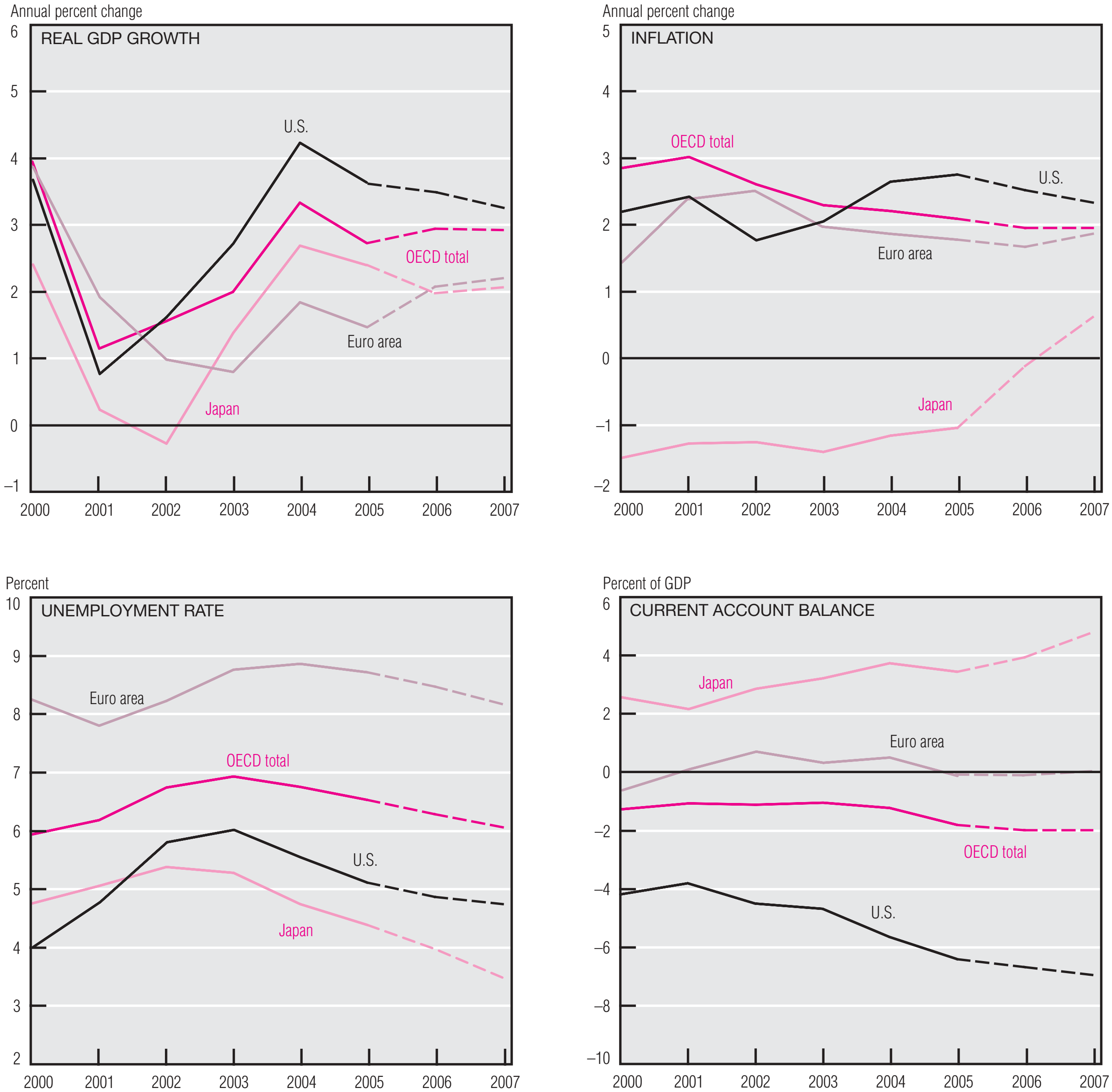
The Economies of OECD Nations



SOURCE: Organisation for Economic Co-operation and Development, *Economic Outlook*, no. 78.

In November, the Organisation for Economic Co-operation and Development (OECD) released the preliminary version of its second biannual *Economic Outlook*. The *Outlook* predicts that real GDP growth will remain robust in OECD member countries overall, with North America and Asia continuing to flourish and Europe sustaining its recovery from its weakness in 2002–03. Inflation expectations for most member countries remain relatively stable, with an average rate holding steady just below 2% for both 2006 and 2007. Long-term headline inflation expectations appear well anchored, despite rising energy costs. The unemployment rate is expected to fall in OECD countries, with declines forecast in Europe, the U.S., and Japan during the next two years.

Despite a positive forecast for world growth, the *Outlook* predicts ever-worsening current account balances. The U.S. external deficit is expected to exceed 7% of GDP by 2007, while Japan and other Asian economies continue to operate well within the surplus range. According to the *Outlook*, these imbalances reflect inadequate economic policies, such as tax incentives biased against savings and large fiscal deficits within the U.S., as well as exchange-rate mechanisms focused on maximizing Asian economies' market share. It also stresses that these conditions need not last forever, since a change in U.S. policy regarding savings and deficits or a decrease in foreigners' willingness to hold U.S. assets (or,

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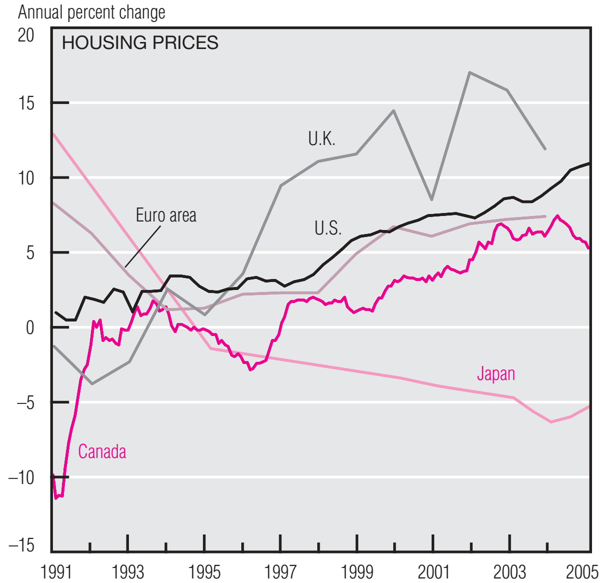
The Economies of OECD Nations *(cont.)*



Household Mortgage Debt
(percent of household disposable income)

	1992	2000	2003
U.S.	58.7	65.0	77.8
Japan	41.6	54.8	58.4
Germany	59.3	84.4	83.0
France	28.5	35.0	39.5
Italy	8.4	15.1	19.8
Canada	61.9	68.0	77.1
U.K.	79.4	83.1	104.6
Spain	22.8	47.8	67.4
Netherlands	77.5	156.9	207.7
Australia	52.8	83.2	119.5

Household Interest Payments[a]
(percent of household disposable income)

	1992	2000	2003
U.S.	4.9	5.2	4.5
Japan	2.5	1.3	1.4
Germany	3.9	4.0	3.0
France	1.7	1.4	1.1
Italy	0.7	0.8	0.7
Canada	5.9	5.7	4.9
U.K.	4.4	3.7	3.0
Spain	1.6	2.2	1.7
Netherlands	5.0	8.4	8.2
Australia	4.8	6.4	7.9

Housing User Costs
(percent of estimated overvaluation, 2004)

U.S.	1.8
Japan	–20.5
Germany	–25.8
France	9.3
Italy	–10.9
Canada	13.0
U.K.	32.8
Spain	13.4
Netherlands	20.4
Australia	51.8

a. Interest payments are approximated using mortgage debt and mortgage interest rates.
SOURCES: Organisation for Economic Co-operation and Development, *Economic Outlook*, no. 78; U.S. Office of Federal Housing Enterprise Oversight; European Central Bank; Japan Real Estate Institute; Statistics Canada; U.K. Office of the Deputy Prime Minister; and the *Economist*.

conversely, an increase in U.S. citizens' willingness to hold foreign assets) could trigger a reversal of the U.S. current account deficit.

In the majority of OECD countries, housing prices in real terms have been rising since the mid-1990s. In the past two years alone, they have surged at an annual rate of more than 5% in the U.S., the euro area, the U.K., and Canada. Within the euro area, France and Spain have seen housing prices leap more than 15% over the past year, exceeding even the U.S. rate. In most cases, analysts believe prices have been driven up by two factors: low interest rates and households' shifting their investments from equities to real estate. A striking exception to the global housing boom is Japan, where housing prices have been falling since the mid-1990s.

Mortgage debt has jumped in many OECD countries, more than doubling in some cases, but the proportion of household income devoted to interest payments did not follow suit. Households' overall ability to service their debt has improved or held steady since the early 1990s in countries such as the U.K., France, Germany, Italy, and Spain. However, notable exceptions include Australia and the Netherlands, where the share of household income needed to pay mortgage interest has increased. According to the OECD, one consequence of the housing boom has been overvaluation, which, in this case, it defines as a high price-to-rent ratio (the nominal housing price index divided by the rent component of the CPI). It estimates that housing prices are considerably "overvalued" in Australia, the Netherlands, and the U.K.