OECD Economic Outlook, Interim Report

Steering through Uncertainty

March 2025

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Steering through uncertainty

Summary

- Global output growth remained resilient in 2024, with robust expansions in the United States and several large emerging-market economies, including China.
- Recent activity indicators have begun to point to a softening of global growth prospects. Business and consumer sentiment have weakened in some countries, and indicators of economic policy uncertainty have risen markedly around the world.
- Significant changes have occurred in trade policies that if sustained would hit global growth and raise inflation.
- Inflationary pressures continue to linger in many economies. Services inflation is still elevated, with labour markets tight, and goods inflation is picking up from very low levels.
- Global GDP growth is projected to moderate from 3.2% in 2024, to 3.1% in 2025 and 3.0% in 2026, with higher trade barriers in several G20 economies and increased geopolitical and policy uncertainty weighing on investment and household spending.
- Annual GDP growth in the United States is projected to slow from its strong recent pace, to be 2.2% in 2025 and 1.6% in 2026. Euro area GDP growth is projected to be 1.0% in 2025 and 1.2% in 2026, as heightened uncertainty keeps growth subdued. Growth in China is projected to slow from 4.8% this year to 4.4% in 2026.
- Inflation is projected to be higher than previously expected, although still moderating as economic growth softens. Headline inflation is projected to fall from 3.8% in 2025 to 3.2% in 2026 in the G20 economies. Core inflation is now projected to remain above central bank targets in many countries in 2026, including the United States.
- These projections are based on an assumption that bilateral tariffs between Canada and the United States and between Mexico and the United States are raised by an additional 25 percentage points on almost all merchandise imports from April. Activity would be stronger and inflation lower in all three economies if these tariff increases were lower or confined to a smaller range of goods, but global growth would still be weaker than previously expected.
- Significant risks remain. Further fragmentation of the global economy is a key concern. Higher and broader increases in trade barriers would hit growth around the world and add to inflation. Higher-than-expected inflation would prompt more restrictive monetary policy and could give rise to disruptive repricing in financial markets. On the upside, a more stable policy environment would reduce uncertainty, and agreements that lower tariffs from current levels and more ambitious structural policy reforms could strengthen growth. Higher government spending on defence could also support growth in the near-term, but potentially add to longer-term fiscal pressures.

- Central banks should remain vigilant given heightened uncertainty and the potential for higher trade costs to push up wage and price pressures. Provided inflation expectations remain well anchored, and trade tensions do not intensify further, policy rate reductions should continue in economies in which underlying inflation is projected to moderate or remain subdued.
- Fiscal discipline is needed to ensure debt sustainability, maintain the ability for governments to react to future shocks and accommodate current and future spending pressures.
- Countries need to find ways of addressing their concerns together within the global trading system. Living standards would benefit from coupling these measures with efforts to strengthen the resilience of supply chains, as well as regulatory reforms that promote dynamic product and labour markets and policies to encourage skill upgrades.
- Faster diffusion of artificial intelligence technologies could also have significant productivity benefits. Governments can help by ensuring the availability of high-speed digital infrastructure, maintaining open and competitive markets and providing opportunities for workers to enhance their skills.

Table 1. Global growth is projected to moderate

	2024	2025		2026	
		Interim EO projections	Difference from December EO	Interim EO projections	Difference from December EO
World	3.2	3.1	-0.2	3.0	-0.3
G20[1]	3.3	3.1	-0.2	2.9	-0.3
Australia	1.1	1.9	0.0	1.8	-0.7
Canada	1.5	0.7	-1.3	0.7	-1.3
Euro area	0.7	1.0	-0.3	1.2	-0.3
Germany	-0.2	0.4	-0.3	1.1	-0.1
France	1.1	0.8	-0.1	1.0	0.0
Italy	0.7	0.7	-0.2	0.9	-0.3
Spain[2]	3.2	2.6	0.3	2.1	0.1
Japan	0.1	1.1	-0.4	0.2	-0.4
Korea	2.1	1.5	-0.6	2.2	0.1
Mexico	1.5	-1.3	-2.5	-0.6	-2.2
Türkiye	3.2	3.1	0.5	3.9	-0.1
United Kingdom	0.9	1.4	-0.3	1.2	-0.1
United States	2.8	2.2	-0.2	1.6	-0.5
Argentina	-1.8	5.7	2.1	4.8	1.0
Brazil	3.4	2.1	-0.2	1.4	-0.5
China	5.0	4.8	0.1	4.4	0.0
India[3]	6.3	6.4	-0.5	6.6	-0.2
Indonesia	5.0	4.9	-0.3	5.0	-0.1
Russia	4.1	1.3	0.2	0.9	0.0
Saudi Arabia	1.2	3.8	0.2	3.6	-0.2
South Africa	0.6	1.6	0.1	1.7	0.0

Note: Difference from December 2024 OECD Economic Outlook in percentage points, based on rounded figures. World and G20 aggregates use moving nominal GDP weights at purchasing power parities (PPPs). Revisions to PPP estimates affect the differences in the aggregates. Based on data available up to 13 March 2025.

1. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.
2. Spain is a permanent invitee to the G20.
3. Fiscal years, starting in April.

Source: OECD Interim Economic Outlook 117 database; and OECD Economic Outlook 116 database.

Table 2. Headline inflation is projected to decline in most countries

	2024	2025		2026	
		Interim EO projections	Difference from December EO	Interim EO projections	Difference from December EO
G20[1]	5.3	3.8	0.3	3.2	0.3
Australia	3.2	2.4	0.1	2.2	-0.4
Canada	2.4	3.1	1.1	2.9	0.8
Euro area	2.3	2.2	0.1	2.0	0.0
Germany	2.5	2.4	0.4	2.0	0.1
France	2.3	1.5	-0.1	1.8	0.0
Italy	1.1	1.7	-0.4	1.9	-0.1
Spain[2]	2.9	2.5	0.4	2.1	0.1
Japan	2.7	3.2	1.3	2.1	0.0
Korea	2.3	1.9	0.1	2.1	0.1
Mexico	4.7	4.4	1.1	3.5	0.5
Türkiye	58.5	31.4	0.7	17.3	0.1
United Kingdom	2.5	2.7	0.0	2.3	0.0
United States	2.5	2.8	0.7	2.6	0.6
Argentina	117.8	28.4	-1.4	24.8	-0.3
Brazil	4.4	5.4	1.2	5.3	1.7
China	0.2	0.6	-0.5	1.4	0.0
India[3]	5.0	4.5	0.3	4.1	0.1
Indonesia	2.2	1.8	-0.4	2.8	0.4
Russia	8.4	9.9	2.9	6.3	1.1
Saudi Arabia	1.7	1.9	0.2	2.0	0.0
South Africa	4.4	4.0	0.1	4.6	0.1
Memorandum item					
G20 countries excluding Argentina and Türkiye	2.5	2.8	0.0	2.6	0.0

Note: Difference from December 2024 OECD Economic Outlook in percentage points, based on rounded figures. The G20 aggregate uses moving nominal GDP weights at purchasing power parities (PPPs). Revisions to PPP estimates affect the difference in the aggregate. Based on data available up to 13 March 2025.

1. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.
2. Spain is a permanent invitee to the G20.
3. Fiscal years, starting in April.

Source: OECD Interim Economic Outlook 117 database; and OECD Economic Outlook 116 database.

Table 3. Core inflation is projected to remain above target in several economies

	2024	2025		2026	
		Interim EO projections	Difference from December EO	Interim EO projections	Difference from December EO
G20 Advanced Economies[1]	2.7	2.6	0.3	2.4	0.3
Australia	3.3	2.4	0.1	2.2	-0.4
Canada	2.6	3.2	1.1	2.9	0.8
Euro area	2.8	2.2	-0.2	2.0	0.0
Germany	3.2	2.7	0.3	2.2	0.2
France	2.3	1.7	-0.3	1.8	0.0
Italy	2.2	1.8	-0.4	1.9	-0.1
Spain[2]	2.8	2.2	-0.1	1.9	-0.1
Japan	2.0	1.8	0.0	2.0	0.0
Korea	2.2	2.0	0.1	2.1	0.1
Mexico	4.1	4.2	1.2	3.5	0.5
Türkiye	59.8	31.2	1.5	17.3	0.1
United Kingdom	3.7	2.9	0.1	2.3	0.0
United States	2.8	3.0	0.7	2.6	0.6
South Africa	4.2	4.1	0.2	4.5	0.0

Note: Difference from December 2024 OECD Economic Outlook in percentage points, based on rounded figures. The G20 advanced economies aggregate uses moving nominal GDP weights at purchasing power parities (PPPs). Revisions to PPP estimates affect the difference in the aggregate. Core inflation excludes food and energy prices. Based on data available up to 13 March 2025.

1. The European Union is a full member of the G20, but the G20 aggregate only includes EU countries that are also G20 members in their own right.
2. Spain is a permanent invitee to the G20.

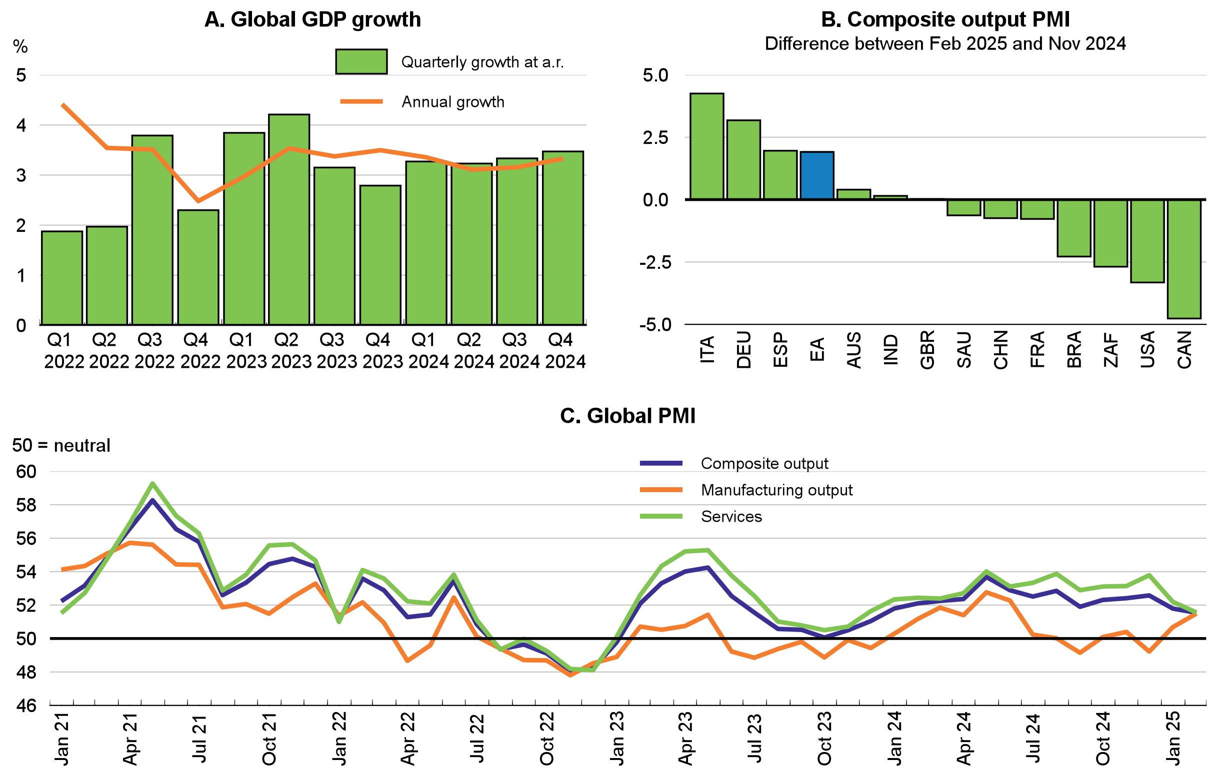
Source: OECD Interim Economic Outlook 117 database; and OECD Economic Outlook 116 database.

Recent developments

Global growth remained solid in the second half of 2024

1. The global economy remained resilient last year, expanding at a solid annualised pace of 3.3% through the second half of 2024 (Figure 1, Panel A). Strong real income growth and lower interest rates were supportive factors, but this was offset in some regions by weaker government spending, sluggish consumer confidence and fluctuations in external demand. In the United States, domestic demand growth continued at a solid pace through to the end of the year, propelled by robust private consumption. Growth in the euro area was broadly stable, despite contractions in France and Germany in the final quarter as exports fell. In Japan, the economy remained resilient in the face of tighter fiscal and monetary policy. Emerging markets exhibited diverse growth patterns, but there was a particularly strong fourth quarter in many. While the pace of economic activity slowed in Mexico toward the end of the year, growth remained robust in Brazil and India, and the deep recession in Argentina continued to abate. Growth in China also improved, with private consumption supported by government incentives and rapid export growth.

Figure 1. Global growth has held up but some signs of weakening have begun to appear



Note: In Panel A, annual growth denotes the change over the year to the quarter shown. Quarterly growth at a.r. denotes quarter-on-quarter growth at an annualised rate. The global aggregate uses moving GDP weights at purchasing power parities.
Source: OECD Interim Economic Outlook 117 database; S&P Global; and OECD calculations.

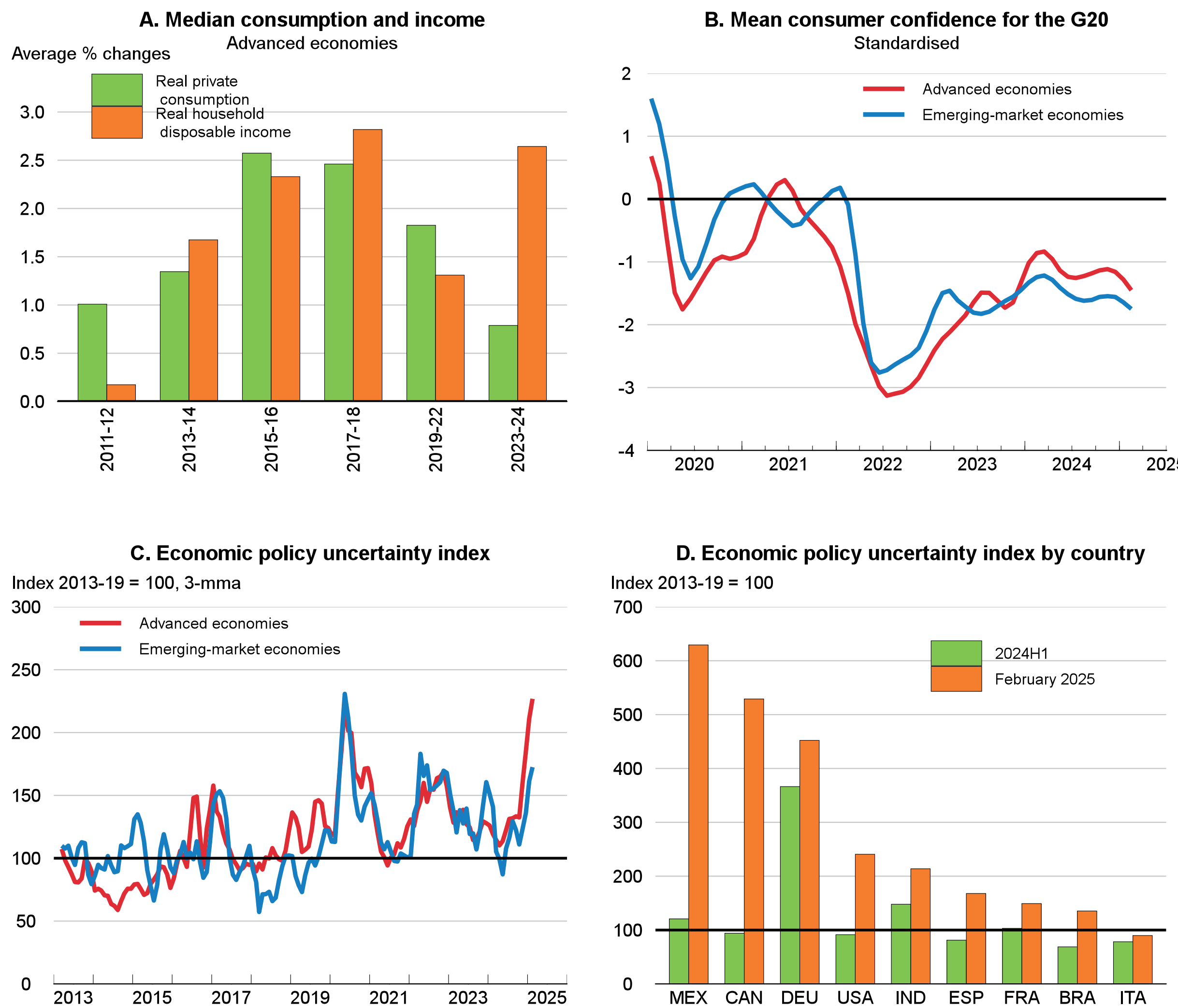
2. Global trade growth rebounded last year, but eased slightly in the final quarter of 2024. A further notable surge in merchandise imports occurred in the United States in January. Recent trade patterns, particularly between Asia and North America, have been affected by the need to manage risks related to shipping availability at peak times, longer journey times and the potential imposition of tariffs, with trade being brought forward in many instances.

Recent activity indicators suggest slower growth amid rising uncertainty

3. High-frequency indicators depict some weakening of global growth in the first quarter of 2025. Business surveys suggest a slowdown in several strong-performing economies in recent months, including the United States and Brazil, as well as Mexico and Canada (Figure 1, Panel B). Much of the weakness has been observed in services sectors, with signs of a pick-up in manufacturing output in the euro area and the United States (Figure 1, Panel C). It is too early to tell whether the latter will be sustained, or whether it reflects a temporary surge in orders for tradeable goods in North America. Consumer confidence generally dipped further in early 2025 and remains below long-run average levels despite strong growth in real incomes in many economies (Figure 2, Panels A and B). In the United States, personal real consumer spending declined in January.

4. Trade policy uncertainty has increased markedly in recent months, with the introduction of new trade barriers by a number of countries. This has translated into a substantial increase in newspaper-based measures of economic policy uncertainty (Figure 2, Panel C). Across the economies with available data, the biggest rise in policy uncertainty has been in Canada and Mexico (Figure 2, Panel D), both countries that are subject to increased tariff rates on bilateral exports to the United States. Greater policy uncertainty can be expected to hold back spending decisions by companies and households, particularly on longer-term items such as fixed capital investment and durable goods.

Figure 2. Consumer confidence remains weak and economic policy uncertainty has spiked in advanced economies



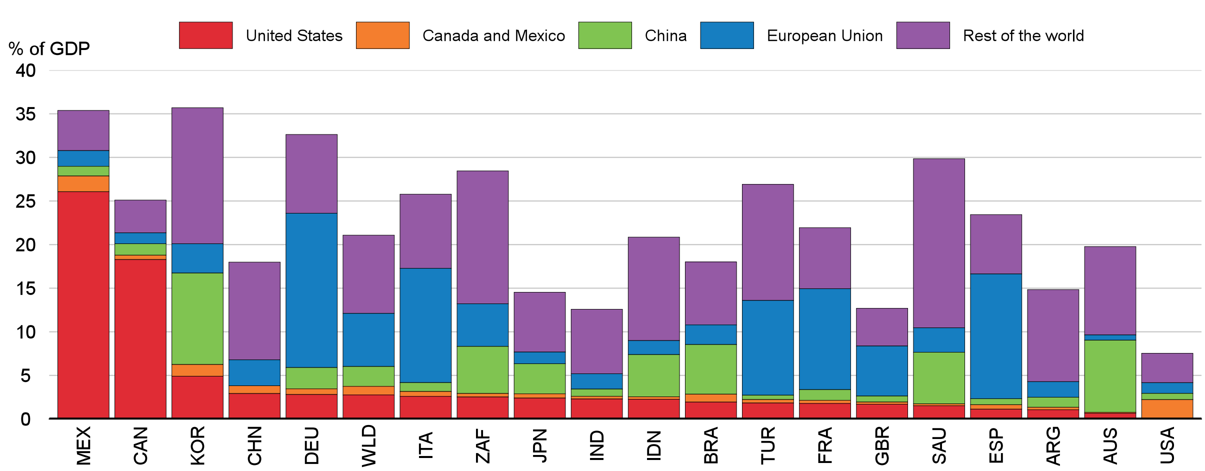
Note: Panel B shows a PPP-based weighted mean and is based on G20 economies except Argentina and Saudi Arabia. In Panel C, 'Advanced economies' includes Australia, Canada, Chile, France, Germany, Ireland, Italy, Japan, Korea, the Netherlands, Spain, Sweden and the United Kingdom, and 'Emerging-market economies' includes Brazil, India and Russia.
Source: policyuncertainty.com; OECD, Main Economic Indicators database; and OECD calculations.

5. A series of recently announced trade policy measures will have implications for the economic outlook if sustained. The United States has raised tariff rates on merchandise imports from China by 20 percentage points, with China taking targeted retaliatory action, and increased tariffs on imports of steel and aluminium from all countries, some of whom have introduced targeted retaliatory measures. The United States has also announced an increase of 25 percentage points in bilateral tariff rates on merchandise imports from Canada and Mexico (alongside a lower 10 percentage point tariff rate increase on imports of energy products from Canada, and potash from both Canada and Mexico). Currently, these higher tariffs apply only to imports that are not compliant with the United States-Mexico-Canada Agreement (USMCA) but they are set to apply to all imports from early April. Canada has raised tariffs on selected imports from the United States in response and announced plans to broaden the range of products affected from April. Mexico has not introduced any specific trade policy changes, but has stated a general intention to retaliate if the broader tariff increases planned by the United States go ahead as announced. Such tariffs are likely to be particularly costly for Canada and Mexico due to their greater openness to trade, and high proportion of trade with the United States (Figure 3). Broader trade policy reviews are also under way in the United States and due to be completed by early April.

6. If the announced trade policy actions persist, as assumed in the projections, the new bilateral tariff rates will raise revenues for the governments imposing them but will be a drag on global activity, incomes and regular tax revenues. They also add to trade costs, raising the price of covered imported final goods for consumers and intermediate inputs for businesses. The impact of higher costs will be amplified where inputs cross borders several times and duties are incurred at each stage, as is the case in the integrated North American market. An agreement that would ease trade tensions, and potentially even lower existing trade barriers, would be welcome and help to improve policy certainty and growth prospects.

Figure 3. The direct impact of merchandise trade tensions varies across countries

Distribution of merchandise export volumes in 2024



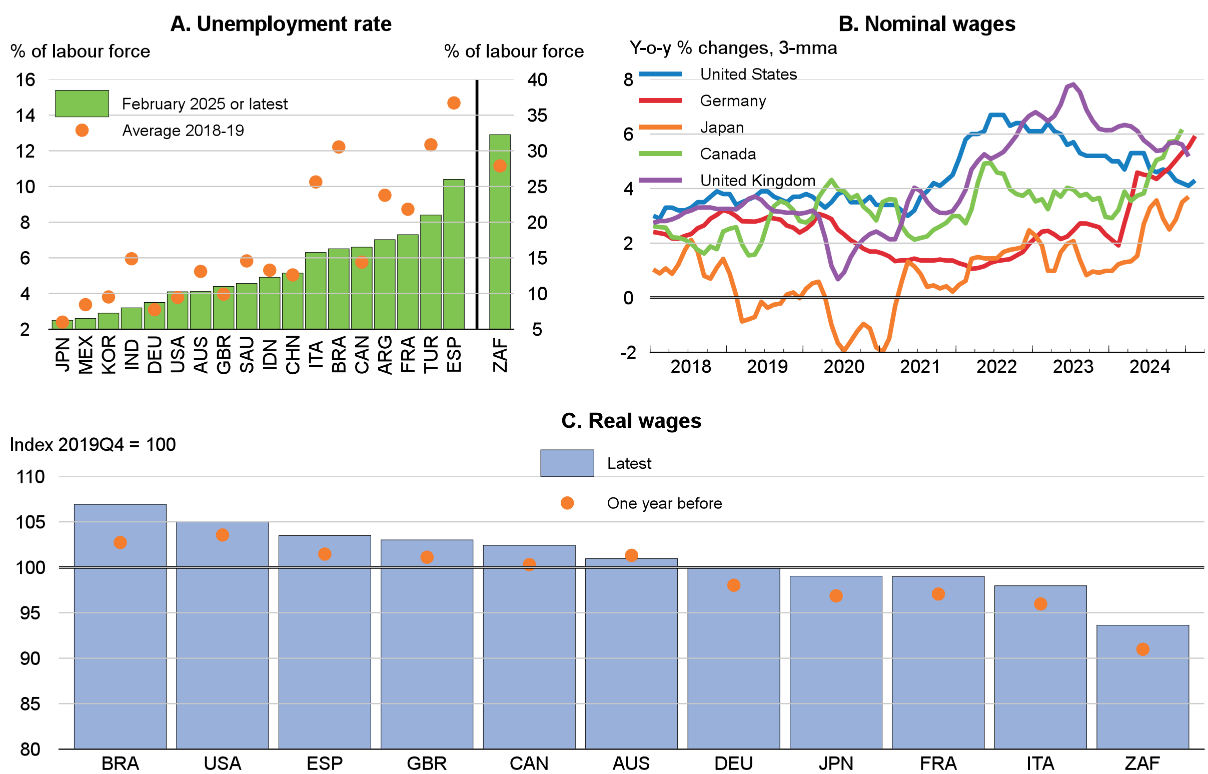
Note: Merchandise export volumes as a share of GDP volumes based on 2024 data, except for Argentina, India, Mexico and Saudi Arabia where data are for 2023, and Türkiye where data are for 2021. Bilateral trade shares based on OECD estimates for 2021.
Source: OECD Interim Economic Outlook 117 database; OECD Balanced International Merchandise Trade Statistics; and OECD calculations.

Labour markets remain tight

7. Labour market conditions are generally still favourable. Even though employment growth slowed somewhat in the second half of 2024, it remained solid and unemployment rates are generally low compared with the pre-pandemic period (Figure 4, Panel A). The OECD average unemployment rate has remained 0.5 percentage point below the 2018-19 average. Unemployment rates are particularly low compared with 2018-19 in Türkiye and Brazil, and also in some southern European economies, such as Italy and Spain.

8. Nominal wage growth continued to ease through the second half of 2024 but remains higher than before the pandemic, with wage pressures lingering in some regions. In most advanced economies, strong wage growth, accompanied by relatively modest productivity gains, has kept unit labour cost growth above levels consistent with central bank inflation targets. Strong minimum wage increases supported ongoing wage momentum in some European economies and robust base pay growth was accompanied by high winter bonus payments in Japan (Figure 4, Panel B). Similarly, nominal pay growth has picked up in South Africa. While real wages at the end of 2024 were well above pre-pandemic levels in Brazil, the United States, Spain, the United Kingdom and Canada, they had not yet returned fully to the pre-pandemic level in South Africa, Italy, France and Japan (Figure 4, Panel C).

Figure 4. Unemployment rates remain relatively low and nominal wage growth is still elevated

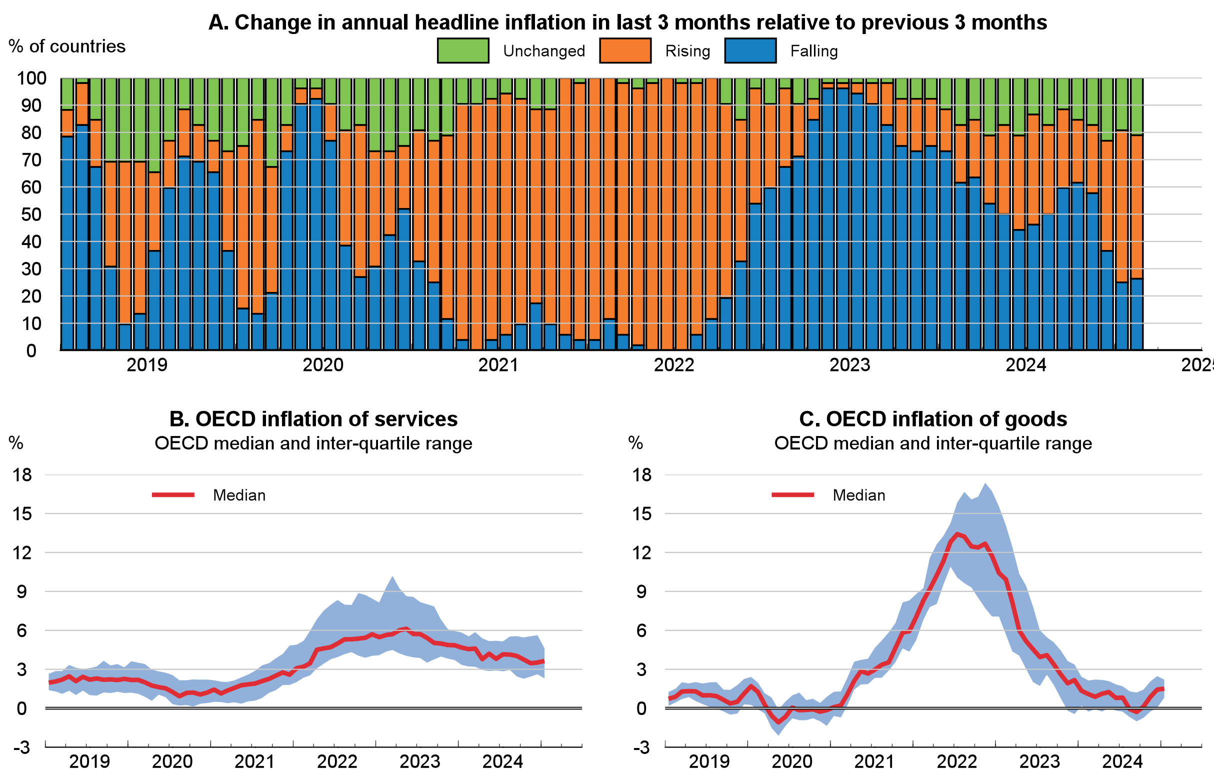


Note: Panel B: For Canada, the data refer to the average hourly earnings for all employees in the industrial aggregate excluding unclassified businesses. For Germany, the data refer to the collectively agreed hourly earnings without extra payments. For Japan, the data refer to total cash earnings. For the United Kingdom, the data refer to the median of pay from PAYE RTI. For the United States, the data refer to economy-wide hourly wages. Panel C shows compensation per employee delated by the private consumption deflator, except for Brazil where it corresponds to real wages (usual earnings). Latest is 2024Q4 for all countries except South Africa (2024Q3).
Source: OECD Economic Outlook 116 database; OECD Labour force database; CEIC; Statistics Canada; Destatis Federal Statistical Office of Germany; Ministry of Health, Labour and Welfare of Japan; Office of National Statistics; US Federal Reserve Bank of Atlanta; CEIC; and OECD calculations.

Inflation continues to linger in many economies

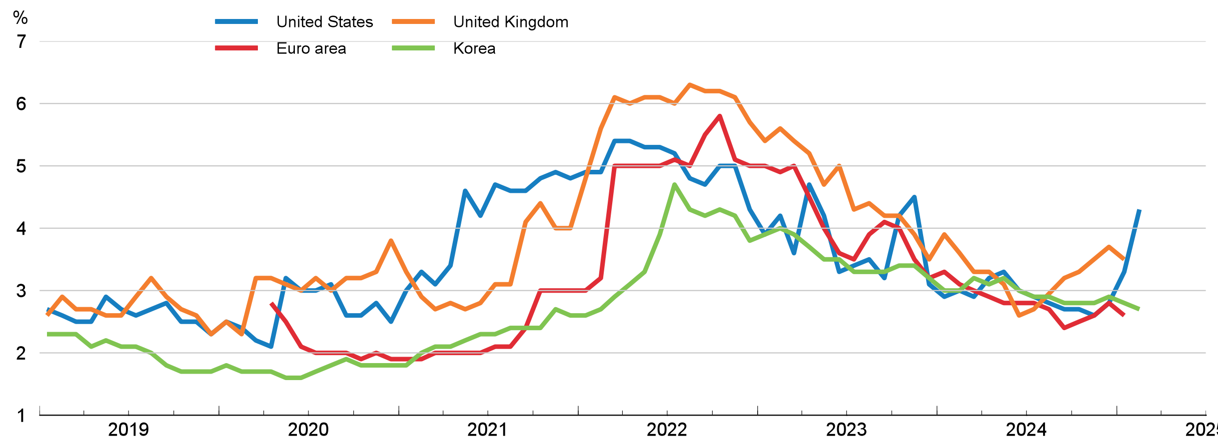
9. Inflationary pressures still persist in many economies, with headline inflation recently turning up again in an increasing share of economies (Figure 5, Panel A). Services price inflation has stayed elevated, with a median rate of 3.6% in January 2025 across OECD economies (Figure 5, Panel B). Some recent survey-based indicators also suggest continued upward momentum, such as in Germany and the United Kingdom where PMI output prices for services have moved higher since December 2024. In addition, goods inflation has recently turned up in many economies, albeit from very low levels (Figure 5, Panel C). This has been most evident in Japan, Spain and Korea, with rising food prices a key factor. Aggregate household inflation expectations have also moved higher in a few economies in recent months, including in the United States and the United Kingdom (Figure 6), and financial market measures of 10-year breakeven inflation have increased in the euro area, Japan and the United States. Oil prices have moderated however, in part reflecting the decision by the OPEC+ economies to unwind production curbs gradually from April.

Figure 5. Inflation is rising again in an increasing share of economies



Note: Panel A is based on 52 economies up to January 2025 and on 38 economies for February 2025. Panels B and C are based on national consumer price index data for 28 OECD countries. The blue shaded areas show the range between the 1st quartile and the 3rd quartile.
Source: OECD Consumer Prices database; National institutes; and OECD calculations.

Figure 6. Household inflation expectations have recently risen in some countries



Source: European Central Bank; Bank of Korea; Office for National Statistics; University of Michigan; and OECD calculations.

Global financial conditions have tightened slightly and volatility has risen recently

10. Global financial conditions have tightened slightly since late 2024, with market volatility increasing recently. 10-year government bond yields have risen in Europe, particularly after the recent announcement of substantial planned additional expenditures on defence and infrastructure in Germany and at the EU level. However, nominal bond yields in the United States have fallen since mid-January, unwinding the rise observed through the final months of 2024. Indicators suggest that the recent movement reflects a fall in real yields as economic growth slows, rather than lower inflation expectations. The US dollar has also fluctuated, with a depreciation against most currencies this year after a sustained rise through the final quarter of 2024 that contributed to tighter financial conditions in emerging market economies.

11. Financial market stress has so far remained contained. Bank credit growth has gradually recovered from low levels in advanced economies, as the impact of easier monetary policy has transmitted to lending interest rates. Despite already-stretched valuations in some sectors and some recent price corrections, equity prices are still higher than in November 2024, particularly in Germany, Spain and Italy. Robust growth in corporate bond and leveraged loan issuance has signalled investor confidence and increased risk appetite, with the equity risk premium having fallen in the United States, the United Kingdom and in Europe.

Projections

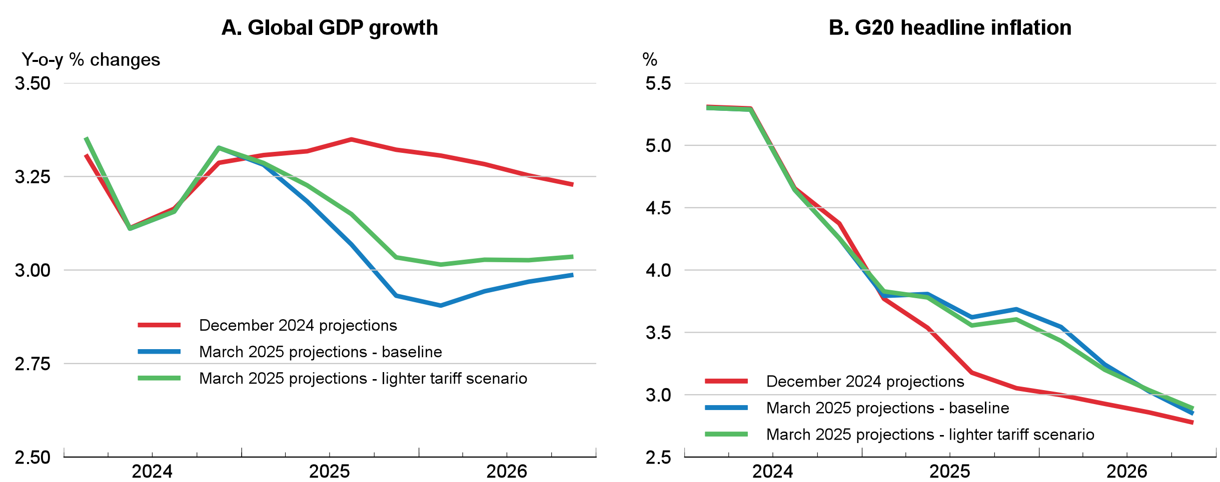
Global growth is expected to soften and inflation to ease further

12. Global GDP growth is projected to slow from 3.2% in 2024, to 3.1% in 2025 and 3.0% in 2026. New data and recent developments result in a downward growth revision from the December 2024 *OECD Economic Outlook* (Figure 7, Panel A). In quarterly terms, growth is expected to soften from the first quarter of 2025 and to remain subdued thereafter. The imposition of new bilateral tariff rates and the associated increase in policy and geopolitical uncertainty will act as a drag, particularly on business investment and trade. In addition, increased trade costs are expected to feed through gradually to final goods prices, putting additional upward pressure on inflation in many countries and requiring monetary policy to remain restrictive for longer than previously expected.

13. The projections assume that the announced tariff increases between China and the United States and the broad-based 25% tariff on United States imports of steel and aluminium are maintained. In addition, tariff rates on all merchandise imports from Canada and Mexico to the United States are assumed to rise by an additional 25 percentage points (with the exception of the lower tariffs on potash and energy products). Equivalent retaliatory tariffs by Canada and Mexico on merchandise imports from the United States are also assumed. No other additional tariffs are incorporated in the projections.

14. In the United States, Canada and Mexico, growth is projected to slow as tariff rate increases take effect. The negative impacts are projected to be particularly severe in Canada and Mexico, given greater trade openness, the importance of the bilateral relationship with the United States and the assumption that they will respond fully to increases in US bilateral tariff rates (Figure 3). These effects will be offset only partly by the eventual scope for monetary policy easing, owing to growing spare capacity. Real GDP growth in the United States is projected to slow from its fast pace of 2.8% in 2024 to 2.2% in 2025 and 1.6% in 2026, with growth in Canada projected to slow from 1.5% in 2024 to 0.7% in 2025 and 0.7% in 2026 (Figure 8, Panel A). In Mexico, the economy is projected to experience a recession, with output declining by 1.3% in 2025 and 0.6% in 2026.

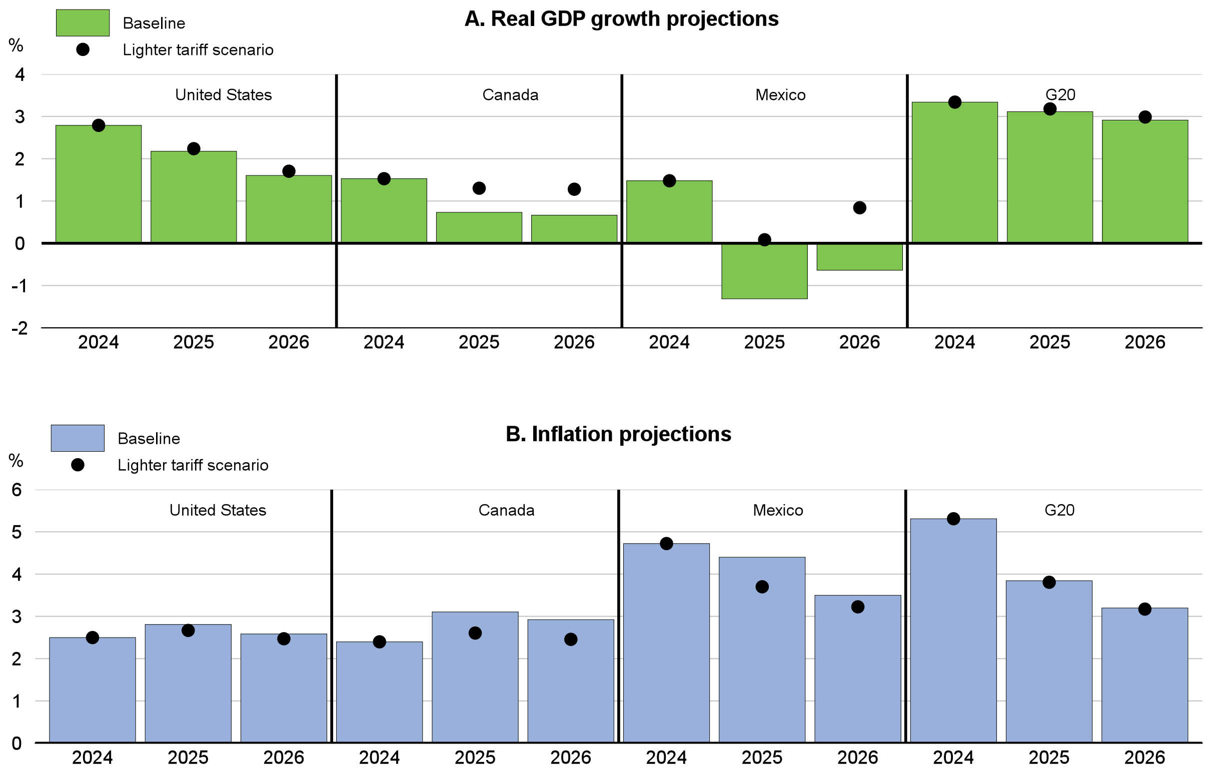
Figure 7. Global growth is projected to weaken



Note: The global and G20 aggregates use moving GDP weights at purchasing power parities. See main text for details of the baseline and lighter tariff scenario.
Source: OECD Interim Economic Outlook 117 database; OECD Economic Outlook 116 database; and OECD calculations.

15. GDP growth would be stronger in all three economies in a lighter tariff scenario in which the current US exemption from higher tariffs for merchandise imports from Canada and Mexico that are compliant with the USMCA is extended beyond early April 2025. In the event that these exemptions are kept throughout the projection period, and that Canada and Mexico adjust down their retaliatory tariffs accordingly, growth in Canada is projected to be 1.3% in both 2025 and 2026 with growth in Mexico projected to be 0.1% in 2025 and 0.8% in 2026 (Figure 8, Panel A). Growth in the United States under this assumption would be marginally stronger in 2026 at 1.7%.

Figure 8. Growth is projected to be stronger and inflation lower in a scenario with fewer tariff increases



Note: See main text for details of the baseline and lighter tariff scenario.
Source: OECD Interim Economic Outlook 117 database; and OECD calculations.

16. European economies will experience fewer direct economic effects from the tariff measures incorporated in the baseline projections, but heightened geopolitical and policy uncertainty is still likely to restrain growth. Euro area growth is projected to edge up from 0.7% in 2024 to 1.0% in 2025 and 1.2% in 2026, with growth in the United Kingdom projected to be 1.4% in 2025 and 1.2% in 2026. Growth in both Korea and Australia is projected to hold up, but to be weaker than previously expected. In Japan, robust corporate profits and strong wage growth are expected to be a tailwind for economic activity this year, with growth projected to rise from 0.1% in 2024 to 1.1% in 2025 before slowing to 0.2% in 2026. The lighter tariff scenario would provide a small additional boost to activity in these countries, with growth in Japan improving marginally to 1.2% and 0.3% in 2025 and 2026 respectively.

17. Economic growth in the emerging market G20 economies is generally projected to ease. The Chinese economy is expected to grow by 4.8% in 2025 as the negative impact of tariffs is largely offset by stronger policy support, before slowing to 4.4% in 2026. The slowdown is projected to be less pronounced in India and Indonesia, with both economies experiencing some support for export growth as they attract new business that is diverted from those exporting countries facing steeper tariff rate increases. In India, GDP growth is projected to be 6.4% in FY 2024-25 and 6.6% in FY 2025-26, while Indonesia is projected to grow by 4.9% in 2025 and 5.0% in 2026. The expansion in Brazil is expected to slow from its recent rapid pace as the impact of monetary policy tightening and higher tariff rates on steel and aluminium exports to the United States dampen growth from 3.4% in 2024 to 2.1% in 2025 and 1.4% in 2026.

18. Projected inflation paths are generally higher than previously expected, with the impact of slower growth offset by the incorporation of new data and the gradual inflationary impact of tariff increases (Figure 7, Panel B). Headline inflation in the G20 is now projected to fall from 5.3% in 2024, to 3.8% in 2025 and 3.2% in 2026, with core inflation in the advanced G20 economies projected to be 2.7% in 2024, 2.6% in 2025 and 2.4% in 2026. The quarterly projections imply that core inflation would still remain above central bank inflation targets at the end of the projection period in over half of the advanced G20 economies, including the United States. While annual inflation in the emerging-market economies is projected to decline more sharply than in advanced economies, this largely reflects significant further falls in inflation in Argentina and Türkiye from the very high rates in 2024. Headline inflation in several other emerging economies, including South Africa, Indonesia and China is projected to rise. In Mexico, the initial upward impetus to inflation from the imposition of tariffs in 2025 is anticipated to fade in 2026 as the growth outlook deteriorates.

19. Inflation would be lower in Mexico, as well as in Canada and the United States, in the lighter tariff scenario whereby the current exemption from higher tariffs for merchandise imports compliant with the USMCA is extended. In this case, headline inflation is projected to be 3.7% in 2025 and 3.2% in 2026 in Mexico, 2.6% in 2025 and 2.5% in 2026 in Canada and 2.7% in 2025 and 2.5% in 2026 in the United States (Figure 8, Panel B). These changes are also reflected in somewhat lower policy interest rate paths in this scenario in all three countries.

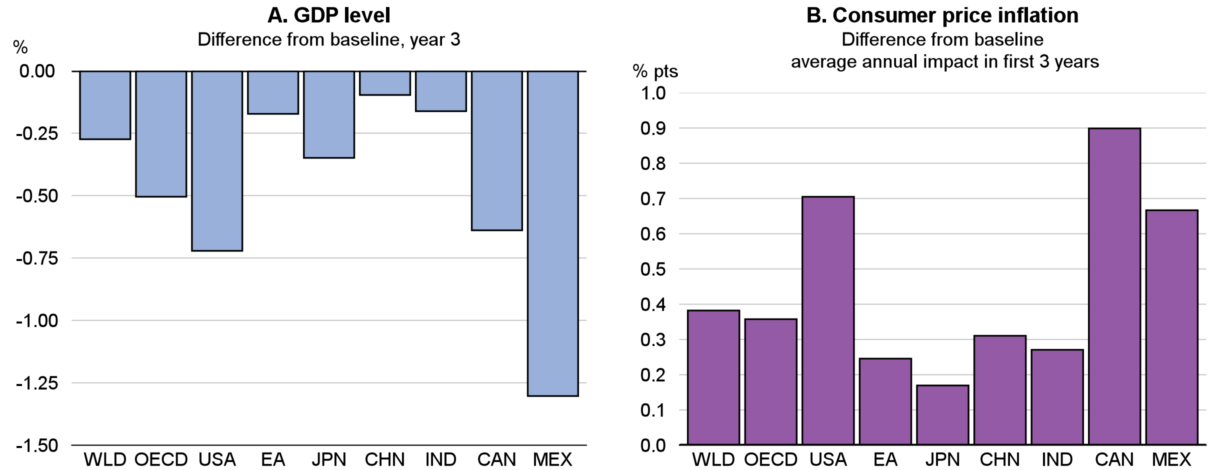
Risks and challenges

20. The high level of geopolitical and policy uncertainty at present brings with it substantial risks to the baseline projections. Developments in global trade policy are difficult to predict, but a proliferation in barriers to international trade and broader fragmentation of the global economy, including through moves to reciprocate existing perceived trade barriers, could add considerably to the adverse impact of the tariff changes incorporated in the baseline projections and weaken business investment by more than anticipated.

21. One possible risk is that bilateral tariffs are raised further on all non-commodity imports into the United States with corresponding increases on tariffs applied to non-commodity imports from the United States in all other countries. In an illustrative simulation in which these bilateral tariff rates are permanently raised by an additional 10 percentage points, global output could fall by around 0.3% by the third year, and global inflation could rise by 0.4 percentage points per annum on average over the first three years (Figure 9; Technical Appendix). World trade volumes would decline by close to 2%. The United States would be hit significantly in this scenario, with output declining by 0.7% by the third year of the shock (relative to baseline) and inflation rising by an average 0.7 percentage points per annum. Canada and Mexico would also be affected significantly, reflecting their comparatively open economies and high exposure to the downturn in demand in the United States and other economies. The impact of these shocks would be magnified if policy uncertainty were to increase further or there was widespread risk repricing in financial markets. These would sap confidence and add to the downward pressures on corporate and household spending around the world.

Figure 9. Further trade fragmentation would harm global growth prospects

Simulation of a rise of 10 percentage points in US tariffs on non-commodity imports from all countries and 10 percentage points higher tariffs on non-commodity imports from the United States by all countries



Note: Illustrative scenario of the impact of 10% US tariffs on non-commodity imports and retaliation from all countries. See technical appendix for details of the shocks considered.
Source: OECD calculations using the NiGEM global macroeconomic model and the OECD METRO model.

22. A second, and related, downside risk is that inflation remains stickier than otherwise anticipated, prompting more restrictive monetary policy. A catalyst may be increased tariff rates having more persistent effects on goods inflation by pushing up inflation expectations. Currently tight labour markets in many economies may also make it more likely that a spike in prices feeds higher nominal wage demands. However, such risks may be tempered by the fact that short-term household inflation expectations generally re-anchored through the past few years. Nonetheless, as discussed earlier, the extent of this re-anchoring has varied across countries and the recent turn upwards in household inflation expectations in a few economies bears close monitoring.

23. A resurgence of inflation or downside surprises to economic growth could trigger a rapid repricing in financial markets and a further rise in market volatility. Asset valuations are still stretched in some segments despite recent moderation and low risk premia suggest that shocks could translate rapidly into falling asset prices with broader systemic effects. The latter could be exacerbated in some markets with high equity market concentration and large-scale passive portfolio management (a strategy which tracks the returns of an established market benchmark). Any increase in risk premia could also cause stress in bond markets and private credit markets amid high debt levels and substantial refinancing needs over the next two years.

24. There are also various upside risks to the forecasts that would push economic growth higher if they were to transpire. The baseline scenario assumes that significantly higher bilateral tariff rates are sustained throughout the projection period in Canada, China, Mexico and the United States. A reversal of these restrictions, or steps towards a broader agreement to lower tariff barriers from current levels would push economic growth higher and reduce inflation relative to the baseline. A peaceful resolution of conflicts in Europe and the Middle East could also reduce geopolitical uncertainty and improve confidence, providing a stronger tailwind for spending and investment. One other potential catalyst for improved sentiment could be a further decline in global energy prices, with an excess supply of oil on global markets expected this year. Recently announced plans in several economies and at the EU level implying an increase in debt-financed government spending, including on defence, are not included in the baseline projections, but would also contribute to stronger near-term economic growth if realised.

Policy requirements

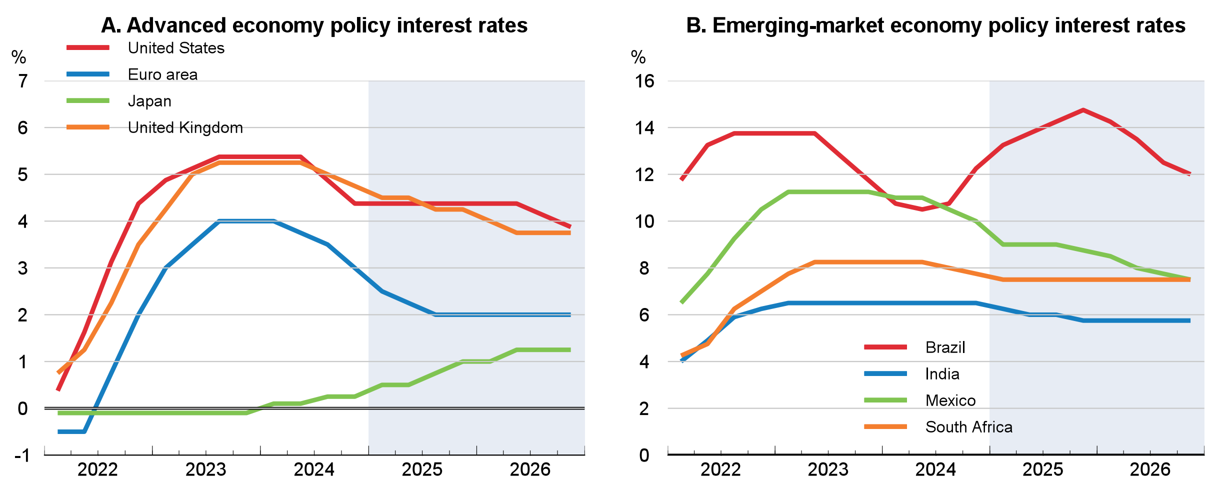
Monetary policy should remain vigilant

25. Policy interest rates have continued to decline in most major economies in recent months and central bank balance sheet reductions have continued, or got underway. There are a few exceptions, notably Japan, where policy interest rates are being raised gradually, and Brazil where the policy rate has been raised again to ensure that inflation expectations remain well-anchored. The monetary policy stance still remains restrictive in most countries, with forward-looking real interest rates above pre-pandemic norms and policy interest rates generally above estimates of long-term equilibrium levels. Borrowing costs are now easing for many firms and households but the effects of past increases in policy rates continue to be felt as rates on existing loans are renegotiated and new higher yielding debt is issued.

26. Faced with heightened uncertainty and the prospect of sizeable increases in the prices of many tradeable goods, central banks will need to remain vigilant to ensure that underlying inflation pressures are durably contained. A one-off rise in the relative price of tradeable goods due to tariffs is likely to be accommodated, but a sequence of such changes, or signs that inflation expectations are rising amidst still-tight labour markets would likely require higher policy rates than would otherwise be the case. Set against this, any associated decline in output would place some general downward pressure on inflation. Such factors, and the potential for currency turbulence as policy rates diverge across countries, likely mean that policy decisions will remain finely balanced for some time to come.

27. Provided inflation expectations remain well anchored, and trade tensions do not intensify further, policy rate reductions can continue in economies in which inflation is projected to moderate. In the euro area, policy interest rates are projected to ease to 2% by the latter half of 2025 (Figure 10, Panel A), with gradual easing also occurring over the next two years in Australia and the United Kingdom. In contrast, policy rates are projected to remain unchanged in the United States until well into 2026 in the baseline projection and ease only slightly earlier in 2026 in the lighter tariff scenario, with inflation projected to remain above target in both cases. Policy rates are projected to increase in Japan as monetary policy accommodation continues to be gradually withdrawn. In Canada, policy rates are projected to be lowered further, but to a greater extent in the lighter tariff scenario, with stronger pressures from higher import costs offset by the weaker economy.

Figure 10. Policy interest rates are projected to ease only gradually



Note: Policy interest rates in the baseline projection. Panel A shows the midpoint of the federal funds target range for the United States and the deposit facility rate for the euro area.
Source: OECD Interim Economic Outlook 117 database; and OECD calculations.

28. Amongst emerging-market economies, policy interest rates are projected to remain broadly stable in Indonesia and South Africa and decline only gently in India to help maintain anchored inflation expectations and avoid disruptive capital outflows from higher-than-expected policy interest rates in the United States (Figure 10, Panel B). Monetary policy is projected to remain restrictive in Mexico in the baseline and the lighter tariff scenario, despite some mild easing in nominal policy rates, and also in Brazil where further policy rate increases may be required during 2025 to limit inflationary pressures. Faced with the risk of sudden changes in investor sentiment and capital flow volatility, tighter supervision would help to secure the health and resilience of banking sectors in emerging-market economies.

Fiscal discipline is needed to ensure debt sustainability

29. Decisive fiscal actions are needed to ensure debt sustainability, preserve room for governments to react to future shocks and generate resources to help meet large current and impending spending pressures from ageing populations, climate change mitigation and adaptation measures, and plans to significantly enhance defence spending. Emerging-market economies also often have large investment needs in human and physical capital and still insufficient social safety nets. Debt-service costs are increasing in many countries as low-yielding debt matures and is replaced by new issuance, with governments in some lower-income countries now spending more on servicing debt than on education or health. Governments may also face calls for additional support in countries facing the adverse impact of higher trade costs. Well-designed and well-targeted government measures to support incomes can help if necessary to cushion the initial near-term impact of such shocks on companies and lower-income households, but alternative, more structural, solutions are required where the adverse impact from shocks to external competitiveness is likely to be prolonged.

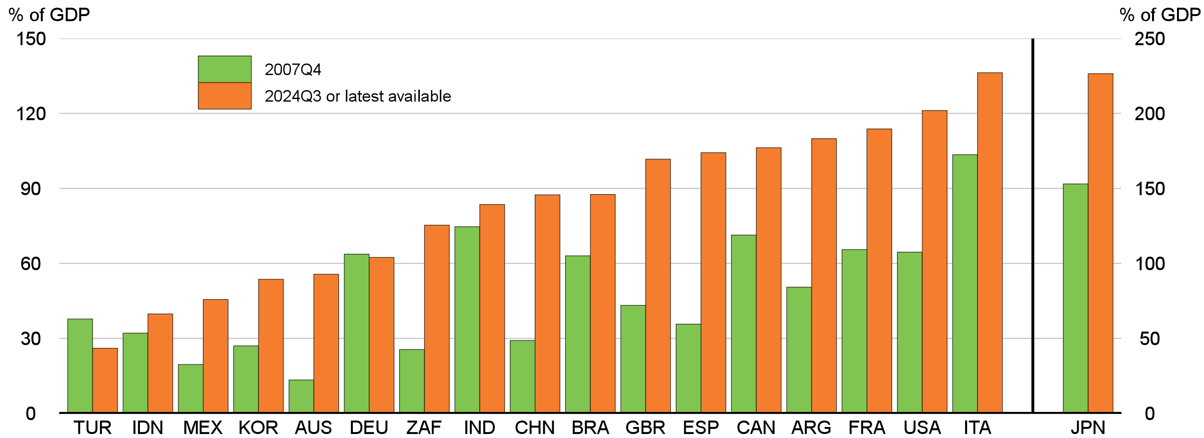
30. Without sustained action, already high government debt burdens (Figure 11) will rise significantly further. Stronger efforts to contain and reallocate spending and enhance revenues, set within credible country-specific medium-term adjustment paths, are key to ensuring that debt burdens stabilise. Some pressing spending pressures, notably the need to raise defence expenditure substantially in many European countries, are already pushing countries to make hard choices about the pace and composition of fiscal adjustment and spending. Careful design of fiscal adjustments is also needed to ensure adequate support to those in need and conserve the resources required to address longer term spending challenges. Where growth is robust enough to withstand additional fiscal headwinds, consolidation efforts should intensify as the monetary policy stance becomes less restrictive.

31. Policy priorities differ across countries, but in many advanced economies include the need to improve the targeting of benefits and subsidies and implement further reforms that help offset the pressures arising from demographic ageing by encouraging longer working lives. Tight fiscal positions also call for thorough expenditure reviews to help reallocate spending towards activities that support longer-term growth. Steps to eliminate distortive tax expenditures, upgrade tax administrations and raise a higher share of revenues from indirect, environmental and property taxes would make the tax system more supportive of growth in many countries.

32. Emerging-market and lower-income economies face similar challenges, but also more urgent pressures to take action to ensure debt sustainability, particularly where a substantial proportion of debt is either short-term or denominated in foreign currencies. Mobilising additional tax revenues is essential, with steps to broaden the tax base, improve compliance and reduce ineffective tax expenditures key priorities in many countries. These would be helped further by reforms to reduce informality. Stronger fiscal frameworks, including independent fiscal institutions and credible fiscal rules, would also help to lower financing costs and enhance sustainability.

Figure 11. Public debt levels have increased

Gross debt



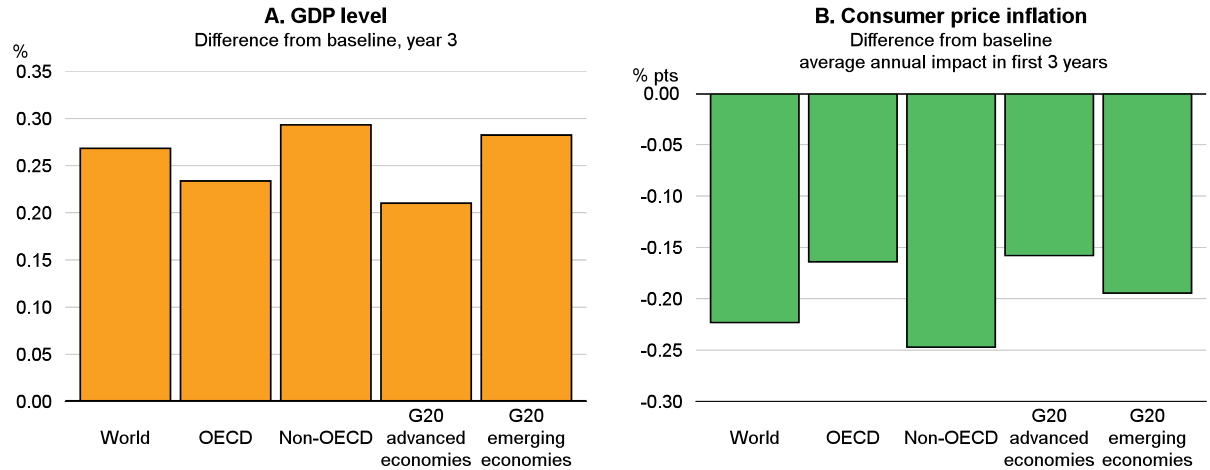
Note: The chart shows general government financial liabilities for Australia, Canada, Japan, Korea and the United States, and general government gross debt in percent of GDP (Maastricht definition for euro area countries). Latest data point for Argentina, Brazil, China, India, Indonesia, Mexico, South Africa and Türkiye is 2024Q2; Australia, Japan and Korea is 2023Q4. For Korea the earliest available data refers to 2008Q4.
Source: Eurostat; IMF Sovereign Debt Investor Base database; OECD Economic Outlook 116 database; Office for National Statistics; and OECD calculations.

International cooperation and structural policy reforms are especially important at the current juncture

33. Governments need to find ways of addressing their concerns together within the global trading system to avoid a significant ratcheting up of retaliatory trade barriers between countries. As already highlighted, a broad-based further increase in trade restrictions would have significant negative impacts on living standards. Efforts to avoid further trade fragmentation should be coupled with reforms that strengthen the resilience of supply chains, including by encouraging firms to diversify both suppliers and buyers. Diversification would be aided by common or shared regulatory standards on key intermediate production inputs between countries. Countries should also not lose sight of the opportunities for potential benefits from collectively agreeing to lower the current tariff and non-tariff barriers on goods and services. In an illustrative scenario in which all countries act to lower their average effective tariff rates by 1½ percentage points (relative to those assumed in the baseline projections), global output would be raised by close to 0.3% by the third year and global inflation reduced by close to ¼ percentage point on average in the first three years (Figure 12).

Figure 12. Opportunities exist to raise living standards by lowering trade barriers

Simulation of a reduction of 1.5 percentage points in average effective tariff rates in all countries



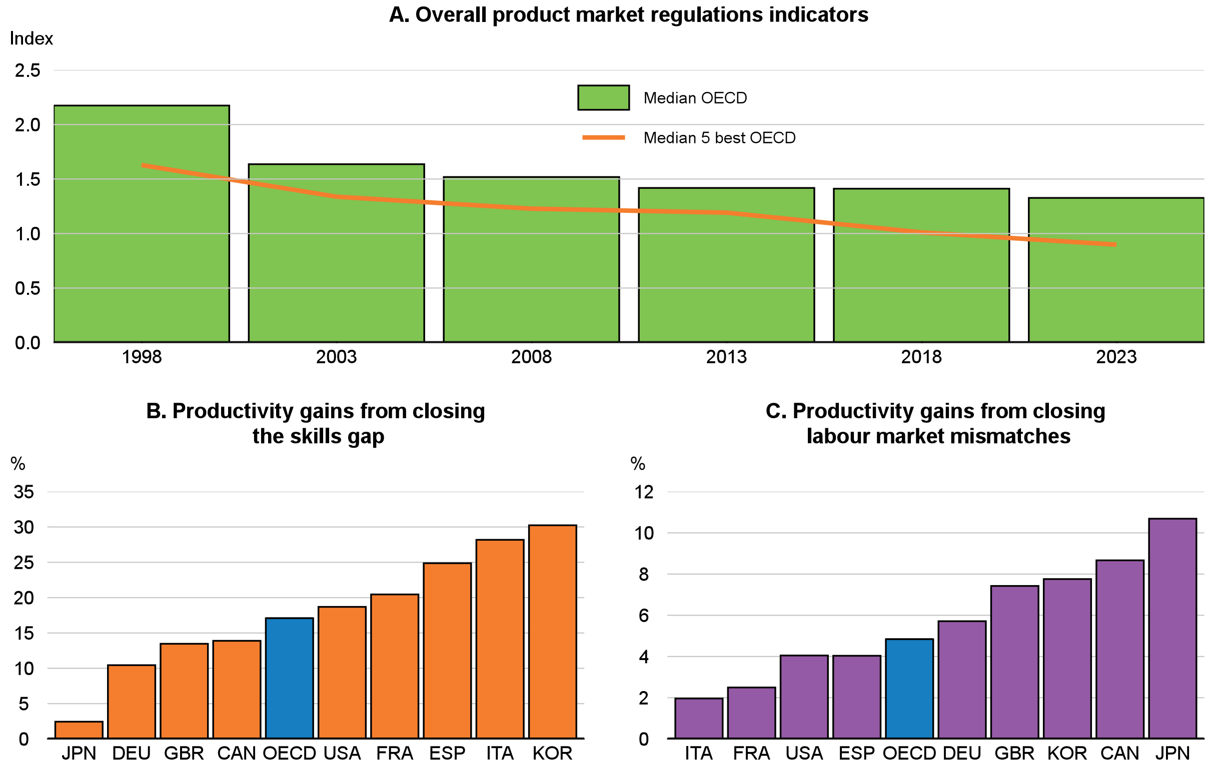
Note: Based on a reduction relative to the tariff rates assumed to prevail in the current baseline projections.
Source: OECD calculations using the NiGEM global macroeconomic model and the OECD METRO model.

34. Rising protectionism, geopolitical uncertainty and weak growth prospects all serve to reinforce the need for ambitious structural policy reforms that ensure healthy domestic markets. These include regulatory reforms that encourage competition, such as by eliminating excessive regulatory burdens on firm entry. The OECD Product Market Regulation indicators highlight a sizeable gap between the stringency of regulations in the average OECD country compared to the best performers, suggesting scope for many countries to reduce regulatory burdens further (Figure 13, Panel A).

35. There is also additional scope to reduce regulatory barriers to the flow of trade and resources between sub-national jurisdictions. One example is Canada, where eliminating differences in technical standards and regulations between provinces would better allow goods and services to flow to where they are most needed, providing a lasting stimulus to output. Similarly, harmonising regulations across states in the United States, such as those related to occupational licensing, would promote efficient resource allocation and boost aggregate productivity growth.

36. Ensuring markets remain open and competitive will be a key element in providing incentives for firms to further develop and adopt artificial intelligence (AI) technologies. This could bring substantial benefits for productivity growth. For instance, OECD research for the United States suggests that AI technologies could contribute between 0.4-0.9 percentage points on average to annual productivity growth over the next decade. As well as pro-competition regulatory reforms, AI diffusion and usage would benefit from the availability of high-speed digital infrastructure and more opportunities for workers to retrain and improve digital skills.

Figure 13. There is scope for further regulatory reforms that would promote productivity growth



Note: In Panel A, the data refer to laws and regulations that were in force in the relevant countries on 1 January of the relevant year. The chart is calculated based on 28 OECD countries for which data are available throughout the 1998-2023 period. A change in methodology for the Product Market Regulation Indicators occurred in 2018/19. In Panel B, gaps are calculated based on results from the Programme for the International Assessment of Adult Competencies. In both Panels B and C, gaps are calculated based on sector-level data in all countries other than the United States.

Source: OECD Product Market Regulation database; and Andrews, D., B. Égert and C. de La Maisonneuve (2025), "Adult skills and productivity: New evidence from PIAAC 2023", OECD Economics Department Working Paper (forthcoming).

37. More broadly, policies that promote skill accumulation and the effective allocation of skilled workers can help moderate the impact of rising trade barriers by enhancing international competitiveness. Recent OECD research estimates that closing the gap in adult skill outcomes between the average OECD country and the top three country performers would be associated with an increase in the level of productivity of 17% (Figure 13, Panel B). Improving the efficiency with which qualified workers are matched to appropriate job roles could yield additional productivity gains of 5% (Figure 13, Panel C). Along with policies that minimise the regulatory burden on business formation and growth, measures that support the movement of labour, including well-designed housing and labour market policies, and lifelong learning participation could help to reduce the severity of skills mismatch.

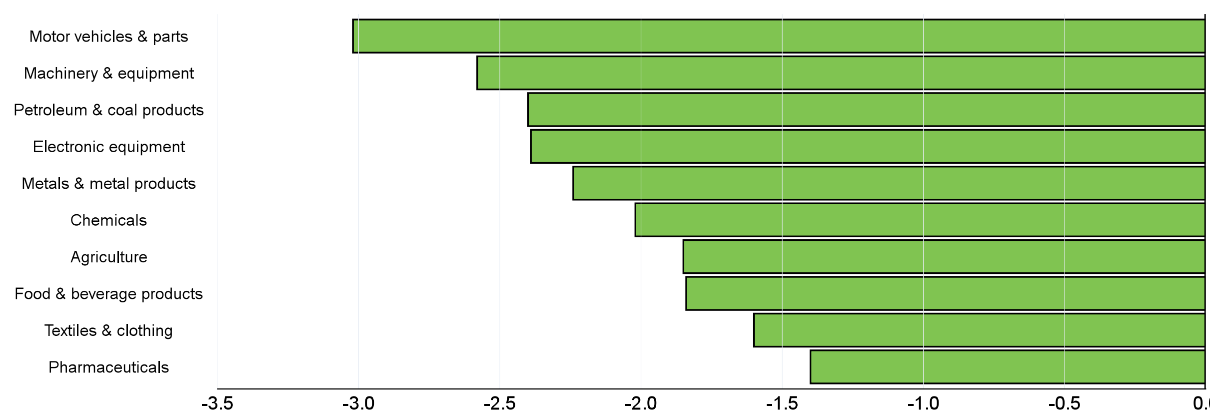
Technical Appendix

38. For the downside scenario of an increase in US bilateral tariffs on all countries and retaliatory action by all countries on imports from the United States, a two-stage modelling approach has been used. The trade volume effects of the change in tariffs were first obtained using the OECD METRO model, a multi-country, multi-sector computable general equilibrium trade model, with these then imposed in the National Institute Global Econometric Model (NiGEM). This approach enables account to be taken of medium-term changes to trade in intermediate and final products, including within tightly interlinked supply chains, and also the adjustment paths of national economies faced with these shocks and the impact of higher tariffs on import costs.

39. The METRO estimates suggest that in the medium-term global trade volumes should fall by close to 2% when the United States raises bilateral tariff rates by 10 percentage points on imports from all trading partners and all countries retaliate by raising bilateral tariff rates on imports from the United States by 10 percentage points. In all, such tariff changes affect approximately 8.2% of total world trade in goods and services. At the sectoral level, trade would fall relatively sharply in many manufacturing sectors, particularly motor vehicles and parts and machinery and equipment (Figure 14).

Figure 14. Global change in export volumes under higher tariffs

Per cent change from baseline



Note: Based on METRO model simulations of the United States raising bilateral tariff rates on imports from all trading partners by 10 percentage points and all partners retaliating by raising tariff rates on imports from the United States by 10 percentage points.
Source: OECD METRO model calculations.

40. Simulations of the bilateral tariff changes using NiGEM in forward-looking mode suggest that the real level of global GDP could be reduced by around 0.3% by the second and third years of the shock, with global inflation raised by around 0.4 percentage points per annum on average over this period (Figure 9). These estimates are based on an assumption that the bilateral tariff increases persist. Outside North America, the outcomes for the other major economies are generally mild, but negative, with GDP collectively declining by close to 0.2% and inflation raised by 0.3 percentage points on average over the first three years.

41. Overall, consumers face much of the burden of higher tariffs, with household real incomes estimated to decline by 1¼ per cent by the third year of the simulation in the United States, and by over 0.5% in Canada. The decline in the United States is equivalent to a reduction of over USD 1600 in real net disposable incomes per household. Private sector investment is also adversely affected, falling by up to 2% at its peak in the United States, with a drop of 1½ per cent in Canada and 0.6% in the euro area. The accumulated decline in the capital stock from weaker investment adds to the persisting costs of the tariff increases.

42. These shocks have implications for macroeconomic policies. The extent to which monetary policy reacts to higher tariffs will depend in practice on whether they are a one-off price level change or whether they have broader second-round effects on wages, prices and inflation expectations. This becomes more likely if, as occurs in the simulations here, tariff increases are applied to a broad range of consumer goods as well as intermediate inputs and applied by a large number of countries. In the scenario shown, US policy interest rates rise by around ¾-1 percentage point relative to baseline on average over the first three years, to help limit the extent to which the rise in import costs generates broader wage and price pressures, and the US effective exchange rate appreciates by 1.7% on impact. Together with the rise in domestic tariff rates, this results in tighter monetary policy than otherwise in other countries, particularly those whose currencies have depreciated against the US dollar. Policy interest rates rise by 1-1¼ per cent on average in Canada, and by between ¼-½ percentage point on average in other advanced and major emerging-market economies. Tighter monetary policy contributes to the near-term weakness in output in the simulations, augmenting the direct effects from higher tariffs.

43. Tariffs also provide additional revenue for governments, who are assumed to set policy to keep budget deficits unchanged from their baseline trajectories. In the particular scenario shown, the tariff revenues amount to around 1.2% of GDP in the United States, 1.5% of GDP in Canada, and around 0.2% of GDP on average in other major economies. This is offset by the associated decline in activity and higher debt servicing costs. The net impact on the public finances means that there is often little scope to use the tariff revenues to lower other taxes or increase spending if planned budgetary objectives are to be met. In some countries, including the United States, the combined fiscal impact of the rise in tariff revenue and broader changes in the economy is negative, implying that additional tax increases or lower fiscal expenditure are needed to keep the overall budget deficit unchanged.

44. Further rises in uncertainty and weaker confidence are not incorporated in these scenarios but would be particularly likely in the event of larger and wider tariff increases than in the baseline projections. This would add to the adverse impact of the original tariff rise. The decline in trade intensity that results from the imposition of higher tariffs could also be expected to have some adverse effects on productivity and living standards in the medium term via lower competition, reduced scope for specialisation, and the slower diffusion of ideas across national borders. Such changes would add further to the cost of raising tariffs.

OECD Economic Outlook, Interim Report

Steering through Uncertainty

March 2025

Global economic growth remained resilient in 2024. However, recent indicators suggest softening growth prospects, with measures of economic policy uncertainty having risen markedly alongside the imposition of new trade barriers by a number of countries. Global growth is expected to moderate over the coming two years and to be weaker than previously expected, with inflation now remaining above target for longer in many economies. Key risks include broader increases in trade barriers that would further hit global growth and raise inflation, or disruptive repricing in financial markets if growth slows more sharply than expected. On the upside, any agreement that lowers tariffs from current levels or increased debt-financed government spending on areas such as defence could result in stronger near-term growth.

The Interim Report says that international cooperation is especially important at the current juncture to prevent a costly ratcheting up of trade barriers. To support economic growth, policy interest rates could be lowered further in countries where underlying inflation is projected to moderate or remain subdued, provided inflation expectations remain well anchored. Further fiscal efforts to contain spending, enhance revenues and improve budgetary frameworks would enable governments to react to future shocks and accommodate future spending pressures. Headwinds from trade pressures reinforce the need to reinvigorate domestic policy reforms that strengthen productivity.

The Interim Report is an update on the assessment in the December 2024 issue of the OECD Economic Outlook (Volume 2024 Issue 2).

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