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OECD urges co-ordination to avoid recession

By Chris Giles in London

Another recession looms for European economies as the eurozone sovereign debt crisis hits confidence, the Organisation for Economic Co-operation and Development warned on Monday, urging countries to adopt a co-ordinated strategy to boost growth.

Slashing its growth forecasts in the week of the Group of 20 summit, the OECD said the grim outlook could be improved if G20 countries adopted a bold plan "to restore confidence through decisive actions in specific countries and regions".

But if countries allowed the current risks to develop into another crisis, economies could plunge by as much as they had in 2007 to 2009.

To avoid a crunch, the OECD said necessary reforms including implementing the eurozone measures agreed last week needed to be introduced "promptly and forcefully". But its economists also recommended that the European Central Bank, with its new president Mario Draghi, cut interest rates rapidly. It called for medium term action in all advanced economies to cut government borrowing with sufficient flexibility to deal with the threat of a near-term recession, greater exchange rate flexibility and domestic demand in surplus economies and structural reforms to boost the growth potential of all economies.

If leaders failed to restore fragile confidence or foster medium-term reform, the OECD warned, "a deterioration of financial conditions of the magnitude observed during the global crisis could lead to a drop in the level of GDP in some of the major OECD economies of up to 5 per cent by the first half of 2013".

In the organisation's central forecasts, which were based on a muddle-through scenario without a sudden crisis, the OECD cut growth forecasts considerably.

The eurozone would suffer "patches of mild negative growth" it predicted, with very weak growth also in the US, UK and other advanced G20 economies. Unemployment would stay high in all advanced economies.

The OECD cut its eurozone growth forecast to only 0.3 per cent in 2012 from its June forecast of 2 per cent. The forecast for the US fell from 3.1 per cent to 1.8 per cent for the same year.

With continued faster growth in emerging economies and oil exporters, the OECD predicted that global trade imbalances would remain high for the foreseeable future, adding further dangers to the outlook from the capital flows these foster.

Unemployment would remain high, the OECD warned and long-term joblessness was increasingly likely to stalk advanced economies, suggesting that temporary weakness in labour markets will become entrenched and some people will give up looking for work.

The bleak outlook, the OECD said, could be improved if all countries and institutions that could help did so promptly. In particular, the OECD called on the ECB to cut interest rates and for eurozone countries to allow the central bank to use its balance sheet to buy bonds and help prevent contagion in the eurozone spreading from Greece to Italy and Spain.

For fiscal policy, the OECD recommended a country-by-country approach with slower deficit reduction than currently planned in the US, more rapid consolidation in some eurozone countries that have lost the confidence of investors and a mixed approach of credible medium term plans alongside short-term flexibility elsewhere.