7
Memorandum item										
China	-11.6	6.9	1.6	7.2	37.0	31.5	15.7	15.1	12.7	6.7
Dynamic Asian Economies[b]	4.9	1.1	-16.6	-8.2	1.0	54.3	72.1	56.2	57.0	54.2
Other Asia	-7.7	-7.6	-14.6	-16.1	-8.9	-10.7	-8.2	-11.7	-12.4	-12.2
Total Non-OECD Asia	-14.4	0.4	-29.6	-17.1	29.0	75.1	79.6	59.6	57.3	48.6
Latin America	-22.5	-22.1	-35.6	-37.1	-59.7	-75.3	-35.6	-25.1	-26.4	-33.0
Africa and Middle-East	-35.3	-23.1	-22.1	-0.7	-3.2	-52.6	-9.6	82.4	82.7	65.1
Central and Eastern Europe	-2.7	7.4	0.9	-1.1	-11.1	-16.0	15.6	27.7	19.0	12.6
Total of non-OECD countries	-74.9	-37.4	-86.4	-55.9	-45.0	-68.9	49.9	144.7	132.6	93.3
World	-63.6	-55.5	-48.2	-46.6	8.1	-71.3	-154.1	-162.4	-205.5	-225.3

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

b) Indonesia, Malaysia, Chinese Taipei, Philippines, Singapore, Thailand and Hong-Kong,China.

Source: OECD

Semiannual demand and output projections

Percentage changes from previous period, seasonally adjusted at annual rates, volume

	2000	2001	2002	2000 I	2000 II	2001 I	2001 II	2002 I	2002 II
Private consumption									
Canada	3.6	2.8	2.6	3.5	3.1	2.8	2.5	2.6	2.6
France	2.6	2.3	2.2	2.6	2.4	2.2	2.2	2.2	2.2
Germany	1.7	2.6	2.4	1.4	2.6	2.6	2.6	2.3	2.3
Italy	2.0	1.8	2.3	2.9	1.2	1.9	2.0	2.3	2.5
Japan	1.6	2.1	2.2	3.0	1.3	2.4	2.2	2.2	2.2
United Kingdom	3.5	2.4	2.2	3.6	2.9	2.3	2.2	2.2	2.2
United States	5.4	3.6	3.0	6.0	4.1	3.6	3.0	3.0	3.0
Euro area[a]	2.5	2.6	2.6	2.7	2.5	2.7	2.6	2.6	2.6
European Union	2.7	2.6	2.5	2.9	2.6	2.6	2.5	2.5	2.5
Total OECD	3.9	3.1	2.8	4.4	3.3	3.1	2.8	2.8	2.8
Public consumption									
Canada	2.0	1.7	1.5	2.2	2.0	1.6	1.5	1.5	1.5
France	1.3	1.3	1.3	1.1	1.1	1.4	1.4	1.4	1.3
Germany	1.0	0.5	0.6	3.0	-2.0	1.4	1.3	0.3	0.3
Italy	1.2	1.1	1.2	1.1	1.0	1.1	1.2	1.2	1.2
Japan	0.2	0.5	0.6	0.1	0.2	0.7	0.5	0.6	0.6
United Kingdom	1.8	4.3	3.3	0.9	4.9	4.3	3.9	3.2	3.0
United States	2.0	2.1	2.5	1.6	1.1	2.3	2.8	2.2	2.5
Euro area[a]	1.3	1.1	1.1	1.8	0.4	1.4	1.4	1.1	1.0
European Union	1.3	1.6	1.5	1.6	1.1	1.8	1.7	1.4	1.3
Total OECD	1.6	1.7	1.8	1.8	1.0	1.9	1.9	1.7	1.8
Investment									
Canada	11.8	6.4	6.1	13.6	7.6	6.1	6.0	6.2	5.9
France	6.0	4.6	4.8	6.8	5.0	4.4	4.6	4.8	4.8
Germany	2.4	2.8	2.7	1.0	3.3	2.7	2.7	2.7	2.6
Italy	6.9	4.7	5.2	8.1	4.6	4.8	4.9	5.2	5.6
Japan	0.6	2.8	1.2	4.5	1.1	5.9	-1.5	2.1	2.2
United Kingdom	2.4	3.8	3.0	0.5	5.0	3.4	3.3	3.0	3.0
United States	9.0	5.1	5.4	11.9	4.3	5.4	5.3	5.5	5.5
Euro area[a]	5.0	4.4	4.3	4.8	4.8	4.2	4.3	4.4	4.3
European Union	4.7	4.3	4.2	4.3	4.9	4.1	4.1	4.2	4.2
Total OECD	6.5	4.7	4.5	8.3	4.7	5.0	3.9	4.6	4.7
Total domestic demand									
Canada	5.4	3.4	3.2	5.5	3.9	3.3	3.1	3.2	3.1
France	3.0	2.5	2.5	3.3	2.5	2.5	2.5	2.6	2.5
Germany	1.9	2.1	2.1	2.3	1.7	2.1	2.2	2.1	2.0
Italy	2.2	2.2	2.7	3.0	1.8	2.3	2.4	2.7	3.0
Japan	1.3	2.4	1.8	3.4	1.4	3.5	1.0	2.0	2.0
United Kingdom	3.4	2.9	2.6	3.3	3.3	2.9	2.7	2.5	2.5
United States	5.8	3.6	3.4	6.5	4.0	3.5	3.3	3.4	3.5
Euro area[a]	2.8	2.6	2.7	3.2	2.5	2.7	2.7	2.7	2.7
European Union	2.9	2.7	2.7	3.2	2.6	2.7	2.7	2.7	2.6
Total OECD	4.2	3.2	3.0	4.9	3.3	3.4	2.9	3.0	3.1
Export of goods and services									
Canada	11.6	7.5	6.4	13.5	10.2	6.8	6.5	6.3	6.5
France	12.8	8.7	7.4	13.6	10.4	8.4	7.8	7.3	7.3
Germany	12.6	9.3	7.4	12.5	10.8	9.0	8.5	7.0	7.0
Italy	9.5	9.3	7.6	7.9	11.3	9.0	8.1	7.4	7.4
Japan	13.6	5.5	5.3	17.0	8.0	4.5	5.0	5.1	6.0
United Kingdom	7.8	7.2	6.0	5.4	7.9	7.0	6.8	5.8	5.7
United States	10.4	9.3	7.7	9.3	13.9	8.0	7.7	7.7	7.5
Euro area[a]	13.2	10.1	7.6	13.2	12.8	9.6	8.6	7.4	7.1
European Union	10.9	8.9	7.3	10.5	10.4	8.6	8.0	7.1	7.0
Total OECD	11.6	8.8	7.4	11.7	11.7	7.9	7.6	7.3	7.3

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD.

(cont'd) **Semiannual demand and output projections**

Percentage changes from previous period, seasonally adjusted at annual rates, volume

	2000	2001	2002	2000 I	2000 II	2001 I	2001 II	2002 I	2002 II
Import of goods and services									
Canada	13.3	7.8	6.8	15.3	10.1	7.0	7.0	6.8	6.8
France	12.5	8.1	8.1	15.3	8.7	8.1	7.3	8.0	9.0
Germany	9.1	7.7	6.5	9.2	8.0	7.7	7.5	6.3	5.8
Italy	7.6	8.1	8.4	8.4	8.0	8.2	7.8	8.4	9.0
Japan	10.5	6.4	4.2	9.8	8.6	6.8	3.5	4.3	4.8
United Kingdom	8.5	7.5	6.1	6.9	8.0	7.6	7.0	5.8	5.7
United States	13.7	8.8	7.2	13.3	13.3	7.5	7.2	7.2	7.2
Euro area[a]	10.0	8.5	7.5	11.1	9.1	8.5	7.8	7.5	7.4
European Union	9.5	8.1	7.3	10.1	8.3	8.3	7.6	7.2	7.3
Total OECD	12.0	8.5	7.0	12.2	10.9	8.0	7.1	7.0	7.1
GDP									
Canada	4.8	3.4	3.0	5.0	4.0	3.3	3.0	3.0	3.1
France	3.3	2.9	2.5	3.2	3.1	2.7	2.8	2.5	2.2
Germany	3.0	2.7	2.5	3.4	2.7	2.7	2.7	2.5	2.5
Italy	2.8	2.7	2.6	3.0	2.8	2.7	2.6	2.6	2.6
Japan	1.9	2.3	2.0	4.5	1.5	3.3	1.3	2.2	2.3
United Kingdom	3.0	2.6	2.3	2.7	3.1	2.4	2.4	2.3	2.3
United States	5.2	3.5	3.3	5.9	3.7	3.5	3.2	3.3	3.4
Euro area[a]	3.5	3.1	2.8	3.7	3.3	3.0	3.0	2.8	2.7
European Union	3.4	3.0	2.7	3.5	3.4	2.8	2.8	2.7	2.6
Total OECD	4.3	3.3	3.1	5.0	3.5	3.3	2.9	3.1	3.1
	Per cent of GDP								
Current account balance									
Canada	1.8	2.2	2.2	1.6	2.0	2.2	2.2	2.2	2.2
France	2.3	2.3	2.4	2.3	2.4	2.2	2.3	2.4	2.4
Germany	-0.9	-0.6	0.0	-1.0	-0.9	-0.7	-0.5	-0.2	0.2
Italy	-0.9	-0.7	-0.6	-0.6	-1.2	-0.8	-0.7	-0.7	-0.5
Japan	2.8	2.7	3.0	2.9	2.7	2.6	2.8	3.0	3.1
United Kingdom	-1.5	-1.9	-1.9	-1.4	-1.6	-1.9	-1.9	-1.9	-1.9
United States	-4.3	-4.5	-4.3	-4.2	-4.4	-4.5	-4.4	-4.4	-4.3
Euro area[a]	0.0	0.1	0.4	0.1	-0.1	0.0	0.2	0.3	0.5
European Union	-0.2	-0.2	0.0	-0.1	-0.3	-0.2	-0.2	0.0	0.1
Total OECD	-1.2	-1.3	-1.2	-1.1	-1.3	-1.3	-1.3	-1.2	-1.1
	$ billions								
Current account balance									
Canada	12.6	16	17	11.1	14.0	15	16	16	17
France	30.0	28	31	30.5	29.6	27	29	31	32
Germany	-17.7	-11	0	-18.8	-16.6	-13	-8	-4	3
Italy	-9.2	-7	-6	-6.5	-11.9	-8	-7	-7	-6
Japan	127.6	126	143	133.1	122.2	121	132	140	146
United Kingdom	-21.5	-27	-29	-20.7	-22.4	-26	-27	-28	-30
United States	-432.8	-470	-483	-415.3	-450.4	-466	-475	-479	-487
Euro area[a]	-1.0	7	23	5.4	-7.4	3	11	18	29
European Union	-15.0	-13	1	-9.1	-19.7	-16	-14	1	7
Total OECD	-307.1	-338	-319	-278.8	-331.5	-341	-333	-314	-310

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

Source: OECD.

Semiannual price, cost and unemployment projections

Percentage changes from previous period, seasonally adjusted at annual rates

	2000	2001	2002	2000		2001		2002	
				I	II	I	II	I	II
Private consumption deflator									
Canada	1.7	2.3	2.1	1.3	2.4	2.4	2.2	2.1	2.0
France	1.5	2.1	2.0	1.6	1.9	2.1	2.1	2.0	1.9
Germany	1.5	1.6	1.6	1.3	1.9	1.6	1.4	1.5	1.7
Italy	2.7	2.5	2.0	2.7	2.7	2.5	2.2	2.0	1.8
Japan	-0.5	0.0	-0.1	-0.6	-0.1	0.2	-0.1	-0.1	-0.1
United Kingdom	1.4	2.4	2.3	0.8	2.1	2.6	2.5	2.3	2.2
United States	2.5	2.1	2.2	2.8	2.1	2.1	2.2	2.2	2.3
Euro area[a]	2.2	2.3	2.0	2.2	2.6	2.3	2.1	2.0	2.0
European Union	2.1	2.3	2.1	2.0	2.5	2.3	2.2	2.1	2.0
Total OECD	3.1	2.6	2.2	3.3	3.1	2.5	2.3	2.2	2.2
Total OECD *less* high inflation countries[b]	1.9	2.0	1.9	1.9	2.2	1.9	1.9	1.9	1.9
GDP deflator									
Canada	3.3	2.4	2.0	3.8	2.6	2.4	2.1	2.0	2.0
France	0.9	1.7	2.3	0.8	1.6	1.6	1.9	2.3	2.6
Germany	0.0	1.0	1.4	-0.4	0.8	1.0	1.2	1.4	1.4
Italy	1.8	2.2	2.0	1.7	2.3	2.2	2.1	2.0	1.9
Japan	-1.5	-0.4	-0.2	-1.8	-0.8	-0.2	-0.4	-0.1	-0.1
United Kingdom	2.0	2.5	2.6	1.3	2.1	2.5	2.7	2.6	2.5
United States	2.1	2.2	2.3	2.6	2.1	2.3	2.2	2.3	2.3
Euro area[a]	1.2	1.9	2.0	1.1	1.8	2.0	2.0	2.1	2.1
European Union	1.4	2.0	2.2	1.2	1.8	2.1	2.1	2.2	2.2
Total OECD	2.6	2.4	2.3	2.6	2.6	2.5	2.3	2.4	2.3
Total OECD *less* high inflation countries[b]	1.3	1.8	1.9	1.4	1.6	1.9	1.8	1.9	1.8
Unit labour cost (total economy)									
Canada	2.1	1.6	1.8	3.4	1.1	1.6	1.9	1.9	1.7
France	1.0	2.0	1.9	0.8	2.3	1.9	1.8	1.9	2.0
Germany	0.0	0.1	0.6	0.1	0.2	0.0	0.2	0.7	0.7
Italy	1.0	1.2	1.0	1.0	1.0	1.3	1.2	1.0	0.8
Japan	-0.8	-1.2	-0.6	1.0	-4.6	0.1	-0.1	-0.8	-0.8
United Kingdom	2.0	2.9	2.8	1.3	2.6	3.0	3.0	2.8	2.6
United States	1.2	2.6	2.8	0.8	2.3	2.7	2.7	2.9	2.8
European Union	1.2	1.7	1.8	1.3	1.5	1.8	1.7	1.8	1.8
Total OECD	2.1	2.3	2.2	2.3	1.9	2.5	2.4	2.2	2.1
Total OECD *less* high inflation countries[b]	1.1	1.7	1.8	1.2	1.1	2.0	1.9	1.8	1.8
	Per cent of labour force								
Unemployment									
Canada	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7
France	9.7	8.8	8.2	9.9	9.4	8.9	8.6	8.3	8.1
Germany	7.7	6.9	6.3	7.8	7.5	7.1	6.7	6.4	6.2
Italy	10.8	10.1	9.4	11.0	10.6	10.3	9.9	9.6	9.3
Japan	4.7	4.6	4.6	4.8	4.7	4.7	4.6	4.6	4.6
United Kingdom	5.5	5.4	5.5	5.7	5.3	5.4	5.4	5.5	5.6
United States	4.0	4.2	4.5	4.0	4.0	4.1	4.3	4.4	4.6
Euro area[a]	9.0	8.3	7.7	9.2	8.8	8.4	8.1	7.8	7.6
European Union	8.2	7.6	7.2	8.4	8.0	7.7	7.5	7.3	7.1
Total OECD	6.2	6.0	5.9	6.3	6.1	6.0	6.0	6.0	5.9

a) Greece will enter the euro area on the 1 January 2001. In order to present consistent projections for the euro area and to ensure comparability of the euro area data over time, Greece has been included in the calculation of the euro area throughout.

b) High inflation countries are defined as countries which have had, on average, 10 per cent or more inflation in terms of the GDP deflator during the 1990s on the basis of historical data. Consequently, Greece, Hungary, Mexico, Poland and Turkey are excluded from the aggregate.

Source: OECD.

II. DEVELOPMENTS IN INDIVIDUAL OECD COUNTRIES

UNITED STATES

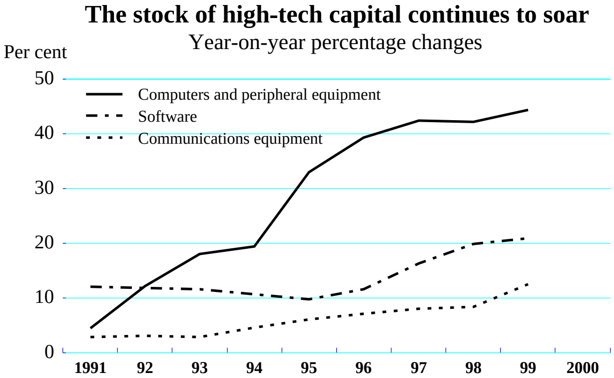
The continuing transformation of the US economy has boosted its estimated annual potential growth rate to 4 per cent. However, output growth has outstripped supply in recent years, resulting in a tight labour market. Inflation has increased, pushed up by higher oil prices and a slight increase in core inflation. With higher short-term interest rates and a stabilisation in the stock market, the growth of demand should slacken. That could lead real GDP growth to drop to around 3¼ to 3½ per cent in 2001 and 2002, from over 5 per cent in 2000 -- a slowdown that should be sufficient to stabilise inflation, with unemployment rising somewhat. The current account deficit is projected to increase further, before levelling out at around 4¼ per cent of GDP.

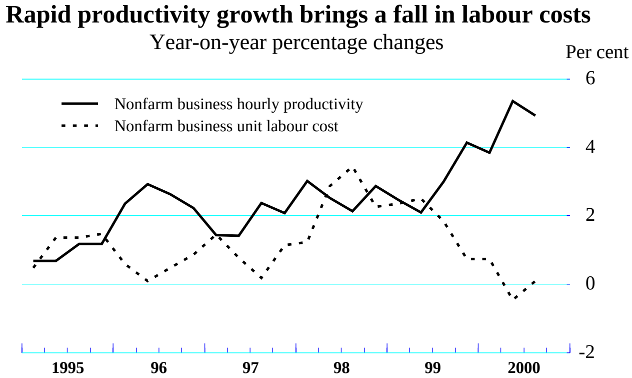
In view of the prospects for increasing core inflation and in order to check inflationary expectations, some additional monetary tightening may be called for. However, given the uncertainty about the potential growth rate and the magnitude of current excess demand, increases should continue to be made cautiously. Although the pace of discretionary government spending has picked up, budget surpluses continue to rise rapidly. Fiscal policy, however, should avoid optimistic assessments about the room for future tax cuts or spending increases in order to avoid both undue stimulus to the economy in the near term and the need for a large reversal later on, as the population ages.

US capacity is now estimated to be growing at 4 per cent

The economy is continuing to pass through a period of rapid change, with the adoption of new information and communications technology boosting its capacity. The OECD now estimates that the underlying rate of expansion of supply is about 4 per cent per annum. The most recent data, covering the period to 1998, showed that multifactor productivity continued to accelerate in the high-tech sector and has also registered gains in other sectors. Moreover, capital deepening continues apace throughout the economy, with the stock of computers rising by more than 40 per cent in 1999. In the first half of 2000, the pace of capital accumulation of this type of equipment was even faster than in 1999. Despite falling prices, outlays on information and communications technology represented half of nominal spending on equipment and software, up from 40 per cent five years ago.

United States



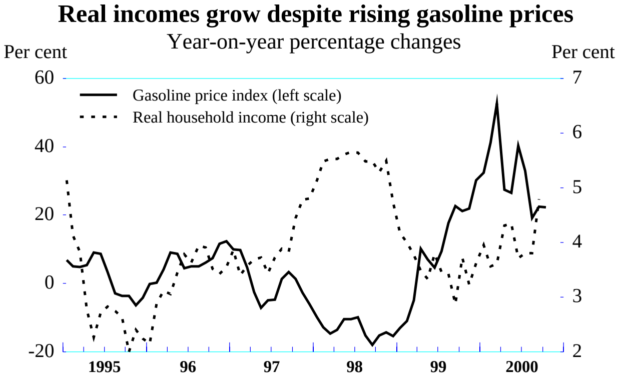


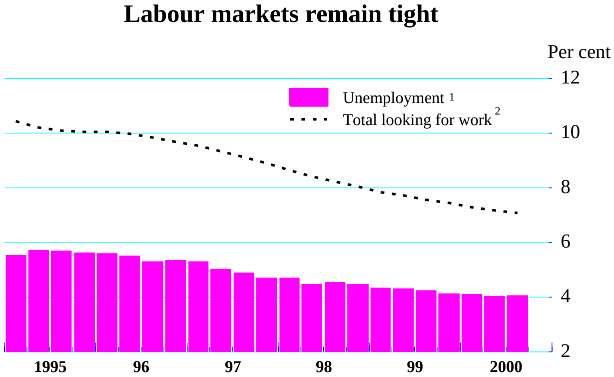
Sources: Bureau of Labor Statistics; Bureau of Economic Analysis.

Growth has been very rapid, and the labour market has tightened with the current account deficit widening

The growth of output, though, has been even faster than that of productive capacity. In the first half of 2000, GDP rose by almost 6 per cent. Such a surge has kept the labour market very tight. Unemployment has fallen only slightly, to about 4 per cent, but there has been a somewhat greater reduction in the number of people who currently want a job even though they are not actively searching. Product market pressure has also resulted in imports growing markedly faster than total demand, a development that, together with the increase in oil prices, has pushed the current account deficit to 4¼ per cent of GDP.

United States





1. Percentage of labour force.
2. Unemployed plus those marginally attached to the labour force and involuntary part-time workers as a percentage of the labour force plus the number of those marginally attached to the labour force.
Sources: Bureau of Labor Statistics; Bureau of Economic Analysis.

Unit labour costs have stabilised, boosting profits, despite an oil-induced jump in inflation

Despite the degree of excess demand, there has been only a limited acceleration in most measures of employee compensation and in unit labour costs remained substantially unchanged over the past year. The rate of growth of productivity has been in line with that of hourly labour compensation. Flat unit labour costs have not been reflected in any deceleration in prices. Indeed in the first half of 2000, the rate of increase of

United States

Employment, income and inflation

Percentage changes

	1998	1999	2000	2001	2002
Employment[a]	2.2	1.9	1.9	1.0	1.1
Unemployment rate[b]	4.5	4.2	4.0	4.2	4.5
Employment cost index	3.5	3.2	4.6	4.7	4.9
Compensation per employee[c]	4.9	4.3	4.5	4.9	5.1
Labour productivity[c]	2.3	2.6	3.8	2.6	2.5
Unit labour cost[c]	2.5	1.6	0.7	2.3	2.5
GDP deflator	1.3	1.5	2.1	2.2	2.3
Private consumption deflator	1.1	1.8	2.5	2.1	2.2
Real household disposable income	4.8	3.2	3.0	3.4	3.3

a) Whole economy, for further details see "Sources and Methods".
b) As a percentage of labour force.
c) In the business sector.
Source: OECD.

the domestic demand deflator for products other than food and energy, picked up, after having been broadly stable in 1999. Such contrasting developments in costs and prices have lifted company earnings. The surge in profits outside the energy sector was accentuated by higher domestic crude oil and natural gas prices and a widening of margins in the refining and distribution chain, that resulted in gasoline prices growing more rapidly than crude oil prices in the first half of 2000. Overall, higher energy prices added 0.8 percentage point to the rate of growth of the consumer price deflator which increased at an annual rate of 2.8 per cent in that period. Nonetheless, real household income continued to grow at a brisk rate. In effect, unexpectedly rapid productivity growth and a fall in unit labour costs have helped offset the impact of higher oil prices on real incomes.

United States

Financial indicators

	1998	1999	2000	2001	2002
Household saving ratio[a]	4.2	2.2	0.0	-0.3	-0.2
Private sector financial balance	-2.6	-4.3	-6.4	-6.7	-6.7
General government financial balance[b]	0.3	1.0	2.3	2.6	2.7
Current account balance[b]	-2.5	-3.6	-4.3	-4.5	-4.3
Short-term interest rate[c]	5.5	5.4	6.5	7.0	7.0
Long-term interest rate[d]	5.3	5.6	6.1	6.4	6.5

a) As a percentage of disposable income.
b) As a percentage of GDP.
c) 3-month Treasury bills.
d) 10-year government bonds.
Source: OECD.

High equity prices led consumers to further reduce their saving rate

By early November, stock prices were at the same level as in December 1999, though some 9 per cent below their all time high. Rising profits have lowered the average price to earnings ratio in the traditional sector of the economy to under 24, the same as at the end of 1997, with a marked narrowing of the premium for technology stocks. Nonetheless, personal sector wealth remains well above the average 1999 level, and this is probably one of the main factors underlying the continued strong growth in household consumption outlays that have brought the saving ratio close to zero in the first half of the year.

United States

Demand and output

	1997	1998	1999	2000	2001	2002
	current prices billion $	Percentage changes, volume (1996 prices)				
Private consumption	5 529.3	4.7	5.3	5.4	3.6	3.0
Government consumption	1 223.3	1.5	2.1	2.0	2.1	2.5
Gross fixed investment	1 592.3	10.7	9.2	9.0	5.1	5.4
Public	264.7	5.3	9.1	4.8	2.4	3.8
Residential	328.3	8.3	6.4	-0.2	-3.4	-1.2
Non-residential	999.4	13.0	10.1	13.1	8.3	7.6
Final domestic demand	8 344.9	5.4	5.6	5.6	3.7	3.4
stockbuilding[a]	62.9	0.2	-0.4	0.2	-0.1	-0.1
Total domestic demand	8 407.8	5.5	5.2	5.8	3.6	3.4
Exports of goods and services	966.4	2.3	2.9	10.4	9.3	7.7
Imports of goods and services	1 055.8	11.9	10.7	13.7	8.8	7.2
net exports[a]	- 89.4	-1.3	-1.2	-0.9	-0.3	-0.3
GDP at market prices	8 318.5	4.4	4.2	5.2	3.5	3.3
Industrial production	_	4.3	3.5	5.5	4.0	4.0

Note: National accounts are based on chain link data. This introduces a discrepancy in the identity between real demand components and the GDP. See "Sources and Methods" for further details.

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

Source: OECD.

Fiscal policy remains tight, but nonetheless a further increase in interest rates may be needed

Once again, there has been a marked increase in the federal government surplus. It is likely to reach $230 billion (2¼ per cent of GDP) in FY2000. This improvement was driven by a jump in income tax receipts, possibly due to continued strong capital gains, that was only partly offset by the pick-up in overall federal non-interest spending following the removal of the discretionary spending caps. In the absence of an agreed budget for 2001, the projections assume growth in discretionary outlays similar to that in recent years and no tax changes. On this basis, the federal surplus should continue to climb, reaching $340 billion (3 per cent of GDP) by 2002, with net federal debt declining to 25 per cent of GDP from 39½ per cent in 1999. As well as a rising fiscal surplus, higher oil prices have also lowered demand. Nonetheless, output remains above potential. Consequently, with a slight increase in the underlying rate of inflation, a resumption of the policy of increasing interest rates may be required, even if some reduction might be envisaged towards the end of the projection period as the economy moves toward balance.

The pace of the expansion should slacken, bringing demand into better balance with supply

The rise in short-term interest rates that has already occurred, together with the modest further tightening (of 50 basis points) assumed in the projections, should slow the economy. Indeed, the process has already started, though third-quarter GDP data (showing an annual growth rate to 2.7 per cent) exaggerate the extend of the slowdown. Moreover, unemployment at 3.9 per cent in October is still below the average for the first half of the year. Higher interest rates are likely to have their effect through two channels. With equity prices stabilising, the growth of consumption will no longer outpace that of income and, in addition, higher long-term borrowing rates should reduce the expansion of investment in the traditional sector of the economy. Even the high-tech sector may be affected, given the signs of over-capacity emerging in the telecommunications industry, the reduction in the rate at which computer prices are falling, financing problems for new start-ups and increasing spreads for borrowers. With the growth of output moving towards that in the rest of the OECD area, the current account deficit should stabilise at about 4¼ per cent of GDP. At the same time, the unemployment rate may start moving back towards 4½ per cent, helping lessen the acceleration in prices outside the food and energy sectors. In the second half of this year, with oil prices increasing less rapidly, the overall rate of inflation should ease markedly. Thereafter, it may edge up slightly, as the increase in core inflation is only partly buffered by easing oil prices.

United States

External indicators

	1998	1999	2000	2001	2002
			$ billion		
Merchandise exports	670.3	684.4	782.6	868	941
Merchandise imports	917.2	1 029.9	1 233.4	1 358	1 447
Trade balance	- 246.9	- 345.6	- 450.9	- 491	- 506
Invisibles, net	29.7	14.1	18.0	20	23
Current account balance	- 217.1	- 331.5	- 432.8	- 470	- 483
			Percentage changes		
Merchandise export volumes[a]	2.2	4.0	12.6	10.0	7.8
Merchandise import volumes[a]	11.8	12.5	14.5	9.4	7.3
Export performance[b]	- 1.1	- 2.3	- 1.1	- 0.1	- 0.3
Terms of trade	3.0	- 1.5	- 3.2	0.2	1.3

a) Customs basis.
b) Ratio between the total of export volumes and export market of total goods.
Source: OECD.

Alternatively, a hard landing could ensue, but better performance is also possible

The current account deficit has been largely financed by direct investment and share purchases by foreigners. Such flows, while in many cases linked to the desire of companies to participate in the surge of innovation in the US economy, are, nonetheless, vulnerable to short-term changes in sentiment. Only a slight slackening in their pace would put the dollar under significant downward pressure, raising the possibility of a more disruptive slowing in the economy. The likelihood of such an adverse out-turn, though, has to be balanced against the fact that economic performance has continued to surprise in the past. If underlying productivity proves to be still accelerating, as many financial market analysts project, then the need for future interest-rate increases would be lessened and actual growth could be somewhat faster without generating any additional inflationary pressures.

JAPAN

The economic recovery in the first half of 2000, with growth at an annual rate of 4½ per cent, has been stronger than expected, led by business investment and surprisingly robust private consumption. Export growth was also strong but has been erratic. A moderate expansion of both investment and consumption is expected over the next two years, although significant uncertainty remains. Growth will nevertheless remain volatile as fiscal measures run their course. Output growth is expected to be around 2 per cent in 2000, rising temporarily to 2¼ per cent in 2001 under the influence of the latest fiscal boost before moving back to about 2 per cent in 2002.

With a modest recovery underway, some re-balancing of policy would now be appropriate. While the stance of monetary policy should remain easy to continue to support the recovery, maintaining the credibility of monetary policy in this context requires a more explicit monetary policy framework than has been the case till now. The recent decision to publish inflation forecasts is a step in this direction. At the same time, fiscal policy should gradually be reoriented toward consolidation in a transparent medium-term framework. Without this policy mix there is a danger that long-term interest rates will rise, thereby reducing growth prospects and subjecting the financial sector to stress. Priority will also need to be given to improving the efficiency of the public expenditure system and to continuing with structural reforms.

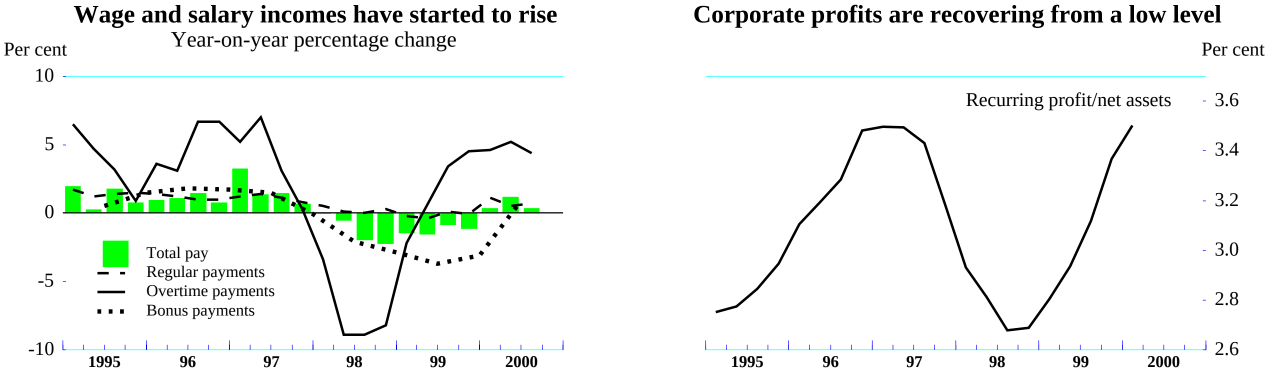
Economic activity has gained momentum…

Activity picked up strongly in the first half of 2000 and forward-looking indicators suggest that economic expansion will continue. Business investment has been the driving force in the recovery, stimulated by a marked increase of actual and expected profits and accelerating demand, both domestic and external, for information technology. Rising activity is now lifting household incomes, and summer bonuses have stabilised. Improved labour demand has in turn underpinned favourable consumer sentiment despite the rise in bankruptcies and a relatively high level of unemployment. Moreover, a large volume of postal savings deposits are maturing this year and next, providing households with additional liquidity. Although the statistics are volatile, consumption is strengthening, broadening the base of the recovery.

… although conflicting forces will constrain the growth of investment

The share of business investment in GDP and the growth rate of investment are both expected to remain below levels reached in past recoveries. Enterprises are still faced with excess capital stock and, although firms are continuing to scrap at a rapid rate, the overhang will nevertheless serve to constrain investment demand. In addition, expectations of lower future output growth than in the past and a greater emphasis on profitability may also serve to limit investment recovery.

Japan



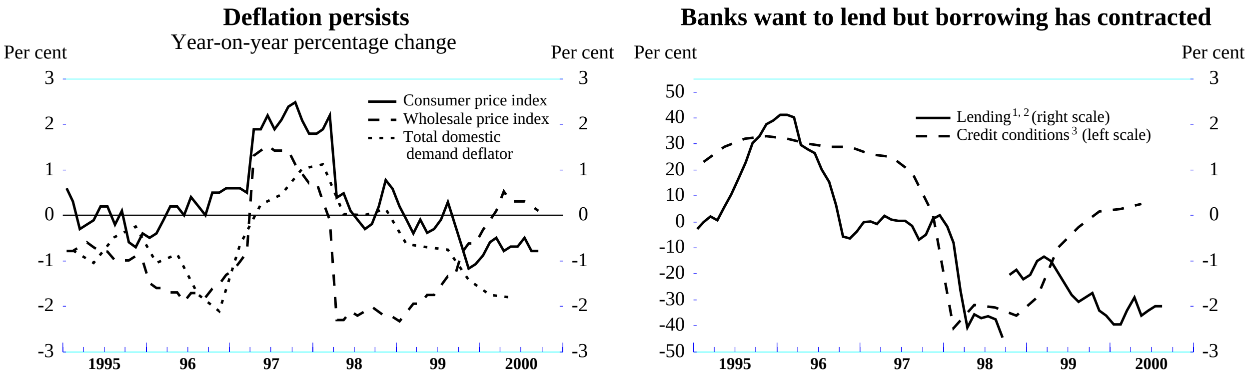
Sources: Ministry of Labour and Ministry of Finance.

Budget pressures are serving to constrain public investment, particularly at the local government level, while fiscal measures to stimulate residential construction have served to bring forward activity, which will subsequently retard demand as from the second half of this year.

Deflation has tended to stabilise

Price developments present a very mixed picture with deflation continuing according to most measures, although there are no indications of a downward spiral developing. The domestic demand deflator has fallen at an annual rate of some 1½ per cent in the first half, a significantly larger decline than in 1999. Price declines have been greatest in the investment goods component, where factors such as technological progress are likely to be important. Consumer prices have continued to decline but only by some ½ per cent, while domestic wholesale prices have been rising since March 2000. Effects of higher oil prices on price movements have been muted by a decrease in the profit margins of oil companies following deregulation of this sector. Land prices continue to fall, although the annual rate of decline has moderated to around 9 per cent.

Japan



1. Year-on-year percentage changes.
2. From third quarter of 1998, adjusted for loan write-offs.
3. Opinions on financial institutions' lending attitudes (accommodative minus severe in per cent).
Source: Bank of Japan.

Japan

Employment, income and inflation

Percentage changes

	1998	1999	2000	2001	2002
Employment	-0.7	-0.8	-0.4	0.3	0.4
Unemployment rate[a]	4.1	4.7	4.7	4.6	4.6
Compensation of employees	-1.0	-1.0	1.1	1.1	1.4
Unit labour cost	1.5	-1.2	-0.8	-1.2	-0.6
Household disposable income	0.3	0.5	0.6	1.7	3.0
GDP deflator	0.3	-0.9	-1.5	-0.4	-0.2
Private consumption deflator	0.2	-0.5	-0.5	0.0	-0.1

a) As a percentage of labour force.
Source: OECD.

Monetary and financial conditions continue to underpin activity

Monetary and financial conditions remain favourable for growth despite policy rates being raised by 25 basis points in August. Base money has grown at around 5 per cent, while lending attitudes of banks are judged to be accommodative. Nevertheless, money supply has grown only slowly, in great part owing to weak demand for bank lending as enterprises restructure their balance sheets and finance investment through improved cash flows. The rate of bankruptcies has moved up sharply, but this reflects the expiry of the one year period of grace for capital repayments for loan guarantees granted to small and medium sized enterprises at the end of 1998 rather than a tightening of financial conditions. The projection assumes no further increases in policy rates over the projection period, although short-term rates will drift upward somewhat. In a welcome departure from past practice, the BOJ has started to publish the inflation and output forecasts of the members of the policy board for the current fiscal year as well as the main risks to the projections.

Japan

Financial indicators

	1998	1999	2000	2001	2002
Household saving ratio[a]	13.4	13.2	12.8	12.4	13.2
General government financial balance[b,e]	-5.0	-7.0	-6.0	-6.0	-5.7
Current account balance[b]	3.2	2.5	2.8	2.7	3.0
Short-term interest rate[c]	0.7	0.2	0.2	0.6	0.9
Long-term interest rate[d]	1.5	1.7	1.8	2.1	2.3

a) As a percentage of disposable income.
b) As a percentage of GDP.
c) 3 month CDs.
d) 10-year government bonds.
e) The 1998 deficit would have risen by 5.4 percentage points if account were taken of the assumption by the central government of the debt of the Japan National Railway Settlement Corporation and the National Forest Special Account.
Source: OECD.

Fiscal policy remains neutral in the short term although public investment continues to weaken

Fiscal policy is projected to remain broadly neutral this year and next but to tighten thereafter. However, the bunching of public works associated with the latest fiscal stimulus package will lead to a temporary surge of demand (concentrated in the first half of 2001). The October fiscal package this year is assumed to result in a rise of infrastructure spending of 2½ trillion yen (½ per cent of GDP). This is less than the announced plan since local governments seem likely to continue to cut back on their own spending over the projection period. Excluding the one-off increases in tax revenues from maturing postal savings deposits this year and next (worth around ¾ and 1 percentage points of GDP, respectively), the underlying structural fiscal deficit should remain around 6-6¼ per cent of GDP this year and next. However, in the absence of a new fiscal package in 2001 and with continuing expenditure cuts by local governments, the underlying structural deficit would decline by 1 per cent of GDP in 2002. Such a consolidation might limit the rise in long-term rates to around 25 basis points by the end of the period. However, in these circumstances, general government liabilities would be likely to increase to around 130 per cent of GDP by 2002. With ongoing financial market reforms, the financing of this debt will increasingly take place in a more transparent manner.

Japan
Demand and output

	1997	1998	1999	2000	2001	2002
	current prices trillion yen	Percentage changes, volume (1990 prices)				
Private consumption	305.9	-0.5	1.2	1.6	2.1	2.2
Government consumption	49.6	1.5	1.3	0.2	0.5	0.6
Gross fixed investment	145.6	-7.4	-1.2	0.6	2.8	1.2
Public[a]	39.5	-3.0	7.8	-8.8	-1.3	-7.3
Residential	23.7	-14.4	1.4	1.0	-4.3	-2.0
Non-residential	82.4	-7.6	-5.9	5.4	6.3	5.5
Final domestic demand	501.1	-2.5	0.5	1.1	2.1	1.7
Stockbuilding[b]	2.6	-0.6	0.1	0.1	0.2	0.0
Total domestic demand	503.6	-3.1	0.5	1.3	2.4	1.8
Exports of goods and services	56.3	-2.5	1.9	13.6	5.5	5.3
Imports of goods and services	50.3	-7.6	5.3	10.5	6.4	4.2
Net exports[b]	6.0	0.5	-0.3	0.7	0.0	0.3
GDP at market prices	509.6	-2.5	0.2	1.9	2.3	2.0
Industrial production[c]	_	-7.2	1.0	5.8	4.0	2.8

a) Including public corporations.
b) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
Source: OECD.

Growth is likely to continue at a moderate pace subject to short-term volatility

Growth is projected to be around 2¼ per cent on average over the projection period, driven by moderate rates of growth of both private consumption and business investment. Export growth should slow to around 5 per cent, although the current account surplus may still increase somewhat. Fiscal measures will impart considerable volatility to half yearly and quarterly growth rates, making policy assessment difficult. The first half of next year is projected to be strong with annual growth of over 3 per cent, since the effects of the 2000 fiscal stimulus package will be felt most strongly in the second quarter. The second half of 2001 might then be weak, however, with just 1 per cent growth as public works decline and residential construction falls further with the expiration of tax incentives. Thereafter the economy is expected to pick up again with growth of around 2 per cent in 2002. Employment growth is expected to remain modest but the rate of unemployment will continue to be high as discouraged workers re-enter the workforce. The output gap is projected to close slowly while deflation should gradually subside.

Japan

External indicators

	1998	1999	2000	2001	2002
			$ billion		
Merchandise exports	374.0	403.4	462.7	482	509
Merchandise imports	251.5	280.3	337.9	365	379
Trade balance	122.4	123.1	124.8	117	131
Invisibles, net	- 1.5	- 16.3	2.8	9	12
Current account balance	120.9	106.9	127.6	126	143
			Percentage changes		
Merchandise export volumes[a]	- 1.2	2.1	12.5	5.7	5.3
Merchandise import volumes[a]	- 5.3	9.6	11.5	7.7	4.2
Export performance[b]	- 3.1	- 7.7	- 3.8	- 4.9	- 3.4
Terms of trade	6.5	4.9	- 5.5	- 1.7	0.9

a) Customs basis.
b) Ratio between the total of export volumes and export market of total goods.
Source: OECD.

Domestic risks remain important although they are now more balanced

Uncertainty about prospects remains high and is reflected in the wide range of projections available. Domestic risks are closely associated with how restructuring will unfold as the scenario rests on the assessment that the expansionary momentum imparted by business investment will more than offset the negative impact of corporate restructuring on employment and hence on private consumption. The potential for disruptive bankruptcies cannot be excluded, while banks remain vulnerable to any marked decline in bond and share prices -- an issue that may become urgent if the latter remains at the low levels prevailing in November. On the other hand, the economy is in the midst of a major restructuring with rapid scrapping of old capital so that investment and growth could easily surprise on the upside.

GERMANY

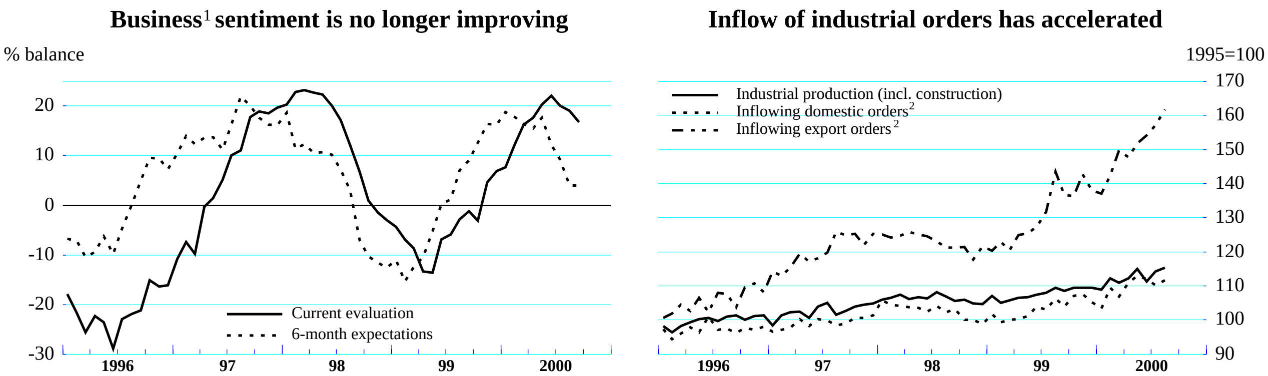
Activity accelerated in the first half of 2000, underpinned by buoyant investment in machinery and equipment and a more rapid expansion of private consumption. Current economic conditions remain favourable for growth above potential, not least because of the major income and business tax reform that will come into effect in 2001. Partly because of higher oil prices, however, economic activity is projected to slow somewhat from the second half of this year. With the expansion in world trade slowing, the contribution from the external sector should decline, bringing GDP growth down from 3 per cent this year to some 2½ per cent by 2002.

One-off proceeds from selling mobile phone licences will generate a substantial general government surplus in 2000 because of the accounting conventions used. But a deficit will re-emerge in 2001, as income tax cuts worth more than one per cent of GDP become effective, and will continue in 2002, though to a lesser degree. With the output gap becoming positive, fiscal restraint, through strict spending control, will be necessary both for conjunctural reasons and to improve public finances in view of population ageing.

Economic activity accelerated in the first half of 2000…

Economic activity accelerated further in the first half of 2000 when real GDP increased at an annual rate of some 3½ per cent. Exports continued to grow at double-digit rates, although the net contribution of the external sector to GDP growth was slightly lower than in the previous half year. On the domestic side, investment in machinery and equipment -- including intangible investment such as computer software -- grew at an annual rate of 12 per cent. Private consumption growth improved strongly in the second quarter after stagnating in the first months of the year. But construction slid back into recession with over-capacity in the new states still constituting the main brake for a recovery in this sector.

Germany



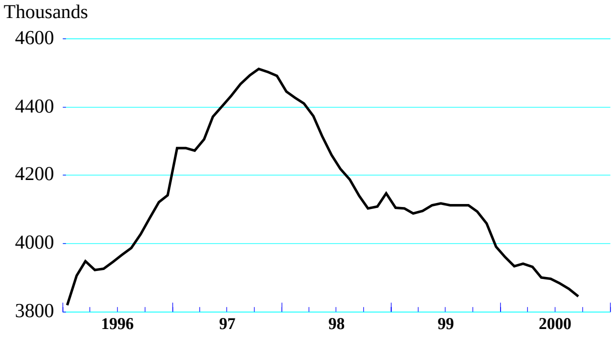
1. Manufacturing excluding food.
2. In manufacturing, volume.
Sources : Ifo Institute; Deutsche Bundesbank and OECD.

… and the labour market improved

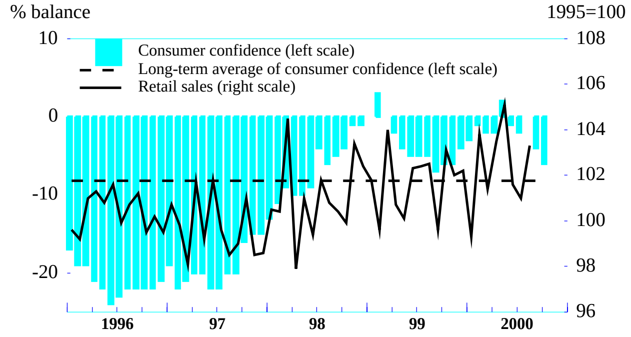
Employment growth also picked up in the first half of 2000, to an annual rate of 1.8 per cent. A large part of the increase appears to be attributable to part-time employment of new entrants into the labour market. Earlier changes in the obligation to pay social security contributions also seem to boost marginal jobs held as a main occupation at the expense of those held as a secondary occupation. While the former are included in the employment statistics, the latter are not.

Germany

Unemployment[1] is coming down



Consumer confidence remains robust



1. Seasonally adjusted, registered unemployment.
Sources : Deutsche Bundesbank and OECD.

Orders are buoyant but while still favourable, the business climate is weakening…

The inflow of industrial orders in manufacturing accelerated in the first half, mainly driven by external demand. Business sentiment peaked at high levels in early summer 2000, after steady improvements since spring 1999. Although still at a high level, the sentiment deteriorated markedly in the middle of the year, owing to downward revisions of business expectations for the next six months. The drop is probably related to the rise in energy prices.

Germany

Employment, income and inflation

Percentage changes

	1998	1999	2000	2001	2002
Employment	0.9	1.1	1.6	1.1	0.8
Unemployment rate[a]	8.9	8.3	7.7	6.9	6.3
Compensation of employees	1.9	2.4	3.0	2.8	3.1
Unit labour cost	-0.1	0.8	0.0	0.1	0.6
GDP deflator	1.1	0.9	0.0	1.0	1.4
Private consumption deflator	1.1	0.3	1.5	1.6	1.6

a) As a percentage of labour force, National accounts basis.
Source: OECD.

... in a context of rising oil prices affecting the terms of trade and inflation

Accelerating oil prices and the depreciation of the euro shaped the development of inflation rates. Import prices accelerated sharply, mainly on account of the oil price rise. Export prices also accelerated -- although to a lesser degree -- responding to the depreciation in the effective exchange rate. The implied deterioration of the terms of trade may have led to a reduction in profit margins, as indicated by a fall in the GDP deflator in the first half of 2000. Consumer price inflation also accelerated, reaching 2½ per cent in the autumn. But core inflation, which excludes oil products, remained at about half this level. Compensation grew more strongly than productivity in the first half (seasonally adjusted) but growth in unit labour costs remained subdued.

Germany

Financial indicators

	1998	1999	2000	2001	2002
Household saving ratio[a]	10.2	9.9	10.1	10.2	9.8
General government financial balance[b,c]	-2.1	-1.4	1.4	-1.7	-1.2
Current account balance[b]	-0.2	-0.9	-0.9	-0.6	0.0
Short-term interest rate[d]	3.5	3.0	4.4	5.4	5.5
Long-term interest rate[e]	4.6	4.5	5.4	5.7	5.7

a) As a percentage of disposable income.
b) As a percentage of GDP.
c) Maastricht definition.
d) 3-month interbank rate.
e) 10-year government bonds.
Source: OECD

Fiscal conditions support domestic demand…

Although public spending restraint is projected to continue, based on the government's budget proposal and consolidation measures legislated earlier, overall fiscal conditions are supporting growth. In 2000, reductions in income taxes and social security contributions have more than compensated for a rise in energy taxes. Moreover, the main income and business tax reform, which will become effective from January 2001 on, includes *inter alia* significant reductions in statutory tax rates for both corporate and personal taxation, an increase in the basic income tax allowance, and a broadening of the tax base. Some of the measures are being phased in over a five-year horizon. Net tax reductions are estimated to total more than 1 per cent of GDP in 2001. With extra revenues from the sales of universal mobile telecommunications systems phone licenses, of the order of 2.5 per cent of GDP**,** being counted as affecting the budget balance, the general government is projected to exhibit a surplus of 1.4 per cent of GDP in 2000. The proceeds from the auctioning are being used for debt redemption, generating savings on interest paid in the following years (which are assumed to be spent on infrastructure investment) To take account of their one-off nature, these revenues have not been included into the Secretariat's estimate of the structural deficit. Overall, this estimate of the structural deficit is projected to deteriorate by 1 per cent of GDP in

2001, owing to the tax reductions, but the structural deficit is then projected to improve by ¼ percentage point in 2002 under the influence of continued spending restraint.

Germany
Demand and output

	1997	1998	1999	2000	2001	2002
	current prices billion DM	Percentage changes, volume (1995 prices)				
Private consumption	2 112.3	2.0	2.6	1.7	2.6	2.4
Government consumption	713.3	0.5	-0.1	1.0	0.5	0.6
Gross fixed investment	784.6	3.0	3.3	2.4	2.8	2.7
Public	69.2	-3.9	5.1	0.7	0.7	0.5
Residential	276.2	0.3	-0.2	-0.3	0.1	0.5
Non-residential	439.2	5.9	5.1	4.3	4.6	4.1
Final domestic demand	3 610.1	1.9	2.2	1.7	2.2	2.1
stockbuilding[a]	6.2	0.4	0.2	0.2	-0.2	0.0
Total domestic demand	3 616.4	2.4	2.4	1.9	2.1	2.1
Exports of goods and services	1 021.1	7.0	5.1	12.6	9.3	7.4
Imports of goods and services	971.0	8.6	8.1	9.1	7.7	6.5
net exports[a]	50.1	-0.3	-0.8	1.1	0.7	0.5
GDP at market prices	3 666.5	2.1	1.6	3.0	2.7	2.5
GDP at market prices in billion euros	1 874.7					
Industrial production	–	4.2	1.5	5.1	4.3	3.2
Memorandum items						
Investment in machinery and equipment	303.5	9.4	7.4	9.1	6.4	5.1
Construction investment	481.1	-1.0	0.5	-2.5	-0.1	0.5

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
Source: OECD.

… and, although decelerating, growth will remain above potential

With world trade expected to slow down over the next two years, the net contribution to growth of the external sector will decline. But domestic demand should remain robust, despite higher interest rates. Private consumption is projected to accelerate further in the second half of 2000 and in 2001, based on income tax reductions and improved labour market conditions. Investment should remain strong, benefiting from tax cuts (despite a tightening of depreciation rules), from very high capacity utilisation in manufacturing, and the favourable investment climate associated with wage moderation embodied in collective agreements that are largely fixed until spring 2002. Construction, however, is expected to remain weak, although it will benefit from higher infrastructure investment. All in all, GDP growth is projected to grow at an annual rate of 3 per cent in 2000 and 2.7 per cent in 2001. Growth will further decelerate in 2002, but will remain above potential, while the output gap will become positive. Headline inflation will edge up this year and wages may accelerate in 2002 when unemployment falls below the estimated non-accelerating inflation rate of unemployment. The unemployment rate should decline from 8.3 per cent in 1999 to 6.3 per cent in 2002. Employment gains will decelerate, however, with growth of marginal employment losing momentum.

Germany

External indicators

	1998	1999	2000	2001	2002
			$ billion		
Merchandise exports	542.7	543.2	546.7	567	618
Merchandise imports	462.9	470.0	482.6	498	537
Trade balance	79.7	73.1	64.1	69	81
Invisibles, net	- 84.4	- 92.5	- 81.9	- 80	- 81
Current account balance	- 4.6	- 19.3	- 17.7	- 11	0
			Percentage changes		
Merchandise export volumes[a]	8.3	4.6	15.7	9.7	7.5
Merchandise import volumes[a]	10.8	4.8	12.6	8.1	7.0
Export performance[b]	0.2	- 1.4	3.1	0.1	- 0.5
Terms of trade	2.7	0.2	- 4.8	- 0.8	0.5

a) Customs basis.
b) Ratio between the total of export volumes and export market of total goods.
Source: OECD.

But there are both external and domestic risks to activity

A risk to these projections would arise if negative terms of trade effects on private consumption and investment associated with persistently high oil prices and a low euro exchange rate prove to be stronger than expected. On the other hand, the tax reductions may induce higher consumption of private households than assumed in the projections.

FRANCE

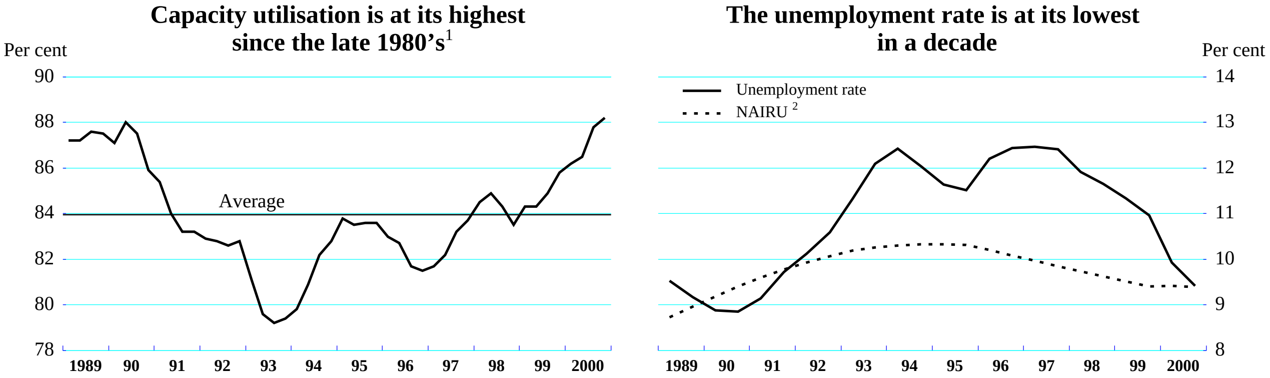
France entered 2000 with robust economic growth and low inflation. Job creation was vigorous, and unemployment dropped to its lowest level in ten years. Strong world trade growth, easy monetary conditions and high consumer confidence underpinned economic activity. Capacity utilisation approached its highest level in a decade, and enterprises therefore stepped up their gross fixed investments. The economic environment has, however, become less supportive recently. Higher crude oil prices are in particular reducing growth in real household incomes and affecting confidence. As a result, the pace of economic expansion appears to have eased somewhat.

At this juncture, fiscal policy needs to be prudent. The significant tax cuts made by the authorities are helpful to support real incomes and launch a supply-side oriented reform of the tax system. They require, however, a strict adherence to the "spending rule" introduced in the medium-term public finance programme in order to preserve a sound budget. Spending restraint is also required in view of the high public indebtedness and large unfunded pension liabilities.

Economic growth slowed somewhat during the first half of 2000…

France entered 2000 with solid growth and moderate inflation. Output growth benefited from a supportive international environment and the weak euro, as well as from gains in real disposable incomes and bullish consumer confidence. Industrial firms encountered growing difficulties in satisfying orders because capacity utilisation was reaching levels unknown for a decade, and therefore stepped up their investment. Higher oil prices, however, have subsequently slowed real income growth, reduced confidence and moderated household spending expansion, so that real GDP growth has weakened somewhat.

France

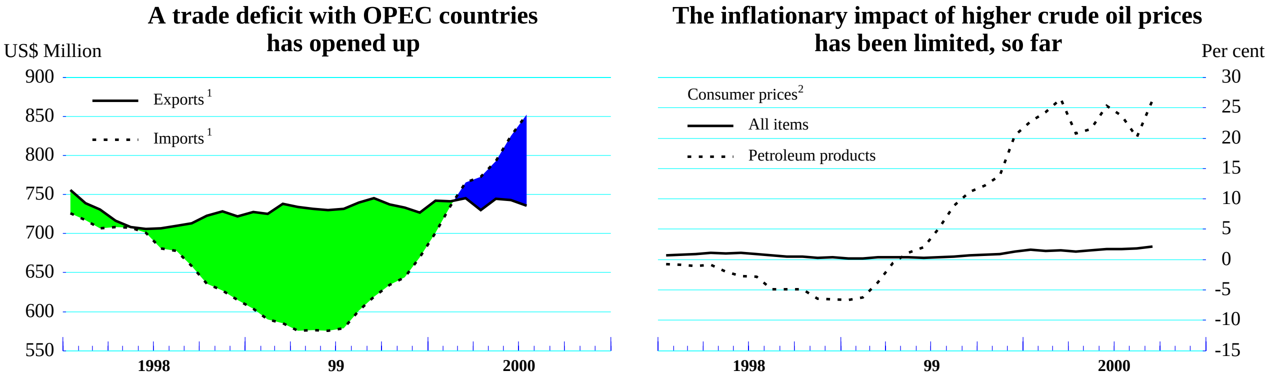


1. Manufacturing sector
2. Secretariat estimate.
Sources: INSEE and OECD.

… but job creation remained strong...

In 1999 and the first half of 2000, enterprises created new jobs at a pace not seen for many years. Besides output expansion, employment growth has been supported by various other factors, including greater labour market flexibility, lower social security contributions, new jobs in the public sector and wage moderation. This has allowed unemployment to fall to its lowest level in ten years, with most categories of job seekers enjoying improved employment prospects. About one-half of workers in large enterprises (20 employees and more) have been covered by 35-hour agreements. These firms have been able to reduce working time without cutting monthly salaries, in part thanks to generous state subsidies. The legislation foresees that small firms (less than 20 employees) will be subject to the 35-hour rules beginning in 2002.

France



1. Three-month moving averages at monthly rates.
2. Growth rate over twelve months.
Sources: INSEE and OECD.

... and inflation is still moderate

With oil prices back to a high level, headline inflation has been creeping up. Higher oil prices and the weaker euro, taken together, have contributed 1 per cent to annual consumer price inflation. However, apart from energy and also food, price movements have so far remained surprisingly subdued, most probably because nominal wages have not reacted to the upward drift in inflation. Hence, although core inflation is presently not a concern, faster nominal wage increases would change this assessment.

The 2001 budget envisages no further progress in fiscal consolidation

General government receipts in 2000 have benefited from vigorous income growth in 1999 (close to half of state tax revenue is linked to previous year’s income). The bulk of these additional revenues was used to cut taxes, in the context of a broad reform of the tax system. The various tax cuts add up to a total of 1 per cent of GDP in 2000. The authorities have announced a new tax cut plan for the period 2001-03 amounting to FF 120 billion (approximately 1.2 per cent of GDP in 2003). The new plan mainly benefits

France

Employment, income and inflation

Percentage changes

	1998	1999	2000	2001	2002
Employment	1.4	1.8	2.1	1.8	1.3
Unemployment rate[a]	11.8	11.1	9.7	8.8	8.2
Compensation of employees	3.9	3.9	4.3	4.9	4.4
Unit labour cost	0.6	0.9	1.0	2.0	1.9
Household disposable income	3.7	3.0	4.0	4.8	4.5
GDP deflator	0.8	0.3	0.9	1.7	2.3
Private consumption deflator	0.7	0.7	1.5	2.1	2.0

a) As a percentage of labour force.
Source: OECD.

households through lower personal income taxes, employee social security contributions, and passenger car taxes. Businesses too will get tax reductions in the form of lower corporate taxes, but to a lesser extent. In addition to this three-year plan, the authorities have decided to soften the impact of higher oilprices on energy consumers. A new system of "floating gasoline taxes" was introduced to help reduce the impact of volatile prices on the cost of fuel for passenger cars and truck fleets. With all these measures, general government revenues are now growing less rapidly than nominal GDP, so that the tax burden is gradually drifting down. On the expenditure side of the budget, the authorities decided to exceed in 2001 the 1.3 per cent per annum real "spending growth rule" that was included in the medium-term public finance programme. In particular, ministries have been authorised to start new recruitment after years of freeze. Public hospitals will also be entitled to new hiring. Finally, the government loosened the restraint on health care spending

France

Financial indicators

	1998	1999	2000	2001	2002
Household saving ratio[a]	15.6	15.6	15.6	16.0	16.2
General government financial balance[b,c]	-2.7	-1.8	-1.4	-0.1	-0.8
Current account balance[b]	2.6	2.6	2.3	2.3	2.4
Short-term interest rate[d]	3.6	3.0	4.4	5.4	5.5
Long-term interest rate[e]	4.7	4.6	5.5	5.8	5.8

a) As a percentage of disposable income.
b) As a percentage of GDP.
c) Maastricht definition.
d) 3-month interbank rate.
e) 10-year benchmark government bonds.
Source: OECD.

and raised pension benefits by more than inflation. Overall, these measures imply that no further progress is being made in consolidating the budget, and that the underlying structural deficit will increase during the period 2000-01. Proceeds from the sale of third generation telephone licenses *via* a "beauty contest" in 2001 (slightly over 1 per cent of GDP) will be used to build up assets of the pension reserve fund and, to a lesser extent, for debt buy-backs (not included in the OECD estimate of the structural deficit).

The economy will lose momentum gradually in 2001 and 2002 with inflation edging up

The short-term outlook is influenced by a mix of negative and positive factors. On the positive side, the environment is propitious for increased investment: business expectations remain positive and profit margins comfortable. In addition, after years of weak investment, companies need to expand their production capacity, modernise equipment, and incorporate new information and communication technologies. Business fixed investment is therefore projected to pick up strongly and approach annual increases of nearly 7 per cent in real terms, allowing the capital stock to grow in line with output. But, at the same time, several negative factors are influencing the outlook. First, the sharp increase in oil prices is reducing household real incomes, and -- notwithstanding the package of tax cuts -- a downward impact on consumer spending should result. Second, world trade is projected to decelerate markedly in the wake of the soft landing expected in

France
Demand and output

	1997	1998	1999	2000	2001	2002
	current prices billion FF	Percentage changes, volume (1995 prices)				
Private consumption	4 509.1	3.4	2.3	2.6	2.3	2.2
Government consumption	1 986.2	0.3	2.5	1.3	1.3	1.3
Gross fixed investment	1 473.0	6.6	7.2	6.0	4.6	4.8
General government	243.2	2.8	2.2	2.8	1.5	1.4
Household	374.3	3.6	8.2	6.2	0.9	0.9
Other	855.6	9.0	8.1	6.8	6.9	7.0
Final domestic demand	7 968.4	3.3	3.3	3.0	2.5	2.6
stockbuilding[a]	- 7.6	0.6	-0.4	0.0	0.0	0.0
Total domestic demand	7 960.7	3.9	2.9	3.0	2.5	2.5
Exports of goods and services	2 093.2	7.7	3.8	12.8	8.7	7.4
Imports of goods and services	1 849.2	11.3	3.8	12.5	8.1	8.1
net exports[a]	244.0	-0.6	0.1	0.4	0.4	0.0
GDP at market prices	8 204.8	3.2	2.9	3.3	2.9	2.5
GDP at market prices in billion euros	1 250.8					
Industrial production[b]	_	5.1	2.1	3.2	2.6	2.3

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) Quarterly index.
Source: OECD.

North America. Third, the monetary tightening by the European Central Bank will have a lagged dampening impact on domestic demand. Finally, French enterprises are running into supply-side constraints (hiring difficulties, high capacity utilisation) and have little leeway to increase output, so that imports are growing faster than domestic production. On balance, the negative factors are expected to somewhat exceed the positive influences, and real GDP is therefore projected to lose speed gradually over the next two years. In this environment, inflation is expected to edge up, initially under the impulse of energy prices, then increasingly under the pressure of higher wage settlements. But with petroleum prices moderating as from the middle of next year, consumer price inflation could remain in the 2 per cent range over the projection period.

France

External indicators

	1998	1999	2000	2001	2002
	$ billion				
Merchandise exports	302.8	298.1	295.0	310	342
Merchandise imports	278.0	278.4	287.0	303	333
Trade balance	24.8	19.8	8.0	7	8
Invisibles, net	13.3	17.8	22.0	21	23
Current account balance	38.2	37.5	30.0	28	31
	Percentage changes				
Merchandise export volumes[a]	8.8	3.8	14.0	9.2	7.7
Merchandise import volumes[a]	12.3	4.7	14.0	8.2	8.5
Export performance[b]	- 0.1	- 1.8	1.5	- 0.1	0.0
Terms of trade	1.5	- 1.0	- 3.4	- 1.4	0.9

a) Customs basis.
b) Ratio between the total of export volumes and export market of total goods.
Source: OECD.

The main risk stems from the impact of high oil prices

This relatively positive outlook of growth persisting despite a less supportive environment is threatened by the risks stemming from high oil prices. So far, energy price hikes have been accompanied by remarkably mild retail price and nominal wage responses -- so mild that they are not entirely explainable. There is therefore a risk that price increases are currently being repressed and that inflationary pressures will be unleashed at some point. Growing inflation would erode real incomes further and undermine confidence. In addition, higher oil prices may also have a larger impact on the world economy than projected. Without a healthy international economic environment, the French economy would lose more speed than projected, and the projected further improvement in labour market conditions would not be realised.

ITALY

GDP growth should be around 2¾ per cent in 2000, based on strong domestic and external demand. But the effects of higher oil prices on inflation and confidence are likely to lead to somewhat slower growth over the projection period. Wage behaviour has remained moderate so far, and if this continues, then consumer price inflation that is running at just below 2¾ per cent at present could fall back to around 2 per cent by 2002.

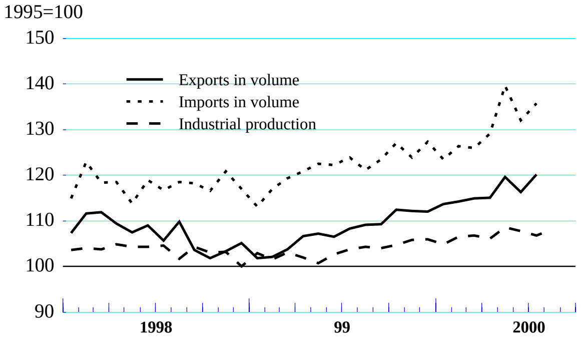
Italy's structural reform requirements focus on the need to increase competition in the sheltered sectors of the economy, where inflation inertia raises costs and affects the exposed sectors, thereby weakening competitiveness *vis-à-vis* the euro area. Continuing efforts are also needed to tackle the wide divergence in labour-market performance between the North and the South.

The recovery has continued but the pace has slowed somewhat

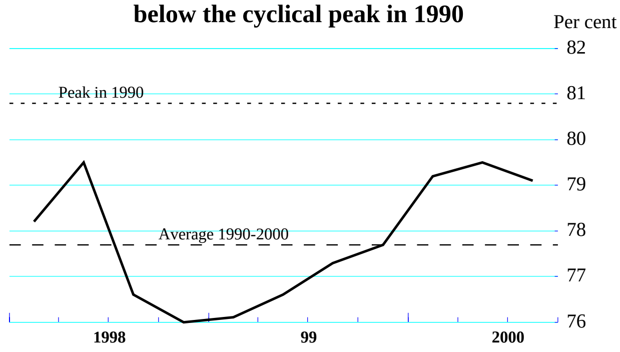
The recovery that began in late 1999 continued during the first half of 2000, underpinned both by domestic demand, most prominently investment in equipment, and by strong exports. However, the pattern of activity changed during the semester. Following a period of negative stockbuilding, inventory accumulation strengthened in the second quarter, while the restraining effects of higher inflation on real income growth translated into a smaller impulse from household spending. On the external side, export growth exhibited a weakening trend and imports jumped. At 2.6 per cent in the second quarter (annual rate), real GDP was below expectations and represented a deceleration compared with the 3 per cent registered in the previous quarter.

Italy

The external sector is driving activity [1]



Capacity utilisation is still below the cyclical peak in 1990

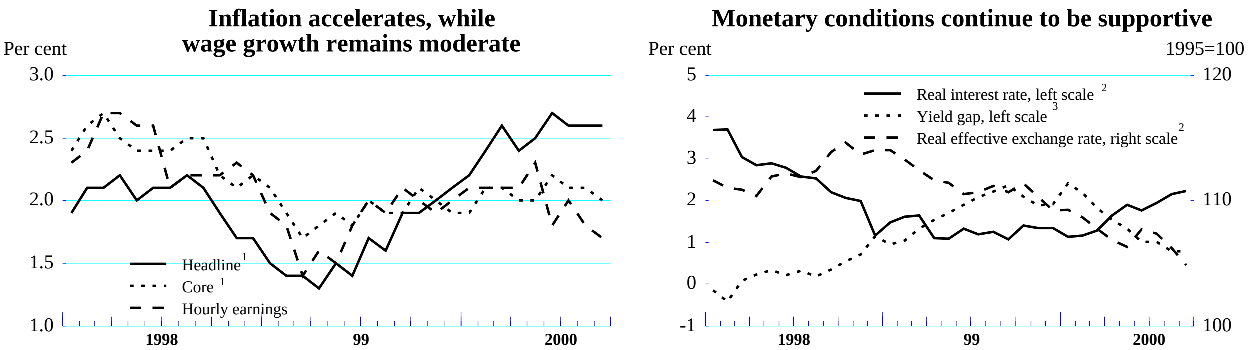


1. Year-on-year percentage changes using three-month moving averages. Data are seasonally adjusted.
Source: OECD.

Import demand has been strong, as have exports to non-EMU countries

Industrial production has recovered substantially since mid-1999 and the level of capacity utilisation is the highest since early 1990. The upswing in industrial production has to a large extent been driven by the solid performance of real merchandise exports, which rose by 9 per cent in the first half of 2000. Export demand has been supported by the weakness of the euro and expanding foreign markets, reflecting mainly strong sales to the US and emerging Asian markets. Sales growth to the euro area has been relatively modest, reflecting an underlying deterioration in competitiveness *vis-à-vis* Italy's euro competitors. Real imports surged in the first half of 2000, over and above the rise implied by the high import content of Italian exports. This accentuated the adverse effects of worsening terms of trade, so that the trade surplus continued to decline.

Italy



1. Year-on-year percentage changes of the harmonised consumer price index. Core inflation excludes energy, food, alcoholic beverages and tobacco.
2. Deflated using the consumer price index.
3. Long-term interest rate minus short-term interest rate.
Sources: OECD; Eurostat.

The labour market has strengthened, without narrowing regional differences

Assisted by accelerating investment, the labour market has registered further improvement. Employment rose by 2 per cent in the third quarter of 2000 (annual rate), corresponding to 430 000 additional employees. There has been a one percentage point reduction in the unemployment rate since the end of 1999 (down to 10.5 per cent in seasonally adjusted terms). However, a decline in unemployment in the South has not sufficed so far to markedly reduce the wide regional disparities which characterise the Italian labour market: the unemployment gap between northern and southern regions is still 16¼ per cent. In the North, the unemployment rate is about 4½ per cent and survey figures point to a relatively tight labour market, with the business sector expressing concerns about a lack of specialised workers.

Italy

Employment, income and inflation

Percentage changes

	1998	1999	2000	2001	2002
Employment	1.1	1.2	1.3	1.2	1.1
Unemployment rate[a]	11.9	11.5	10.8	10.1	9.4
Compensation of employees	-1.2	3.6	3.9	3.9	3.6
Unit labour cost[b]	-2.7	2.2	1.0	1.2	1.0
Household disposable income	2.6	3.0	3.6	4.3	3.9
GDP deflator	2.7	1.5	1.8	2.2	2.0
Private consumption deflator	2.1	2.2	2.7	2.5	2.0

a) As a percentage of labour force.
b) The figure for 1998 reflects the introduction of the regional tax (IRAP) which was accompanied by the partial abolition of the employers' compulsory contributions to the health care system.
Source: OECD.

Inflation has increased, but wage tensions are absent and external competitiveness has been maintained

There is no evidence thus far that such tensions have compromised wage moderation. Assisted by the improved economic momentum, labour productivity increased relative to 1999, and this, combined with wage moderation and euro depreciation, has supported Italy's external competitiveness outside the euro area. However, oil prices continued to increase over the summer and the euro depreciated further, exacerbating producer price inflation. Reflecting these mounting pressures, the rate of consumer price inflation drifted up to somewhat above 2½ per cent in the third quarter of 2000, the highest level since early 1997.

Italy

Financial indicators

	1998	1999	2000	2001	2002
Household saving ratio[a]	13.1	12.3	11.3	11.3	11.0
General government financial balance[b]	-2.8	-1.9	-0.1	-1.0	-0.8
Current account balance[b]	1.8	0.6	-0.9	-0.7	-0.6
Short-term interest rate[c]	5.0	3.0	4.4	5.4	5.5
Long-term interest rate[d]	4.9	4.7	5.7	5.9	5.9

a) As a percentage of disposable income.
b) As a percentage of GDP.
c) Interbank deposit rate.
d) 10-year government bonds.
Source: OECD.

Higher tax receipts are being given back as tax cuts

The projection for the general government deficit takes into account the planned concession of a "fiscal bonus" (some ½ percentage point of GDP in 2000 and 1 point in 2001). The official (and OECD) assumption is that this will not worsen the deficit outturn for 2000, thanks to the higher baseline for receipts, resulting from tax reforms (including the fight against tax evasion). For this year the OECD is projecting a deficit outcome consistent with the official target.[24] However, for 2001 the official expenditure assumption may be optimistic in light of a possible overrun, including on health. The projection thus sees the possibility of a slight slippage from target in the absence of new structural measures to keep expenditures under better control.

Italy
Demand and output

	1997	1998	1999	2000	2001	2002
	current prices trillion L.	Percentage changes, volume (1995 prices)				
Private consumption[a]	1 167.8	2.3	1.7	2.0	1.8	2.3
Government consumption	360.5	0.7	0.6	1.2	1.1	1.2
Gross fixed investment	359.6	4.1	4.4	6.9	4.7	5.2
Machinery and equipment	200.9	7.4	6.2	7.9	5.6	6.0
Construction	158.8	-0.1	1.8	5.5	3.4	4.0
Residential	88.9	-0.6	1.6	0.0	0.5	1.0
Non-residential	69.8	0.5	1.9	12.3	6.7	7.2
Final domestic demand	1 888.0	2.4	2.0	2.9	2.3	2.7
stockbuilding[b]	15.4	0.6	0.4	-0.6	0.0	0.0
Total domestic demand	1 903.4	2.9	2.5	2.2	2.2	2.7
Exports of goods and services	524.4	3.3	-0.4	9.5	9.3	7.6
Imports of goods and services	444.0	9.1	3.4	7.6	8.1	8.4
net exports[b]	80.5	-1.3	-1.0	0.6	0.5	-0.1
GDP at market prices	1 983.9	1.5	1.4	2.8	2.7	2.6
GDP at market prices in billion euros	1024.6					
Industrial production	_	1.3	0.0	4.4	3.5	2.9

a) Final consumption in the domestic market by households.
b) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
Source: OECD.

Monetary conditions are supporting activity but inflation is rising

Despite the increases in short-term interest rates by the European Central Bank, monetary conditions remain accommodating. While long-term rates have also risen recently, so too has inflation, and real interest rates remain low by historical standards. Taking into account both the direct effect of the oil-price hike on consumer prices and the related second-round effects on the price of imported intermediate inputs, the

24. The projection for the general government deficit in 2000 takes into account the revenues from selling of third-generation mobile phone licences (UMTS). These equal L 26.8 trillion, some 1.2 per cent of GDP. Such an amount is set against the underlying budget deficit of 1.3 per cent and allowed to reduce the debt.

projection sees consumer price inflation rising to just below 2¾ per cent in 2000, then decelerating somewhat from the first half of 2001. It should continue to moderate thereafter, as the combined impacts of higher oil prices and exchange rate depreciation unwind. However, following a year of moderate wage gains, wage inflation seems set to accelerate somewhat in 2001, as the new round of wage negotiations is expected to imply a partial recuperation of the losses caused by the gap between actual and expected inflation in 2000.

Consumption is expected to weaken temporarily, but business sentiment remains strong

Stronger inflationary pressures seem to have had some negative impact on consumer confidence, which points to some temporary weakening in consumption growth. Corporate surveys also suggest somewhat less optimistic business-sector sentiment. But order books are still healthy and investment should remain robust, albeit decelerating somewhat. Moreover, despite rising unit labour costs, the new exchange rate assumptions imply a positive contribution to growth arising from the external sector in both 2000 and 2001. GDP is thus projected to rise by 2¾ per cent in 2001 and some 2½ per cent in 2002.

Italy

External indicators

	1998	1999	2000	2001	2002
	$ billion				
Merchandise exports	245.5	231.0	233.1	251	276
Merchandise imports	209.2	210.5	220.8	238	263
Trade balance	36.4	20.6	12.3	13	13
Invisibles, net	- 14.6	- 13.9	- 21.5	- 20	- 20
Current account balance	21.8	6.6	- 9.2	- 7	- 6
	Percentage changes				
Merchandise export volumes[a]	3.3	1.5	10.6	9.4	7.7
Merchandise import volumes[a]	10.9	3.8	8.9	8.7	8.9
Export performance[b]	- 6.2	- 5.8	- 2.1	0.0	- 0.2
Terms of trade	5.2	- 3.1	- 5.8	- 0.8	0.7

a) Customs basis.
b) Ratio between the total of export volumes and export market of total goods.
Source: OECD.

The projections contain significant risks

The main uncertainties attaching to the projections relate to the possible consequences of the oil price hike on consumption and investment. Higher costs of intermediate inputs could combine with weakening business confidence to dampen investment plans, partly offsetting the influence of an accommodating monetary policy stance. Although the employment picture is improving, weakening household confidence could lead to a temporary recovery in saving rates following the marked decline which has occurred this year. On the other hand, if and when such confidence effects dissipate, the positive impact on household consumption arising from the planned "fiscal bonus" could be underestimated, with inflationary consequences.

UNITED KINGDOM

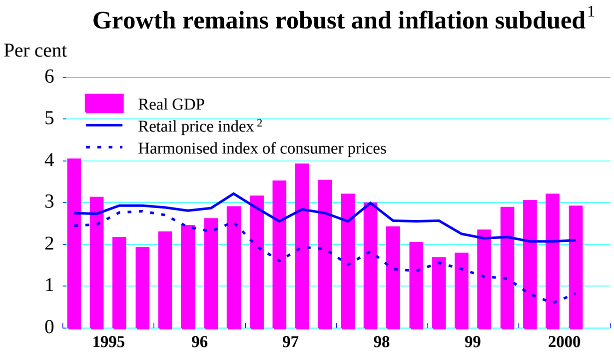
Growth has been robust in the first half of this year, mainly driven by household consumption. Labour markets have continued to tighten, with unemployment reaching very low levels by historical standards, but wage and price inflation remain subdued. The outlook is for a gradual deceleration of output, corresponding to a smooth slowdown in domestic demand, and for a limited pick-up in inflation.

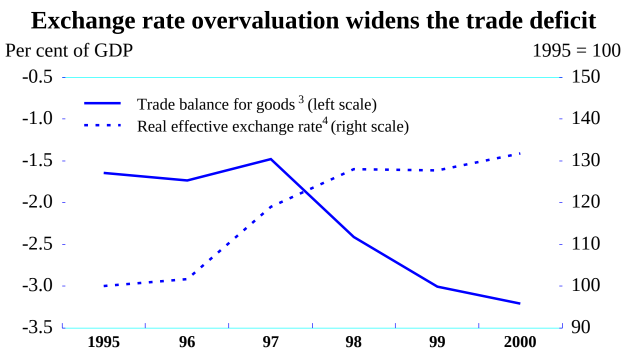
Fiscal policy in the first half of the year has been slightly restrictive, reflecting buoyant revenue. This has eased the burden borne by monetary policy in an economy with little slack. Interest rates might have to increase a bit further, however, if the impact on aggregate demand of the acceleration of public spending is not offset by a sufficient slowdown of private consumption, or if the exchange rate were to depreciate markedly.

Growth has been robust, led by consumption

Over the past year and a half, activity expanded at a rate exceeding potential and approaching 3 per cent. The key factor underlying this vigorous performance was buoyant household consumption. This was accompanied by a sharp decline in the household saving ratio, to only 3 per cent of disposable income, in the second quarter, the lowest level since the 1980s and well below what is observed in most other European countries (but above the current level in the United States). Meanwhile, private fixed investment continued to slow -- albeit after half a decade of rapid growth -- somewhat diminishing the likelihood of a sharp productivity acceleration. Exports picked up, reflecting the dynamism of demand overseas, but market share erosion continued owing to the strength of the pound, despite

United Kingdom

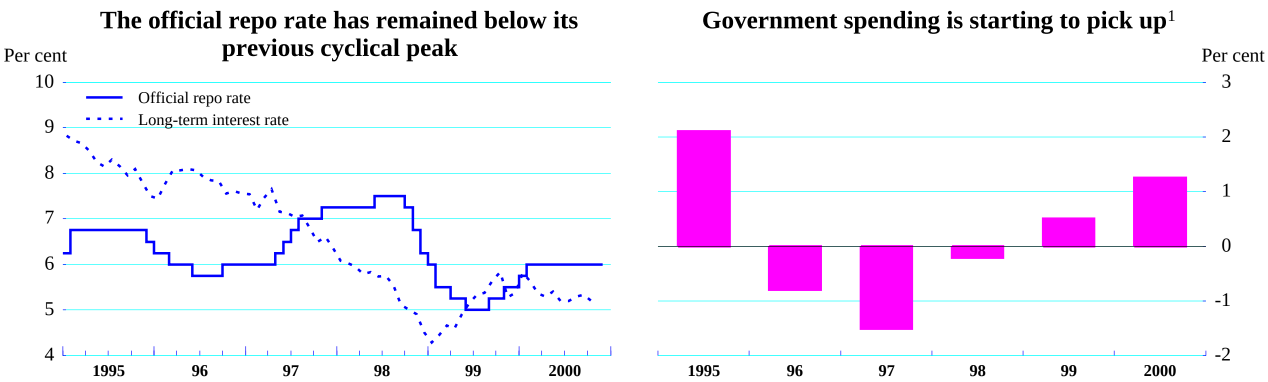




1. Year-on-year percentage changes.
2. All items excluding mortgage interest payments (RPIX).
3. Balance of payments basis.
4. Based on consumer prices.
Sources: ONS and OECD.

the compression of exporters' margins. In effective terms, the currency has come down from its spring 2000 peak, having depreciated significantly against the dollar and to a lesser extent against the euro. Nevertheless, on most estimates the pound remains overvalued. In this context, and given the vigour of domestic demand, import growth barely abated and the goods trade deficit widened to over 3 per cent of GDP (at current prices).

United Kingdom



1. Growth of total general government expenditure in real terms (using the GDP deflator).
Sources: Bank of England and ONS.

Although unemployment has declined further, inflationary pressures have been contained thus far

At the same time, the strength of the pound helped offset the inflationary pressures stemming from domestic labour and product markets. Unemployment continued to decline, down to 5.3 per cent of the labour force, not least reflecting a welcome decrease in long-term joblessness. Skill shortages remained pronounced in some sectors. Meanwhile, prices for materials and fuels purchased by manufacturing industry were rising at double digit rates. Notwithstanding, wage inflation as reflected in regular pay as well as wage settlements did not increase and headline average earnings even decelerated, owing partly to the ending of millennium-related bonuses. Moreover, retail price inflation (excluding mortgage interest payments) remained clearly below the 2½ per cent target, while consumer price inflation (on a harmonised basis) did not exceed 1 per cent and was the lowest in the European Union. The intensification of competition in various sectors, including the car sector, helped contain inflation. Furthermore, house price inflation slowed down significantly.

Monetary policy has remained on hold…

Faced with those mixed signs, and taking into account the time needed for earlier pre-emptive interest rate hikes to work their way through, the Monetary Policy Committee of the Bank of England has left the official repo rate unchanged since last February, at 6 per cent. In general, market participants no longer expect a further rise. Long-term interest rates have not fluctuated much since the Spring, remaining below corresponding euro area averages, with the yield curve continuing to be negatively sloped.

United Kingdom

Employment, income and inflation

Percentage changes

	1998	1999	2000	2001	2002
Employment	1.1	1.3	1.2	0.7	0.4
Unemployment rate[a]	5.9	6.0	5.5	5.4	5.5
Compensation of employees	7.1	6.3	5.0	5.6	5.2
Unit labour cost	4.3	4.0	2.0	2.9	2.8
Household disposable income	2.5	5.5	4.5	5.5	5.0
GDP deflator	3.0	2.5	2.0	2.5	2.6
Private consumption deflator	2.4	2.0	1.4	2.4	2.3

a) As a percentage of labour force.
Source: OECD.

… while public spending is about to accelerate

Tax receipts grew much faster than forecast at the time of the March 2000 Budget, including on account of higher oil prices, while unemployment-related outlays undershot budgeted amounts. As a result, the cyclically-adjusted fiscal surplus rose in the first half of 2000.[25] Other current and capital spending, however, has started to pick up and the cyclically-adjusted surplus is projected to shrink by almost one percentage point of GDP over the projection period. Measures on fuel duties and

United Kingdom

Financial indicators

	1998	1999	2000	2001	2002
Household saving ratio[a]	5.8	5.1	3.9	4.3	4.6
General government financial balance[b]	0.4	1.3	2.7	2.2	1.8
Current account balance[b]	0.0	-1.2	-1.5	-1.9	-1.9
Short-term interest rate[c]	7.3	5.4	6.3	6.6	6.3
Long-term interest rate[d]	5.5	5.1	5.5	5.7	5.7

a) As a percentage of disposable income.
b) As a percentage of GDP.
c) 3-month interbank rate.
d) 10-year government bonds.
Source: OECD.

25. Unlike for most other European countries, the receipts associated with the auction of third-generation mobile phone licences (totalling 2.4 per cent of annual GDP) are not included by the United Kingdom authorities in general government revenue as the sale of an asset, but classified as rental income over the lifetime of the licences. The OECD has applied national treatment.

increases in state-financed pension entitlements are presently under consideration but not taken into account in the projections.[26] The structural surplus would nonetheless remain higher and the debt-to-GDP ratio lower than in the largest euro area countries.

The economy is projected to revert to trend

Growth is projected to gradually moderate to trend rates over the next two years, so that the current small positive output gap would increase only slightly. The main underlying force would be the deceleration in private consumption, which would be affected by higher oil prices and no longer boosted by the sizeable wealth effects witnessed in recent years in connection with the buoyancy of stock and housing markets. This would be consistent with survey evidence of weakening consumer confidence. Concomitantly, the household saving ratio would recover somewhat. Capacity utilisation is high and fixed business investment is projected to pick up. Public sector investment is set to rise more rapidly, in line with the July 2000 Spending Review, following a string of lean years. The external balance would exert a diminishing but still significant drag on growth over the projection period. Against this background, unemployment would not decline further from its current low level. Wage and price inflation are projected to rise a bit, but retail prices are unlikely to increase much faster than the target.

United Kingdom
Demand and output

	1997	1998	1999	2000	2001	2002
	current prices billion £	Percentage changes, volume (1995 prices)				
Private consumption	517.9	4.0	4.3	3.5	2.4	2.2
Government consumption	148.4	1.1	3.3	1.8	4.3	3.3
Gross fixed investment	134.2	10.1	6.1	2.4	3.8	3.0
Public[a]	11.5	3.7	0.5	4.7	7.0	6.7
Private residential	29.6	-0.3	2.7	0.0	2.7	2.9
Private non-residential	93.0	13.8	7.6	2.7	3.7	2.7
Final domestic demand	800.5	4.5	4.5	3.0	3.0	2.6
Stockbuilding[b]	4.4	0.1	-0.7	0.4	-0.1	0.0
Total domestic demand	804.9	4.6	3.7	3.4	2.9	2.6
Exports of goods and services	229.3	2.6	3.3	7.8	7.2	6.0
Imports of goods and services	228.8	8.8	7.6	8.5	7.5	6.1
Net exports[b]	0.5	-2.0	-1.6	-0.6	-0.5	-0.3
GDP at market prices	805.4	2.6	2.2	3.0	2.6	2.3
Manufacturing production	_	0.5	-0.1	1.5	3.0	2.8

a) Including nationalised industries and public corporations.
b) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
Source: OECD.

26. The November 2000 Pre-Budget Report, which will contain a number of new measures, is to be published after the cut-off date for this Outlook.

Overheating remains a risk

Risks to this rather benign outlook go both ways. On the bright side, the numerous measures taken over the past few years to boost product market competition, raise the employability of the low-skilled and sharpen work incentives for the low-paid should help ease the inflationary pressures stemming from rising oil prices. On the opposite side, some uncertainties loom. One relates to wage moderation or the lack thereof, in the context of a tight labour market. Another pertains to households' propensity to save, which could turn out to be lower than projected if they feel that their balance sheet positions are still strong, with interest rates far below their levels a decade ago. A third one is associated with a possible firming of the euro *vis-à-vis* sterling, which would ease many exporters' plight but push domestic prices up.

United Kingdom

External indicators

	1998	1999	2000	2001	2002
			$ billion		
Merchandise exports	271.9	268.0	282.1	299	325
Merchandise imports	305.9	311.4	327.5	349	377
Trade balance	- 34.1	- 43.4	- 45.5	- 50	- 52
Invisibles, net	33.9	25.6	23.9	23	23
Current account balance	- 0.2	- 17.8	- 21.5	- 27	- 29
			Percentage changes		
Merchandise export volumes[a]	1.5	3.4	7.9	7.4	6.0
Merchandise import volumes[a]	9.4	7.2	7.6	7.8	6.1
Export performance[b]	- 6.5	- 2.4	- 3.9	- 2.0	- 1.7
Terms of trade	1.7	0.9	- 0.5	- 0.2	0.6

a) Customs basis.
b) Ratio between the total of export volumes and export market of total goods.
Source: OECD.

CANADA

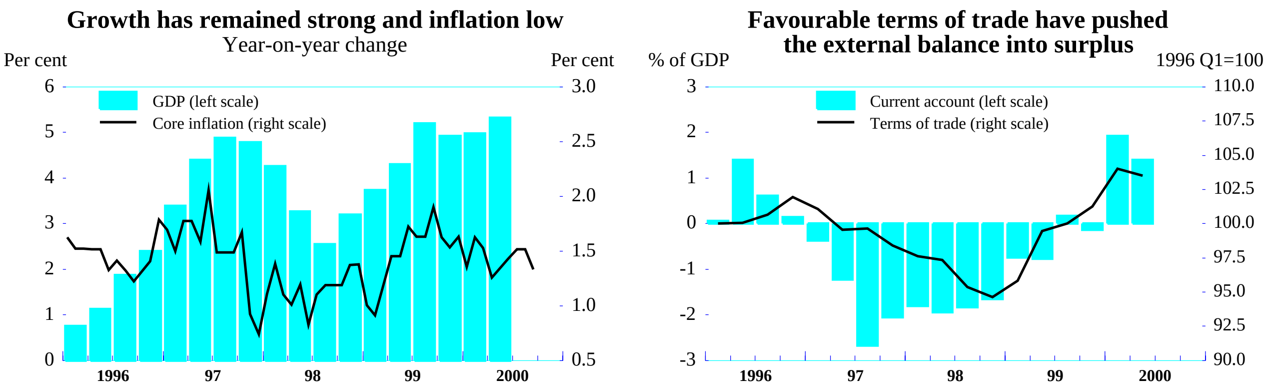
Growth performance remained strong through mid-2000, aided by persistently robust demand in the United States and rising world commodity prices. With income gains in the export sector spilling over into the rest of the economy, business investment has surged and household demand has strengthened. Despite the recent momentum of the economy, underlying cost and price pressures are still subdued. On the back of the improving terms of trade, the current account has moved into substantial surplus. At the same time, stronger-than-anticipated economic growth has contributed to large fiscal surpluses. Even with tax cuts, the economy is projected to shift to a more moderate pace of growth, owing to monetary tightening and the expected slowdown in the United States.

Although core inflation is still low, a further moderate tightening of monetary policy may be needed in the near term, given that the economy already appears to be operating at, or slightly above, full capacity. Against this backdrop, it would be advisable to use any extra revenues beyond budgeted levels for public debt reduction rather than funding one-off spending initiatives, so as to take pressure off monetary policy. Maintaining the pace of economic growth will also entail continuing policy efforts in the area of structural reform. In this context, the proposed changes to the Employment Insurance programme, which may have adverse effects on structural unemployment and hence potential growth, should be reconsidered.

Following a period of strong growth, there are signs of moderation

In the first half of 2000, real GDP expanded at an annual rate of 5 per cent, about the same pace as recorded in the two preceding half years. Growth continued to be driven by exports and business fixed investment, with both advancing at double-digit rates. Corporate capital spending has been supported by the rise in both capacity utilisation and profitability to historical highs. Investment in machinery and equipment has been

Canada

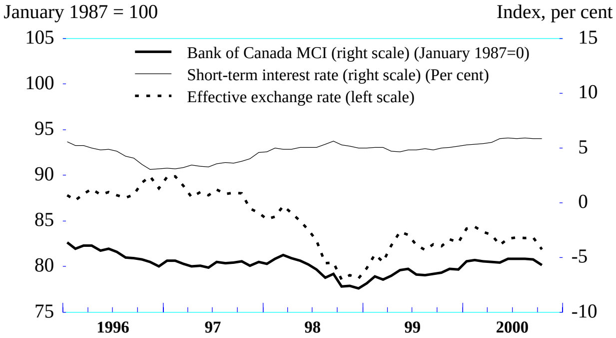


Sources: Statistics Canada and Bank of Canada.

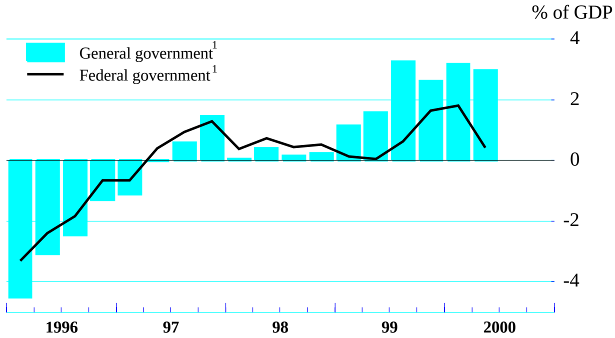
particularly buoyant in recent quarters, as strong spending on computers, continued unabated following the year 2000 episode. On the other hand, demand has shown some signs of slowing in the most interest-sensitive sectors, such as construction and durable goods, apparently reflecting the monetary tightening from late 1999, though special factors have also played a role. Recent employment developments suggest that this tendency has begun to translate into a more moderate pace of overall economic expansion, although output growth has increasingly relied on productivity gains. Combined with rising labour-force participation, slower employment growth has caused the unemployment rate to edge up from its low of just over 6½ per cent reached in the middle of the year.

Canada

Monetary conditions have changed little



The budget has been in substantial surplus



1. National Accounts definition.
Sources: Statistics Canada and Bank of Canada.

Rising commodity prices are reflected in higher headline inflation and an external surplus

Although economic slack seems to have been absorbed, underlying inflation has remained muted so far. While the annual increase in the all-items consumer price index has moved toward the ceiling of the official 1 to 3 per cent target band, the Bank of Canada's indicator of core inflation (excluding energy, food and indirect taxes) has stayed well below the mid-point of the band. For the time being, there is no evidence that higher energy prices, which have pulled up "headline" inflation, are feeding to any significant extent into prices of other goods and services, or into inflation expectations. With Canada being a net exporter of commodities in general and of energy in particular, rising world market prices have entailed a marked improvement in its terms of trade. This, in turn, has resulted in a large positive swing in the current account, which registered a surplus of over 1½ per cent of GDP in the first half of 2000. Despite strong export volume growth, the real foreign balance has actually deteriorated somewhat, as strong aggregate demand has boosted import volume growth.

Canada

Employment, income and inflation

Percentage changes

	1998	1999	2000	2001	2002
Employment	2.6	2.8	2.7	1.6	1.3
Unemployment rate[a]	8.3	7.6	6.7	6.7	6.7
Compensation of employees	4.7	5.1	7.0	5.0	4.9
Unit labour cost	1.4	0.5	2.1	1.6	1.8
Household disposable income	3.9	4.0	6.1	5.6	5.4
GDP deflator	-0.6	1.6	3.3	2.4	2.0
Private consumption deflator	1.0	1.3	1.7	2.3	2.1

a) As a percentage of labour force.
Source: OECD.

Monetary conditions have changed little

Given signs that the economy was rapidly approaching capacity limits, the authorities sought to pre-empt inflation pressures by raising interest rates in parallel with US rates over the six months to May 2000. Since then, with inflation continuing to surprise on the downside, the Bank of Canada has left interest rates unchanged. Taking account of exchange-rate developments, overall monetary conditions have also changed relatively little in recent months. Some recent weakening notwithstanding, the fact that the Canadian dollar has held up much better than many other currencies against its US counterpart and remained roughly stable in effective terms reflects the significant improvement in economic fundamentals in recent years. The projections described below assume that further modest interest-rate increases will be necessary in coming months to keep inflation comfortably within the target range. Some monetary easing is expected, however, later in the projection period, when capacity pressures are seen to diminish.

Canada

Financial indicators

	1998	1999	2000	2001	2002
Household saving ratio[a]	6.1	5.4	6.1	6.4	7.0
General government financial balance[b]	0.2	2.2	2.5	2.1	1.9
Current account balance[b]	-1.8	-0.4	1.8	2.2	2.2
Short-term interest rate[c]	5.0	4.9	5.7	6.2	6.2
Long-term interest rate[d]	5.5	5.7	5.9	6.2	6.3

a) As a percentage of disposable income.
b) As a percentage of GDP.
c) 3-month prime corporate paper.
d) Over-10-year government bonds.
Source: OECD.

Fiscal surpluses remain large

Boosted by better-than-expected economic performance, the federal budget surplus in the fiscal year 1999/2000 (ending in March) reached 1¼ per cent of GDP. This is about 1 percentage point more than in the preceding year and compares with the authorities' commitment to achieve "a balanced budget or better". At the general government level, the financial surplus has been running in the 3 per cent range (national accounts definition) since mid-1999, reflecting the progress provinces have also made in improving their fiscal position. Since the mid-1990s, general government debt has declined by about 15 percentage points. Nonetheless, at over 100 per cent of GDP, gross public debt is still high, although the fact that Canadian data now include funded government pension liabilities tends to overstate the margin over other OECD countries. With substantial tax reductions and additional spending, fiscal surpluses are projected to decline in the period ahead but remain relatively favourable by international comparison, both in actual and cyclically-adjusted terms.

Canada
Demand and output

	1997	1998	1999	2000	2001	2002
	current prices billion C$	Percentage changes, volume (1992 prices)				
Private consumption	512.5	2.9	3.5	3.6	2.8	2.6
Government consumption	171.7	1.6	1.3	2.0	1.7	1.5
Gross fixed investment	167.9	3.4	10.1	11.8	6.4	6.1
Public[a]	18.5	1.4	15.9	15.7	4.2	3.5
Residential	45.1	-2.0	6.6	3.3	3.5	3.9
Non-residential	104.2	6.1	10.5	14.4	7.8	7.3
Final domestic demand	852.1	2.8	4.4	5.1	3.4	3.2
stockbuilding[b]	10.6	-0.5	-0.2	0.4	0.0	0.0
Total domestic demand	862.7	2.2	4.2	5.4	3.4	3.2
Exports of goods and services	346.5	8.9	10.0	11.6	7.5	6.4
Imports of goods and services	331.5	6.1	9.4	13.3	7.8	6.8
net exports[b]	15.0	1.1	0.4	-0.4	0.1	-0.1
error of estimate[b]	0.2	0.0	0.0	-0.1	0.0	0.0
GDP at market prices	877.9	3.3	4.5	4.8	3.4	3.0
Industrial production	_	2.3	4.5	5.7	3.6	3.7

a) Excluding nationalized industries and public corporations.
b) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
Source: OECD.

The government has announced changes to the Employment Insurance programme

The investment boom in recent years has boosted economic efficiency and potential output growth, which is estimated to have moved into the 3 to 3½ per cent range. However, recently announced changes to labour market policy risk having a negative impact on the economy's productive capacity. In particular, they would eliminate the "intensity rule", which is meant to discourage repeat users of the Employment Insurance system by reducing their benefits. Boosting the system's generosity, when a further tightening of eligibility criteria would seem to be desirable to enhance work incentives, could arrest, or even reverse, the decline in the structural rate of unemployment, which has made a significant contribution to raising potential growth in recent years.

Canada

External indicators

	1998	1999	2000	2001	2002
	$ billion				
Merchandise exports	217.4	242.8	281.5	300	323
Merchandise imports	204.6	220.1	247.2	264	285
Trade balance	12.8	22.8	34.4	37	38
Invisibles, net	- 23.8	- 25.1	- 21.8	- 21	- 21
Current account balance	- 11.0	- 2.3	12.6	16	17
	Percentage changes				
Merchandise export volumes[a]	8.5	11.0	12.4	7.7	6.4
Merchandise import volumes[a]	7.3	10.4	15.5	8.2	6.9
Export performance[b]	- 1.5	- 0.9	- 1.5	- 1.3	- 0.7
Terms of trade	- 3.2	3.2	6.1	0.4	- 0.1

a) Customs basis.
b) Ratio between the total of export volumes and export market of total goods.
Source: OECD.

Economic growth is projected to continue at a more moderate pace…

After still growing faster than aggregate supply in the second half of 2000, real GDP is projected to expand thereafter at a rate a little below that of estimated potential output, as US demand becomes less supportive while past and prospective monetary tightening dampens domestic spending. Nonetheless, core inflation is expected to rise somewhat, though staying well within the official target range. At the same time, headline inflation is projected to fall back to the core rate as the effect of energy price increases dissipates, reducing the risk of spill-over effects and an increase in inflation expectations. The external balance should remain in comfortable surplus, as import growth slows broadly in line with that of exports.

… but there are some risks to the outlook

Other less favourable scenarios cannot be ruled out, however. On the one hand, there are a number of risks that could result in a sharper-than-expected downturn in the US economy. Given the strong trade linkages between the two countries, this would obviously have serious consequences for Canada's growth prospects. On the other hand, given the recent economic momentum both in the United States and Canada, the slowdown in activity could be less pronounced than expected. The emergence of sizeable excess demand could entail significant inflation pressures and necessitate a more substantial tightening in monetary conditions than assumed. This highlights the importance of continued prudence in fiscal-policy setting as well as the avoidance of structural policy changes that could adversely affect the economy's growth potential.

AUSTRALIA

The economy continued to perform strongly in the first half of 2000, supported by robust domestic demand and buoyant exports. With employment growth accelerating, unemployment fell further. Largely due to higher oil prices, headline inflation rose above its 2 to 3 per cent target, but underlying inflation remained well in check. Economic activity is projected to slow mildly, to 3¾ per cent, with exports remaining a major pillar of growth, reflecting the supportive external environment. The current account deficit is projected to narrow substantially.

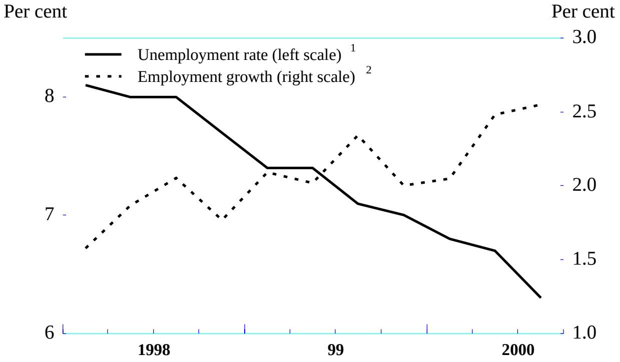
Given that the economy is operating at a cyclical peak, it is essential that the budget surplus be maintained. Monetary policy should remain vigilant against possible second-round effects flowing from the mid-year introduction of the goods and services tax. Further labour-market reform efforts are needed to reduce the still relatively high structural unemployment.

Strong domestic demand and dynamic exports have kept economic activity high

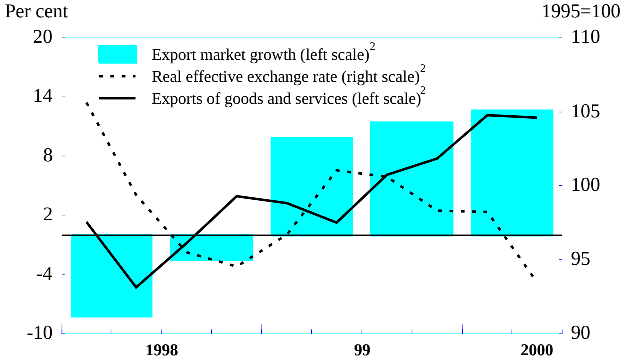
Real GDP grew at an annual rate of nearly 5 per cent in the first half of 2000, making for an average 4.4 per cent growth rate over the past eight fiscal years. Exports were boosted by buoyant world trade and a lower exchange rate. Domestic demand remained robust, with its composition being heavily influenced by anticipations of the introduction of goods and services tax (GST) on 1 July 2000: dwelling investment was brought forward to avoid the new tax while business investment and some consumer spending seem to have been deferred to take advantage of the new regime. Public spending was boosted by the preparation of the Olympic Games and peace-keeping commitments in East Timor. Recent household and business surveys indicate continued strong domestic demand in the second half of 2000, supported by the positive impact of the Olympics.

Australia

The labour market continues to improve



Exports remain dynamic



1. As a percentage of labour force.
2. Year-on-year percentage changes.
Source: OECD.

Substantial employment gains have reduced unemployment further, while underlying inflation remains under control

Employment growth accelerated sharply in the first three quarters of 2000, coinciding with higher labour-force participation and a reduction in the unemployment rate to 6¼ per cent in the third quarter. Despite the recent acceleration in some earnings indicators, the wage cost index suggests continued wage moderation. Helped by further productivity gains, unit labour cost growth is well in check. The slight overshooting of the Reserve Bank's 2 to 3 per cent consumer price inflation target in the second quarter was largely due to higher oil prices, while measures of core inflation were still running at around 2½ per cent. The jump in headline inflation in the third quarter of 2000 to 6.1 per cent is a one-off effect from the introduction of the broad based GST, which will fall out of the statistics next year.

Monetary policy has tightened to reduce the inflation risks…

With recent growth and inflation data somewhat higher than forecast, the Reserve Bank raised its target cash rate by a further 25 basis points to 6.25 per cent in early August 2000. It was the fifth increase since November 1999, when the cash rate was 4.75 per cent. The projections incorporate some further rate increases, but are based on the assumption that there will be no secondary inflation effects in response to the new GST.

Australia

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion A$	Percentage changes, volume (1996/97 prices)				
Private consumption	325.8	4.6	5.2	3.7	3.5	3.2
Government consumption	98.7	4.0	5.3	6.0	3.3	3.1
Gross fixed capital formation	126.5	7.5	6.5	3.6	4.8	4.4
Final domestic demand	551.0	5.2	5.5	4.1	3.8	3.5
Stockbuilding[a]	- 4.6	1.8	0.3	-0.1	0.1	0.0
Total domestic demand	546.3	7.0	5.7	4.0	3.9	3.4
Exports of goods and services	112.3	-0.3	4.6	10.8	8.5	8.3
Imports of goods and services	110.5	5.9	9.5	9.9	6.8	7.1
Net exports[a]	1.8	-1.3	-1.1	-0.1	0.1	0.0
Statistical discrepancy[a]	0.2	-0.2	0.0	0.2	-0.4	0.2
GDP at market prices	548.3	5.6	4.7	4.2	3.7	3.7
GDP deflator	_	0.1	1.0	3.4	2.8	2.6
Memorandum items						
Private consumption deflator	_	1.0	0.6	4.0	3.4	2.8
Industrial production	_	0.9	2.0	3.0	3.3	3.6
Unemployment rate	_	8.0	7.2	6.6	6.3	6.1
Household saving ratio[b]	_	2.1	1.8	2.4	2.8	3.1
General government financial balance[c]	_	0.6	1.9	0.9	0.7	1.0
Current account balance[c]	_	-5.0	-5.8	-4.8	-4.4	-4.0

Note: National accounts are based on chain linked data. This introduces a discrepancy in the identity between real demand components and GDP. See "Sources and Methods" for further details.

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

b) As a percentage of disposable income.

c) As a percentage of GDP.

Source: OECD.

… while the recent tax reform package will result in a declining budget surplus

The Commonwealth recorded its largest ever budget surplus (2 per cent of GDP) in FY 1999-2000, around 0.6 percentage point higher than the latest budget estimate. Stronger-than-expected tax revenues and lower expenses have both contributed, but much of the improvement was due to one-off events. The tax reform (which came into effect on 1 July 2000) will result in higher indirect tax revenues but this will be more than offset by the accompanying income tax cuts and increases in welfare benefits, so that the general government fiscal surplus is set to decline this year and next.

The upswing will continue, although there are risks

Over 2001-02, the economy is expected to slow somewhat, mainly as a result of tighter monetary policy and relatively high household indebtedness. Exports will remain a major source of growth and should, together with the import-dampening effect of slowing domestic demand, help to reduce the external deficit from its current high level. A major risk in the projections is that an international slowdown could weaken the domestic economy. Further, the introduction of GST could raise inflation expectations. This would require tighter monetary policy than assumed and could necessitate household balance-sheet restructuring, impacting negatively on private consumption. However, there is also an upward risk to household consumption from income-tax cuts and higher social benefits.

AUSTRIA

Economic growth accelerated in 2000 as exports gathered momentum following the depreciation of the euro and the recovery in Austria's export markets, and as private consumption strengthened further. Over the next two years, export growth is expected to moderate and private consumption should slow as robust increases in wage income are partly offset by higher taxes, while high capacity utilisation should underpin buoyant business investment. Overall, GDP growth is projected to remain above potential, although declining from 3½ per cent in 2000 to about 2½ per cent in 2002.

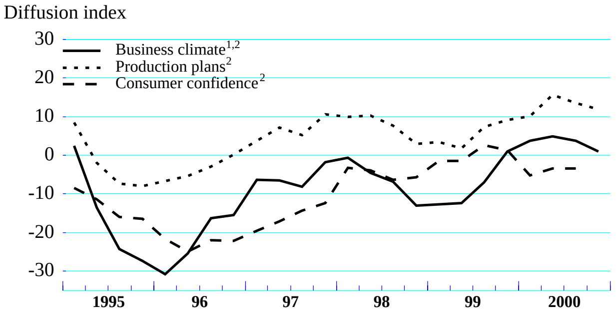
The government's ambitious fiscal consolidation effort is taking place during a period of high growth, which should ease its implementation. However, the reliance on revenue increasing measures may require additional efforts to eliminate the structural budget deficit. The prospect of the lowest unemployment rate in a decade may also require additional structural reforms to avoid the build-up of inflationary pressures.

The economic recovery is broadening…

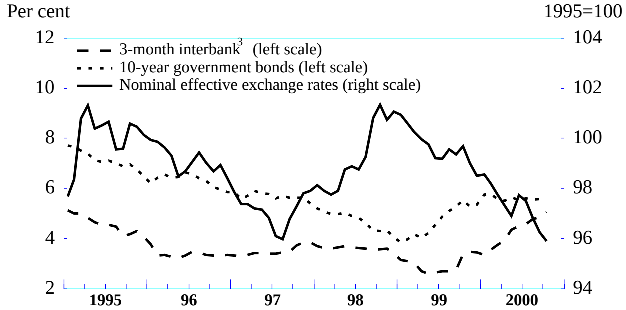
The economic recovery became more broadly based in 2000, as private consumption growth strengthened to 3 per cent and export growth accelerated to 9 per cent in response to the recovery in Austria's main export markets and improved external competitiveness. High capacity utilisation bolstered business investment as well as inducing higher import growth. But the contribution of net exports to growth remained positive at above 1 percentage point.

Austria

Confidence remains high



Monetary conditions are supportive



1. Anticipated business conditions.
2. Seasonally adjusted. Balance of positive-negative replies.
3. From January 1999, Euribor.

Sources: WIFO and OECD.

… and the labour market outlook is improving

Rapid employment creation continued into 2000, mainly taking place in the service sector and with the support of public job creation programmes. Moreover, part-time employment increased faster than full-time employment. Labour supply growth moderated, allowing the registered unemployment rate to decline to around 4½ per cent in the second half of 2000, although this trend in labour supply should reverse with recent labour market reforms, which are focused on raising the age of early retirement and restricting benefits. Overall wage growth remained stable at a low level, partly due to the current wage agreements and partly due to negative wage drift, resulting from the increasing share of part-time workers. On the other hand, consumer price inflation (as measured by the consumer price index) increased to 3 per cent in the second half of 2000, driven by higher oil and import prices as well as by indirect tax increases. As these temporary effects peter out, consumer price inflation should return to below 2 per cent in the latter part of 2001.

Austria

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Sch	Percentage changes, volume (1995 prices)				
Private consumption	1 433.7	1.5	2.7	3.0	2.3	2.3
Government consumption	499.1	2.0	1.0	0.5	0.0	-1.0
Gross fixed capital formation	582.5	6.8	2.9	3.6	3.5	3.4
Final domestic demand	2 515.3	2.8	2.4	2.7	2.2	1.9
Stockbuilding[a]	17.8	-0.1	-0.7	-0.1	0.0	0.1
Total domestic demand	2 533.1	2.7	1.7	2.5	2.2	2.1
Exports of goods and services	1 074.3	8.7	3.5	8.8	8.4	7.3
Imports of goods and services	1 110.7	6.9	1.9	6.5	7.2	6.6
Net exports[a]	- 36.4	0.7	0.7	1.1	0.7	0.5
GDP at market prices	2 522.2	2.9	2.1	3.6	2.9	2.6
GDP at market prices in billion euros	183.3					
GDP deflator	_	0.6	0.9	0.5	1.5	1.8
Memorandum items						
Private consumption deflator	_	0.7	0.7	2.1	1.9	1.8
Industrial production	_	8.3	5.5	8.0	6.5	4.5
Unemployment rate[b]	_	5.7	5.2	4.6	4.2	4.0
General government financial balance[c]	_	-2.3	-2.1	-1.6	-0.7	0.0
Current account balance[c]	_	-2.5	-2.8	-3.0	-2.5	-2.0

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) See data annex for details.
c) As a percentage of GDP.
Source: OECD.

The fiscal stance becomes restrictive, but…

The government's ongoing fiscal consolidation effort began with the Stability Programme of spring 2000, centred mainly on reducing government employment and pension expenditures. It was further extended in the two-year budget 2001-02, which relies more on higher tax revenues and local government surpluses (the latter accounting for about 15 per cent of the overall fiscal consolidation) in an effort to balance the general government budget by 2002. Overall, fiscal consolidation for 2000 to 2002 should average just above 1 per cent of GDP over the period with the central government's share based on two-thirds revenue increases and one-third spending cuts. Although interest rates are projected to rise, monetary conditions remain quite favourable to growth.

… growth prospects remain favourable…

Continued solid income growth, despite higher taxes and fees, should maintain the expansion in private consumption at around 2¼ per cent in 2001 and 2002. The external competitive position is expected to remain favourable but, in line with world trade, export growth is projected to moderate over the projection period. At the same time, import growth should remain strong in response to the high level of domestic demand, implying a declining contribution to growth from net exports. The high level of capacity utilisation should underpin business investment, while government consumption is expected to remain weak. Overall, GDP growth is projected to remain robust and above its potential, although the pace slows from 3½ per cent in 2000 to about 2½ per cent in 2002.

… though domestic risks remain

The fiscal consolidation programme's reliance on revenue increasing measures may reduce the tax base more than estimated. This may carry the risk of the government being forced to implement additional consolidation measures in order to reach its 2002 objective, thus further restricting economic activity at a time when the economy is projected to be slowing. However, there is also an inflation risk since wages may be higher than projected if recent labour market reforms (especially the increase in effective retirement age) are insufficient to avoid bottlenecks in the labour market as the unemployment rate reaches its lowest point in a decade.

BELGIUM

Real GDP growth is estimated to be around 3¾ per cent in 2000, despite a slowdown in the last months. Driven by exports, robust expansion is projected to continue, although gradually slowing to around 3 per cent in 2002. With the economy virtually at potential, some tensions may emerge in the labour market, but the increase in wages and compensation per employee may remain moderate. On the basis of announced fiscal policy, the general government budget is likely to move from broad balance in 2000 to a small surplus in the next two years, with the debt-to-GDP ratio falling to 100 per cent in 2002.

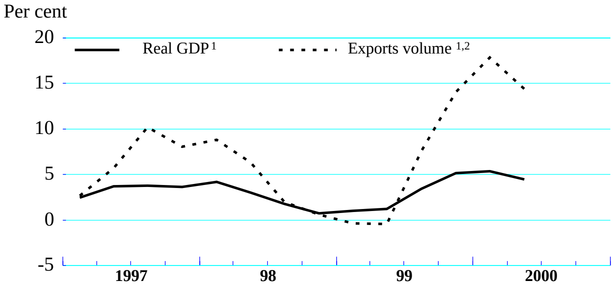
Given the strength of the economy and the still high public sector indebtedness, it is essential to avoid a pro-cyclical easing in the fiscal consolidation path. However, with appropriate spending restraint, an income tax reform aiming to reduce replacement rates in the labour market would strengthen current supply measures designed to tap the large pool of benefit recipients not in employment.

A strong broadly based expansion

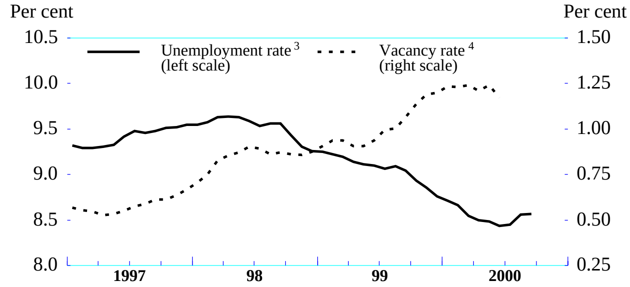
Economic activity was buoyant in the first half of 2000, boosted by rising exports as well as by strong private consumption, business fixed investment and residential construction. The strength of private spending was underpinned by a large increase in real disposable income, historically high consumer confidence and a further decline in the saving ratio. However, higher import prices and uncertainties about the price of oil seem to have weighed on economic activity in the more recent period. Nonetheless, for 2000 as a whole, real GDP growth is estimated to be of the order of 3¾ per cent, compared with 2¾ per cent in 1999. Employment has continued to grow at a rapid pace and the standardised unemployment rate

Belgium

Export-led growth has continued



The labour market has tightened



1. Year-on-year percentage changes.
2. Goods and services.
3. Standardised unemployment rates.
4. Unfilled vacancies as a percentage of the labour force.
Source: OECD.

fell to 8.6 per cent in September 2000. The increase in wages has accelerated somewhat but the rise in compensation per employee has remained moderate, as the government has stepped up the multi-annual programme of cuts in employers' social security contributions. Reflecting increases in oil prices and euro weakness, consumer price inflation reached 3.3 per cent in September. On the basis of the "health index", which excludes most energy products, alcohol and tobacco, inflation rose to 2.6 per cent.

Belgium
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion BF	Percentage changes, volume (1995 prices)				
Private consumption	4 694.7	3.3	1.9	2.6	2.4	2.2
Government consumption	1 857.2	1.4	3.4	0.8	1.4	1.4
Gross fixed capital formation	1 801.6	4.6	4.8	4.5	2.5	2.7
Final domestic demand	8 353.5	3.2	2.9	2.6	2.2	2.2
Stockbuilding[a]	- 20.0	0.6	-0.7	0.1	0.0	0.0
Total domestic demand	8 333.4	3.9	2.1	2.7	2.2	2.2
Exports of goods and services	6 608.3	4.4	5.2	12.4	9.2	7.7
Imports of goods and services	6 214.7	6.5	4.5	11.5	8.5	7.2
Net exports[a]	393.6	-1.2	0.7	1.2	1.0	0.9
GDP at market prices	8 727.0	2.4	2.7	3.8	3.1	2.9
GDP at market prices in billion euros	216.3					
GDP deflator	_	1.6	1.0	1.7	2.0	1.9
Memorandum items						
Private consumption deflator	_	1.0	1.2	2.6	1.9	1.6
Industrial production	_	3.2	0.9	2.5	3.0	2.7
Unemployment rate	_	9.5	9.0	8.2	7.9	7.6
Household saving ratio[b]	_	14.0	14.2	13.4	13.9	14.3
General government financial balance[c]	_	-0.9	-0.7	-0.1	0.3	0.7
Current account balance[c]	_	4.1	3.9	4.2	5.1	6.0

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income.
c) As a percentage of GDP.
Source: OECD.

While fiscal policy is expected to remain neutral, monetary conditions may tighten somewhat

The 2001 Budget and the stability programme for 2001-2005, imply a broadly neutral fiscal policy. Under cautious assumptions, notably an average annual rate of growth of real GDP of 2½ per cent, the government has set a target for general government surpluses of 0.2 and 0.3 per cent of GDP in 2001 and 2002 respectively. With a somewhat higher projected rate of growth, the OECD expects the general government budget to move from broad balance in 2000 to a small surplus of around ¾ per cent of GDP by 2002. The primary surplus may widen somewhat to 6½ per cent of GDP in 2002 but, in cyclically adjusted terms, it is likely to remain stable. The debt-to-GDP ratio may fall to 100 per cent in 2002 continuing its strong downward path of recent years. On the assumption that monetary policy in the euro area is tightened somewhat further over the next two years, monetary conditions in Belgium are likely to become progressively less supportive of growth.

The expansion is projected to continue, albeit at a slower pace

The depreciation of the euro in effective terms has boosted the international competitiveness of Belgian firms, which will also benefit from a period of broad wage moderation and further cuts in employers' social security contributions. Hence, Belgian firms stand to gain market shares. However, as growth in the EU and the OECD area in general is projected to slow, a progressive loss of buoyancy in Belgian exports will weigh on domestic activity as well as on imports. All told, while the ex-post contribution of net exports to growth may remain close to 1 per cent, real GDP growth is projected to slow to around 3 per cent in 2002.

The labour market is expected to tighten further, with a risk of inflationary tensions

Employment is projected to continue to grow at a robust pace, and the standardised unemployment rate may decline to around 7½ per cent in 2002 -- close to its estimated structural rate. With tight labour market conditions and relatively high inflation -- even in terms of the health index -- wages and compensation per employee are expected to accelerate but only moderately, as the government is considering further initiatives, notably an income tax reform, to bolster disposable incomes. However, wage developments constitute the main risk to the projection, since it is not certain that wage moderation will be sustained given the recent spike in inflation, with the result that Belgium's competitive position might worsen. Another risk concerns exports, which may be weaker if the slowdown in foreign markets is more pronounced than projected.

CZECH REPUBLIC

Growth picked up to around 3 per cent in the first half of 2000, reflecting strong exports, a substantial fiscal stimulus and a pick-up in investment spending. Notwithstanding the acceleration in foreign sales, the current account deficit widened during the second quarter because of rising imports and higher oil prices. Meanwhile, inflation, after having fallen sharply in 1999, increased somewhat but was held in check by high unemployment. Looking forward, output should continue to expand, albeit at moderate rates, with the current account deficit rising to above 5 per cent of GDP.

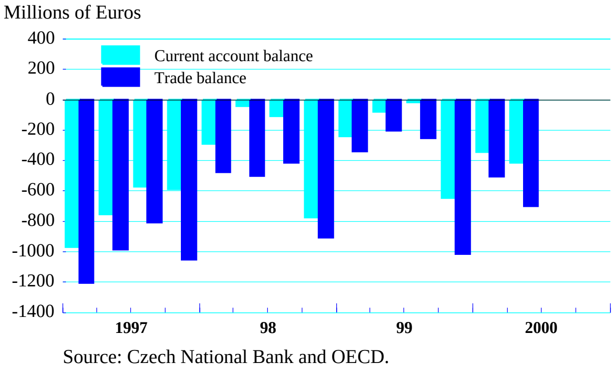
In order to ensure that economic prospects are not seriously threatened, the substantial rise in the general government deficit in 2000 should be reversed by adopting a much tighter fiscal stance. Rather than stimulating demand, emphasis should be placed on reinforcing recent structural reforms so as to improve the supply-side response of the economy, thereby laying the foundations for a more balanced pattern of growth over the medium term.

Growth picked up moderately in 2000, reflecting both domestic and external factors…

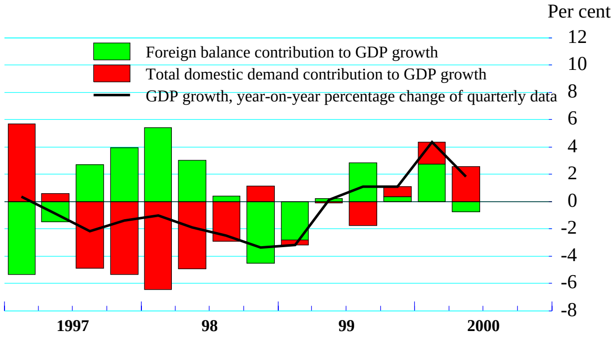
Aggregate demand increased by 3.1 per cent (year-on-year) in the first half of 2000, spurred by a strengthening of private consumption and a surge in investment, which grew by 1.8 and 6 per cent respectively. The rapid expansion of exports in the first quarter, itself a response to a pick-up in European demand, slowed somewhat in the second. This, combined with sustained imports, due to higher oil prices and strong domestic demand, led the current account deficit to widen to 3.2 per cent of GDP.

Czech Republic

The current account deficit widens



Net exports weaken



Source: Czech National Bank and OECD.

… and inflation increased from last year's low levels, despite still high unemployment

Both headline and net inflation (*i.e.* changes in the prices of non-regulated goods and services), after falling substantially last year, rose throughout 2000, reaching 4.4 and 3.5 per cent respectively by October 2000. Much of this rise represents the influence of energy and food prices, as well as an end to various one-off factors that had served to lower price increases in 1999. For this reason, the hike in inflation was largely anticipated and, despite high unemployment, real wages rose by 2.5 per cent -- broadly in line with productivity. As a consequence, employment continued to fall, although by the end of the second quarter the standardised unemployment rate, at 8.9 per cent, was about the same level as a year earlier.

Czech Republic
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Kc	Percentage changes, volume (1995 prices)				
Private consumption	889.6	-2.6	1.2	1.2	2.4	3.0
Government consumption	331.8	-0.9	-0.1	1.0	3.0	3.0
Gross fixed capital formation	514.4	-3.9	-5.5	5.0	6.5	5.5
Final domestic demand	1 735.8	-2.7	-1.1	2.3	3.7	3.8
Stockbuilding[a]	33.0	-0.4	0.8	-0.2	0.0	0.0
Total domestic demand	1 768.8	-3.0	-0.4	2.1	3.7	3.7
Exports of goods and services	949.7	10.7	6.6	16.1	12.0	10.6
Imports of goods and services	1 049.7	7.9	5.8	14.4	11.8	10.6
Net exports[a]	- 100.0	1.1	0.1	0.3	-0.6	-0.8
GDP at market prices	1 668.8	-2.2	-0.2	2.5	3.3	3.2
GDP deflator	_	10.2	2.4	1.9	3.4	4.3
Memorandum items						
Consumer price index	_	10.7	2.1	4.0	4.3	4.4
Private consumption deflator	_	9.6	2.0	4.0	4.2	4.2
Industrial production	_	3.1	-2.9	5.5	5.0	4.9
Unemployment rate	_	6.5	8.8	9.0	9.1	9.0
Household saving ratio[b]	_	9.6	11.2	12.1	11.2	11.1
General government financial balance[c,d]	_	-2.3	-4.9	-7.7	-6.5	-7.5
Current account balance[c]	_	-2.4	-2.0	-3.9	-5.0	-5.4

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income.
c) As a percentage of GDP.
d) OECD estimate which adjusts official data so as to increase international and intertemporal comparability.
Source: OECD.

Macroeconomic policy eased sharply, helping to swell domestic demand…

The recovery of domestic demand reflected a substantial easing of macroeconomic policy in both 1999 and 2000. Despite the pick-up in inflation, the Central Bank's two-week repo rate has stood at 5 per cent since October 1999, implying less than 2 per cent real interest rates throughout this year. Moreover, according to official estimates the general government budget deficit is expected to widen sharply, reaching 7.7 per cent of GDP (excluding some 2.4 per cent of GDP in privatisation revenues), up from 4.3 per cent in 1999. The increase reflects moderate current revenue growth of 4.4 per cent and substantial hikes in discretionary spending, including a 17 per cent rise in expenditures on goods and services, a 50 per cent hike in subsidies and a 10 per cent boost to household transfers.

… but growth will remain moderate, as the current account deficit rises

Growth for 2000 as a whole is expected to be somewhat slower than in the first half of the year with some weakening of the still rapid growth of exports and continuing strong imports. Over the period 2001-02, domestic demand and the current account deficit are projected to increase under the impact of the persistent strong fiscal stimulus. Thus, assuming unchanged policies and notwithstanding a windfall revenue of 1 per cent of GDP from a mobile telephone auction, the general government deficit is projected to remain at about 7 per cent of GDP. In this context, personal consumption is expected to rise steadily and investment is projected to remain strong, reflecting both new tax incentives and direct government spending. While still high unemployment and a moderate tightening of monetary policy should keep inflationary pressures muted, on-going restructuring at the firm level and tight domestic credit conditions, as banks clean up their balance sheets, will continue to constrain the economy's capacity to meet this demand. As a result, a significant proportion of the additional demand is projected to be met by imports and the current account deficit is expected to rise to more than 5 per cent of GDP.

The main risk stems from the fiscal stimulus and an inadequate supply-side response

The main risk to this projection is that the supply-side will not respond adequately to the ongoing fiscal stimulus in 2001 and 2002, resulting in an even larger than projected widening of the current account deficit. Indeed, to date, the net increment to output from the substantial increase in the general government deficit has been limited, because of rising imports. In this context, with domestic demand strengthening, the current expansionary stance of fiscal policy may be counter-productive yielding increased imports and foreign indebtedness without generating a significant increase in output.

DENMARK

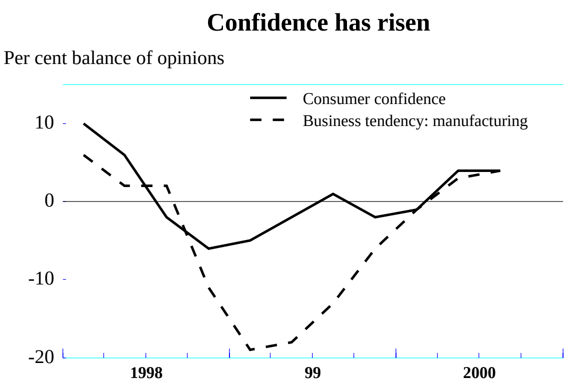
The Danish economy is expected to grow at around 2¾ per cent in 2000. Wage pressures have eased, although unemployment has remained low, and the economy is operating very close to its potential. With annual GDP growth projected to be around 2½ per cent in both 2001 and 2002, driven by buoyant exports and a pick-up in private consumption, supply constraints may lead to accelerating wages and inflation remaining above the European Union average.

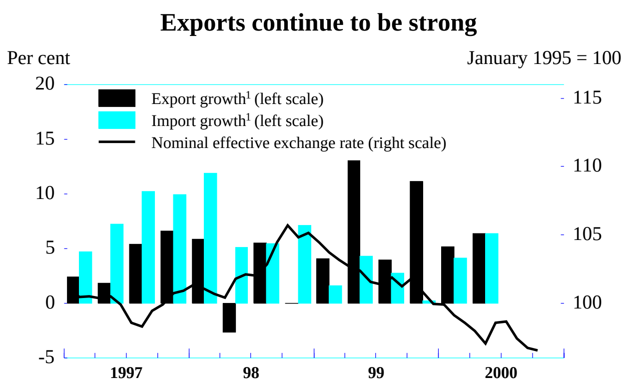
A tighter fiscal stance might become necessary to alleviate emerging pressures, and restraining the planned increases in public consumption would be the most helpful way to achieve this. Further measures to expand labour supply would also contribute to raising capacity, allowing Denmark to sustain high growth in the medium term.

Growth has picked up in 2000

GDP grew by 2½ per cent (at an annual rate and seasonally adjusted) in the first half of 2000, following a strong performance in the second half of 1999. Business confidence recovered and this fed through into expanding capacity through a strong pick-up in machinery and equipment investment. Investment was also boosted sharply as the extensive damage caused by the December 1999 hurricane was repaired. However, private consumption fell, despite rising confidence among households, reflecting in part the end of the car restocking cycle and some rebuilding of savings from their low levels. Expected strong export growth, based on both the improvement in export markets and the effective exchange rate depreciation, did not materialise in the first half of the year. Even with a recovery in the second half, Denmark's export market share will shrink. Nevertheless, the current account surplus in the first half of 2000 remained at around 1 per cent of GDP. Employment growth has

Denmark





1. Year-on-year percentage change.
Sources: Statistics Denmark; OECD.

continued while unemployment has stabilised at just over 5 per cent of the labour force. Annual wage gains have moderated to around 3½ per cent, and consumer price inflation has probably peaked, although to some extent this reflects earlier indirect tax increases, and the harmonised index of consumer prices is still rising at around 2¾ per cent.

Monetary policy remains firmly linked to euro developments…

Despite the decision against joining European Economic and Monetary Union in the recent referendum, the long-standing monetary policy framework remains unchanged, and the Danish krone continues to be fixed to the euro. Increases in euro interest rates have been matched by Denmark, although some unilateral moves were also taken in the run up and aftermath of the referendum so as to reaffirm the commitment to a fixed exchange rate. With the Danish economy currently at a similar point in the economic cycle as the euro area as a whole, monetary conditions appear broadly appropriate and should help at the margin to dampen activity and reduce the risks of overheating.

Denmark
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Dkr	Percentage changes, volume (1995 prices)				
Private consumption	564.0	3.5	0.6	0.5	1.4	1.7
Government consumption	284.5	3.0	1.4	1.1	1.3	1.1
Gross fixed capital formation	218.0	6.7	0.3	7.9	2.3	3.3
Final domestic demand	1 066.6	4.0	0.8	2.2	1.6	1.9
Stockbuilding[a]	6.5	0.3	-1.2	0.1	0.0	0.0
Total domestic demand	1 073.1	4.3	-0.4	2.3	1.6	1.9
Exports of goods and services	405.7	2.2	7.9	6.0	7.8	6.5
Imports of goods and services	366.8	7.3	2.2	4.9	5.9	5.4
Net exports[a]	38.9	-1.6	2.1	0.6	1.0	0.7
GDP at market prices	1 112.0	2.5	1.7	2.8	2.5	2.5
GDP deflator	_	2.1	2.7	2.8	2.7	2.6
Memorandum items						
Private consumption deflator	_	1.8	2.6	2.9	2.7	2.6
Industrial production	_	2.1	2.6	4.5	4.0	3.7
Unemployment rate	_	5.2	5.2	5.2	5.1	5.1
Household saving ratio[b]	_	3.9	2.4	2.8	3.1	3.2
General government financial balance[c]	_	1.2	2.8	2.7	2.9	3.1
Current account balance[c]	_	-0.6	1.8	1.4	2.2	2.7

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income.
c) As a percentage of GDP.
Source: OECD.

… while the budget remains in healthy surplus

The fiscal outcome for 2000 is likely to be even better than the general government surplus of 2.4 per cent of GDP projected in the government's budget, because of stronger growth. But the underlying fiscal stance is easier this year than it was in 1999. Although the government's budget for 2001 contains some spending initiatives on education, research, culture and the environment, fiscal policy is assumed to remain broadly neutral next year and also in 2002. On this basis, the overall budget surplus is expected to gradually rise, bringing with it a rapid decline in the public debt to GDP ratio (Maastricht definition) to around 40 per cent by 2002.

Growth is likely to remain close to potential, but overheating remains a risk

A pick-up in both exports and consumption over the projection period is expected, with GDP growth at 2½ per cent per year, only slightly higher than the estimated rate of growth of potential output. However, the relatively tight labour situation and shortages of some skilled workers, together with the effects of higher oil prices, may boost wage demands and make it more difficult to bring inflation down. Despite the healthy budget surplus, fiscal policy may need to be tightened in order to dampen activity if signs of overheating start to emerge: given already high tax burdens, restraining the growth of public consumption projected in the 2001 budget should be a prime candidate. Policies that would help to increase labour supply in future years would also contribute to easing pressures on the labour market, especially those changes that could generate relatively rapid responses, such as providing stronger incentives to work through reform of the tax system.

FINLAND

Less buoyant world trade and capacity constraints in major export sectors are projected to lead to some slowdown in the growth of economic activity to around 4½ per cent in 2001 and 2002. However, growth is expected to remain far above the euro area average and unemployment should continue to drop rapidly. Labour market shortages are likely to push up wage costs by more than in the euro area. Nonetheless, with the effects of the oil price hike waning, price inflation could recede to 2¼ per cent in 2002.

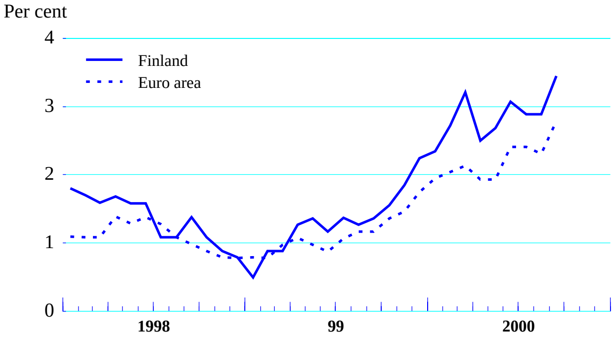
In this context, stringent control of government expenditure should be maintained to prevent overheating, while taxes on labour should be reduced further in order to improve the supply side. Furthermore, other structural reforms aimed at raising potential output should be stepped up to ensure a continued fall in unemployment, while avoiding rising cost pressures.

Buoyant exports boost output growth and inflation is up

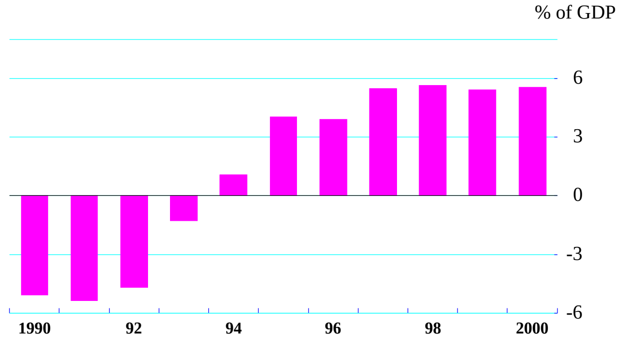
Since mid-1999, the Finnish economy has regained momentum due to stronger world demand. Real GDP growth accelerated to 5 per cent in the first half of 2000 (year-on-year), boosted primarily by soaring exports but also by robust domestic demand. Activity has been underpinned by the extraordinary growth in the electronic equipment industry, with an increase of 48 per cent in the 12 months to August. These developments were reflected in some further decline in the unemployment rate, to 9.7 per cent in September, and labour shortages have become more pressing in the south of the country, and in the electronic equipment and construction industries. Most sectors have, nevertheless, agreed a relatively moderate wage rise of just over 3 per cent for 2000. In some industries, however,

Finland

Inflation[1] surpasses the euro area average



Current account surplus is at a record level



1. Harmonised consumer price index, year-on-year percentage change.
Sources: Statistics Finland and Eurostat.

covering 10 per cent of the employees, the settlement led to a stronger increase, of 4 to 5 per cent, which could lead to catch-up effects in 2001. Primarily due to the surge in oil prices, consumer price inflation (measured by the 12 month change in the harmonised consumer price index) has risen from the trough of 0.5 per cent in January 1999 to 3.4 per cent in September 2000 -- some 0.6 percentage point above the euro area average.

Stronger income tax cuts are planned for 2001

Owing to tight expenditure control, the fiscal stance is expected to be somewhat restrictive in 2000 despite an income tax cut of around 0.4 per cent of GDP. In its draft 2001 budget, the government has proposed to reduce income taxes further by around 0.6 per cent of GDP in 2001. This is welcome, as it will improve the supply side of the economy. But with the economy close to overheating, it will necessitate the continuation of a tight grip on expenditures. Despite the further tax cuts, the fiscal stance is projected to be neutral in 2001 and 2002. Strong revenue growth could lead to a general government surplus of over 5 per cent of GDP by 2002, the second largest in the euro area.

Finland
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion FIM	Percentage changes, volume (1995 prices)				
Private consumption	323.6	4.9	3.6	3.3	2.5	2.4
Government consumption	142.6	1.7	2.0	0.4	0.9	0.8
Gross fixed capital formation	114.3	9.4	4.6	5.4	6.0	5.1
Final domestic demand	580.5	5.0	3.4	3.1	2.9	2.6
Stockbuilding[a]	2.8	0.7	-0.5	0.0	-0.1	0.0
Total domestic demand	583.3	5.7	2.8	3.1	2.7	2.6
Exports of goods and services	248.3	8.9	6.3	11.3	9.2	7.9
Imports of goods and services	196.5	8.3	3.2	6.8	5.9	5.3
Net exports[a]	51.8	1.0	1.6	2.6	2.2	2.0
GDP at market prices	635.5	5.5	4.0	5.4	4.6	4.2
GDP at market prices in billion euros	106.9					
GDP deflator	_	3.1	0.7	1.3	2.1	2.1
Memorandum items						
Private consumption deflator	_	1.9	1.7	3.2	2.6	2.2
Unemployment rate	_	11.4	10.2	9.6	8.8	8.4
General government financial balance[b]	_	1.3	1.9	4.0	4.8	5.3
Current account balance[b]	_	5.7	5.4	5.5	6.5	8.0

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of GDP.
Source: OECD.

The overall outlook is bright

The economic outlook remains favourable, although the income tax cuts will only partly offset less buoyant world demand, the effect of higher oil prices and the impact of higher interest rates on private consumption. Thus, economic growth could slow from 5½ per cent in 2000 to around 4½ per cent on average in 2001 and 2002. This is still above the growth rate of potential output, so that excess demand is projected to intensify. Despite capacity constraints, the electronic equipment industry will continue to contribute substantially to economic expansion. Unemployment should remain on a downward trend, and bottlenecks in the labour market are likely to become more severe. This could lead to a further acceleration of wage inflation to around 4½ per cent in 2001 and 2002. Nevertheless, due to an assumed fall in oil prices, price inflation is projected to decelerate from its peak of 3¼ per cent in 2000 to around 2¼ per cent by 2002. Boosted by soaring exports and despite a terms of trade loss, the current account surplus is set to mount to around 8 per cent of GDP by 2002.

A major uncertainty concerns wage developments

The main uncertainty in the outlook concerns labour cost developments. Despite labour market tensions, it cannot be excluded that a moderate tripartite central wage agreement will be reached for 2001-02. This would lead to lower inflationary pressures, especially if underpinned by further structural reform. On the other hand, failure to reach such an agreement might lead to even stronger cost pressures than embedded in the projections.

GREECE

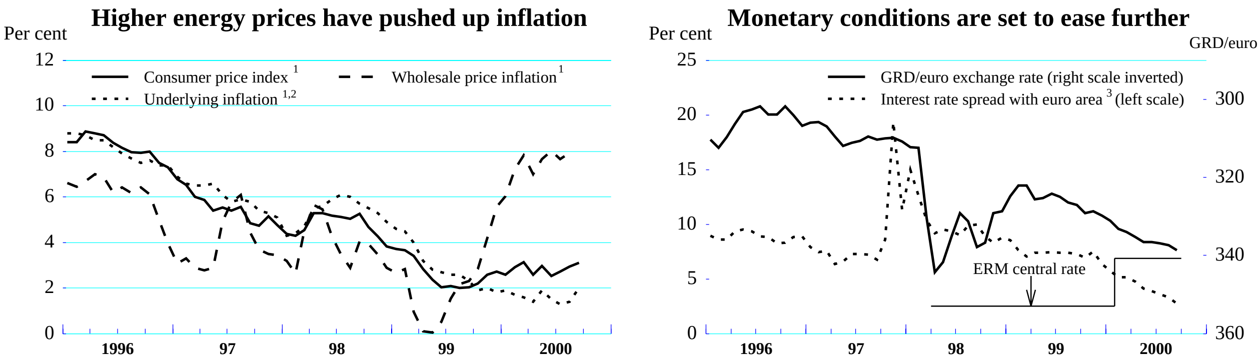
Growth has remained robust in 2000 at about 4 per cent. Activity is set to gather further momentum in 2001 and 2002, driven by surging investment outlays and healthy export growth. This should lead to a decline in the unemployment rate, which is currently among the highest in the OECD. Headline inflation has picked up, largely due to higher energy prices, but may recede somewhat over the projection period. Greece's application for euro area membership was approved in mid-June 2000 and the country will join the single currency area in January 2001.

Sustaining inflation at levels close to the euro area average in the face of strong momentum could become a major policy challenge. With monetary conditions set to ease further in the run up to euro area membership, the pace of fiscal consolidation should be stepped up by reining in primary government expenditure. Progress in reforming the labour market and enhancing competition in product markets, including a faster opening to competition of network industries, would help to secure low inflation and boost incomes.

Growth has remained resilient and headline inflation has picked up

Economic activity has remained vigorous in 2000, with output estimated to grow at around 4 per cent, driven by surging exports and strong investment activity. Retail sales weakened in early 2000, due to the waning effect of the reductions in the car sales tax and the stock market slump. However, lower interest rates and the 1999 tax/benefit package are expected to reinvigorate household spending. Headline inflation has picked up to 3 per cent in September 2000, reflecting higher oil prices, the depreciation of the drachma and the waning effects of indirect tax cuts. Core inflation has, however, remained low so far even though it has drifted up in recent months to 2 per cent in September 2000. The collective agreement concluded in May 2000 ensures subdued labour cost pressures until 2001, although wage drift has risen in some rapidly-expanding sectors, for instance in financial services.

Greece



1. Year-on-year percentage change.
2. Excluding fresh food and energy products.
3. 3-month ATHIBOR and EURIBOR rates.
Sources: Bank of Greece and ECB.

Monetary conditions are set to ease further…

Monetary conditions have eased, with the Bank of Greece reducing its key intervention rate by 2.25 percentage points since January 2000. Even looser monetary conditions are predicted, due to the elimination of the interest rate differential with the euro area. Indeed, on current assumptions, short-term interest rates would have to drop a further 250 basis points by end-2000. The exchange rate has already converged to the central rate in the Exchange Rate Mechanism, and also the differential on the long-term interest rate has become small. In July 2000, the Bank of Greece reduced the minimum reserve requirement for commercial banks from 12 per cent to 2 per cent (the level mandated by the European Central Bank). In order to prevent a surge in liquidity, only 10 per cent will be returned to the banks in January 2001, while the rest will be converted into time deposits maturing in 6 to 18 months.

… while the fiscal stance will be broadly neutral in 2001 and 2002

The government deficit is projected to decline to 1 per cent of GDP in 2000, despite the implementation of the 1999 tax and benefit package and lower revenues from the stock market transactions tax. Buoyant revenues during the first half of 2000 have more than offset slippage on current primary expenditure. The draft 2001 Budget again

Greece

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Dr	Percentage changes, volume (1995 prices)				
Private consumption	23 905.9	3.1	2.9	2.9	3.0	3.2
Government consumption	5 018.9	1.7	-0.1	0.8	0.5	0.5
Gross fixed capital formation[a]	6 612.4	11.8	7.3	7.8	9.1	9.7
Final domestic demand	35 537.2	4.5	3.4	3.6	4.0	4.4
Stockbuilding[b,c]	64.5	0.2	-0.5	0.0	0.0	0.0
Total domestic demand	35 601.7	4.7	2.9	3.7	4.0	4.4
Exports of goods and services	6 432.0	5.9	6.5	12.5	11.9	9.0
Imports of goods and services	8 929.9	11.3	3.9	8.7	7.9	7.7
Net exports[b]	-2 497.9	-2.0	0.2	0.0	0.2	-0.3
GDP at market prices	33 103.8	3.1	3.4	4.0	4.6	4.4
GDP deflator	_	5.2	2.9	3.0	2.4	2.6
Memorandum items						
Private consumption deflator	_	4.5	2.4	2.9	2.7	2.5
Industrial production	_	4.3	0.6	5.4	6.1	6.0
Unemployment rate	_	11.2	12.0	11.4	10.7	10.0
General government financial balance[d]	_	-2.5	-1.8	-1.0	-0.4	0.3
Current account balance[d,e]	_	-3.2	-4.2	-4.6	-4.6	-4.4

a) Excluding ships operating overseas.
b) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
c) Including statistical discrepancy.
d) As a percentage of GDP.
e) On settlement basis.
Source: OECD.

includes tax cuts and various spending initiatives. However, strong growth and buoyant underlying revenue developments due to better revenue collection should lead to a further reduction in the deficit to ½ per cent of GDP in 2001. The budget is projected to move into a small surplus in 2002.

Growth will strengthen further, and inflationary pressures could rise

Led by strong investment activity, healthy exports, and relaxed monetary conditions, output is projected to grow by around 4½ per cent in 2001 and 2002. Joining the euro area should boost private sector confidence and profitability should be sustained due to the moderate collective agreement, at least until 2001. The labour market is expected to benefit from strong activity, with the unemployment rate declining to 10 per cent in 2002. Inflation is projected to rise by 2¾ per cent in 2001 before edging down to 2½ per cent in 2002. The main policy issue is the sustainability of low inflation in the face of strong momentum. Cost pressures could arise from capacity constraints and stronger wage drift, while domestic demand could gather even more steam than projected.

HUNGARY

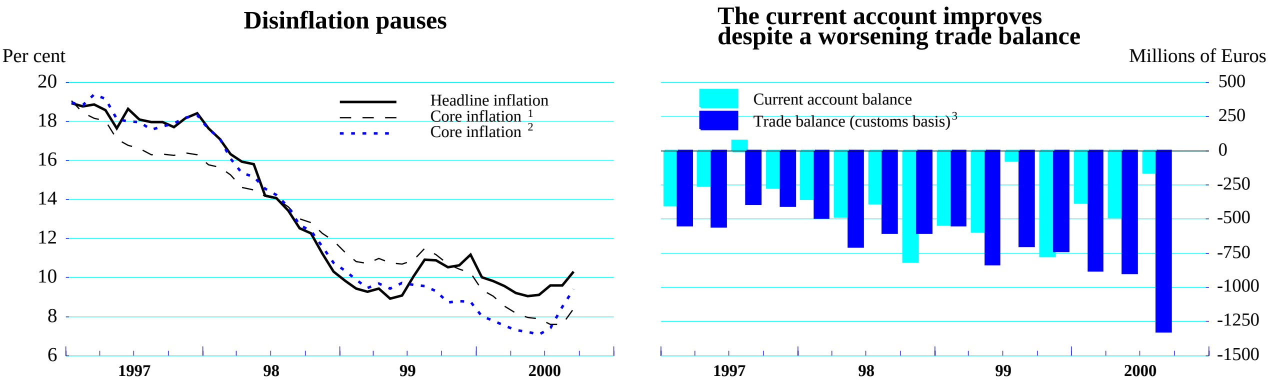
GDP growth accelerated to more than 6 per cent in the first half of 2000. Meanwhile, inflation remained well above government targets. Despite these conditions, strong export performance and comparatively slow import growth helped reduce the current account deficit significantly. Looking forward and assuming unchanged policies, growth is projected to remain strong, with falling unemployment, lower inflation and a smaller budget deficit.

Given the strength of the economy and in order to ensure that this balanced growth is achieved, the significant tax cuts and spending measures currently envisaged as part of the 2001-02 budget will have to be offset by cuts in permanent expenditures. Otherwise, the significant fiscal stimulus implicit in these plans runs the risk of overheating the economy.

Economic activity accelerated further…

Output expanded by 6.2 per cent (year-on-year) in the first semester of 2000, driven by stronger net exports and moderate growth of domestic demand. Consumer expenditure rose 3.8 per cent and although investment grew rapidly overall -- due to a pick-up in government projects -- private spending on machinery and equipment decelerated sharply. Exports of goods and services rose rapidly throughout the first half, with import growth not far behind. Notwithstanding higher energy prices, the cumulative current account deficit improved significantly, falling to 1 billion euros in the third quarter, down from 1.25 billion at the same time in 1999.

Hungary



1. As measured by the Central Statistical Office.
2. As measured by the National Bank of Hungary.
3. 2000Q3 is an estimate based on data for July and August.
Source: OECD, Central Statistical Office and National Bank of Hungary.

… while employment growth slowed and inflation proved much higher than expected

Despite the strong expansion of output, employment growth slowed from more than 3 to less than 1 per cent and the unemployment rate fell modestly to 6½ per cent. Inflation, after falling early in 2000, began picking up towards the middle of the year under the influence of high energy and food prices and despite strict limits placed on price increases of regulated goods and services. As a result, consumer prices grew 9½ per cent over the first eight months of the year, well above the government's initial target of 6-7 per cent. Indeed, even core inflation, after falling during the first half of the year, began climbing in the third quarter.

In this context, interest rates fell pro-cyclically, while the general government deficit is on track to meet its target

Macroeconomic policy has been broadly supportive of demand. Improved investor sentiment towards the end of 1999 resulted in a pick-up of capital inflows, which pushed interest rates down. Moreover, the authorities decided to keep the currency's rate of crawl steady at 0.3 per cent per month until the end of the year. As a result, and notwithstanding a 100 basis point increase in interest rates in October 2000, monetary conditions have loosened pro-cyclically. Meanwhile, although still high, the general government deficit is on track to fall by about 1 per cent of GDP as compared with 1999, as revenues have responded to both the strong growth and higher than expected inflation.

Hungary
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion HUF	Percentage changes, volume (1995 prices)				
Private consumption	4 206.2	4.8	5.1	4.4	5.4	5.1
Government consumption	1 964.7	2.8	2.5	1.5	2.5	2.5
Gross fixed capital formation	1 898.9	13.3	6.6	6.0	6.5	7.5
Final domestic demand	8 069.8	6.3	4.8	4.1	5.0	5.2
Stockbuilding[a]	467.9	1.9	-0.2	0.2	0.2	0.2
Total domestic demand	8 537.7	7.8	4.3	4.1	4.9	5.0
Exports of goods and services	3 885.6	16.7	13.2	18.0	13.0	11.4
Imports of goods and services	3 882.6	22.8	12.3	15.0	12.0	11.2
Net exports[a]	3.0	-2.9	0.1	1.3	0.5	0.1
GDP at market prices	8 540.7	4.9	4.5	5.5	5.5	5.1
GDP deflator	_	12.6	9.0	7.9	6.6	5.7
Memorandum items						
Consumer price index	_	14.2	10.0	9.6	8.0	6.0
Private consumption deflator	_	13.3	10.5	9.6	7.8	5.8
Industrial production	_	12.5	10.2	15.0	9.0	7.2
Unemployment rate	_	8.0	7.1	6.7	6.4	6.2
Household saving ratio[b]	_	26.8	26.6	26.1	25.7	25.3
General government financial balance[c,d]	_	-6.1	-5.3	-4.3	-3.4	-2.5
Current account balance[c]	_	-4.9	-4.3	-3.2	-4.1	-4.2

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income.
c) As a percentage of GDP.
d) OECD estimate which adjusts official data so as to increase international and intertemporal comparability.
Source: OECD.

Growth could remain strong and balanced…

GDP is projected to expand by 5½ per cent in both 2000 and 2001, and somewhat less rapidly in 2002. This projection is based on the continuation of the tax and spending policies of the 2000 budget, with the general government deficit expected to gradually fall as automatic stabilisers respond to the strength of demand. This should help inflation to fall slowly. While exports are projected to continue growing quickly, they should weaken as the pace at which new capacity comes on line slackens. Imports, however, are expected to remain relatively strong, so that the external sector's net contribution to growth should diminish and the current account deficit gradually widen. Despite the rapid pace of GDP expansion, employment growth is projected to remain moderate. Unemployment is projected to fall only moderately because of a gradual increase in labour force participation.

… unless external demand slows or the fiscal stance loosens

Outcomes would be considerably different if demand for Hungary's exports slows or if there is a significant relaxation of the fiscal stance in the 2001-02 budget. In the first event, the current account deficit would be higher than projected, and growth would slow. A second risk stems from the tax and spending measures embodied in the forthcoming budget, which could increase the government deficit by a further 1½ per cent of GDP. These steps could well lead to significantly higher inflation than projected here, a larger current account imbalance, and an increase in the risk premium on the currency. Moreover, the proposal to raise the minimum wage by 57 per cent would add to inflationary pressures, while simultaneously increasing joblessness among the less skilled.

ICELAND

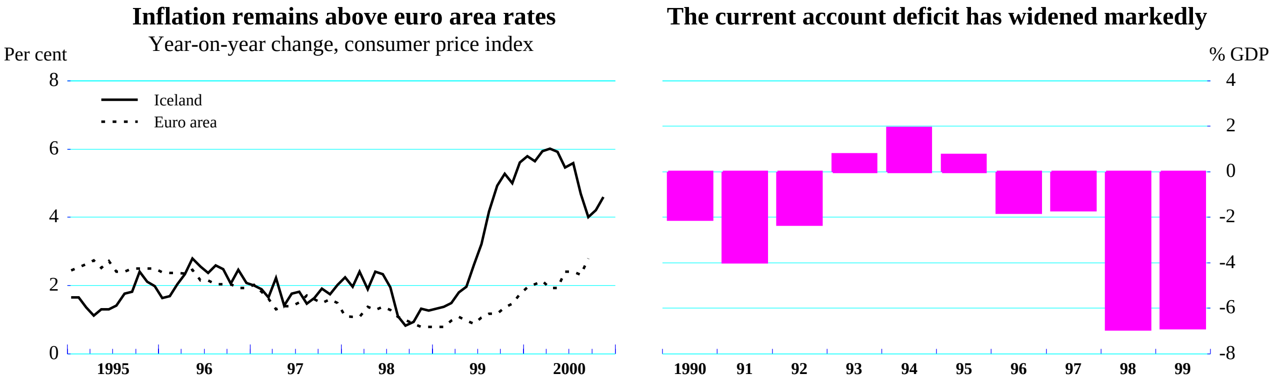
Following a boom period in which Iceland's economy became overheated, the economy now appears to be slowing. Output growth is likely to be close to 3½ per cent in 2000, after four years of increases averaging 4¾ per cent. Inflation peaked earlier this year, but remains high. Output is expected to slow considerably further next year, in part reflecting a cutback in the allowable fish catch. Despite a projected rise in unemployment, inflationary pressures could gain momentum in the near term, following the recent fall in the exchange rate.

Monetary and fiscal policy may nevertheless be sufficiently restrictive to ensure at least a stabilisation in the rate of inflation at 5 per cent by 2002. However, further interest rate increases cannot be ruled out, given the need to finance a very high current account deficit, to counter sporadic weakness in the exchange rate and to reduce inflation to that of its trading partners.

Inflation peaked earlier this year, but remains high

Inflation rose significantly in 1999 and the first half of this year. The twelve-month change in the consumer price index peaked at 6 per cent in April. After a brief slowdown, consumer price inflation began to accelerate again in the fall, registering an annual gain of 4.6 per cent in October. Although some of this movement reflects developments in oil prices, a pick-up in underlying inflation reflects continued tightness in the real economy. Real GDP growth was 4.3 per cent in 1999, only slightly less than during the previous three years. Activity is likely to have expanded more slowly in 2000, but output is still growing faster than its potential rate. With the unemployment rate averaging about 1¼ per cent this year, increases in private-sector compensation are likely to exceed 7 per cent, following an even more rapid increase in 1999.

Iceland



Source: OECD.

Monetary and fiscal policies are restrictive

Nominal policy rates have been raised during this year, and real interest rates have risen further in the summer as inflation eased. A sudden decline in the value of the currency following the announcement of the fishing quota cutback at mid-year prompted two rounds of central bank intervention and the brief closure of the inter-bank foreign exchange market. The value of the currency has continued to decline since the summer, leading to a further increase in the policy rate to 11.4 per cent in November (from the 10.6 per cent it had reached in June). The projections assume that official rates will be raised once again before falling in 2002 when the positive output gap will have nearly closed. The government budget surplus rose to 2 per cent of GDP in 1999, and a record surplus of 2¾ per cent of GDP is likely this year. Revenue growth has exceeded expectations to a greater extent than expenditure. The budget for 2001 is expected to increase the structural surplus somewhat further.

Iceland
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Ikr	Percentage changes, volume (1990 prices)				
Private consumption	299.4	10.0	6.9	4.0	2.0	2.5
Government consumption	112.8	3.4	4.9	3.5	2.5	1.1
Gross fixed capital formation	109.5	26.6	-0.8	11.1	0.5	1.7
Final domestic demand	521.7	12.1	4.7	5.5	1.7	2.0
Stockbuilding[a]	- 0.2	0.1	-0.1	-0.1	0.1	0.1
Total domestic demand	521.4	12.3	4.6	5.4	1.8	2.1
Exports of goods and services	190.9	2.2	5.5	2.6	-1.0	3.4
Imports of goods and services	187.7	23.3	6.1	7.0	0.6	2.5
Net exports[a]	3.2	-7.6	-0.6	-2.1	-0.6	0.1
GDP at market prices	524.7	4.5	4.3	3.6	1.3	2.4
GDP deflator	_	5.3	3.8	4.2	4.8	5.2
Memorandum items						
Private consumption deflator	_	1.0	3.3	5.0	5.9	4.9
Unemployment rate	_	2.8	1.9	1.3	1.8	2.6
General government financial balance[b]	_	0.5	2.0	2.8	2.4	2.5
Current account balance[b]	_	-6.9	-6.9	-9.1	-10.0	-9.2

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of GDP.
Source: OECD.

Output growth should slow considerably next year…

Following a marked downward revision to the estimate of the cod stock made by the Marine Research Institute, the government lowered the allowable fishing quota for the current fishing season. This sharp reduction in the catch, combined with fairly restrictive monetary and fiscal policies, is expected to produce a considerable slowdown in activity. GDP growth is projected to drop to 1.1 per cent next year, with a decline in exports and a deceleration in domestic demand, especially business investment. With the recent drop in the exchange rate, inflationary pressures are likely to increase. In 2002, growth should rebound to about 2½ per cent, as real net exports improve and financial conditions are eased.

… while the large current account continues to be a risk

With a current account deficit expected to reach 10 per cent of GDP in 2001, the economy remains vulnerable to a change in investor sentiment, which might be brought about by any re-opening of the national wage contracts in February 2001. Such developments would accentuate inflationary pressures, by weakening the exchange rate and raising labour costs, and could engender a harder landing for the economy than projected. Furthermore, should domestic demand prove to be more resilient than expected to the reduction in the cod catch, import growth could be higher, putting further pressure on the external accounts.

IRELAND

Strong, broad-based economic expansion is likely to continue this year with real GDP growing by around 11 per cent. But it should slow steadily thereafter, to some 7 per cent by 2002, as labour shortages become more pronounced. Consumer price inflation should peak this year and slowly decline to annual rates of under 4 per cent in 2002, even though wages are projected to increase rapidly.

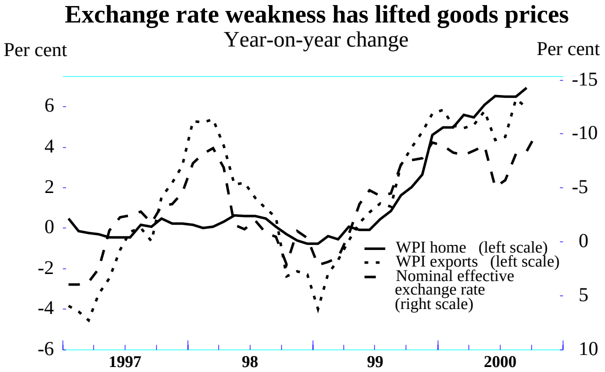
The key policy issue is to ensure that price and wage increases, which have been in part stimulated by the weak exchange rate and oil price hikes, do not get out of control. The structural budget surplus is set to rise, tightening the fiscal stance. Further tax cuts should be oriented to raising labour supply rather than increasing net real wages and cuts in indirect taxes to reduce headline inflation should be resisted. Meanwhile it would be helpful to spread out public investment over time so as to both raise efficiency and reduce demand pressures.

The growth momentum remains strong…

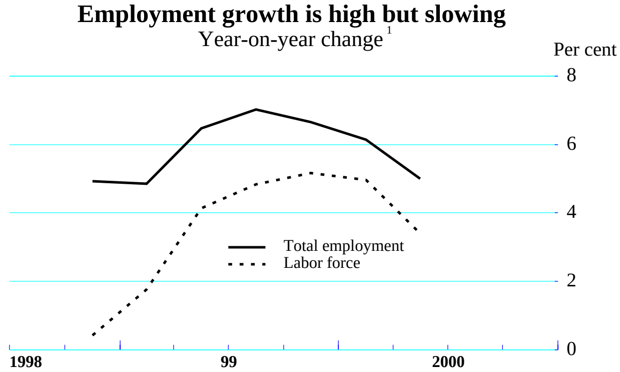
Economic activity grew by 9¾ per cent in 1999, and the momentum has carried into this year with growth expected to be around 11 per cent. In the first half of 2000, consumer spending has been exceptionally strong, while exports have expanded at an annualised rate of 17 per cent owing to buoyant foreign markets and a favourable exchange rate. With demand buoyant in all areas, the growth rate has been determined by supply factors: the labour force has continued to increase by some 3½ per cent, underpinning even higher growth rates of employment, although this is now starting to slow. Investment in machinery and equipment has been increasing by some 14 per cent per annum, mainly in the high technology sector where productivity growth is rapid. Despite the recent appearance of labour shortages, foreign direct investment inflows, a key element in the take-off during the 1990s, remain robust.

Ireland

Exchange rate weakness has lifted goods prices



Employment growth is high but slowing



1. Comparable data are not available prior to the fourth quarter of 1997.
Sources: Central Statistics Office and OECD.

… but inflation has accelerated, threatening the national wage agreement

Consumer price inflation (measured by the harmonised consumer price index) has risen from 2 per cent in the middle of 1999 to some 5¾ per cent in the third quarter of this year. Increases in indirect taxes account for ¾ percentage point of this acceleration while goods and energy prices have also risen rapidly, reflecting the weakness of the nominal effective exchange rate and oil price increases. While these factors may be temporary, service prices continue to rise rapidly, reflecting strong demand and the need to pay wages similar to those in the high-productivity exporting sectors. Possible second round effects from compensatory wage increases have become an issue as pressures mount to change the terms of the national wage agreement, which sought to limit increases to 5½ per cent assuming an inflation rate of some 3 per cent this year. In response, the government has introduced some minor price controls and sought to speed up the release of residential land in order to bring down the high rate of house price inflation.

Ireland

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Ir£	Percentage changes, volume (1995 prices)				
Private consumption	27.9	7.8	7.7	8.7	8.0	8.0
Government consumption	7.3	5.1	5.2	3.0	3.6	3.4
Gross fixed capital formation	10.7	15.5	13.0	11.3	9.5	10.1
Final domestic demand	45.8	9.1	8.6	8.6	7.8	7.9
Stockbuilding[a]	0.7	0.3	-1.9	0.0	0.0	0.0
Total domestic demand	46.5	9.4	6.3	8.6	7.8	7.9
Exports of goods and services	42.1	21.4	12.4	15.5	13.3	8.4
Imports of goods and services	35.4	25.8	8.7	14.9	14.1	9.5
Net exports[a]	6.7	-0.3	4.5	2.7	1.4	0.4
GDP at market prices	52.8	8.6	9.8	11.0	7.9	7.0
GDP at market prices in billion euros	67.0					
GDP deflator	_	5.8	3.8	4.8	4.6	3.8
GNP at market prices	46.4	7.8	7.8	9.0	6.2	5.5
Memorandum items						
Private consumption deflator	_	3.8	3.3	6.5	4.8	3.8
Industrial production	_	15.3	12.0	14.0	10.5	8.7
Unemployment rate	_	7.6	5.6	4.2	3.6	3.6
Household saving ratio[b]	_	10.4	10.6	7.9	7.1	6.4
General government financial balance[c]	_	2.2	2.7	4.0	6.5	7.3
Current account balance[d]	_	0.9	0.7	0.9	0.3	-1.0

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income.
c) As a percentage of GDP.
d) As a percentage of GNP.
Source: OECD.

The budget surplus is set to rise further

Despite tax cuts, revenues have been very strong in the first half, and even with high levels of spending the general government surplus is set to rise although the fiscal stance should remain neutral. After excluding the prepayment of off-budget pension liabilities last year, worth some 2 per cent of GDP, it appears that the underlying structural budget surplus should remain at around 4 per cent this year but it is expected to tighten in the following two years. The budget projections assume that tax cuts for 2001 will remain moderate and that implementation of investment spending in the National Development Plan will be spread out over the projection period. Indirect taxes are assumed to remain at existing levels, despite calls from some quarters for cuts to lower inflation.

Growth should remain very strong this year although the peak might have been passed

Economic activity and inflation are projected to peak this year, with GDP growth expected to slow to some 8 per cent in 2001, which is closer to its estimated current potential rate. With labour market conditions remaining tight, wage increases are likely to remain high, stimulating imports and reducing the contribution of the foreign sector to growth. With imports rising and exports gradually slowing, the current account is projected to move into deficit. Inflation should gradually decline as the effects of the depreciation of the exchange rate and oil price hikes wear off.

Unwinding inflationary pressures remains the greatest risk

The main risk to the projection is that the current surge of inflation may become entrenched in expectations, leading both wages and inflation to overshoot and resulting in a greater slowdown of activity than foreseen. Such a risk would become more pronounced if the nominal effective exchange rate were to rebound from its current low level. On the other hand, investment, technology, population growth and productivity could continue to underpin growth at very high rates.

KOREA

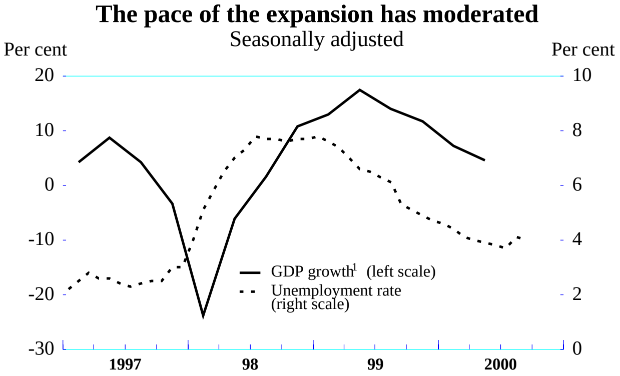
The economic expansion continued through 2000, though at a more moderate pace, in the face of restructuring in the financial and corporate sectors. The strong recovery reduced the unemployment rate to under 4 per cent, while inflation appears to have been limited to around 2½ per cent for the year. Output growth is projected to continue slowing from the nearly 11 per cent rate recorded in 1999 to a more sustainable level close to 6 per cent in 2001 and 2002.

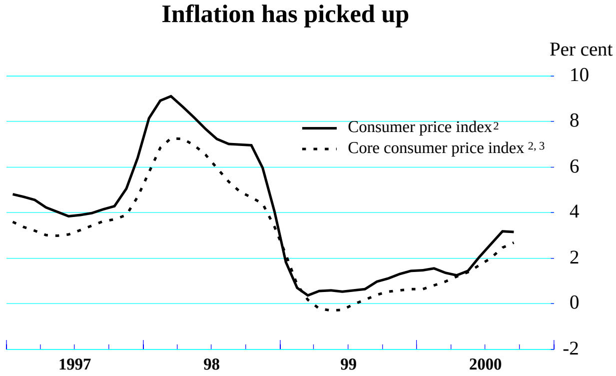
Sustaining the recovery from the 1997 economic crisis requires effective implementation of reforms to advance market-based restructuring of the financial and corporate sectors. It is important that the newly-independent central bank demonstrate that achieving its medium-term inflation target is its primary objective. Containing the growth of public spending in line with the medium-term fiscal plan is necessary to meet the costs of financial-sector restructuring as well as future spending pressures.

The pace of the recovery slowed in the first half of 2000…

The strong rebound from the severe recession of 1998 was followed by a deceleration in output growth to 7½ per cent (seasonally-adjusted annual rate) in the first half of 2000. The expansion continued to be centred on large increases in wages and employment, which have fuelled private consumption, and a recovery in fixed investment. Rising imports of capital goods, combined with higher oil prices, reduced the current account surplus from 6 per cent of GDP in 1999 to around 2½ per cent in 2000. The jump in oil prices has also contributed to a pick-up in inflation from a 1½ per cent rate (year-on-year) in the first half of 2000 to an estimated 3 per cent in the second. Nevertheless, there appears to be some slack remaining in the economy, given that the labour force participation rate is about 1½ percentage points below its pre-crisis

Korea





1. Percentage change over previous quarter, annual rates.
2. Three-month moving average, year-on-year changes.
3. Excludes energy and agricultural products (apart from grains).
Sources: Bank of Korea and OECD.

level. Moreover, capacity utilisation is at moderate levels, except in the consumer electronics and communication equipment sectors, which accounted for one-fifth of the rise in industrial production in the first half of 2000.

… owing, in part, to higher oil prices and uncertainty about the restructuring of the corporate and financial sectors

The slowdown in growth has been partly a normal reaction to the strong rebound seen in 1999. But it also reflected the impact of higher oil prices (Korea relying on imported oil for about half of its energy needs), fiscal consolidation and concerns about problems in restructuring weak firms, including Daewoo Motors, which has been declared bankrupt. These concerns have contributed to a 45 per cent fall in the stock market price index since the beginning of 2000, with negative implications for wealth and confidence. In this context, a number of firms have had trouble rolling over their maturing bonds, prompting the government to establish a 10 trillion won (2 per cent of GDP) fund to purchase bonds.

Korea
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices trillion won	Percentage changes, volume (1995 prices)				
Private consumption	255.0	-11.4	10.3	7.0	5.0	5.0
Government consumption	45.7	-0.4	-0.6	1.0	1.0	1.0
Gross fixed capital formation	159.1	-21.2	4.1	12.0	4.0	3.0
Final domestic demand	459.8	-13.8	7.1	7.9	4.3	3.9
Stockbuilding[a]	- 3.9	-5.5	5.5	-0.6	1.0	0.0
Total domestic demand	455.8	-19.6	14.3	7.3	5.5	4.0
Exports of goods and services	157.4	13.2	16.3	20.4	15.5	12.0
Imports of goods and services	162.0	-22.4	28.9	21.3	19.0	11.0
Net exports[a]	- 4.6	12.3	-0.8	2.6	1.1	2.3
Statistical discrepancy[a]	2.1	0.0	-0.5	0.0	0.0	0.0
GDP at market prices	453.3	-6.7	10.7	8.9	5.8	5.6
GDP deflator	_	5.1	-1.6	-0.9	2.0	1.5
Memorandum items						
Private consumption deflator	_	7.8	0.4	2.5	3.5	2.8
Industrial production	_	-6.5	24.1	19.0	10.0	7.0
Unemployment rate	_	6.8	6.3	4.0	3.7	3.5
Household saving ratio[b]	_	22.7	24.8	24.0	22.0	19.2
Consolidated central government balance[c]	_	-4.2	-2.7	-1.5	-0.2	0.0
Current account balance[c]	_	12.8	6.0	2.5	1.7	2.3

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income.
c) As a percentage of GDP.
Source: OECD.

Government efforts to complete financial-sector restructuring have been accompanied by fiscal consolidation

The government has launched a second financial-sector restructuring programme using 40 trillion won (7½ per cent of GDP) of public money. This brings net expenditures in this area to around 130 trillion won. While these primarily debt-financed outlays have boosted government interest payments, the growth of overall expenditures has been limited in line with the goal of balancing the consolidated central government deficit by 2003. A large surge in tax revenues in the first half of 2000 suggests that this objective may be achieved prior to the target date. Monetary policy remains supportive of the expansion, with the central bank giving priority thus far to concerns about financial-market stability. However, with oil price increases now feeding through, the emphasis is shifting to controlling inflation, as evidenced by the 25 basis point rise in the call rate in October.

The economy is projected to slow to a more sustainable pace in 2001 and 2002, although there are some downside risks

Output growth is projected to slow to close to 6 per cent -- a rate roughly in line with the economy's potential -- in 2001 and 2002. Achieving a soft landing would help stabilise core inflation around the medium-term target of 2.5 per cent by 2002, while supporting continued job creation to bring the employment-to-population ratio back towards its 1997 level. Such a favourable outcome does depend on effective actions to resolve outstanding problems in the financial and corporate sectors. Moreover, the possibility of additional failures among the large chaebols raises the risk of even more serious financial-sector problems that would impinge on the real economy. However, the risk of a second foreign-exchange crisis is limited by the fact that Korea's foreign reserves -- which now exceed $92 billion, the second-highest in the OECD area -- are almost double its short-term foreign debt. The major risk on the external side would be a sharp slowdown in key overseas markets, particularly the United States.

LUXEMBOURG

Real GDP growth is projected to decline from 8 per cent this year to around 5½ per cent in 2002. This pattern mainly reflects developments in the euro and in activity in neighbouring countries, which have led to a strong boost to exports. Inflation may also peak this year at around 3 per cent, mainly due to rising energy prices, and fall back to about 2 per cent in 2002. Employment growth should remain high, with most new jobs going to cross-border workers.

Wage indexation arrangements should be terminated, or at least be linked to underlying inflation, to reduce the risk that the increase in energy prices sets off a wage-price spiral. A more restrictive fiscal policy could also be helpful in countering growing inflationary pressures.

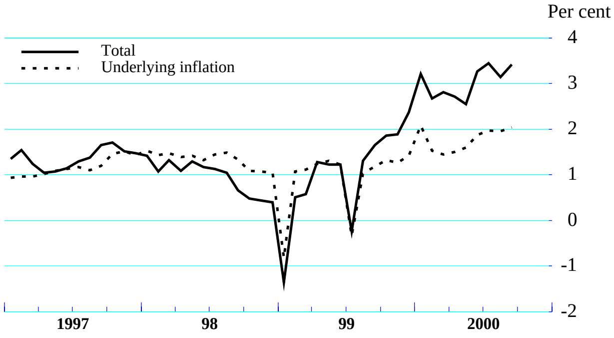
Economic growth has been high and inflation has risen

Real GDP growth rose to 7½ per cent in 1999, well above the long-term average (5½ per cent since 1985). Although this overstates underlying trends because a new system for elderly care boosted public consumption and hence GDP (by 0.8 percentage point in 1999), there was nevertheless a broadly based acceleration in economic activity. A buoyant labour market and the activation of an indexation threshold for wages and social security benefits contributed to the strengthening in private consumption, while the rise in export growth mainly reflects developments in the finance and transport and communications sectors. Growth in fixed investment also rose markedly, although a large part of this reflects one-off purchases of aircraft and satellites. These purchases and the strength in domestic demand more generally, resulted in a very large increase in imports, slashing the net foreign contribution to growth. Indicators for the first half of 2000 suggest that underlying growth has accelerated, notably in

Luxembourg

Growth and employment[1] have increased

Inflation[1] has accelerated



1. Year-on-year percentage changes.
Source: STATEC.

the finance, manufacturing and construction industries. Employment growth has also picked up, to around 5½ per cent (year-on-year) in recent months, and the unemployment rate (national definition) has edged down to 2½ per cent. Cross-border workers again took most new jobs with the (resident) labour force growing at not much more than 2 per cent. Inflation has accelerated over the past year to almost 3½ per cent, mainly owing to the rise in energy prices; meanwhile, underlying inflation has doubled, to around 2 per cent.[27] A price index threshold was breached in June, triggering a 2½ per cent increase in wages and social security benefits, less than one year after the previous indexed increase. Another threshold is likely to be breached in mid-2001. The short intervals between index-linked wage increases have contributed to an acceleration in wage rate growth to around 4½ per cent.

Luxembourg
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion LF	Percentage changes, volume (1990 prices)				
Private consumption	289.0	2.3	4.1	3.5	5.5	5.0
Government consumption	107.9	2.8	12.8	3.9	3.6	3.6
Gross fixed capital formation	125.8	1.5	26.6	0.1	3.2	4.0
Final domestic demand	522.8	2.2	11.4	2.6	4.5	4.4
Stockbuilding[a]	1.8	0.1	0.1	-0.1	0.0	0.0
Total domestic demand	524.6	2.3	11.5	2.5	4.5	4.4
Exports of goods and services	685.5	9.9	7.9	15.0	10.0	8.3
Imports of goods and services	585.6	8.3	11.2	11.2	9.3	8.0
Net exports[a]	100.0	3.0	-1.9	6.0	2.6	2.0
GDP at market prices	624.6	5.0	7.5	8.1	6.2	5.5
GDP at market prices in billion euros	15.5					
GDP deflator	_	1.5	2.3	2.6	2.8	2.1
Memorandum items						
Private consumption deflator	_	1.7	1.4	3.1	2.3	2.1
Industrial production	_	4.3	3.1	8.0	6.0	4.0
Unemployment rate	_	3.1	2.9	2.7	2.5	2.3

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
Source: OECD.

27. Underlying inflation excludes petroleum products, solid fuels, coffee, tea, cocoa, potatoes and cut flowers.

Monetary conditions and export markets should become progressively less supportive

The depreciation of the euro and the strengthening in export market growth in the past year have provided a powerful boost to economic activity. This source of stimulus should nevertheless wane over the coming two years. While the stance of fiscal policy is set to ease, this is unlikely to be as significant for activity as developments in the euro or in export markets. The government has announced personal and corporate income tax cuts amounting to 1.2 per cent of GDP in 2001 and 0.5 per cent of GDP in 2002. As result, the general government budget surplus is likely to decline from 4½ per cent of GDP in 1999 to 1½ per cent of GDP in 2002.

Growth should remain robust, albeit weakening, but underlying inflation may rise

Real GDP growth is projected to reach a peak of around 8 per cent this year and to slow progressively over the next two years to a more sustainable rate of 5½ per cent as export markets weaken and the stimulus from euro depreciation passes. Employment growth should remain solid, albeit easing to 3¾ per cent, with cross-border workers continuing to fill most new jobs and unemployment edging down to about 2¼ per cent in 2002. Inflation is likely to peak this year at 3 per cent or so and to fall to around 2 per cent in 2002. The main risk to these projections is that the energy-price shock leads to a serious wage-price spiral owing to indexation arrangements.

MEXICO

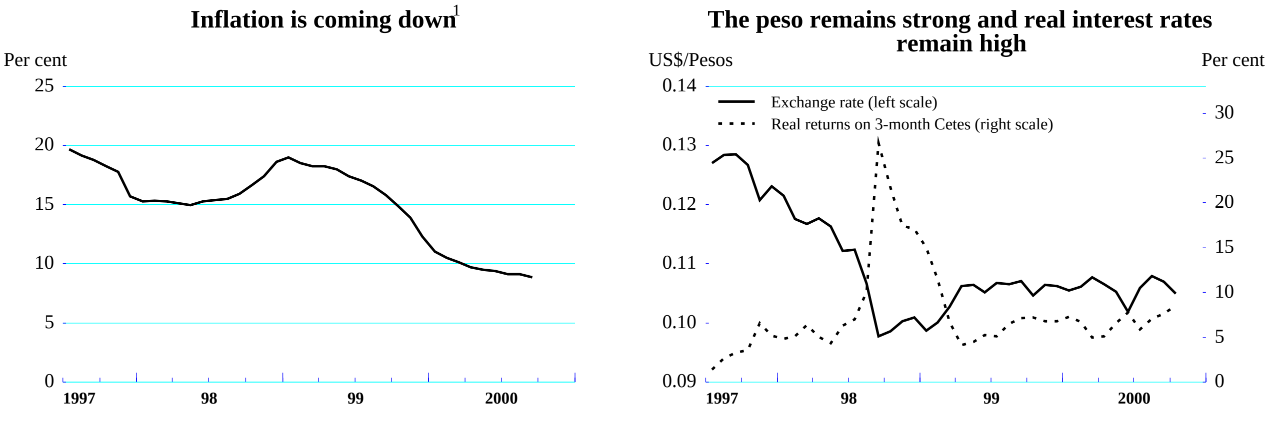
Output may have grown by around 7 per cent in 2000, helped by the continued expansion of the United States' economy, while the strength of the peso and tighter monetary conditions have allowed inflation to come down. The deterioration in the current account has been limited by rising oil-export revenue. The external factors at work this year are likely to wane in 2001, GDP growth being projected to ease to a more sustainable rate of around 5 per cent per year over the next two years. Inflation should continue to fall steadily, while the current account deficit could widen to just over 4 per cent of GDP by 2002.

To reduce risks of overheating, monetary action needs to be supported by fiscal restraint. Moreover, the incoming administration, which will take office on 1 December, should take the opportunity of the current benign economic climate to move ahead in areas where structural reform has stalled. High on the list of priorities is a tax reform to strengthen budget revenues and limit tax distortions. Reforms to enhance competition in product markets are also needed, in the electricity sector in particular.

Economic activity picked up in 2000…

Robust exports to the United States and booming domestic demand underpinned real output growth of 8½ per cent in the first half of 2000, at an annual rate. GDP growth could reach close to 7 per cent for the year as a whole. The expansion has induced strong job creation in the formal sector, and real wage increases have boosted household disposable income. The buoyancy of aggregate demand, combined with a strong exchange rate, has led to a surge in imports; but rising oil export prices have helped limit the deterioration of the trade deficit. The current account deficit could move to nearly 3½ per cent of GDP in 2000, mostly financed by long-term capital inflows.

Mexico



1. Consumer price index inflation, year-on-year percentage change.
Source: OECD.

… and inflation has continued to decline

Despite election-related volatility earlier this year, the effective exchange rate has appreciated, helping to bring 12-month consumer price inflation down to 8.8 per cent in September, while underlying inflation moved below that rate. The headline rate is likely to fall to just over 8 per cent by December 2000, almost 2 percentage points below the central bank target.

After strong public spending growth in 2000, a deceleration is assumed

Revenue from privatisation operations fell short of budget projections for 2000, but booming activity and oil-related receipts (which still account for one-third of budget revenues) created a substantial revenue windfall. Hence, the public-sector deficit target of 1 per cent of GDP should easily be met, with higher-than-budgeted revenue largely offset by higher spending. For 2001 and 2002, a prudent spending stance is assumed, and the budget deficit should fall to around ½ per cent of GDP.

Real interest rates might be slow to come down

Short-term interest rates declined steadily in late 1999 and early 2000, when the downward trend was halted and then reversed, partly as a result of central bank action. By October, the three-month *Cetes* rate had risen above 17 per cent, up from a low of 14 per cent earlier in the year, implying stubbornly high real interest rates. Since the central bank has

Mexico
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Pesos	Percentage changes, volume (1993 prices)				
Private consumption	2 040.4	5.4	4.3	8.0	5.5	4.8
Government consumption	314.6	2.2	1.0	4.3	1.0	3.5
Gross fixed capital formation	619.5	10.3	5.8	10.6	9.7	9.2
Final domestic demand	2 974.5	6.0	4.3	8.1	5.9	5.6
Stockbuilding[a]	206.3	0.2	-0.8	0.7	0.2	0.0
Total domestic demand	3 180.8	6.0	3.4	8.6	5.9	5.5
Exports of goods and services	963.9	12.1	13.9	16.0	11.0	9.0
Imports of goods and services	965.6	16.5	12.8	21.0	13.2	10.5
Net exports[a]	- 1.7	-1.1	0.3	-1.7	-1.0	-0.8
GDP at market prices	3 179.1	4.8	3.7	7.0	5.0	4.8
GDP deflator	_	15.5	15.9	10.1	7.7	5.8
Memorandum items						
Private consumption deflator	_	20.5	16.4	9.3	7.2	5.5
Unemployment rate[b]	_	3.2	2.6	2.4	2.6	2.8
Current account balance[c]	_	-3.8	-2.9	-3.4	-3.8	-4.2

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) Based on the National Survey of Urban Employment.
c) As a percentage of GDP.
Source: OECD.

announced that it will maintain tight monetary conditions in order to consolidate the disinflation process, real rates are assumed not to come down much in the short term. The aim is to bring down the inflation rate close to that of Mexico's main trading partners by 2003.

Output growth should moderate to a more sustainable rate

Demand from the United States is projected to slow, while oil prices are assumed to stabilise at a relatively high level. Against this background, and in the context of relatively tight macroeconomic policies, real GDP growth is projected to moderate to a more sustainable rate around 5 per cent in 2001 and 2002. Inflation should continue to come down gradually, to 5 per cent by the end of 2002, although this projection hinges on the usual assumption of an unchanged exchange rate. The current account deficit could widen to just over 4 per cent of GDP by 2002, but with long-term capital inflows expected to remain strong, financing should not be a problem. The main risk concerns the pace of deceleration of domestic demand, in the context of the uncertain strength of Mexico's main export markets. The prudent fiscal policy stance that is assumed might not be sufficient to support the disinflation process, creating risks of an excessive appreciation of the real exchange rate and of a widening of the current-account deficit. In this case, further fiscal tightening might be required.

NETHERLANDS

After increasing to 4½ per cent in 2000, real GDP growth is projected to ease progressively to around 3½ per cent in 2002, as the boost from euro weakness and the tax cut in 2001 dissipates. The labour market is expected to tighten further and the unemployment rate to fall to around 2¼ per cent. Reflecting growing labour shortages, real compensation per employee is projected to accelerate somewhat, while headline inflation, after rising further in 2001, is expected to fall in 2002, as the impact of higher import prices and the increase in value added tax fades away. Due to the strength of activity, the general government budget is likely to stay in surplus despite a considerable tax cut in 2001. Consequently, the cyclically-adjusted budget may remain close to balance.

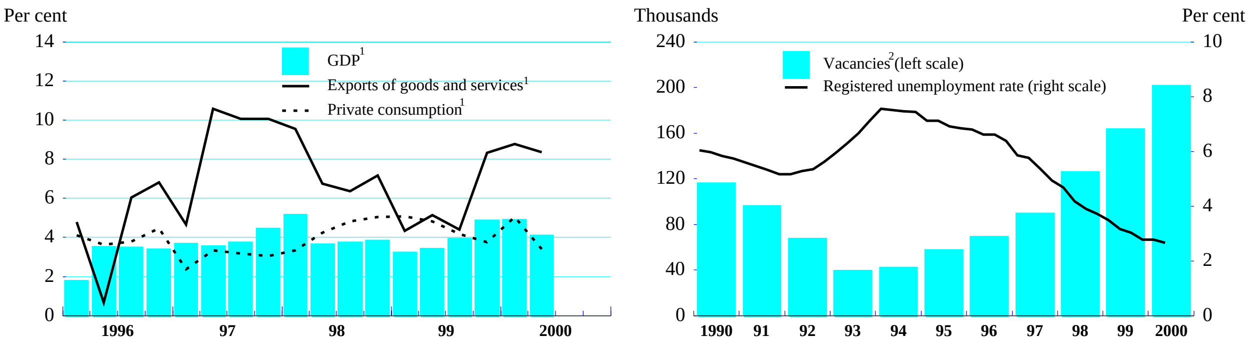
Given the strength of the economy, increasing shortages in the labour market and the expansionary stance of fiscal policy embodied in the 2001 budget and in the tax reform, the authorities should refrain from using future budgetary windfalls for additional spending or further tax cuts. Also, in view of the very low unemployment rate and the still large pool of working-age benefit recipients without a job, a further tightening of welfare programmes, in terms of level of benefits and eligibility conditions, should be considered.

Export led growth has continued

In the first half of 2000, economic activity remained buoyant, with surging exports offsetting a slight deceleration in domestic demand, notably private consumption. Until August both consumer and producer confidence remained quite strong. In recent months, however, as a result of the rise in energy prices and the more uncertain environment, private consumption and economic activity seem likely to have weakened somewhat. Nonetheless, in 2000 as a whole, real GDP growth is estimated to increase to around 4½ per cent (compared with 3.9 per cent in 1999), far

Netherlands

Growth remains export led **The labour market has tightened**



1. Volume, year-on-year percentage changes of quarterly data.
2. Vacancies for 2000 are the average of the first two quarters.
Sources: Statistics Netherlands and OECD.

above the potential rate of growth estimated by the OECD at around 3½ per cent. Registered unemployment has continued to trend down, to 2.4 per cent in the second quarter of 2000. The growth in average wages has remained moderate, partly as a result of the increasing number of employees at the lower end of the labour market. Consumer price inflation increased to 2.5 per cent in August 2000, but underlying inflation remained subdued at around 1½ per cent.

Netherlands

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Gld	Percentage changes, volume (1995 prices)				
Private consumption	363.6	4.4	4.4	4.1	4.3	3.5
Government consumption	168.4	3.4	2.5	3.5	2.3	2.5
Gross fixed capital formation	158.0	4.1	6.5	6.6	4.1	4.3
Final domestic demand	690.0	4.1	4.4	4.5	3.8	3.5
Stockbuilding[a]	1.9	0.1	-0.2	-0.1	0.0	0.0
Total domestic demand	691.8	4.2	4.2	4.4	3.8	3.4
Exports of goods and services	449.2	7.4	5.6	10.3	9.3	6.8
Imports of goods and services	405.6	8.0	6.3	10.8	9.6	7.1
Net exports[a]	43.6	0.1	-0.1	0.3	0.3	0.2
GDP at market prices	735.4	4.1	3.9	4.5	3.9	3.4
GDP at market prices in billion euros	333.7					
GDP deflator	_	2.0	1.6	3.0	3.9	2.6
Memorandum items						
Private consumption deflator	_	1.8	1.9	3.0	4.1	2.5
Industrial production	_	2.4	1.4	5.0	4.5	3.0
Unemployment rate	_	4.2	3.2	2.8	2.5	2.3
Household saving ratio[b]	_	13.4	10.6	9.4	10.6	10.6
General government financial balance[c]	_	-0.7	1.0	1.6	1.0	1.3
Current account balance[c]	_	6.3	5.3	5.1	5.2	5.1

Note: National accounts are based on chain linked data. This introduces a discrepancy in the identity between real demand components and GDP. See "Sources and Methods" for further details.
a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income, excluding net contributions (actual and imputed) to life insurance and pension schemes.
c) As a percentage of GDP.
Source: OECD.

Fiscal policy is becoming expansionary, while monetary policy may be tightened further

The stance of fiscal policy will be eased significantly in 2001, as a reform of the personal income tax regime, implying a tax cut of 0.7 per cent of GDP, will be implemented. The reform includes a shift from direct taxes to indirect taxes and a reduction in social security contributions. The hike in indirect taxes will result in a one-off increase in inflation of one percentage point while the whole package will entail a rise in households' disposable income of around 5¼ per cent. The reform also implies a further decline in the replacement rate, which should encourage persons of working age on welfare to return to the labour market. In the 2001 budget, unemployment outlays and interest payments are expected once again to be considerably lower than was projected a few years ago in the coalition agreement, which was based on very cautious growth assumptions. The windfall gains in expenditure will be fully spent, but additional revenues will not be used for additional tax cuts or lower social security contributions, although the budgetary rules would have allowed it. Monetary conditions in the euro area are expected to be tightened further over the next two years, with both short- and long-term interest rates rising somewhat.

Other forces may become less supportive of activity

The boost to economic activity provided by exports is likely to weaken progressively, as the effect of stronger competitiveness due to the depreciation of the euro is limited by increasing capacity problems and growth in export markets is projected to slow. Also, the strong fall in new second mortgage contracts in the first quarter of 2000 may point to a declining contribution to consumption growth of wealth effects stemming from rising house prices.

Economic growth is expected to remain above potential, with a risk of inflationary pressures

Expansion in real GDP is projected to decline only moderately, to 3½ per cent in 2002, roughly in line with potential output growth. Private consumption is expected to remain buoyant, due to the rise in disposable income following the tax reform. But, after the very rapid increase of production capacity from 1997 to 2000, the growth in business fixed investment is projected to slow down, as a result of lower profits and higher interest rates. Reflecting growing labour shortages, real wages and compensation per employee are expected to accelerate, albeit only modestly, to around 2 per cent in 2002. The private consumption deflator is projected to rise temporarily to 4 per cent in 2001, and to fall back in 2002. The main risk is that wage moderation may not be as effective as assumed in the projections. Moreover, it is uncertain to what extent the tax reforms and other structural measures will lead to a further "activation" of working-age persons on welfare.

NEW ZEALAND

With past interest rate hikes and some recent policy measures damping confidence and domestic demand, real GDP fell in the second quarter of 2000. As exports have continued to advance strongly, spurred by a substantial exchange rate depreciation, the large current account deficit narrowed to about 6 per cent of GDP in the same period. The depreciation, combined with the rise in oil prices saw inflation reach the official target ceiling of 3 per cent in the third quarter of 2000, and a further increase is likely. Economic activity is projected to rebound, boosted by strong exports, although the strength of the recovery will depend on the extent to which confidence and domestic demand improve.

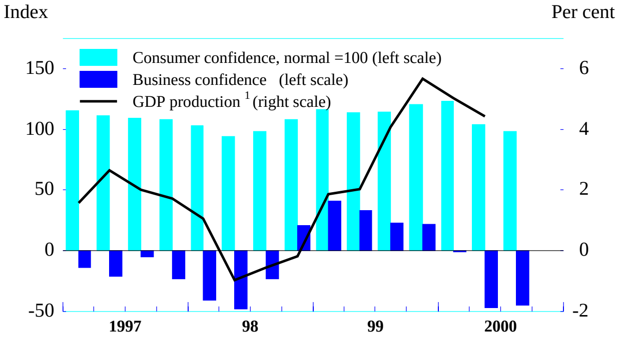
Although the recent drop in output has headed off a build-up in excess demand, some further tightening in monetary conditions is likely to be necessary to avoid the emergence of generalised inflation. Managing spending pressures will be a major challenge for fiscal policy, and should eventually be addressed by budget savings. Nevertheless, if the rebound falters, the automatic stabilisers should be allowed to operate.

Economic activity slumped in the second quarter…

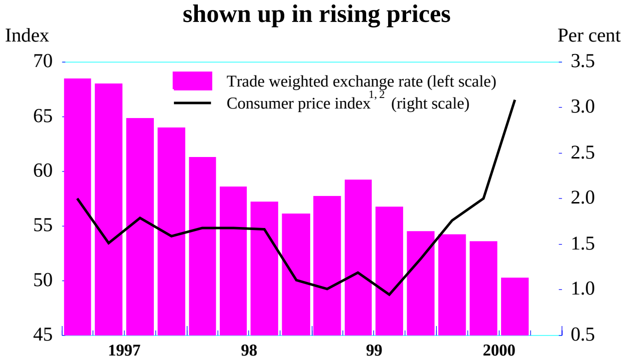
Real GDP fell 0.6 per cent (actual rate, production-based) in the second quarter of 2000, led by a pronounced decline in construction activity. Past interest rate hikes also slowed consumer spending. On the positive side, machinery and equipment investment kept growing despite increasing business-sector pessimism, while continued export growth meant that the trade balance moved back into surplus. Meanwhile, employment fell in the first half of the year, but rebounded thereafter. Thus the unemployment rate dropped to just under 6 per cent, slightly above its estimated structural rate. At the same time, excess demand in product markets, which had emerged as a result of the strong momentum of the

New Zealand

Slumping confidence has affected GDP growth



A falling exchange rate has already shown up in rising prices



1. Year-on-year percentage changes.
2. Excluding credit services.
Source : Statistics New Zealand.

economy in the second half of 1999, is likely to have been temporarily eliminated. With inflationary pressures from rising oil prices and the currency depreciation, the increase in the consumer price index reached 3 per cent (year-over-year basis) in the third quarter. Moreover there are recent indications that firms increasingly plan to raise prices.

… while monetary conditions eased substantially

With interest rates holding steady, the marked fall in the value of the currency in recent months has meant that monetary conditions (the effect of both interest-rate and exchange-rate movements) have eased substantially. The depreciation came in spite of firming export prices and probably reflects the still-large current account deficit and uncertainty over government policies and growth prospects. The projections incorporate a modest rise in interest rates in the near term to restrain a spill-over from higher import costs into domestic prices against a backdrop of the possible re-emergence of capacity pressures.

New Zealand

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion NZ$	Percentage changes, volume (1991/92 prices)				
Private consumption	61.5	1.7	2.4	1.8	1.7	1.7
Government consumption	14.6	-1.0	8.7	-4.8	1.5	1.0
Gross fixed capital formation	19.9	-1.9	8.4	6.2	3.5	4.4
Final domestic demand	96.0	0.5	4.7	1.8	2.1	2.3
Stockbuilding[a,b]	0.7	-0.7	1.1	-0.1	0.0	0.0
Total domestic demand	96.8	-0.2	5.8	1.7	2.1	2.2
Exports of goods and services	27.9	1.6	6.2	9.2	7.8	7.4
Imports of goods and services	27.3	2.7	12.0	3.3	5.3	5.7
Net exports[a]	0.7	-0.4	-2.2	1.8	0.7	0.5
GDP (expenditure) at market prices	97.4	-0.6	3.7	3.6	2.9	2.8
GDP deflator	_	1.7	0.1	2.2	2.9	2.0
Memorandum items						
GDP (production)	_	-0.2	3.4	3.5	2.9	2.8
Private consumption deflator	_	2.0	1.2	1.8	2.9	2.0
Unemployment rate	_	7.5	6.8	6.1	6.0	6.0
Current account balance[c]	_	-4.1	-6.7	-5.7	-4.7	-4.0

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) Including statistical discrepancy.
c) As a percentage of GDP.
Source: OECD.

The government's books have remained in surplus

The government recorded a surplus on its accounts in the June 2000 fiscal year, owing partly to tax increases and better-than-expected economic conditions earlier in the period. The June Budget foresees rising actual and structural surpluses, although both expenditures and revenues will be at a higher share of GDP than envisaged under the previous administration. However, spending pressures, especially in the health and education sectors, will need to be carefully managed in order to meet fiscal targets.

Output growth should resume in the second half of this year…

Real GDP is projected to expand at a moderate pace over the next two years, supported mainly by the external sector due to continued solid growth in New Zealand's trading partners and a favourable competitive position. The drop in confidence is expected to be temporary, given these positive factors. Nonetheless, household spending is projected to remain relatively subdued because of interest-rate hikes. On the other hand, business investment is projected to hold up relatively well due to capacity constraints. Meanwhile, the boost in rates should help avoid a significant overshoot of the economy's potential and restrain inflationary pressures. Headline consumer price inflation should begin to slow by the end of 2001 as the effects of the recent depreciation and oil price increases dissipate. The unemployment rate, while edging down, will probably remain above its structural rate.

… but downside risks exist

The current economic situation is clouded by mixed indicators, creating considerable uncertainty over future developments. Should the slump in confidence persist, domestic demand could be weaker than projected, helping to contain cost pressures and lessening the need for interest-rate increases. But if the new industrial relations framework encourages wage settlements beyond productivity gains, the economy could see more inflation than projected, leading to larger interest rate hikes along with subdued growth. This situation would be exacerbated by any greater-than-expected slowing in New Zealand's export markets.

NORWAY

The rebound in output growth that started in mid-1999 has continued in 2000 and, with the economy already close to full employment, has heightened the inflationary pressures prompted by the oil price hike. The central bank has reacted swiftly by increasing its key deposit rate from 5½ to 7 per cent. The high oil price is projected to lead to a current account surplus of about 20 per cent of GDP in 2001 while the government surplus is likely to be close to 15 per cent of GDP.

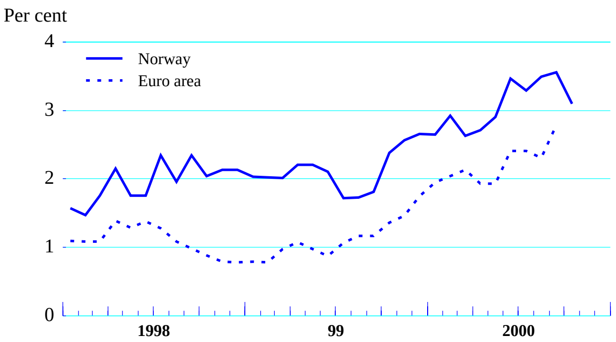
Despite the speedy monetary policy reaction since April, the overheating risks remain substantial. They could become more severe, because labour supply will be reduced by the introduction of a fifth holiday week, the strong rise in childcare cash benefit, the continuing sharp increase in sickness leave and the absence of measures to contain early retirement. Monetary policy should stand ready to restrain demand should inflationary pressures not dissipate, while the fiscal authorities should at least avoid departing from the intended neutral budgetary stance.

The pick-up in output growth and the oil price hike have led to a further rise in inflation

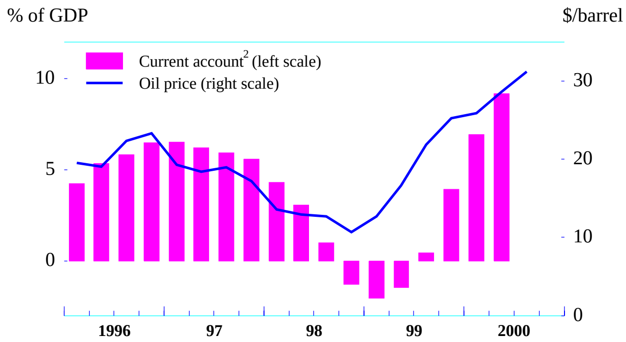
The Norwegian economy experienced a short and shallow growth pause that ended in mid-1999, under the impact of an easing of monetary policy and increasing world demand for Norwegian products. Real mainland GDP increased by 2.4 per cent in the first half of 2000 compared with a year earlier. Falling oil investment has remained a substantial drag on output growth but the coming on stream of new oil and gas fields has started to boost petroleum exports. The labour market response to stronger activity has been rapid, with the unemployment rate falling back to 3.4 per cent in the third quarter. New vacancies are now higher than at any time during the 1990s. High oil prices and the tight labour market have pushed up inflation, with consumer prices (measured by the harmonised index)

Norway

Inflation[1] remains well above the euro area average



Current account surplus explodes due to oil price



1. Harmonised consumer price index, year-on-year percentage change.
2. Four quarter moving average for both the current account balance and GDP.
Source: Statistics Norway.

rising 3.6 per cent in the year to September, 0.8 percentage point more than in the euro area and the highest rate since 1992. The tight labour market conditions have affected the two-year wage agreement for 2000 and 2001. Wage increases will remain higher than those granted in trading partner countries, while labour costs are increasing even more due to the granting of two extra days of vacation in both 2001 and 2002 and the supplementary payroll tax proposed in the draft 2001 budget.

The central bank has reacted swiftly to inflationary pressures

With monetary policy aiming to achieve low inflation as the fundamental precondition for exchange rate stability *vis-à-vis* the euro, the inflationary pressures have led to a rise in the key deposit rate of 1½ percentage points to 7 per cent between April and September. Based on a projected economic slowdown and an assumed neutral fiscal policy in the coming years, the Norwegian central bank switched its monetary policy bias from upward to neutral in September. There are indications that the monetary tightening already had some damping effect on private consumption and on the housing market in the third quarter.

Norway
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion NOK	Percentage changes, volume (1990 prices)				
Private consumption	520.8	3.3	2.4	2.9	2.0	2.0
Government consumption	218.4	3.8	2.7	2.8	2.4	2.0
Gross fixed capital formation	252.1	5.8	-5.6	-2.2	-2.2	0.9
Final domestic demand	991.3	4.0	0.4	1.6	1.1	1.7
Stockbuilding[a]	23.0	1.4	-1.2	0.2	-0.1	0.0
Total domestic demand	1 014.2	5.4	-0.9	1.8	1.0	1.6
Exports of goods and services	448.1	0.3	1.7	5.0	4.8	3.4
Imports of goods and services	366.2	9.3	-3.1	1.6	2.5	3.6
Net exports[a]	81.9	-3.0	1.8	1.5	1.1	0.2
GDP at market prices	1 096.2	2.0	0.9	3.1	2.4	1.9
GDP deflator	_	-0.8	6.6	16.1	7.5	1.0
Memorandum items						
Mainland GDP at market prices[b]	_	3.3	0.8	2.3	1.8	1.9
Mainland GDP deflator[b]	_	3.9	2.8	2.9	4.4	3.1
Exports of non-manufactures (incl. energy)	_	-2.8	2.4	7.4	5.0	2.0
Private consumption deflator	_	2.7	2.2	3.0	2.8	2.6
Unemployment rate	_	3.2	3.2	3.3	3.3	3.4
Household saving ratio[c]	_	6.6	6.7	6.3	6.6	6.8
General government financial balance[d]	_	3.6	4.9	14.0	14.8	14.4
Current account balance[d]	_	-1.3	3.9	15.4	20.5	19.7

Note: National accounts are based on chain linked data. This introduces a discrepancy in the identity between real demand components and GDP. See "Sources and Methods" for further details.
a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) GDP excluding oil and shipping.
c) As a percentage of disposable income.
d) As a percentage of GDP.
Source: OECD.

Pressures for higher government outlays are very strong

The draft budget presented in early October shows indeed a neutral stance, with relatively strong expenditure growth offset by tax increases, especially on capital income. With strong oil revenues leading to an estimated general government surplus of 15 per cent of GDP in 2001, pressures to raise government expenditure are very strong.

Slower demand and lower inflation are projected…

Reflecting the tightening of monetary policy and less buoyant world trade, mainland GDP growth is projected to decelerate somewhat from 2.3 per cent in 2000 to slightly below 2 per cent in 2001 and 2002. The output gap, however, should remain positive. The slowdown in private consumption, induced by the interest rate rise, is expected to be partly offset by a gradual recovery of oil-sector investment. The deterioration in competitiveness should lead to a further loss of market share by manufacturing exporters. With oil prices assumed to decline only slightly and the labour market remaining extremely tight, headline inflation is projected still to be clearly above 2 per cent at the end of the projection period.

… but inflation risks remain substantial

The economy remains on the brink of overheating despite the speedy shift in monetary policy and the neutral fiscal policy stance in 2001. Monetary policy should stand ready to restrain demand further if price and cost pressures do not diminish sufficiently.

POLAND

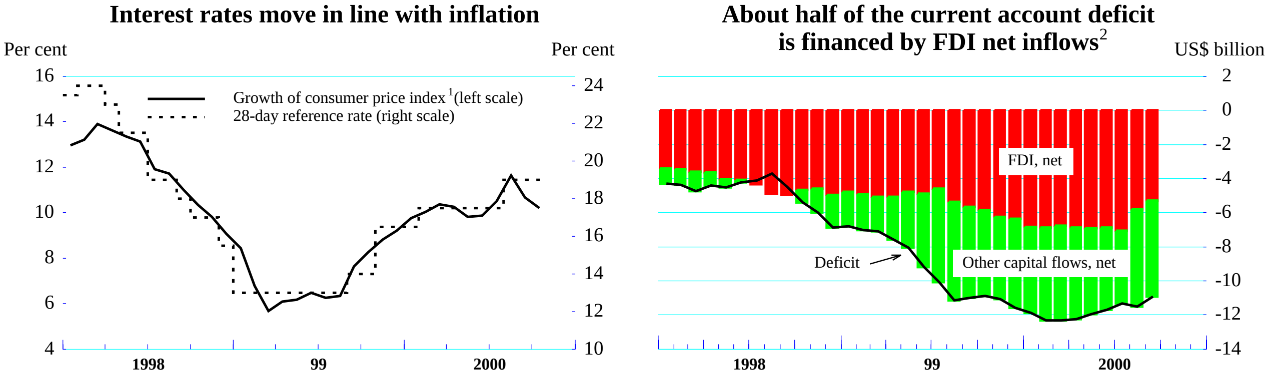
Poland has been one of the fastest growing European economies in 1999-2000, with real GDP expanding by 4½ per cent annually on average. Activity has been underpinned by supportive economic policies, including relatively low interest rates until recently and an easy fiscal stance. Strong domestic demand, fuelled by aggressive bank lending, has led to double-digit inflation and a growing current account deficit. Higher energy prices, together with a jump in food prices, are aggravating these trends.

These symptoms of overheating call for careful monetary and fiscal policies. The National Bank of Poland has appropriately tightened its stance since late 1999 within its inflation-targeting framework. However, inflation is unlikely to be reduced sufficiently to reach the target range in December 2000. Monetary policy and structural measures are thus necessary to make further disinflationary progress. Similarly, the authorities should resume their fiscal consolidation efforts so as to reduce the need for external financing through short-term capital flows.

Output growth slowed during 2000…

The Polish economy has expanded rapidly in 2000, fuelled by supportive financial conditions and a favourable external environment. Output growth has been strong, but it has also become more balanced. In the first part of the year, domestic demand increased rapidly, in particular household spending, while net exports contributed negatively to growth. In the second part of the year, indications are that these contributions have changed: domestic demand growth has eased under the pressure of higher interest rates, and net exports have become a positive contributor to GDP growth. Despite strong activity, labour market conditions have deteriorated.

Poland



1. Lagged by one month.
2. Cumulated over twelve months.
Sources: Central Statistical Office and OECD.

Net job creation has been virtually flat, and unemployment has risen sharply. Industrial firms (especially coal mines) appear to have finally embarked on long-delayed restructuring, with the government providing generous financial support to departing workers.

… but inflation remained high…

Inflation rose significantly in the first half of 2000. After reaching a single-digit low in 1999, consumer price increases gathered pace, peaking at 11.6 per cent in July 2000, well above the 5.4 to 6.8 per cent target range established by the National Bank of Poland for the end of the year. Apart from strong domestic demand, the rise in inflation resulted from a number of factors, including crude oil price hikes, drought-related food price increases, and higher excise taxes and value added tax. Although some of these factors are temporary, core inflation is estimated to have increased by over 3 percentage points in 2000.

Poland
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Zl	Percentage changes, volume (1995 prices)				
Private consumption	301.1	4.8	5.1	4.6	4.2	4.4
Government consumption	75.7	1.4	0.8	2.1	2.0	2.0
Gross fixed capital formation	110.9	14.4	6.9	6.5	5.0	8.0
Final domestic demand	487.6	6.5	4.9	4.7	4.1	5.0
Stockbuilding[a,b]	5.2	0.1	-0.2	0.1	0.1	0.1
Total domestic demand	492.7	6.6	4.7	4.8	4.1	5.1
Exports of goods and services	120.4	17.0	-2.1	9.8	9.9	8.4
Imports of goods and services	140.8	19.1	1.5	7.8	6.4	7.8
Net exports[a]	- 20.4	-1.3	-1.2	0.2	0.8	-0.1
GDP at market prices	472.4	4.9	4.0	5.1	4.9	5.0
GDP deflator	_	11.8	7.1	10.0	9.2	9.5
Memorandum items						
Private consumption deflator	_	11.5	7.2	10.2	8.4	7.2
Industrial production	_	4.9	4.5	9.0	8.0	8.0
Unemployment rate	_	10.6	13.9	15.1	15.0	15.0
General government financial balance[c]	_	-2.3	-3.2	-2.8	-1.5	-2.3
Current account balance[c]	_	-4.4	-8.0	-7.6	-7.1	-6.0

Note: National accounts are based on chain linked data. This introduces a discrepancy in the identity between real demand components and GDP. See "Sources and Methods" for further details.
a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) Including statistical discrepancy.
c) As a percentage of GDP.
Source: OECD.

… and the current account deficit stabilised at a very high level

With export performance improving -- thanks to the recovery in Europe -- and domestic demand weakening, the current account deficit has stabilised at around 7½ per cent of GDP in 2000.[28] Net foreign direct investment flows provided financing for about half of the external deficit this year, notably with the privatisation of a large stake of telecom giant TPSA. High interest rates on zloty-denominated securities have also attracted short-term portfolio investment.

The tightening of monetary policy should slow domestic demand growth and reduce inflation…

With inflation exceeding its target range in both 1999 and 2000, the National Bank of Poland raised its reference rate several times, to 19 per cent at the end of August 2000. The tightening of monetary policy has already contributed to lower domestic demand growth and should help reduce inflation. Hence, the inflation target of 6-8 per cent established for December 2001 seems achievable. With inflation drifting down, it should be possible to ease monetary policy at some stage, allowing domestic demand to pick up again in 2002.

… and the authorities intend to tighten fiscal policy in 2001

Fiscal policy remained loose in 2000, with the general government deficit expected to stay at around 3 per cent of GDP. Higher inflation led to wage increases, debt servicing payments rose, costly separation packages were paid in the context of industrial restructuring plans, and unemployment benefits grew rapidly. The draft 2001 budget calls for a reduction of the official budget deficit by 0.9 per cent to 1.6 per cent of GDP. This would be achieved by raising indirect tax rates and cutting back on some social transfers.

The growing recourse to short-term capital inflows carries a risk of financial volatility

With its growing dependence on short-term capital inflows to finance the budget and balance of payment deficits, Poland is vulnerable to abrupt changes in market sentiment. Investors have so far been attracted by the country's impressive economic potential and its prospective membership in the European Union. Nevertheless, there are other aspects that make the macro picture less attractive, including the lack of fiscal consolidation, growing short-term indebtedness, and uncertainties concerning forthcoming parliamentary elections. In these circumstances, a sudden slowdown in the European Union would make the current account deficit more problematic. A flight to quality in international capital markets would also make Poland vulnerable to financial distress. This would lead to a lower exchange rate, higher inflation, tighter money and slower activity than projected.

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[28]. The OECD balance-of-payments projections are on a transactions basis, which can differ substantially from the cash basis.

PORTUGAL

Economic activity remained strong in 2000, as a recovery in exports more than offset a sharp slowdown in private consumption. Unemployment continued to edge down and inflation picked up, boosted by the increase in the domestic price of oil and its second-round effects. Output growth should remain at around 3 per cent on average over the period 2000-02, as exports and investment continue to expand strongly. The current account deficit is projected to widen to 12 per cent of GDP in 2002. Consumer price inflation is likely to remain above the euro average, due to the rising price of domestic oil products and the tightness in the labour market.

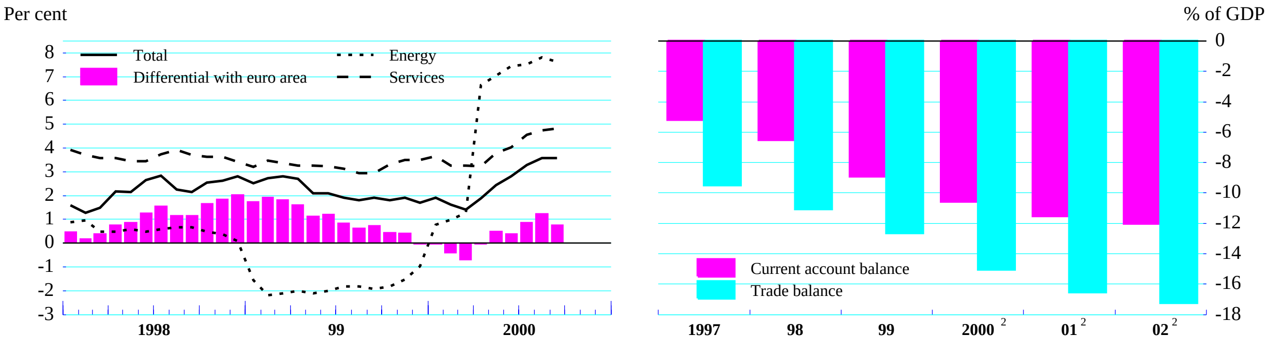
Fiscal policy targets are unambitious, given the state of the cycle, the external deficit and the recent intensification of price and wage pressures. Moreover, fiscal consolidation in the future will require better control of public spending, including structural reforms in health and social security. A tighter rein should be kept on the ballooning public sector wage bill, which typically has strong spill-over effects on private sector wage demands. Finally, current tax reform proposals need to be implemented and additional measures taken to improve tax administration and control.

Output growth remains strong…

After seven years of expansion, the economy is now operating close to its estimated potential. Real output growth is projected at around 3¼ per cent for 2000, with the momentum shifting from domestic demand to the external sector. Private consumption decelerated sharply as the increase in the domestic price of oil derivatives and rising interest rates affected real disposable income. This was in part offset by a strong pick-up in exports, which benefited from the growth of export markets and the depreciation of the euro, although Portugal has continued to lose market share. Fixed capital formation has remained strong, as private investment has picked up. Buoyant import growth and a deterioration in the terms of trade have led to a widening of the trade balance, with the current account deficit exceeding 10 per cent of GDP in 2000.

Portugal

Inflation picks up[1] **The current account deficit widens**



. Harmonised index of consumer price. Year-on-year percentage change.
. Estimates and projections.
ources: Banco de Portugal; Eurostat.

… with the labour market tight and inflation moving up

Employment has continued to grow strongly, leading to a further fall in unemployment to around 4 per cent. In spite of the slowdown in consumption, inflation continued to rise. The year-on-year consumer price increase accelerated to 3.4 per cent in the third quarter, as the direct effect of the rise in domestic oil prices (an administratively delayed and partial reflection of the rise in international oil prices) was followed by a broader second-round impact.

A public spending freeze and extraordinary revenues will help achieve the 2000 budget deficit target

Government current spending has continued to grow significantly more rapidly than nominal GDP. Contrary to previous years, however, tax revenue growth has been lower than budgeted. This was mainly the result of lower-than-expected receipts from oil excise taxes, as the rise in international oil prices was not fully passed on to domestic consumers. The introduction of a mid-year spending freeze and extraordinary revenues from the sale of mobile phone concessions -- equivalent to 0.4 per cent of GDP -- will help the achievement of the budget deficit target of 1.5 per cent of GDP in 2000. The draft budget for 2001 calls for a further reduction in the deficit to 1.1 per cent, while the Stability and Growth Programme targets a

Portugal
Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Esc	Percentage changes, volume (1995 prices)				
Private consumption	11 802.3	5.4	4.8	3.3	2.9	2.8
Government consumption	3 592.2	4.6	3.4	3.0	2.1	2.3
Gross fixed capital formation	4 469.5	8.7	6.0	5.8	6.0	5.8
Final domestic demand	19 863.9	6.0	4.8	3.8	3.5	3.5
Stockbuilding[a]	76.1	0.0	0.0	-0.1	-0.1	0.0
Total domestic demand	19 940.0	6.0	4.8	3.7	3.4	3.5
Exports of goods and services	5 685.6	7.6	4.8	8.9	9.2	8.2
Imports of goods and services	7 076.1	13.8	8.8	8.7	8.5	8.4
Net exports[a]	-1 390.5	-2.9	-2.2	-0.9	-0.7	-1.1
GDP at market prices	18 549.4	3.5	3.0	3.2	3.0	2.9
GDP at market prices in billion euros	92.5					
GDP deflator	_	4.0	2.7	2.3	3.0	3.1
Memorandum items						
Private consumption deflator	_	2.6	2.3	2.7	3.0	2.9
Industrial production[b]	_	5.7	3.1	1.5	2.5	2.5
Unemployment rate	_	5.1	4.5	4.1	4.1	4.2
Household saving ratio[c]	_	10.8	9.5	9.2	9.1	9.1
Current account balance[d]	_	-6.5	-8.9	-10.6	-11.5	-12.0

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) Industrial production index.
c) As a percentage of disposable income.
d) As a percentage of GDP.
Source: OECD.

balanced budget in 2004. Even assuming a recovery in receipts from oil excise taxes, meeting these targets will require new tax measures and/or actions to improve spending control which have not been incorporated in the central projections.

Output growth is likely to remain strong

Price and wage increases are likely to accelerate in 2001, especially if the cost of oil products rises further. Economic activity is projected to remain strong, with real output growing at around 3 per cent in 2001 and 2002. Investment should stay buoyant, as EU transfers are stepped up and a new round of infrastructure projects gets under way. Higher inflation should lead to lower real wage growth and a further deceleration of real disposable income, and hence slower consumption growth. At the same time, employment growth is likely to slow, the unemployment rate stabilising at present low levels. As export-market growth slows and imports remain strong, the current account deficit could widen to 12 per cent of GDP in 2002.

Wages and public spending constitute a risk

The main risk to the projections concerns the behaviour of wages as well as possible public spending overruns which would tend to exacerbate demand pressures. As the economy continues to operate close to potential and in the absence of a sharper fiscal policy tightening, wages could rise faster than expected. In this case, growing inflationary pressures in domestically-oriented sectors and a steeper erosion of external competitiveness would cause a further widening of the external imbalance, lower output growth and higher unemployment.

SPAIN

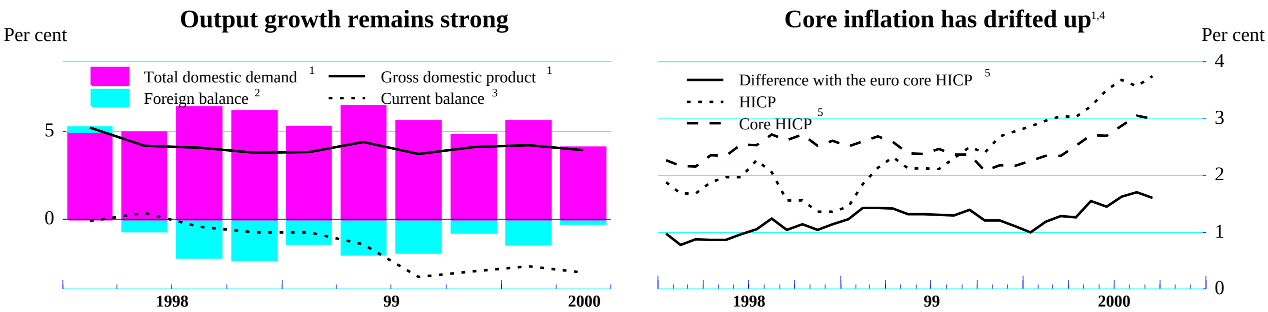
Domestic demand slowed somewhat in the first half of 2000, but activity remained strong as exports were buoyant. Headline and core inflation have risen substantially during the year. While slowing, output and employment growth are projected to remain strong and the unemployment rate to decline to 12 per cent in 2002. With the effect of the oil price hike waning, but GDP growing above potential, headline inflation is likely to stabilise over the projection horizon at around 3 per cent.

In the face of rising core inflation and still relaxed monetary conditions, the fiscal stance should be tightened to damp demand pressures. On the supply side, the liberalisation of product markets should continue. Given the current risk of a wage-price spiral, a reform of the wage bargaining process and the removal of indexation of wage contracts to headline inflation would help to contain labour cost pressures. Easing the stringent employment protection legislation would also help to sustain strong employment growth.

Activity remains strong while underlying inflation has accelerated

After several years of growth of around 4 per cent, the economy remained strong in the first half of 2000, despite a deceleration of domestic demand. Private consumption remained buoyant as unemployment continued to fall, although it slowed somewhat due to higher interest rates and the oil price hike. Machinery investment was weak in the second quarter, but construction remained buoyant. The mild deceleration of domestic demand was compensated by stronger exports. The labour market continued to improve, with national accounts employment growing at more than 3 per cent. Despite a sharp rise in the labour force, the unemployment rate declined by 1¾ percentage points to 13.7 per cent in the year up to the third quarter of 2000. Consumer price inflation hit 4.0 per cent in

Spain



1. Year-on-year percentage changes.
2. Contribution to GDP growth.
3. As a percentage of GDP.
4. Harmonised inflation as defined by Eurostat.
5. Excluding energy, food, alcohol and tobacco.

Sources: Ministry of Economy and Finance; National Institute of Statistics and Eurostat.

October 2000, pushed up by the oil price hike and the depreciation of the euro. Underlying inflation also rose during the summer reaching 2.8 per cent, and the inflation differential with the euro area has widened. Wage inflation has increased only moderately so far.

The fiscal stance remains neutral and monetary conditions relaxed

With the euro weak and inflation above the European Union average, monetary conditions remain relaxed even though interest rates have been rising. The government deficit for 2000 is likely to be lower than originally expected by the government due to booming value-added tax receipts and higher than expected revenues from direct income taxes. For 2001, the government aims at a balanced budget. The restrictions on hiring and on wages for civil servants will remain and a new tax on the use of electromagnetic spectrum will collect the equivalent of 0.2 per cent of GDP. However, this will be offset by higher social spending as the government is legally obliged to make additional pension payments to compensate for higher than expected inflation in 2000, and infrastructure spending will be boosted further. Overall, the fiscal stance measured by the structural budget balance will be broadly neutral.

Spain

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion Ptas	Percentage changes, volume (1995 prices)				
Private consumption	48 626.2	4.5	4.7	4.1	3.3	3.3
Government consumption	14 415.3	3.7	2.9	1.2	1.4	1.4
Gross fixed capital formation	17 999.2	9.7	8.9	6.1	6.6	5.0
Final domestic demand	81 040.7	5.5	5.4	4.1	3.8	3.4
Stockbuilding[a]	180.2	0.1	0.2	0.2	-0.1	0.0
Total domestic demand	81 220.9	5.6	5.5	4.2	3.7	3.4
Exports of goods and services	21 989.9	8.3	6.6	11.0	9.4	8.8
Imports of goods and services	21 151.3	13.4	11.9	11.0	9.8	9.2
Net exports[a]	838.6	-1.3	-1.5	-0.2	-0.3	-0.3
GDP at market prices	82 059.5	4.3	4.0	4.1	3.5	3.1
GDP at market prices in billion euros	493.2					
GDP deflator	_	2.3	2.9	2.9	2.9	2.9
Memorandum items						
Private consumption deflator	_	2.0	2.4	3.4	3.2	2.9
Industrial production	_	5.4	3.2	4.0	3.4	3.1
Unemployment rate	_	18.8	15.9	14.1	12.9	12.2
Household saving ratio[b]	_	12.7	11.9	11.2	11.1	11.1
General government financial balance[c]	_	-2.6	-1.1	-0.3	0.2	0.4
Current account balance[c]	_	-0.2	-2.1	-3.3	-3.7	-3.8

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of disposable income.
c) As a percentage of GDP.
Source: OECD.

Output growth is projected to slow

Private consumption is likely to slow due to higher interest rates and the oil price shock. Investment should remain strong, given the high level of capacity utilisation and the additional infrastructure spending for public sector projects and for third generation mobile telephony. Overall, domestic demand growth is projected to fall to below 3½ per cent in 2002 with GDP growth easing to 3 per cent in 2002 as the negative contribution of net exports to GDP stabilises at around a quarter per cent of GDP. The current account deficit is likely to exceed 3½ per cent of GDP in 2001 and 2002. The consumption deflator is expected to remain above 3 per cent in 2001, reflecting strong demand pressures, while wages are likely to edge up somewhat.

The economy risks overheating

In a context of output growing above potential, the main risk concerns wage developments. Wage increases could be stronger, as many contracts are indexed to headline inflation. This could create a price-wage spiral that would drive up inflation further and result in losses of output and employment in the medium term.

SWEDEN

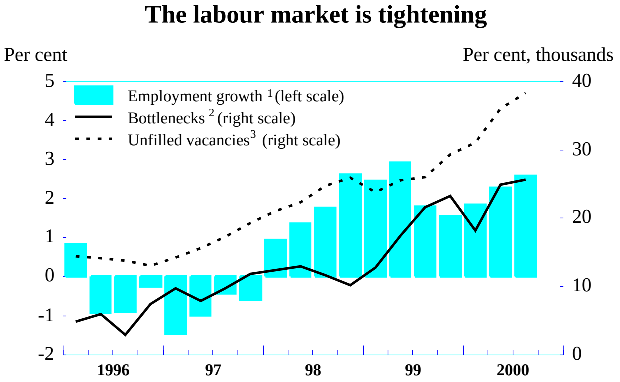
The economy continued to expand vigorously in the first half of 2000, and GDP is expected to increase by 4 per cent for the year. Demand stimulus from fiscal policy has been significant, and monetary policy has remained supportive. Short-term interest rates have risen less than elsewhere and have been lower than in the euro area since June 2000, while inflation remains low. Nonetheless, the output gap is judged to have closed this year and GDP is expected to grow faster than potential in 2001 before moderating to that rate (2½ per cent) in 2002.

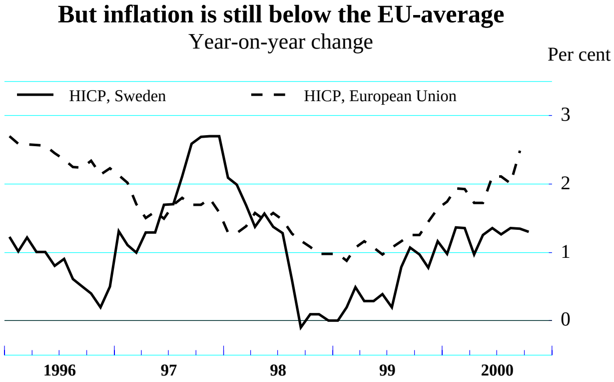
With the budget and the current account both in comfortable surplus and inflation still well below the average EU level, there are no immediate risks of serious imbalances. However, a steadily tighter labour market, spurred by expansionary macro policies, may increase inflationary pressures. The upcoming wage negotiations, the oil shock and recent weakness in the crown reinforce such risks. In this light, it would have been preferable to have offset the considerable tax cuts announced in the Budget for 2001 with spending cuts, and to aim them more directly at increasing labour supply. The onus is now on the monetary authorities to contain overheating risks by raising interest rates.

High growth and low inflation were sustained in the first half of 2000

The economy continued to expand at an annual rate close to 4 per cent in the first half of 2000, underpinned by both domestic demand and net exports. Employment growth was also well maintained, increasing at an annualised rate of 2 per cent. Unemployment has therefore fallen quite rapidly to near 4 per cent, the government's target level for this year, and labour shortages have spread. Against this backdrop inflation stayed remarkably low, with the HICP up a mere 1.1 per cent over the 12 months to August. In the run-up to the wage negotiations this winter, private-sector wage increases have remained broadly stable at 3½ to 4 per cent. Since the implied real wage gains exceed productivity growth, the profit share is declining further.

Sweden





1. Year-on-year percentage change.
2. Production restricted by shortage of skilled labour. Percentage balance of opinions.
3. Thousands.
Source: Statistics Sweden; OECD.

Demand has been supported by low interest rates, strong consumer and business confidence…

The Central Bank has kept the repo rate unchanged at 3¾ per cent since February, while recorded inflation has stayed low and indicators have pointed to inflation expectations close to the 2 per cent inflation target. Thus, monetary policy has accommodated buoyant demand, and the short-term interest rate has been below that of the euro area since June, thereby causing the crown to weaken slightly against the European currency. Long-term interest rates on government bonds have edged down in 2000, and the yield spread *vis-à-vis* Germany has disappeared. In addition to low interest rates, consumer confidence continues to benefit from healthy household balance sheets, falling unemployment and substantial increases in real disposable incomes. Business confidence has also strengthened, albeit more moderately.

Sweden

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion SKr	Percentage changes, volume (1995 prices)				
Private consumption	919.2	2.4	4.1	5.0	4.8	3.0
Government consumption	484.6	2.2	1.8	-1.4	1.3	1.8
Gross fixed capital formation	269.6	9.4	8.1	4.9	6.4	5.9
Final domestic demand	1 673.4	3.5	4.2	3.2	4.2	3.3
Stockbuilding[a]	11.0	0.3	-0.5	0.1	-0.1	0.0
Total domestic demand	1 684.4	3.9	3.6	3.3	4.1	3.2
Exports of goods and services	773.6	7.3	5.2	9.7	6.8	5.1
Imports of goods and services	644.9	10.4	5.0	8.5	9.0	7.0
Net exports[a]	128.7	-0.5	0.5	1.3	-0.3	-0.4
GDP at market prices	1 813.1	3.0	3.8	4.0	3.2	2.4
GDP deflator	_	1.3	0.5	0.7	1.9	2.7
Memorandum items						
Private consumption deflator	_	1.0	0.7	1.0	1.8	2.3
Industrial production	_	4.6	2.1	7.6	5.5	4.5
Unemployment rate[b]	_	6.5	5.6	4.7	4.1	3.7
Household saving ratio[c]	_	3.1	2.1	2.1	2.0	2.2
General government financial balance[d,e]	_	1.9	1.9	3.4	3.3	3.8
Current account balance[d]	_	2.8	2.5	2.4	1.6	1.1

Note: National accounts are based on chain linked data. This introduces a discrepancy in the identity between real demand components and GDP. See "Sources and Methods" for further details.

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

b) Based on monthly Labour Force Surveys.

c) As a percentage of disposable income.

d) As a percentage of GDP.

e) Maastricht definition.

Source: OECD.

… and expansionary fiscal policy

The fiscal policy assumptions underlying the projection are based on the Budgets for 2000 and 2001 which include annual tax cuts of some 0.7 per cent of GDP in each of these years. Previously set expenditure ceilings are restraining total central government spending but they allow cyclical savings to be converted into higher discretionary outlays. One-off factors have worked to reduce public consumption this year, but the underlying increasing trend should show up in 2001 and 2002, particularly at the local level. Notwithstanding the easier fiscal stance, cyclical gains and falling net interest payments have combined to increase the budget surplus to almost 3½ per cent of GDP in 2000, a level that should be maintained next year. Even so, the cyclically-adjusted surplus is expected to fall from 2¾ per cent of GDP this year to just over 2 per cent in 2001.

Interest rates are expected to increase in response to mounting inflationary pressure

With the current policy ease likely to keep growth above potential -- real GDP is projected to rise by more than 3 per cent in 2001 -- the unemployment rate is expected to move further below its sustainable level, prompting wage increases to accelerate to around 5¼ per cent by the end of the projection period. Against this background, monetary policy is expected to be tightened. The short-term interest rate is assumed to increase by 1½ percentage points to 5¼ per cent by the end of 2001, thereby eliminating most of the current negative differential against the euro area. Nevertheless, with spreading capacity constraints leading to losses in market shares the current account surplus is projected to shrink from 2½ per cent of GDP in 2000 to just over 1 per cent in 2002 and consumer price inflation to move slightly beyond the 2 per cent target by the end of the projection period.

The risks are mostly on the upside

The main risk to the projection, other than the possibility of weaker external developments, is on the side of faster growth, particularly in 2001. A continued decline in the household savings rate in the forthcoming years or less pronounced losses of export market shares than assumed in the projection would push GDP growth higher. Unless accompanied by a more rapid increase in labour supply, inflationary pressures could be further aggravated in such a scenario.

SWITZERLAND

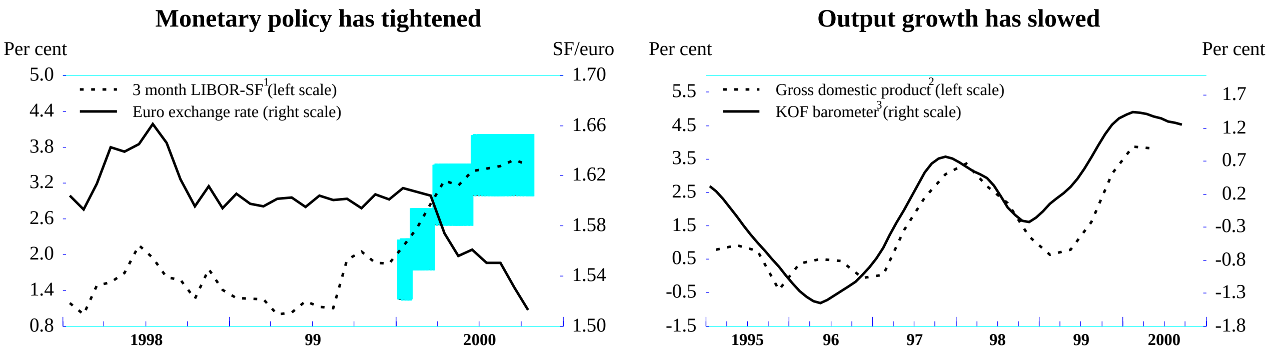
The sharp increase in activity in late 1999 and early 2000 slowed considerably in the second quarter following the tightening of monetary policy and the rise in the oil price. The unemployment rate fell to 1¾ per cent in early autumn, but underlying inflation remained low. Output should continue to grow moderately at about 2¼ per cent over the coming two years, while unemployment could stabilise somewhat below 2 per cent at about its structural level. Inflation should remain below 2 per cent over the projection period, the objective aimed at by the Swiss National Bank.

The gradual tightening of monetary policy towards more neutral monetary conditions seems appropriate in order to guarantee a prolonged period of non-inflationary growth. In view of the comfortable public finance position, which should ensure a balanced federal budget in 2001, as planned, any easing of fiscal policy would be inopportune, given the need to reduce borrowing further. The Swiss authorities should increase their efforts to raise productive potential by strengthening competition in product markets.

Activity slowed in the second quarter while inflationary pressures remained moderate

GDP grew by 3¾ per cent in the first half of 2000 with respect to the previous half year thanks to buoyant exports and investment. However, activity slowed significantly between the first and second quarter to an annual rate of around 2¼ per cent. The monetary tightening of late 1999 and the increase in inflation due to the rise in oil prices have restrained private consumption, while export growth has also slowed. According to the leading indicators, activity is likely to remain moderate in the second half of 2000 reflecting less buoyant order books, even though consumer confidence remains at historically high levels . The unemployment rate fell to 1.7 per cent in early autumn. The big rise in employment was offset by the increase in the labour force, especially of foreigners. There are still few

Switzerland



1. The shaded area indicates the target ranges of the 3-month LIBOR, which have been fixed by the Swiss National Bank since early 2000.
2. Real terms. Year-on year percentage changes.
3. The KOF barometer is a leading indicator of future development of GDP growth, with an average lead of 6 to 9 months.
Sources: KOF/ETH; OECD.

signs of wage pressures in the labour market, since the fall in unemployment is partly structural, as indicated by the reduction in the long-term unemployed. Inflationary pressures are still low. Underlying inflation has remained stable at around 0.5 per cent over the past few months, although the oil price hike has pushed headline inflation to 1.9 per cent in October 2000.

Monetary conditions have tightened

The gradual tightening of monetary policy that began in the autumn of 1999 continued until mid-2000. The 3-month Libor fluctuation margin was increased by half a point in mid-June to 3 to 4 per cent. This tightening has resulted in a slight appreciation of the Swiss franc against the euro since the first quarter of 2000, partly offsetting the depreciation against the US dollar. The projections include small interest rates rises in late 2000 and early 2001, in parallel to those expected in the euro area. As a result, monetary conditions are expected to become neutral.

Switzerland

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion SF	Percentage changes, volume (1990 prices)				
Private consumption	224.2	2.2	2.2	2.1	2.0	1.9
Government consumption	55.8	0.7	-0.4	0.3	0.3	0.2
Gross fixed capital formation	72.9	4.5	1.8	6.2	4.6	4.5
Final domestic demand	353.0	2.6	1.7	2.9	2.4	2.4
Stockbuilding[a]	2.2	1.7	-0.2	-0.2	0.0	0.0
Total domestic demand	355.2	4.3	1.4	2.6	2.4	2.3
Exports of goods and services	147.1	5.0	5.9	9.9	6.6	5.8
Imports of goods and services	130.9	9.6	5.5	8.2	6.7	6.4
Net exports[a]	16.2	-1.9	0.1	0.7	-0.1	-0.4
GDP at market prices	371.4	2.3	1.5	3.3	2.4	2.0
GDP deflator	_	0.2	0.6	1.0	1.6	1.8
Memorandum items						
Private consumption deflator	_	-0.3	0.3	1.7	1.8	1.7
Industrial production	_	4.3	3.3	5.4	3.2	2.3
Unemployment rate	_	3.9	2.7	2.0	1.8	1.8
Current account balance[b]	_	9.8	11.6	12.7	12.7	12.9

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of GDP.
Source: OECD.

The objective of balancing the budget for 2001 will be easily achieved

The objective of fiscal policy is to bring the federal budget into balance in 2001 and to be in surplus as from 2002. With better than expected economic conditions, budget outcomes for the federal and the general government will be above target, yielding a surplus in 2000.This surplus will probably increase in 2001, and could be boosted by extraordinary revenues from the sale of third-generation mobile telephone licences, scheduled for end-2000.

The growth slowdown should prevent overheating risks

The recent slowdown of GDP growth to around 2 per cent is likely to persist in 2001-02 as a result of the tightening of monetary policy and of a less favourable international environment. The deceleration is expected to come mainly through slower growth in exports and investment, but to be less marked for private consumption, since higher real wage increases should compensate lower employment creation. With growth slowing to a rate close to potential and limited tensions on capacity, inflation should remain at around 1¾ per cent in 2001-02 despite the oil price rise. Unemployment could stabilise at just under 2 per cent, around its structural rate. Two main risks are attached to these projections. One relates to the labour market, where bottlenecks could lead to stronger wage gains. The second concerns the Swiss franc, which could appreciate significantly given the large current account surplus and the recent volatility in financial markets and could lead to a deterioration of competitiveness of the economy and a more pronounced slowdown of output.

TURKEY

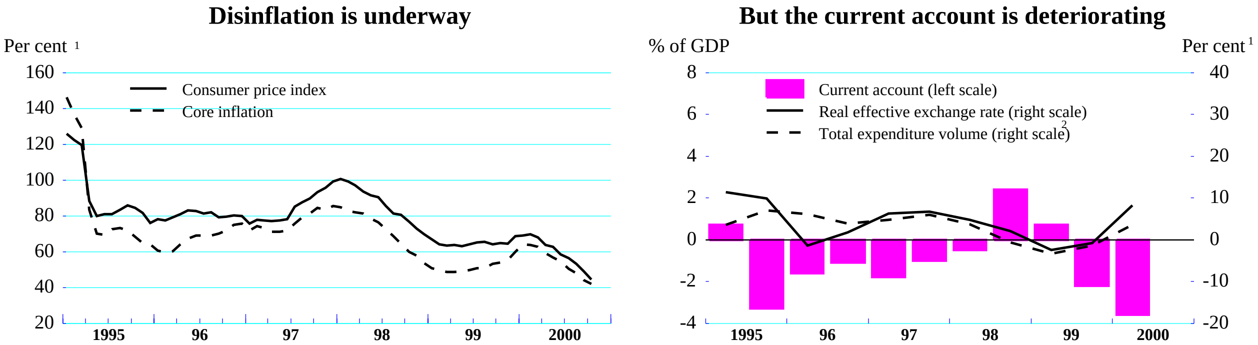
GDP growth should be in the range of 7 per cent in 2000, the first year of the stabilisation programme supported by the International Monetary Fund. Linking the rate of exchange-rate depreciation to targeted inflation has affected price dynamics and inflation has fallen. However, the current account has deteriorated sharply. The target of single-digit inflation by the end of 2002 seems achievable if demand pressure decelerates over the next two years, as projected. At the same time, the external deficit is likely to narrow toward a more sustainable level.

The stabilisation programme is accompanied by an extensive structural reform agenda, aimed at improving budget transparency, privatising state-owned enterprises and liberalising product markets. The full implementation of these reforms is required for credibility in the programme to be maintained.

GDP is growing fast and inflation is falling

Real GDP grew by nearly 6 per cent in the first half of 2000, reflecting a strong recovery of both consumption and investment from a very weak base. The main contributing factor was a sharp fall in real interest rates which accompanied the announcement of a three-year stabilisation programme in late 1999. The programme has been followed by a marked decline in inflation expectations and a steady reduction in inflation, although the target of a 25 per cent consumer price increase by December will be overshot by around 10 percentage points.

Turkey



1. Year-on-year percentage changes.
2. Total expenditure volume excluding government wage consumption.
Sources: State Planning Organisation; OECD.

Exchange-rate depreciation is based on targeted inflation

Monetary policy is providing an anchor to inflation expectations, with the rate of exchange-rate crawl strictly geared to the inflation target. Critical support is coming from the side of incomes policy which applies to the government sector and the minimum wage. However, neither public-enterprise nor private-sector wage bargaining outcomes are covered by the incomes policy, and these have been slow to adjust to the inflation target.

Domestic demand is booming and the current account deficit rising

Real disposable incomes have benefited from the decline in inflation, while earnings from earlier high nominal yields continued to accrue to holders of longer-term bonds, accentuating the positive demand effects of lower current yields. However, booming demand has spilled over into imports, and the oil-price rise has exacerbated the resulting negative impact on the current account, which is expected to exceed 4½ per cent of GDP in 2000. The government has increased the rate of value-added tax on luxury cars, as well as fees on consumer credits, in order to curb domestic demand and imports. The new budget also extends a number of "temporary" tax-raising measures into 2001.

Turkey

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices trillion TL	Percentage changes, volume (1987 prices)				
Private consumption	19 619	0.6	-3.1	6.0	3.2	3.5
Government consumption	3 535	7.8	6.5	5.0	2.0	2.0
Gross fixed capital formation	7 618	-3.9	-16.0	16.2	7.0	5.3
Final domestic demand	30 773	-0.2	-6.0	8.5	4.1	3.9
Stockbuilding[a]	- 377	0.9	2.1	0.0	0.0	0.0
Total domestic demand	30 395	0.6	-4.0	8.3	4.1	3.8
Exports of goods and services	7 088	12.0	-7.0	15.0	6.6	7.5
Imports of goods and services	8 763	2.3	-3.7	18.0	4.0	5.6
Net exports[a]	-1 674	2.6	-0.9	-1.7	0.6	0.3
Statistical discrepancy[a]	115	-0.1	0.1	0.0	0.0	0.0
GDP at market prices	28 836	3.1	-5.0	7.0	4.9	4.4
GDP deflator	_	75.7	56.0	50.1	22.4	15.8
Memorandum items						
Private consumption deflator	_	83.0	60.7	54.3	22.5	11.8
Unemployment rate	_	6.3	7.3	7.1	7.0	6.8
Current account balance[b]	_	1.1	-0.9	-4.6	-4.2	-3.4

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of GDP.
Source: OECD.

Fiscal policy is in line with the programme

Fiscal restraint is an essential part of the stabilisation programme and entails new controls over off-budget entities and inclusion of the state-owned enterprises in the fiscal targets. These have been a prime source of chronic fiscal deficits in the past. As to the central government, there have been major tax increases which, in conjunction with high growth, have allowed its primary surplus target to be surpassed by August. Primary expenditures have been kept under control by income policy measures and by the early positive impact of the social security reform. The decline in interest rates has also begun to reduce interest expenditures substantially. It is expected that the high primary surplus of the central government, along with buoyant privatisation revenues, will allow the level of the debt relative to the gross national product to stabilise in 2000, following a sharp rise in 1999.

Decelerating demand will help achieve the programme's targets in 2001 and 2002

A marked deceleration of domestic demand is projected over the next two years. First, the income effects of the recent interest rate declines will turn sharply negative as outstanding bonds (with an average maturity of around one year) mature. Second, the impact of the recent demand-curbing measures will be felt. Third, the real interest rate is expected to rise to a more "normal" level (in the 10 to 15 per cent range) from its recent undershooting. Weaker demand growth should allow the target of single-digit inflation to be met by the end of 2002. However, real exchange-rate appreciation (amounting to a cumulative 20 per cent in 2000 and 2001) will hold back export volume. The current-account deficit is thus likely to remain above 4 per cent of GDP in 2001, before falling back to around 3½ per cent in 2002 as the impact of real appreciation unwinds.

Risks attach to the current account deficit and to wage

A principal risk relates to the perverse effects of possible demand overheating on the inflation and current-account targets of the programme. The risk to inflation is amplified by a possible failure to achieve the goals of wage policy. Although state-owned utilities have not been allowed to pass on the rising world oil price, this comes at the cost of higher state enterprise-sector deficits. These risks and tensions will be reduced to the extent that the fundamental fiscal and structural elements of the programme are implemented in full.

III. DEVELOPMENTS IN SELECTED NON-MEMBER ECONOMIES

Recoveries in most non-member economies in Asia, Europe, and South America have gained momentum in the past six months, underpinned by exports and a strengthening of domestic demand. Inflation has remained moderate. Growth in Dynamic Asia has been stronger than expected and activity in China has also picked up modestly. Russia has profited from much higher oil and other key export prices. Performance in South America has been somewhat uneven, with Brazil recovering strongly and growth in Argentina remaining sluggish.

Recovery is projected to broaden and gain further momentum in most non-member countries over the next two years. But higher oil prices will restrain growth somewhat in 2001 in those countries more dependent on oil imports, such as Thailand and the Philippines. The overall impact is likely to be modest unless higher oil prices lead to a greater slowdown in OECD countries than is now expected. The downside risks posed by high oil prices, or a harder than expected landing of the United States economy, are underscored by the marked drop in equity prices recorded in most Asian non-members since the first quarter of 2000. There are some upside risks on inflation if oil prices do not moderate.

DYNAMIC ASIA AND CHINA

Economic recoveries have been stronger than expected

Economic recoveries have been stronger than foreseen last spring but differences among countries are becoming more apparent. The leaders have been Malaysia, Singapore and Hong Kong, China, all of which recorded growth in real GDP above potential in the first half of 2000. Growth in Thailand has also picked up but has been less robust in relation to past growth performance than in the other three. The recovery in Indonesia, particularly in domestic demand, is still comparatively weak and fragile.

Exports have been especially strong

Very rapid export growth driven by strong external demand particularly from the United States and Asian OECD countries, has been a major factor in the unexpectedly strong recoveries. Imports have also been growing rapidly, spurred by sharply rising demand for imported inputs used by export industries and for inventory restocking. Domestic demand growth has picked up significantly since the second half of 1999 and is becoming increasingly important to the recoveries. Private consumption, inventory accumulation, and fiscal stimulus have been the strongest contributors to domestic demand. But business fixed investment in the crisis countries is now reviving and, except in Indonesia, is expected to record positive year-on-year growth in 2000 for the first time since 1997.

Underlying forces favour continued recovery

Underlying forces are on balance favourable to a continuation and broadening of the recoveries. Although posted inflation rates have risen with the surge in oil prices, core inflation rates are still low and, except possibly in the Philippines, appear unlikely to rise to levels that would require a reversal of the current supportive stance of monetary policy, at least before 2002. Rising capacity utilisation rates, particularly in export sectors, should stimulate growing momentum in business investment in 2001. Fiscal stimulus is likely to diminish after this year in those economies that are net oil importers, particularly in Thailand and Chinese Taipei where general government deficit levels are now above 5 per cent of GDP. However the rise in oil prices will provide more room for expansionary fiscal policy in Indonesia.

Higher oil prices and debt loads will restrain growth

Higher oil prices and the heavy private sector debt loads in some crisis countries are expected to damp growth moderately in 2001, but could pose further downside risks. Rapid growth has led to substantial improvement in financial conditions in Malaysia and in Hong Kong, China. The improvement in Thailand has been more gradual and modest and financial risks remain somewhat greater. There has been very little improvement in the severe debt problems of the corporate sector in Indonesia, which remain a major constraint on growth. The comparatively large decline in equity prices since the first quarter of 2000 recorded by Thailand and Indonesia may be an indication of market unease over their continuing financial burdens. The dampening impact of higher oil prices is likely to be greatest for Thailand and the Philippines, which are relatively dependent on net oil imports, but small for the region as a whole. The rise in oil prices is unlikely to pose a major risk to the recoveries unless it was to lead to a much greater slowdown in OECD countries than is now foreseen.

Recovery in China is gaining strength…

In China, the rebound in activity witnessed during the second half of 1999 gained strength in the first nine months of 2000, when GDP increased at an annual rate of around 8 per cent. The pick-up in growth was underpinned by strong export growth but also by a recovery in urban consumption and in investment. Both construction and industry grew rapidly, reversing last year’s weakening trends and compensating for the sluggish performance in agriculture.

… and fundamentals are healthier than in previous upturns

The current recovery is still largely dependent on macroeconomic policy stimulus and external demand. However, fundamentals are healthier than in previous economic upturns. Consumer and business confidence is improving, retail sales have been rising steadily, reported industry profits are rising, capacity utilisation is increasing, and there are signs of improvement in the inventory overhang. In addition, deflation has been arrested, helped by the recovery in domestic consumption. On the external side, export growth has remained robust, spurred by strong global and regional demand. Imports of goods and services have also been growing

Table IIII.1. **Projections for selected Asian Economies**[a]

	1999	2000	2001	2002
China				
Real GDP growth	7.1	8.0	7.6	7.8
Domestic demand growth	7.8	7.9	7.9	8.0
Inflation	-1.3	0.4	1.0	2.0
Current account balance (US$ bn)	15.7	15.1	12.7	6.7
Current account balance (% of GDP)	1.6	1.4	1.1	0.7
Hong Kong, China				
Real GDP growth	3.1	9.0	7.1	5.5
Domestic demand growth	-2.1	8.3	6.9	5.8
Inflation	-2.0	-1.8	2.0	1.5
Current account balance (US$ bn)	7.2	5.9	5.6	5.2
Current account balance (% of GDP)	4.3	3.3	2.8	2.4
Indonesia				
Real GDP growth	0.0	3.7	5.0	6.1
Domestic demand growth	-3.0	2.3	5.4	7.9
Inflation	20.0	2.6	5.0	4.5
Current account balance (US$ bn)	5.8	11.1	11.1	9.6
Current account balance (% of GDP)	4.4	8.2	8.5	6.6
Malaysia				
Real GDP growth	5.4	8.5	7.0	6.5
Domestic demand growth	2.4	9.0	7.6	6.8
Inflation	2.8	2.5	3.5	3.0
Current account balance (US$ bn)	12.6	13.6	12.8	12.5
Current account balance (% of GDP)	16.1	15.6	13.3	11.9
Philippines				
Real GDP growth	3.2	3.5	3.0	3.5
Domestic demand growth	-1.0	3.8	2.6	4.2
Inflation	7.0	5.0	5.5	5.0
Current account balance (US$ bn)	7.8	5.8	5.9	5.3
Current account balance (% of GDP)	10.4	8.2	9.0	7.4
Thailand				
Real GDP growth	4.2	5.6	5.8	7.0
Domestic demand growth	6.2	5.8	5.1	7.8
Inflation	0.0	2.0	4.0	3.5
Current account balance (US$ bn)	12.5	9.9	10.5	9.2
Current account balance (% of GDP)	9.6	7.6	8.0	6.3

a) The figures given for GDP and inflation are percentage changes from the previous period. Inflation refers to the Consumer Price Index. Current account estimates for Hong Kong, China correspond to net exports of goods and services on a national accounts basis and therefore exclude investment income and transfer

Source: Figures for 1999 are preliminary figures from national sources or OECD estimates. Figures for 2000-2002 are OECD projections.

Box III.1. **Progress in reforms to China's enterprises**

China has been undertaking extensive reforms to its business sector that are very important to its macroeconomic performance and which will become all the more essential once it enters the World Trade Organisation. A recently published OECD Economics Department study[1] assessing these reforms finds that significant progress is being made, but that much more needs to be done if the reform process is to succeed.

The first objective of enterprise reform is to improve financial performance, which has deteriorated markedly for both state-owned enterprises (SOE) and non-state enterprises during the 1990s. Reforms to improve performance have focused on retiring excess industry capacity built up during the investment boom of the early 1990s, reducing excess labour and other government-imposed burdens on SOE, and reorganising and downsizing of the SOE sector. As a result, surplus labour of SOE has been reduced by roughly one-half, industry capacity utilisation has begun to improve, and debt loads of many larger SOE have been reduced substantially through the debt-equity swap programme instituted in 1999. However several factors have limited the gains from these measures. First, government efforts have focused on larger loss-making SOE, while the serious problems of non-state enterprises, whose overall importance to the economy is greater, have received relatively little attention. Second, because government revenues are quite limited, SOE continue to bear much of the burden for supporting laid-off workers and so do not reap the full benefits of their labour shedding. And third, industry reorganisation through mergers and acquisitions has been severely hampered by government imposition of non-economic considerations and by regional protectionism.

The second key objective of enterprise reforms is to improve enterprise behaviour. Distortions in management and in external incentives that are responsible for many of the current problems of enterprises need to be corrected so that enterprises make effective use of the gains from measures to improve financial performance. Reforms in this area have focused on establishing effective corporate governance structures in SOE and on improving the discipline exercised by the financial system. Some progress has been made in removing line government agencies from day-to-day enterprise management and in establishing boards of directors and other structures to improve the accountability of SOE management to their state owners. Commercial bank lending standards have been tightened considerably and an important step toward dealing with the extensive non-performing bank loans was taken with the formation of four bank asset management companies in 1999. However, progress has been uneven and constrained by several factors that have limited the benefits. Top SOE managers continue to be appointed by government or political officials and boards of directors tend to be dominated by insiders. Policy considerations such as the need to sustain operations of large loss-making SOE continue to influence bank lending. It is also doubtful that current reforms will be sufficient to fully resolve non-performing bank loans.

The third reform objective is to develop institutions needed to allow enterprises to focus on their commercial objectives. A key priority is to establish modern social insurance systems to relieve SOE of their excess social burdens and to improve the functioning of labour markets. Key institutional foundations have been laid for socialising these programmes and extending their coverage. However progress in implementation is limited by the scarcity of government revenues.

Overall, enterprise reforms in China are now at a critical stage. Rapid progress needs to be made over the next several years to break bottlenecks in key areas, notably in ending undue government interference in SOE operations and bolstering efforts to improve financial discipline. Without such progress, the reform process is likely to become more difficult to sustain and the gains that have been made could be jeopardised.

1. *Reforming China's Enterprises*, OECD, 2000.

strongly. The economy has continued to receive a boost from fiscal expansion, funded by US$18 billion worth of extra-budgetary treasury bonds issued this year. The bulk of the government bond proceeds has been used for infrastructure investment in western provinces, reflecting the priority now being given by the central government to development of China's West. Further stimulus has been provided by housing reforms, which have boosted spending for home renovation and decoration, and the suspension of direct taxes on investment. In addition, improvement in business financial conditions arising from ongoing enterprise reforms (see Box III.1) should contribute to an overall strengthening of the macroeconomic situation.

Continued recovery in domestic demand should support growth

Real GDP growth is expected to moderate next year, as the contribution from net exports and state investment weakens, but should remain in the 7½ to 8 per cent range over the next two years. The recovery in private consumption is expected to strengthen somewhat, although its speed will be constrained by labour shedding by urban enterprises and subdued growth in the cash income of rural residents. Fiscal and monetary policies are expected to remain largely supportive of growth. Inflation will continue to edge up, as the situation of oversupply gradually improves and the rise in service prices continues. Although the trade and services balances will decline, the current account is expected to remain in surplus. Contracted foreign direct investment inflows registered with the authorities have been rising again, perhaps in anticipation of China's entry to the World Trade Organisation. The impact of high oil prices is expected to be relatively mild in China, as net oil imports are relatively low in relation to GDP.

THE RUSSIAN FEDERATION

Strong GDP and industrial growth continues in Russia

Fuelled by high prices for a number of key exports, notably energy products and metals, the Russian economy continues to exhibit strong growth in 2000. GDP grew by a reported 7½ per cent in the first half of 2000, while industrial output was 10 per cent higher than in the corresponding period of the previous year. While industrial growth is still concentrated primarily in a number of export-oriented and import-substituting sectors, there has also been a partial recovery in domestic demand. While still well below pre-crises levels, real incomes were 13 per cent higher in the first half of 2000 relative to the same period in 1999, while retail trade was up by 8 per cent. The production of investment goods has also picked up, mirroring an estimated 17 per cent growth in fixed capital investment relative to the same period of 1999. The high export prices and growth in export volumes, coupled with only a modest recovery in import demand, have significantly increased Russia's current account surplus. The surplus rose from US$9 billion in the first half of 1999 to a reported US$23 billion in the first half of 2000.

Higher reserves have bolstered monetary policy, but central bank intervention may be adding to inflationary pressures

The very strong current account has helped restore credibility to monetary policy and the rouble. Despite the burden of foreign debt service, gross gold and foreign currency reserves doubled in the first three quarters of 2000, reaching US$24 billion. As the nominal exchange rate has remained rather stable in the range of 27-28 roubles to the dollar, the strong inflows can be associated with somewhat greater inflationary pressures. CPI inflation for the first eight months of 2000 amounted to 12.5 per cent, and annual inflation could well exceed the annual December-on-December target of 18 per cent.

The federal budget is in surplus

In contrast to the chronic budget deficits of the past, the federal budget experienced a surplus amounting to 4 per cent of GDP in the first half of 2000. The primary surplus was 7 per cent. The turnaround in the Russian federal budgetary position is due primarily to increases in tax collection, particularly higher export and excise tax receipts. The federal government is on track to more than meet its budgetary deficit target for 2000 of 1 per cent of GDP.

The outlook for the Russian economy is favourable in the short term, but key structural reforms are still needed

Current positive trends in output, investment, fiscal consolidation, and macroeconomic stability are sufficiently strong to carry into at least early 2001. Meanwhile the current account surplus is likely to narrow in 2001 and 2002 as further recoveries in consumption and investment fuel imports. The pace of industrial growth is likely to slow somewhat because of continued pressure for the real appreciation of the rouble and necessary increases in repressed domestic energy and transportation prices. Medium-term prospects continue to depend critically on key structural reforms, including taxation, fiscal federalist relations, corporate governance, and competition. The current political and economic situation presents a major opportunity for Russia to make progress in this area. The recently adopted comprehensive economic programme of the government, and a number of recent initiatives to amend or pass new laws are important first steps in this direction.

Table III.2. **Projections for the Russian Federation**[a]

	1999	2000	2001	2002
Russia				
Real GDP growth (annual %)	3.2	6.5	4.0	4.0
Inflation	36.7	22.0	15.0	15.0
Unemployment (ILO definition)	12.0	10.0	10.0	10.0
Consolidated fiscal balance (% of GDP)[b]	-2.0	0.0	0.0	0.0
Current account (US$ bn)	25.0	40.0	25.0	12.0
Current account balance (% of GDP)	14.0	18.0	9.0	4.0

a) The figures given for GDP are percentage changes from previous year. Inflation refers to end-of-year consumer price index.
b) Includes federal, regional and local budgets.
Source: Figures for 1999 are final figures from national sources, figures for 2000 are preliminary estimates from national sources or the OECD estimates, and figures for 2001 and 2002 are OECD projections.

SOUTH AMERICA

Growth in South America is expected to strengthen

Growth in South America is tending to pick up, though somewhat unevenly. Strong exports and accelerating domestic demand are underpinning growth in Brazil while oil revenues are helping economic activity in Venezuela and easing condition for the dollarisation process in Ecuador. On the other hand, in the second quarter of 2000 a slight deceleration occurred in some countries, notably Argentina, Colombia and Chile. Inflation has remained moderate. Growth is expected to strengthen somewhat further over the projection horizon, though generally remaining below estimated potential. Inflation seems likely to remain subdued though pressures may emerge from the impact of rising oil prices. Additional pressures may emerge in the external accounts.

Export-led growth continued in Brazil also supported by a revival of domestic demand

The Brazilian economy is projected to grow at around 3½ per cent in 2000, accelerating to 4 per cent in 2001. Recent export performance has been very positive. Comparing the first half of 1999 with the first half of 2000, total export volume increased by 15.3 per cent, while import growth was only 9½ per cent. Brazilian exporters seem to have benefited from the combination of currency devaluation and strong world demand. A process of import substitution also took place. While imports of capital goods and consumer durables decreased by 13 and 23 per cent (year-on-year) respectively in the first half of 2000, there were increases in domestic demand for these products. Recently, there are signs of a more general revival of domestic demand supported by lower consumer interest rates, following the continuous decrease in overnight money market rates (200 basis points since June, falling to 16½ per cent in October).

Inflation has remained subdued, but adjustments in regulated tariffs (electricity and telephone), rising prices for fuel and a seasonal increase in the price of some agricultural products (grains and meat) induced a larger than expected increase in the consumer price index in July and August (over 1 per cent in July and in August). However, these pressures had only a temporary effect and inflation will remain moderate.

Labour market conditions are also improving…

The labour market has also developed favourably, notably industrial employment with a growth rate of 4.3 per cent in July (year-on-year), together with employment in the informal sector. As a result, the unemployment rate fell to 6.7 per cent in September (seasonally adjusted) from a peak of 8.3 per cent in November 1999. Real incomes also recovered from last year’s losses and are roughly back at their level one year ago.

… and the fiscal position is on track

These conditions are helping the ongoing fiscal adjustment. While the increase in revenues in 1999 was due to temporary measures and increased social security contributions, this year the economic recovery is leading the revenue expansion. Federal government revenues in 2000 are expected to increase by 11 per cent. Given improved control of expenditure, largely as a result of the Fiscal Responsibility Law -- the fiscal targets for this year (including a primary surplus at 3¼ per cent of GDP) should be met. The fiscal adjustment and the fall in interest rates are also improving the management of the public debt.

But, medium-term challenges are substantial

Nonetheless, Brazil faces important challenges in the medium-term in the areas of tax reform and fiscal federal relations, public pensions and social security reform. Education and health care also need to be addressed firmly in order to increase the prospects for sustained growth. The external balance may also constrain economic expansion. Indeed, the export growth induced a surge of imports of intermediate products (32½ per cent growth year-on-year for the first half of 2000). Exports to the OECD area are also dominated by traditional goods very sensitive to cyclical conditions, and this raises questions about the sustainability of the current export performance.

With a fragile recovery, Argentina presents a difficult situation

Recovery in Argentina is fragile. The economy is in a vicious circle of high interest rates, recession and loss of confidence. While for the first half of 2000 GDP grew by 1.2 per cent (year-on-year), indicators of industrial activity and retail sales indicate a slump in the second quarter. Consumer prices continue to decline. The fiscal deficit is turning out larger than programmed (despite tax increases at the beginning of the year). The improvement in the trade balance barely offset the deterioration in the income balance, so that the current account deficit in the first quarter of 2000 was roughly unchanged from that of 1999 (4.3 per cent of GDP).

Capital markets remain wary…

Capital inflows have not resumed, and interest rate spreads are high. The sovereign risk spread was 560 basis points by the end of July, higher than the low of 420 basis points in March. These conditions are reflected in very high domestic interest rates. The opportunities for new foreign investments have declined since the privatisation programme is already well advanced. The lack of market confidence undermines the fiscal account owing to the large refinancing needs of the public sector; and public borrowing is crowding out financial resources for the private sector in the domestic market.

… despite the fiscal tightening

Seeking to prove its commitment to fiscal austerity by reducing the fiscal deficit and to improve financial market confidence, the Argentinian government raised consumption and personal income taxes at the beginning of 2000 and undertook expenditure cuts (about US$ ½ billion) starting in May (among them a 12-15 per cent cut in public sector wages). But fiscal tightening further depressed domestic demand and exacerbated social unrest. This, in turn, contributed to the caution of foreign investors who are reluctant to increase their exposure to Argentina.

The real sector is still suffering from loss in competitiveness

The strength of the dollar, to which the Argentinian peso is pegged, and Brazil's successful (non-inflationary) devaluation led to significant losses of competitiveness. Timid labour market reform is too recent to have yet had any effect on productivity and labour costs. The agricultural sector is also suffering from the terms-of-trade losses due to the fall in international commodity prices. Falling domestic demand is also reflected in a sharp contraction of the construction sector. As a result, employment contracted in the first quarter of 2000 by 1.3 per cent with respect to the same period in 1999, and the unemployment rate rose from 14½ to 15¼ per cent.

Some relief could come from external factors…

In the present configuration domestic demand seems unlikely to be able to drive a recovery. Export prospects are also limited by a weak competitive position, although rising world demand has led to a pick-up in the iron and steel sectors as well as automobile and heavy industry. The Argentinian government is firmly committed to the currency board and this position is justified by extremely high costs involved in abandoning the present regime (with risks of insolvency in the public sector and a large part of the private sector). The economic stagnation itself is exacerbating risk perceptions. The recovery in Brazil and in other countries in South-America should help the export sector. Despite the depreciation of the Brazilian real, the price and wage deflation in Argentina has created an inflation differential *vis-à-vis* Brazil which is gradually restoring some competitiveness. Any reversal in the dollar appreciation would also help, especially in restoring competitiveness *vis-à-vis* European markets, the main export outlet.

… with continued support from government policies

In the short term, some loosening of fiscal policy may be needed, although it should be targeted to stimulate consumption or private investments without compromising medium-term public spending. The Argentinian government has already increased the fiscal target for this year. To the extent that financial markets are willing to finance it, there is some room for an increase in the debt stock (currently at 45 per cent of GDP). The government is also seeking ways around the constraints imposed by the currency board. For example it intends to persuade privatised public utilities to allow a three-month delay for payment of enterprise bills, or to persuade banks to lend against VAT credits accumulated by large enterprises (unable to use them due to insufficient turnover). In addition, the government is preparing some tax measures to reduce the cost of credit. Over the medium term, however, the sustainability of the currency board is only compatible with deeper labour and product market reforms.

Table III.3. **Projections for Brazil and Argentina**

	1999	2000	2001	2002
Brazil				
Real GDP growth	0.8	3.5	4.0	4.3
Inflation[a]	4.3	7.9	6.8	4.2
Fiscal balance (% of GDP)	-10.0	-5.0	-4.0	-3.5
Primary fiscal balance (% of GDP)	3.0	3.3	3.5	3.0
Current account balance (US$ bn)	-24.4	-25.0	-27.0	-28.0
Current account balance (% of GDP)	-4.3	-4.2	-4.1	-3.9
Argentina				
Real GDP growth	-3.2	2.0	2.5	2.5
Inflation[a]	-1.0	-1.0	0.5	1.0
Fiscal balance (% of GDP)[b]	-2.5	-2.0	-2.0	-2.0
Current account balance (US$ bn)	-12.3	-12.0	-11.5	-11.0
Current account balance (% of GDP)	-4.3	-4.0	-3.7	-3.5

a) Consumer price index average annual growth rate.
b) Central government, excluding privatisation receipts.
Source: Figures for 2000-2002 are OECD estimates or projections.

SLOVAK REPUBLIC[29]

In spite of the strength of exports, GDP growth softened during the first half of 2000 as domestic demand fell. Inflation continued its downward track, falling faster than expected in the middle of the year. Real wages kept declining even as already high unemployment rose. The government has maintained the tighter fiscal stance it adopted in the middle of 1999, though it may use a significant windfall from privatisation to ease this a little during the last quarter. GDP growth is projected to pick up modestly as structural changes gradually promote job-generating growth in the enterprise sector and domestic demand revives.

The authorities will have to remain vigilant to keep the fiscal position under control as they push ahead with structural changes in the enterprise sector, reform of the welfare system and complete restructuring in the banking sector.

29. The process of accession of the Slovak Republic to the OECD is in its final stage. On 28 September 2000, the OECD and the Slovak Republic signed the Agreement on the invitation to the Slovak Republic to accede to the Convention on the OECD. This Agreement contains the terms and conditions under which the Slovak Republic will be able to join the OECD. It was ratified by the Slovak Parliament on the 26 October. The Slovak Republic will become an OECD member on the date on which it deposits its instrument of accession with the French authorities, depository of the OECD Convention.

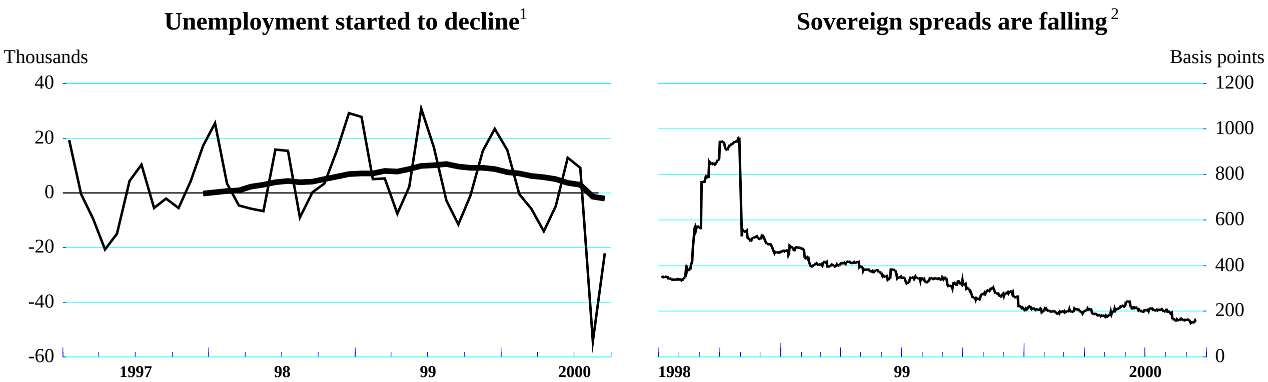
Growth has weakened…

GDP growth of 1.7 per cent during the first half was almost ¾ of a per cent lower than that recorded for the same period in the previous year. However, exports rose by 19.8 per cent, outweighing strong reductions both in household and government consumption, and investment. A bare recovery in domestic demand during the first quarter was reversed in the second quarter, when all its components fell sharply -- in aggregate by 2.1 per cent. The current account balance has continued to improve as demand for imports lags export growth. The trade deficit in the first half was 2.3 per cent of GDP compared with 6.8 per cent in the previous year.

… and core inflation fallen, as unemployment remains high

The one-off impact of price deregulation (during 1999) has now almost fallen away, and CPI inflation has declined unexpectedly quickly. Twelve-month inflation in August was 8.7 per cent, almost half of that at the peak recorded in March. Given nominal wage moderation, real wages have fallen by some 7 per cent in the first half of 2000. However, unemployment in the growing labour force remains high. In August, the government introduced subsidies for employers taking on long-term unemployed. Together with a previous tightening of qualification criteria, this resulted in a sharp fall in the rate of registered unemployment.

Slovak Republic



1. Monthly changes in registered unemployment; the line in bold is the 12-month moving average.
2. Spread measured as difference in annual yield between equivalent German and Slovak sovereign bonds, in basis points.
Sources: Slovak Statistical Office, Bloomberg and OECD.

A cautious macroeconomic stance underlies ongoing efforts to implement structural reforms

A cautious monetary policy has successfully targeted a reduction in core inflation; interest rates have fallen and international reserves have risen. The exchange rate has been broadly stable against the euro. Fiscal policy has remained tight since the third quarter of 1999 as the government has made greater efforts to reduce tax arrears, and has continued to keep government expenditure in check. Restructuring in the banking sector is well advanced, and the sale of major state-owned banks to strategic investors should be completed during the first half of 2001. Privatisation has resumed: a majority holding in the telecommunications company was sold in July, and the largest commercial banks have been put out to tender.

Growth is expected to pick up modestly as investment rises…

Two transitory factors should lead to some recovery in domestic demand over the next year. First, the government is intending to invest a significant amount of the SKK 25 billion cash it received from telecom privatisation in, banking sector restructuring, repayment of government guaranteed loans, repayment of arrears in the health sector and housing construction. Second, SKK 27 billion of privatisation bonds issued in 1995 fall due for repayment during 2001.

… but will only take root if reforms facilitate the generation of new jobs

Robust export growth (18 per cent in the first half of 2000 year-on-year) has not so far spilled over into the rest of the economy, though by off-setting the fall in domestic demand it has averted a transitional recession associated with restructuring. Only if structural changes allow recovery in the enterprise sector, will the anticipated easing of fiscal policy lead to renewed consumer confidence and sustained growth in domestic demand. To this end, and to maintain low international financing costs, the government should conclude the reforms it is implementing in the banking sector and develop its plans to achieve financial sustainability in the welfare system. Such policies are also valuable in promoting international confidence in the economy. This should help attract greater foreign direct investment, which in the medium term should lead to a higher share of export value-added originating in the Slovak Republic.

Slovak Republic

Demand, output and prices

	1997	1998	1999	2000	2001	2002
	current prices billion KKC	Percentage changes, volume (1995 prices)				
Private consumption	356.6	5.8	-0.2	-1.7	4.0	3.5
Government consumption	145.7	4.0	-6.9	-0.7	3.0	2.5
Gross fixed capital formation	246.5	11.1	-18.8	-1.0	8.5	6.5
Final domestic demand	748.8	7.2	-7.7	-1.3	5.1	4.2
Stockbuilding[a]	4.7	2.3	3.3	-0.5	-0.2	0.0
Total domestic demand	753.5	9.5	-4.8	-1.8	4.8	4.1
Exports of goods and services	397.8	12.2	3.6	22.0	13.0	12.0
Imports of goods and services	465.2	19.9	-6.1	15.8	15.5	12.5
Net exports[a]	- 67.4	-5.9	7.2	3.7	-2.1	-0.7
GDP at market prices	686.1	4.1	1.9	1.9	2.7	3.5
GDP deflator	_	5.1	6.6	6.0	5.7	5.1
Memorandum items						
Private consumption deflator	_	6.1	10.2	9.5	7.5	7.0
Industrial production	_	5.0	-3.3	5.0	4.5	3.5
Unemployment rate	_	12.1	16.4	18.9	18.0	17.0
General government financial balance[b]	_	-4.6	-3.6	-3.8	-4.2	-4.0
Current account balance[b]	_	-10.0	-5.8	-2.5	-4.6	-5.3

a) Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
b) As a percentage of GDP.
Source: OECD.