**Global growth: effect for the Baltic States**
By Eugene Eteris, 8 November 2018

**Twice a year OECD makes analysis of the major global economic trends. It provides growth projections through most important socio-economic development factors for the next two years. The outlook also includes a summary of international trade and financial integration data.**

Quite symptomatic, that the new economic outlook for the next two years predicted generally strong growth with some risks. After a lengthy period of weak growth, the world economy is finally growing around 4% per year, which is the historical average of the past few decades.

Good news is even better knowing that such strong growth in the world economy is supported by increased investments and accelerated global trade. The recovery in investment is particularly good, since the fate of the current expansion is highly dependent on investment performance.

However, pick-up in investment remains weaker than in the past: the same is true for global trade, which is expected to grow at a "respectable rate", unless it is derailed by trade tensions.

However, contrary to previous periods, 4% world growth is not due to rising productivity gains or sweeping structural change: this time stronger economy is largely due to monetary and fiscal policy support.

**Monetary and fiscal policies**
For many years, monetary policy was the main driving force in growth: during the international financial crisis, central banks cut interest rates aggressively, injected funds into the economy and purchased assets at a record pace in an attempt to boost the economy.

In contrast, in most countries, fiscal policy remained prudent. Still, historically low interest rates provided an opportunity for governments to use their available fiscal space to help foster growth. Many OECD member states and governments are now following this OECD's advice. At first, the resources enabled by lower interest payments were used by governments to avoid cutting expenditures or raising taxes. With the improving economic situation, many governments have started to undertake additional fiscal easing.

Now that monetary policy is finally starting to return to normal, governments are stepping in to provide fiscal policy support. It is a notable trend: fiscal policy is a dominant feature in states' policies: during 2018, the OECD countries are undertaking fiscal easing.

Numerous fiscal stimulus in some countries is very significant, while it is less ambitious in other countries; however, this fiscal easing will have important repercussions for the world economy. In the short run, it will add to growth; though countries experiencing longer expansions might find that this fiscal stimulus (where it is large) will also add to inflationary pressures in the medium term. Only time will tell if these short type gains might be offset by some medium term pain. What matters is that, in making these choices, governments are fully aware of the medium term impact of their policies, and do not focus only on the short-term benefits from fiscal stimulus, underlined OECD Acting Chief Economist, Álvaro Santos Pereira.

**Other structural trends**

Presently witnessed strong growth is also associated with robust job creation in many economies. It is particularly satisfying to see that among OECD states, unemployment is set to reach its lowest level since 1980, even though it remains high in some countries. Thanks to this robust job creation and the related intensifying labour shortages, a rise in real wages in many countries is now projecting; this increase is still somewhat modest.

However, there are clear signs that wages are finally on the way up. This is an important development, since the global crisis had a severe impact on household incomes, particularly for the unskilled and low-income workers.

In spite of all this good news, risks loom large for the global outlook. The risks are mainly dealt with, first and foremost, with an escalation of trade tensions among some states. It is worth remembering that, in part, the rise in trade restrictions is nothing new. After all, more than 1200 new trade restrictions have been implemented by G-20 countries since the outset of the global financial crisis in 2007-08. Still, since the world economy is much more integrated and linked today than in the past, a further escalation of trade tensions might significantly affect the economic expansion and disrupt vital global value chains.

Another important risk going forward is related to the rise in oil prices. Oil prices have risen by close to 50% over the past year. Persistently higher oil prices will push up inflationary pressures and will aggravate external imbalances in many countries.

In the past few years, very low interest rates have encouraged borrowing by households and corporations in some countries and led to overvaluation of assets (e.g. houses, equities) in many others. In this context, rising interest rates might be challenging for highly indebted countries, families and corporations. Of course, this rise in interest rates has been widely anticipated and should thus not cause any major disruptions. Nevertheless, if inflation rises more than expected and central banks are forced to raise rates at a faster pace, it is likely that market sentiment could shift abruptly, leading to a sudden correction in asset prices.

A swifter rise in interest rates in advanced economies might also continue to lead to significant currency depreciation and volatility in some emerging market economies that are highly reliant on external financing and facing internal or external imbalances. Geopolitical tensions might also contribute to sudden market corrections or a further rise in oil prices. Brexit and policy uncertainty in Italy could add pressures to the expansion in the euro area.

**Effect for states' political economy**

Since private and public debt remain high in some countries, improving productivity, decreasing debt levels and building fiscal buffers are important in strengthening the resilience of states' economies. As monetary and fiscal policies are not going to sustain the expansion forever and might even contribute to financial risks, it is absolutely essential that structural reforms become a priority. In the past couple of years, few countries have undertaken substantial structural reforms.

Most of the countries that reformed are in the emerging economies, e.g. in Argentina, Brazil and India. In the advanced economies, important labour reforms were introduced in France and a sweeping tax reform was implemented in the United States. However, the OECD-2018 "Going for Growth" report points out, these important exceptions do not counter the rule that reform efforts have been lagging.

Important is that the only way to sustain the current expansion and making further growth work for all is to undertake reforms aimed at enhancing productivity. As many OECD Education Policy Reviews and OECD National Skills Strategies show, it is crucial to redesign curricula to develop the cognitive, social and emotional skills that enable success at work, and to improve teaching quality and the resources necessary to deliver those skills effectively.

In many countries, investment in quality early childhood education and vocational education and apprenticeships are of particular importance. Attention to skills in the labour market reforms is also crucial. Reforms to boost competition, improve insolvency regimes, reduce barriers to entry in services and cut red tape are also making states' economies more dynamic, more inclusive and more entrepreneurial. Investment in digital infrastructure will also be essential in this digital age. In addition, there are significant opportunities to reduce trade costs in both goods and, in particular, services, boosting growth and jobs across the world.

**Additional reference sources:**
On the OECD economic outlook: https://www.oecd-ilibrary.org/economics/oecd-economic-outlook-volume-2018-issue-1_eco_outlook-v2018-1-en
On main global economic indicators: https://read.oecd-ilibrary.org/economics/main-economic-indicators/volume-2018/issue-10_mei-v2018-10-en#page1
On Latvian economic development statistics: https://read.oecd-ilibrary.org/economics/oecd-economic-outlook-volume-2018-issue-1_eco_outlook-v2018-1-en#page184

In spite of stronger growth, there is no time for complacency. Structural reforms are vital to sustain the current expansion while mitigating risks. Therefore, at the modern stage in the world economy, it is truly crucial to provide for expensive structural reforms. After monetary and fiscal policies have been implemented, it is time for reforms to sustain the expansion, to improve well-being, and to make growth work for all. The World Bank Group Report-2018 includes special chapters on international trade and financial integration as well as on each country's statistical index. See: World Bank Group Report on Latvian economy and business in: www.doingbusiness.org

**General reference:**
**https://www.oecd-ilibrary.org/sites/97a8d82a-en/index.html?itemId=/content/component/97a8d82a-en**